January 24, 2012

Patel Engineering (PATEN)

₹ 101

Rating matrix

Rating	:	Hold
Target	:	₹ 99
Target Period	:	12 months
Potential Upside	:	-2%

Key Financials

₹ crore	FY10	FY11	FY12E	FY13E
Net sales	3190.9	3475.9	3307.2	3677.6
EBITDA	508.7	462.0	467.8	488.0
Net profit	169.3	114.6	99.5	80.2

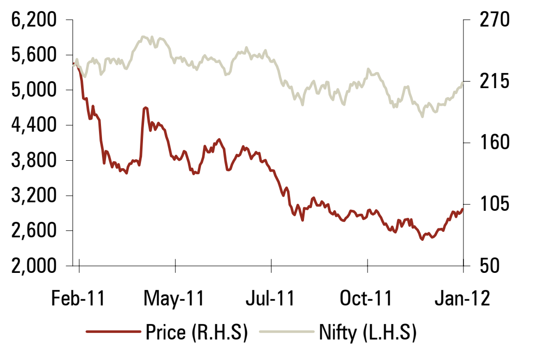
Valuation summary

	FY10	FY11	FY12E	FY13E
EPS (₹)	24.2	16.4	14.3	11.5
PE(x)	3.5	5.7	7.1	8.8
Target PE(x)	4.1	6.0	7.0	8.6
EV/EBITDA(x)	4.5	6.4	7.2	1.4
P/BV(x)	0.5	0.5	0.5	0.4
RoNW(%)	17.8	9.4	7.1	5.1
RoCE(%)	14.6	10.7	9.4	8.1

Stock data

Mcap	₹ 703 crore
Debt (Q2FY12)	₹ 2,844 crore
Cash (Q2FY12)	₹ 331 crore
EV	₹ 3,216 crore
52 week H/L	257/73
Equity cap	₹ 7 crore
Face Value	₹ 2.0
DII Holding (%)	7.1
FII Holding (%)	7.7

Price movement



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WHAT'S CHANGED…

PRICE TARGET .... Changed from ₹ 80 to ₹ 99
EPS (FY12E) .... Changed from ₹ 14.7 to ₹ 14.3
EPS (FY13E) .... Changed from ₹ 13.7 to ₹ 11.5
RATING .... Unchanged

Margin surprises but visibility remains low…

Patel Engineering's (PEL) Q3FY12 operating performance was better than our estimates on account of superior margins of 18% (11.8% in Q2FY12) vs. our estimates of 13% despite lower topline of ₹ 619.3 crore vs. our estimate of ₹ 793.6 crore. Consequently, PEL reported a bottomline of ₹ 20 crore vs. our estimates of ₹ 12.7 crore. While construction order inflow and execution has remained sluggish in the last couple of quarters, providing low visibility, the volatility in margins is also inexplicable. We maintain our HOLD recommendation on the stock.

- **Margins surprise positively**

PEL's Q3FY12 performance positively surprised on the margin front where the company reported an EBITDA margin of 18% on account of superior margins in the construction & real estate division. The construction segment registered an EBIT margin of ~13.1% vs. 9.6% in Q2FY12 and the real estate segment clocked EBIT margins of 28.2% vs. 21.7% in Q2FY12. We highlight that the margins have been erratic for PEL in the last couple of quarters, which is inexplicable.

- **But…visibility continues to remain low on construction order book**

The company has failed to bag any major orders in the last couple of quarters. Currently, the order book stands at ₹ 9000-10,000 crore. We still await further clarity on the exact order inflow and order book break-up. Nevertheless, adjusting for Andhra Pradesh (~₹ 2200 crore) and contentious orders (₹ 1,500 crore –Kotlibel, ₹ 300 crore from Tanzania), the order book provides low revenue visibility of less than two years.

Valuation

At the CMP, the stock is trading at a P/E of 8.8x FY13E earnings. Considering execution delays in the construction segment, volatility in margins, lower visibility on the current order book, high debt level and lack of clarity over tax raids, we recommend **HOLD** with an SOTP price target of ₹ 99. We have valued the construction business using EV/EBITDA multiple in order to capture rising debt level.

Exhibit 1: Financial Performance

₹ crore	Q3FY12	Q3FY12E	Q3FY11	Q2FY12	YoY Gr (%)	QoQ Gr (%)
Net sales	619.3	793.6	434.6	948.5	42.5	-34.7
EBITDA	111.3	102.9	108.0	111.5	3.0	-0.2
EBITDA Margin (%)	18.0	13.0	24.9	11.8		
Depreciation	20.5	28.3	18.6	15.1	10.5	35.8
Interest	59.2	66.0	86.2	51.9	-31.4	14.1
PAT	20.0	12.7	8.8	30.1	128.1	-33.4

Source: Company, ICICIdirect.com Research

The surprise was on the margin front where the company reported an EBITDA margin of 18% on account of superior margins in the construction & real estate division

₹ crore	Q3FY12	Q2FY12	QoQ (%)	Q3FY11	YoY (%)
Construction					
Revenues	541.6	881.7	-38.6	421.4	28.5
EBIT	71.2	84.5	-15.7	91.0	-21.8
EBIT margin (%)	13.1	9.6		21.6	
Real Estate					
Revenues	77.7	66.8	16.4	13.2	487.2
EBIT	21.9	14.5	51.6	5.5	295.8
EBIT margin (%)	28.2	21.7		41.8	

Adjusting for AP orders and contentious orders, the current order book gives low revenue visibility of less than two years

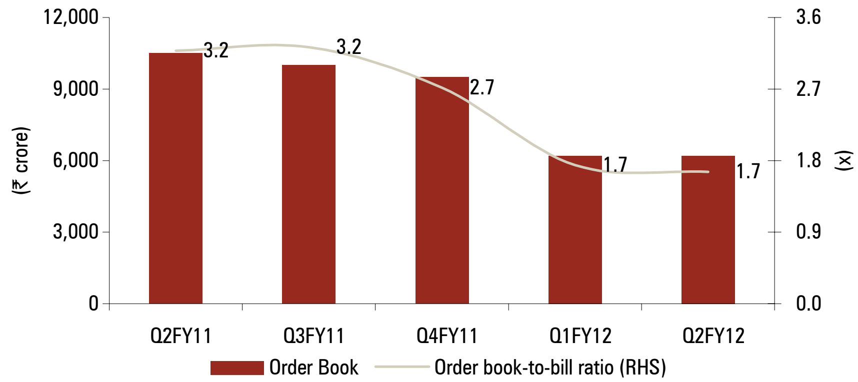
Topline disappoints but margin a positive surprise

- Patel reported a disappointing topline of ₹ 619.3 crore vs. our estimates of ₹ 793.6 crore on account of slower execution. In terms of segmental revenue, construction contributed ₹ 542 crore (87% of the topline) while real estate accounted for the remaining 13%
- The surprise was on the margin front where the company reported EBITDA margin of 18% on account of superior margins in the construction & real estate division. We highlight that PEL's margins have been volatile, which is inexplicable
- The construction segment registered an EBIT margin of ~13.1% while the real estate segment clocked EBIT margins of 28.2%
- As a result, PAT at ₹ 20 crore was higher than our estimates of ₹12.7 crore

Order book remains stagnant, await clarity for further traction

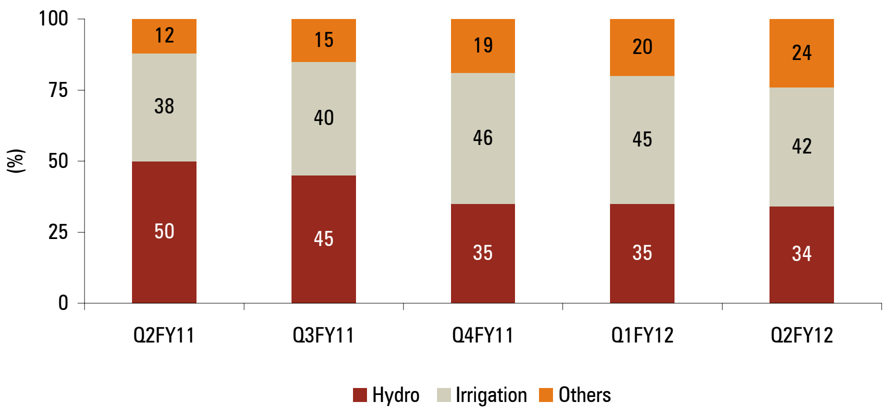
As on Q3FY12, the order book was stagnant at ₹ 9000-10,000 crore. We still await clarity from the company on the break-up and movement of order inflows.

Exhibit 2: Order book trend



Source: Company, ICICIdirect.com Research

Exhibit 3: Order book break-up as on Q2FY12



Source: Company, ICICIdirect.com Research

We have assigned a **HOLD** rating to the stock with an SOTP target price of ₹ 99/share

Valuations

The stock is currently trading at a P/E of 8.8x its FY12E earnings. Considering the execution delays in construction segments, volatility in margins, muted order inflow, lack of clarity on the Noida extension, high debt level and lack of clarity over tax raids, etc, we recommend a **HOLD** rating with an SOTP price target of ₹ 99/share. We have valued PEL's construction business using EV/EBITDA multiple in order to incorporate the rising debt level.

Exhibit 4: SOTP Valuation - PEL

Entity	Value (₹ crore)	Per share (₹)	Comment
Construction business	2,928.0	419	6x FY13 EV/EBITDA
Road BOTs	**60**	**9**	
KNT - 1 Karnataka	29.7	4	Based on FCFE metholdogy. We have assumed COE of 13%
AP - 7 Andhra Pradesh	30.7	4	
Real Estate	**494**	**71**	
Corporate Tower, Jogeshwari	123.4	18	Based on NPV metholdogy.
Smondoville, Bangalore	29.7	4	
Other Land Bank Value	341.3	49	Based on discounted market price
Power BOTs	**135.0**	**19**	0.5x P/BV
Less: consolidated debt	(2,925.8)	(419)	FY13E Net debt
Fair Value	**691.9**	**99**	

Source: Company, ICICIdirect.com Research

Exhibit 5: Valuation metrics

	Sales (₹ crore)	Sales Gr (%)	EPS (₹)	EPS Gr (%)	P/E (x)	P/BV (x)	RoNW (%)	RoCE (%)
FY10	3190.9	29.7	24.2	-22.3	3.5	0.5	17.8	14.6
FY11	3475.9	8.9	16.4	-32.3	5.7	0.5	9.4	10.7
FY12E	3307.2	-4.9	14.3	-13.2	7.1	0.5	7.1	9.4
FY13E	3677.6	11.2	11.5	-19.4	8.8	0.4	5.1	8.1

Source: Company, ICICIdirect.com Research

Financial summary

Profit and loss statement

(₹ Crore)	FY10	FY11	FY12E	FY13E
Total operating Income	3,190.9	3,475.9	3,307.2	3,677.6
Growth (%)	29.7	8.9	-4.9	11.2
Op. Expenditure	2,682.3	3,013.9	2,839.4	3,189.6
EBITDA	508.7	462.0	467.8	488.0
Growth (%)	28.7	-9.2	1.3	4.3
Depreciation	109.0	82.0	80.2	126.7
EBIT	399.6	379.9	387.6	361.3
Interest	157.7	218.2	243.4	278.3
Other Income	63.0	23.0	17.0	36.8
Extraordinary Item	0.0	0.0	0.0	0.0
PBT	305.0	184.7	161.2	119.8
Tax	92.9	54.0	55.7	39.5
Rep. PAT before MI	212.1	130.7	105.5	80.2
Minority Interest (MI)	13.9	8.1	5.9	0.0
Rep. PAT after MI	198.2	122.6	99.5	80.2
Adjustments	-28.9	-8.0	0.0	0.0
Adj. Net Profit	169.3	114.6	99.5	80.2
Growth (%)	-9.0	-32.3	-13.2	-19.4
EPS (₹)	28.4	17.6	14.3	11.5

Source: Company, ICICIdirect.com Research

Cash flow statement

(₹ Crore)	FY10	FY11	FY12E	FY13E
Net Profit before Tax	305.0	184.7	161.2	119.8
Other Non Cash Exp	0.0	0.0	0.0	0.0
Depreciation	109.0	82.0	80.2	126.7
Direct Tax Paid	92.9	54.0	55.7	39.5
Other Non Cash Inc	21.1	14.6	33.1	36.8
Other Items	115.8	209.8	243.4	278.3
Change in Contractees Adv	-157.6	23.3	0.0	0.0
CF before change in WC	258.2	431.2	396.0	448.5
Inc./Dec. In WC	-670.9	-674.2	-232.5	-255.5
CF from Operations	-412.7	-242.9	163.6	193.0
Pur. of Fix Assets	-191.5	-152.2	-390.0	-200.0
Pur. of Inv	-19.4	-8.2	0.0	0.0
CF from Investing	-147.9	-137.4	-356.9	-163.2
Inc./(Dec.) in Debt	548.8	644.5	350.0	150.0
Inc./(Dec.) in Net Worth	337.4	3.6	0.0	0.0
Others	-174.1	-226.3	-248.4	-282.9
CF from Financing	712.1	421.7	101.6	-132.9
Opening Cash Balance	295.1	232.4	243.5	151.8
Closing Cash Balance	232.4	243.5	151.8	48.7

Source: Company, ICICIdirect.com Research

Balance sheet

(₹ Crore)	FY10	FY11	FY12E	FY13E
Liabilities				
Equity Capital	7.0	7.0	7.0	7.0
Reserves & Surplus	1,355.8	1,420.9	1,527.5	1,603.2
Shareholder's Fund	1,362.8	1,427.9	1,534.5	1,610.2
Borrowings	1,203.7	1,713.0	1,713.0	1,713.0
Unsecured Loans	626.3	761.5	1,111.5	1,261.5
Contractees Advances	307.9	331.1	331.1	331.1
Deferred Tax Liability	11.5	13.2	13.2	13.2
Minority Interest	61.5	70.4	70.4	70.4
Source of Funds	3,573.7	4,317.1	4,773.7	4,999.4
Assets				
Gross Block	839.2	985.8	1,025.8	1,075.8
Less: Acc. Depreciation	300.5	356.4	428.6	553.4
Net Block	538.7	629.4	597.2	522.3
Capital WIP	204.2	209.1	559.1	709.1
Net Fixed Assets	742.9	838.5	1,156.3	1,231.5
Intangible Assets	16.3	14.5	12.6	10.7
Investments	69.8	78.0	78.0	78.0
Cash	232.4	243.5	151.8	48.7
Trade Receivables	695.7	872.2	969.5	1,000.9
Loans & Advances	953.2	1,305.9	1,508.2	1,715.8
Inventory	1,803.3	2,038.5	2,002.0	2,246.0
Total Current Asset	3,757.8	4,547.9	4,723.1	5,118.5
Current Liab. & Prov.	1,019.7	1,170.1	1,204.6	1,447.6
Net Current Asset	2,738.0	3,377.8	3,518.5	3,670.9
P&L Account	6.7	8.2	8.2	8.2
Application of Funds	3,573.7	4,317.1	4,773.7	4,999.4

Source: Company, ICICIdirect.com Research

Key ratios

	FY10	FY11	FY12E	FY13E
Per share data (₹)				
EPS	28.4	17.6	14.3	11.5
Cash EPS	46.0	30.5	26.6	29.6
BV	194.2	203.3	218.6	229.4
DPS	2.0	1.0	0.6	0.6
Cash Per Share	33.3	34.9	21.7	7.0
Operating Ratios (%)				
EBITDA Margin	16.0	13.3	14.1	13.3
PBT / Total Operating income	9.6	5.3	4.9	3.3
PAT Margin	6.7	3.8	3.2	2.2
Inventory days	167	202	223	211
Debtor days	73	82	102	98
Creditor days	83	96	111	122
Return Ratios (%)				
RoE	17.8	9.4	7.1	5.1
RoCE	14.6	10.7	9.4	8.1
RoIC	13.7	10.2	8.9	7.5
Valuation Ratios (x)				
P/E	3.5	5.7	7.1	8.8
Dividend Yield (%)	2.0	1.0	0.6	0.6
EV / EBITDA	4.5	6.4	7.2	1.4
EV / Net Sales	0.7	0.8	1.0	0.2
Price to Book Value	0.5	0.5	0.5	0.4
Solvency Ratios (x)				
Debt/EBITDA	3.6	5.4	6.0	6.1
Debt / Equity	1.2	1.6	1.7	1.8
Current Ratio	3.7	3.9	3.9	3.5

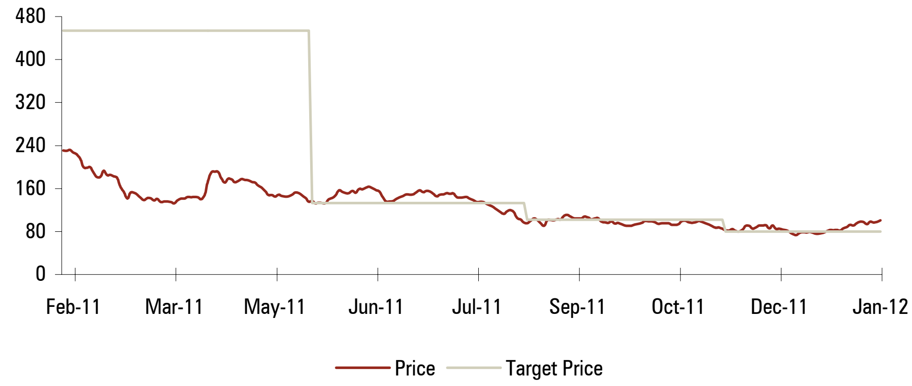
Source: Company, ICICIdirect.com Research

ICICIdirect.com coverage universe (Construction)

Simplex Infra					Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)
Idirect Code	SIMCON	CMP	203	FY10	FY10	24.7	8.3	1.1	13.1	12.8
Mcap (₹ crore)	1023	Target	285	FY11	FY11	24.8	8.3	0.9	12.0	11.9
		% Upside	41%	FY12E	FY12E	17.9	11.5	0.9	7.9	11.0
				FY13E	FY13E	22.9	9.0	0.8	9.2	11.5
Unity Infra										
Idirect Code	UNIINF	CMP	40	FY10	1,476.8	11.7	3.4	0.4	17.6	17.6
Mcap (₹ crore)	296	Target	52	FY11	1,701.5	12.7	3.1	0.4	15.5	16.5
		% Upside	30%	FY12E	1,949.9	13.2	3.0	0.3	14.1	16.9
				FY13E	2,217.6	14.7	2.7	0.3	13.8	17.2
IVRCL										
Idirect Code	IVRINF	CMP	50	FY10	5,477.6	7.9	2.8	0.5	11.5	14.3
Mcap (₹ crore)	1340	Target	48	FY11	5,617.4	5.9	3.8	0.5	8.2	11.6
		% Upside	-4%	FY12E	5,842.9	4.0	5.6	0.5	5.2	9.4
				FY13E	7,049.8	5.3	4.2	0.5	6.6	10.7
NCC										
Idirect Code	NAGCON	CMP	55	FY10	4,777.8	7.5	1.6	0.6	11.8	12.9
Mcap (₹ crore)	1398	Target	64	FY11	5,073.7	6.4	2.3	0.6	7.1	9.7
		% Upside	17%	FY12E	5,312.0	4.2	3.5	0.6	4.4	8.5
				FY13E	6,098.4	5.3	2.8	0.5	5.4	9.0
Patel Engineering										
Idirect Code	PATEN	CMP	101	FY10	3,190.9	24.2	3.5	0.5	17.8	14.6
Mcap (₹ crore)	703	Target	99	FY11	3,475.9	16.4	5.7	0.5	9.4	10.7
		% Upside	-2%	FY12E	3,307.2	14.3	7.1	0.5	7.1	9.4
				FY13E	3,677.6	11.5	8.8	0.4	5.1	8.1
Hindustan Construction										
Idirect Code	HINCON	CMP	23	FY10	3,644.2	1.6	15.7	0.8	6.5	9.5
Mcap (₹ crore)	1377	Target	20	FY11	4,093.2	1.1	18.0	0.8	4.7	8.7
		% Upside	-12%	FY12E	4,067.8	-1.0	NA	0.9	-11.7	6.2
				FY13E	4,554.1	-0.4	NA	1.0	-1.9	7.1

Source: Company, ICICIdirect.com Research

Exhibit 6: Recommendation History



Source: Reuters, ICICIdirect.com Research

Exhibit 7: Recent Releases

Date	Event	CMP	Target Price	Rating
15-Feb-11	Q3FY11 Result Update	181	191	Hold
20-May-11	Q4FY11 Result Update	137	133	Hold
19-Aug-11	Q1FY12 Result Update	95	102	Hold
18-Nov-11	Q2FY12 Result Update	82	80	Hold

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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Strong Buy: >15%/20% for large caps / midcaps, respectively, with high conviction;
Buy: >10%/15% for large caps / midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

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