

Gammon India Ltd.

₹ 51

Icon Arising !!!**Buy**

March 02, 2012

Company Background

Gammon India Limited (Gammon) is the largest civil engineering construction company in India. Headquartered in Mumbai; it was founded in 1922 by John C. Gammon. In last nine decades Gammon has built significant landmark projects, with a prominent presence across all sectors of civil engineering, design and construction. While its projects talk about its construction quality, It also to its badge has the honour of being one of the earliest set Construction Company in India thus having more experience about the Indian Scenario.

It has a track record of building structures, some of which have become iconic. The company started with the iconic 'The Gateway of India', the piling and civil foundation work for which was successfully executed by Gammon as its maiden project. It completed the Pre-Stresses Concrete (PSC) Ball Tank of India's first Atomic Reactor Plant in Trombay. The company has executed many multifarious civil engineering works from cotton godowns to bridges/flyovers, marine structures, cooling towers, chimneys, tunnels and dams in India and in the Middle-East. This includes First 500 MW thermal power station at Trombay, Maharashtra, in 1983 as well as Railway tunnel of seven kilometres for Konkan Railway at Ratnagiri, Maharashtra, in 1995, then the longest in Asia.

Gammon has received accolades and recognitions from a variety of reputed institutions. Examples include the Indian Concrete Institute Award for most outstanding concrete structure presented for the segmental arch bridge across the River Beas (Himachal Pradesh) and the first prize for 'Excellent Aesthetics' for the Vidyasagar Sethu Project across the River Hoogly in Kolkata. Gammon India was also the recipient of a performance bonus based on its delivery of the 'Extra Dosed Flyover' ahead of the 2010 Commonwealth Games at Delhi for the Delhi Metro Rail Corporation (DMRC).

Financial Performance

For the quarter ended on December 31, 2011 (Q3FY12) Gammon India has posted a drop of 13.68% in net sales. Sales declined to ₹ 11.84 bn in the quarter ended December 2011 as against ₹ 13.72 bn during the previous quarter ended December 2010. Consumption of raw material shot up by nearly 43% to ₹ 6.6 bn as against ₹ 4.6 bn during Q3FY11. During the quarter, the operating profit margin declined 29 bps to 5.92% from 6.21% in Q3FY11. Gammon's tax expenses double to stand at ₹ 72 mn as against ₹ 36 mn during the previous quarter. Net profit of Gammon India declined 89.96% to a meagre ₹ 10.2 mn in the quarter ended December 2011 as against ₹ 101.6 mn during the previous quarter ended December 2010.

The last few quarters have been quite disappointing for Gammon India. The company has suffered drop in sales as well as margin. For the year ended March 31, 2011 the company posted revenues of ₹ 56 bn as compared to ₹ 44 bn in the same period the previous year. Similarly, PAT was ₹ 12.48 bn as compared to ₹ 12.57 bn in the same period on account of higher proportion of lower margin projects.

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Info Codes

Reuters	GAMM.BO
Bloomberg	GMON@IN
NSE	GAMMONIND
BSE	509550

Market Data

52 Wk Range (₹)	: 140 / 39
Shares in Issue (mn)	: 136.5
Mkt. Cap (₹ bn)	: 6.79
BSE 2 Wk Avg Vol	: 128000

Share Holding Pattern (%)

Promoters	: 32.65
DII's	: 13.84
FII's	: 23.04
Others	: 30.47

Investment Theme

Gammon is a pioneer and leading Indian infra company in India. As the largest infrastructure player, the company has built many landmark projects. It has a strong presence in bridges as well as other construction verticals. It is trying penetrating further in the power sector although it was Gammon which had built the first nuclear power plant in India at Trombay. It has acquired three European Cos which will help it enter European market & gain technical capabilities. The company has underperformed the market due to higher debt and subdued margins. Going forward we believe the company could do well. Reducing interest rates make the scrip attractive at these prices. We are bullish on it and expect it to do well in the near future. Thus we recommend to buy this share.

Good Company... Great Price !!!

Gammon

Investment Rationale

➔ Business Portfolio

Gammon is amongst the largest physical infra construction companies in India. It is the only Indian construction company to have been accredited with ISO 9001 certification for all fields of civil engineering including design. It has a dominant presence in energy business in which it operates in the hydro, nuclear & thermal power sectors. It's projects cover businesses and projects involving highways, public utilities, environmental engineering and marine structures. It's expertise also covers the design, financing, construction and operation of modern bridges, viaducts, and metro rail, both on a Built-Operate-Transfer (BOT) basis as well as contract execution. It is also active in the Social Infra sector through its operations in the realty project segment.

➔ Foreign Acquisition to help in future

Gammon international acquired majority holdings in Franco Tosi Meccanica, SAE Power lines, and Sofinter group, Italy spanning the sectors of power and industrial boilers as well as waste and environment management systems. This would help the company to penetrate in power sector with access to equipment technology and EPC skills in the power vertical. This facilitated Gammon's entry to Europe market. The companies were working on a low capacity utilization ratio, which offered Gammon likely benefits from additional capacities, without fresh capex.

➔ Changing Macro scenario to change the trend

Over the past few years, Gammon has been carrying low margin legacy orders, which impacted its resources, working capital and margins. It has now put the projects on the fast track, with a view to exiting them at the earliest. This boosted revenue at the cost of blended margins. Faster execution of legacy orders triggered it's need for working capital, which contributed to its high debt. Consequently the share price has dropped by more than 70% as the scrip has underperformed the market and its peers. However as the interest rates started to taper, the scrip looks attractive. Going forward, the domestic market is expected to offer great potentials for large and high margin projects. The Indian railways as well as NHAI, two of the largest components of infrastructure in India are trying to improve the infrastructure across the country. We believe Gammon's international subsidiaries will start contributing to the company's turnover. Gammon Infrastructure, the infrastructure holding subsidiary of Gammon India recently received an order worth ₹ 16 bn from NHAI and we expect the scenario to improve further.

Key Financials

Year Ended 31 st	Mar 09	Mar 10	Mar 11
Revenue (₹ mn)	37748.5	46959.6	59118.1
Rev. growth (%)	57.83	24.40	25.89
EBITDA (₹ mn)	4086.7	4295.4	5042.8
Net profit (₹ mn)	1404.8	1257.1	1184.5
Shares outstanding (mn)	88.4	129.0	137.3
EPS (₹)	15.9	9.7	8.6
EPS growth (%)	63.10	(38.71)	(11.47)
P/E (x)	3.6	24.2	13.7
EV/ EBITDA	14.8	73.8	36.2
ROCE (%)	10.25	6.97	5.33

Sector View

Infrastructure can be a game-stopper for the economy if capacity addition is not done proactively. It is the key to growth of an economy. However despite of the many elaborate planning in the past the state in infrastructure has remained very poor. Consequently, the growth rate of the economy has fallen considerably. The matters were made worse by the steep rise in inflation. The government is trying to give push to the infrastructure which could be very positive for infra players.

Railways

A high-level panel was formed September 2011 to recommend ways and means to modernise Indian Railways. The expert group headed by Sam Pitroda, recently suggested a total funding of over ₹ 8 tn modernisation of the Indian Railways network in the next five years. The report recommended modernization of 19,000 km tracks strengthening of 11,250 bridges to sustain higher load at higher speed and eliminating all level crossings. The panel suggested development of public private partnership PPP models and policies in various areas to encourage private players.

Road

Even the NHAI- responsible for road development is looking to expand infrastructure. Gammon Infrastructure Projects recently received the letter of award for ₹ 16.84 bn road project from the National Highways Authority of India (NHAI). The project is for six laning of the Vijayawada - Gundugolanu section of NH 5 in the State of Andhra Pradesh on BOT Toll mode on design, build, and finance, operate and transfer basis.

Financial Statements

Income Statement

(₹ mn)

Year end	Mar 09	Mar 10	% Chg	Mar 11	% Chg
Total Sales + Excise	37280.0	46538.7	24.84	56603.2	21.63
Other Income	928.5	1082.3	16.56	3367.6	211.15
Change in Stocks	1065.3	1082.6	1.62	831.8	(23.17)
Raw Material Con.	17760.3	19133.0	7.73	26033.4	36.07
Employee Exp.	2078.7	2903.2	39.66	4035.4	39.00
Indirect Taxes	1417.6	1830.6	29.13	2164.5	18.24
Other Exp.	13930.5	20541.4	47.46	23526.5	14.53
Operating Exp.	34121.8	43325.6	26.97	54928.0	26.78
Operating Profit	3158.2	3213.1	1.74	1675.2	(47.86)
Total Interest	1345.5	1664.3	23.69	2358.9	41.74
Gross Profit	2741.2	2631.1	(4.02)	2683.9	2.01
Net Dep.	639.5	709.3	10.91	917.1	29.30
Total Taxation	696.9	664.7	(4.62)	582.3	(12.40)
Net Profit/Loss	1404.8	1257.1	(10.51)	1184.5	(5.78)

4 Years Balance Sheet

(₹ mn)

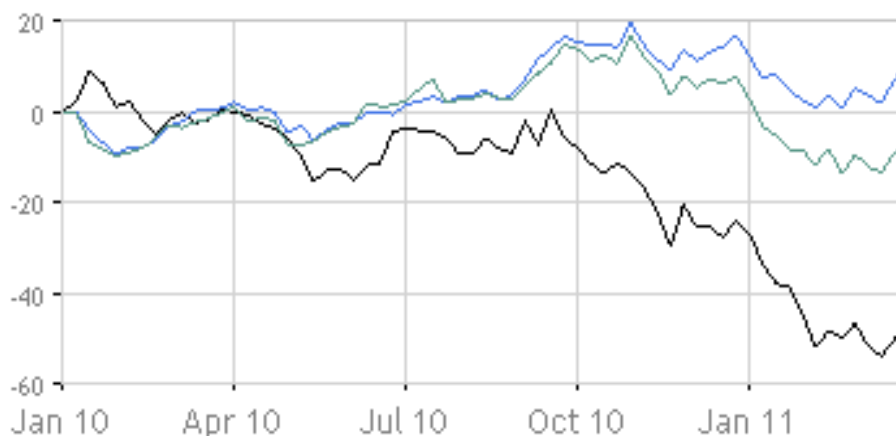
Balance Sheet as on 31 st	Mar 08	Mar 09	Mar 10	Mar 11
SOURCES OF FUNDS	13560.6	23073.4	29970.3	40036.5
Equity Share capital	176.9	176.9	258.3	274.9
Share Application Money	0.0	1090.2	0.0	0.0
Preference Share Capital	0.0	0.0	0.0	0.0
Reserves & Surplus	9613.1	12083.6	16580.5	18500.1
Loan Funds	2439.9	3252.5	5071.4	7602.9
Unsecured Loans	1330.7	6470.2	8060.1	13658.6
USES OF FUNDS	13560.6	23073.4	29970.3	40036.5
Gross Block	10268.3	12750.1	14788.0	18026.0
Less : Revaluation Reserves	2496.6	2455.7	2424.3	2393.0
Less : Accumulated Depreciation	2535.7	3269.8	3944.5	4726.3
Net Block	5236.0	7024.6	8419.2	10906.7
Capital Work in Progress	181.9	353.8	846.4	526.8
Investments	1607.8	2206.1	1981.9	2113.0
Current Assets	17407.8	35828.7	45534.9	53800.0
Less : Current Liabilities	10872.9	22339.8	26812.1	27310.0
Total Net Current Assets	6534.9	13488.9	18722.8	26490.0
Misc. Expenses not written	0.0	0.0	0.0	0.0
NOTE				
Bk Val Unquoted Investments	1521.3	1090.7	841.9	983.3
Mkt Val. Quoted Investments	1419.5	5720.0	14816.4	10185.4
Contingent Liabilities	24461.5	51686.8	60748.0	71917.4
Dividend (%)	25	30	30	40

Quarterly Income Sheets

(₹ mn)

Quarter Ended	Mar 11	Jun 11	Sep 11	Dec 11
Net Sales	17451.80	13904.80	11017.30	11846.90
Cost Of Sales	17990.10	12684.80	10072.20	11030.70
Operating Profit	(538.30)	1220.00	945.10	816.20
Recurring Income	1611.10	10.00	10.50	24.20
Adjusted PBDIT	1072.80	1230.00	955.60	840.40
Financial Expenses	0.00	520.80	577.60	506.00
Depreciation	248.40	255.20	252.60	248.00
Other Write Offs	0.00	0.00	0.00	0.00
Adjusted PBT	824.40	454.00	125.40	86.40
Tax Charges	219.80	164.70	36.90	76.20
Adjusted PAT	604.60	289.30	88.50	10.20
Non Recurring Items	0.00	0.00	(47.00)	0.00
Other Non Cash Adjust	0.00	0.00	0.00	0.00
Net Profit	604.60	289.30	41.50	10.20

52 Week Index Relative Percentage Appreciation



GAMMON vs SENSEX

Risks Associated

➔ Crude Oil could spoil the play

The crisis in Iran has created some doubts over the world economy. Iran's defiance of warnings issued by western countries has escalated the tension further. Iran is amongst the top oil exporters especially crucial for India. The sustained tensions have resulted in Crude oil prices reaching yearly highs. This is going to impact the recovery especially emerging market which had just started to see inflation soothing.

➔ Higher Debt

Gammon has made some bold acquisitions in European market. However the European economy has been struggling to protect from an economic crisis. If the large bailout package given to Greece fails, it could further create problems. Gammon's debt has increased due to acquisitions however the revenue generation is yet low. Gammon's debt at the end of FY11 was ₹ 22 bn. the company has been trying to execute lower margin projects speedily to exit from them. This has resulted in higher working capital requirements. Further the advances to subsidiary have also gone up. As the interest rates have remained high, this has put immense pressure on the margin of the company.

In a Nutshell

Gammon India Limited is the largest civil engineering construction company in India. Headquartered in Mumbai; it was founded in 1922 by John C. Gammon. In last nine decades the company has built significant landmark projects, with a prominent presence across all sectors of civil engineering, design and construction. As the largest infrastructure player, the company has built many landmark projects across the country. It is the only Indian construction company to have been accredited with ISO 9001 certification for all fields of civil engineering works including design. The company has strong presence in bridges as well as other construction verticals. It is trying penetrating further in the power sector although it was Gammon which had built the first nuclear power plant in India at Trombay. It has acquired three European companies which helped it to enter European market as well as gaining technical capabilities. The company has underperformed the market due to higher debt and subdued margins. Going forward we believe the company could do well. Gammon Infrastructure, the infrastructure holding subsidiary of Gammon India recently received an order worth 1 bn from NHAI. We believe Gammon's international subsidiaries will start contributing to the company's turnover. Reducing interest rates make the company attractive at these price levels. We are bullish the company and expect it to do well in the near future. Thus we recommend to buy this share.

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Rating Interpretation

Buy	: Expected to appreciate 20% or more over 12-months	Reduce	: Expected to depreciate up to 10% over 12-months
Accumulate	: Expected to appreciate 10% to 20% over 12-months	Sell	: Expected to depreciate 10% or more over 12-months
Trade Buy	: Expected to appreciate more than 10% over 45-days	Trade Sell	: Expected to depreciate more than 10% over 45-days

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