

PATEL ENGINEERING LTD

CMP : Rs 370

Rating : BUY

Target : Rs 490

17th September, 2008

PEL is one of the leading construction companies in India with a strong presence in the hydropower construction and irrigation segments. With proven project execution capabilities over 58 years, a strong order book position, high operating margins, access to advanced technologies, and the huge land bank position, the company is expected to deliver strong results in the future.

(Rs. mn)

Key Financials	FY06	FY07	FY08	FY09E*	FY10E*
Net Sales	10,223	12,900	18,596	22,805	26,915
Growth in Sales (%)	43.5	26.2	44.2	22.6	18.0
EBIDTA	1,321	1,660	2,740	3,398	4,145
EBIDTA Margins (%)	12.9	12.9	14.7	14.9	15.4
Net Profit	742	1,171	1,628	1,266	1,543
Net Profit Margin (%)	7.3	9.1	8.8	5.5	5.7
EPS (Rs)	14.8	19.6	27.3	21.2	25.9
BVPS (Rs)	40.1	118.6	141.8	161.0	184.5

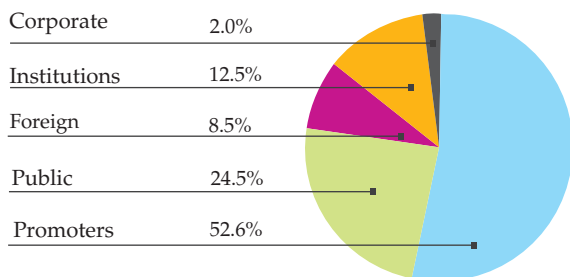
* Assuming full tax rate at 33% in FY09E and FY10E

Key Ratios	FY06	FY07	FY08	FY09E	FY10E
P / E	24.9	18.8	13.6	17.4	14.3
P / BV	9.2	3.1	2.6	2.3	2.0
EV / EBIDTA	16.2	14.7	10.6	8.8	7.7
Mcap / Sales	1.8	1.7	1.2	1.0	0.8
ROE (%)	43.3	26.0	21.0	14.0	15.0
ROCE (%)	27.2	17.5	14.7	13.8	14.8

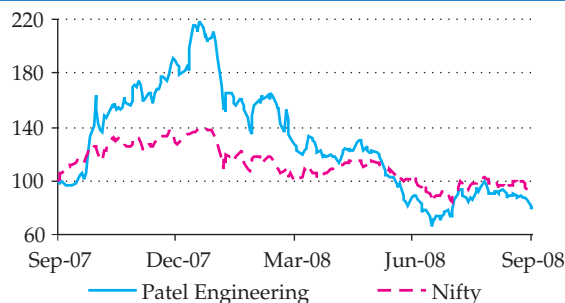
Key Data

Face Value (Rs.)	1
Shares Outstanding(mn)	59.7
Market Cap (Rs bn / US \$ mn)	22.07 / 525
52 Week High/Low (Rs.)	1070 / 286
Nifty	4075
Bloomberg Code	PEC. IN
Year End	March

Shareholding pattern(%) June 08



Relative Price Performance



Strong order book position and high operating margins

PEL's current order book of Rs60.5bn (3.23x FY08 sales) predominantly comprises of hydropower construction projects (accounting for 58% of the current order book), while the remaining orders are from the irrigation (17%), transportation (15%) and urban infrastructure (10%) segments. We expect a consolidated revenue growth of CAGR of 20% from FY08 to FY10E. The company's operating margins are higher compared to that of its peers due to its exposure to the high margin hydropower segment. The EBIDTA margin in FY08 on the core construction business was 15.6% and we expect the margins to be at 14.9% and 15.4% in FY09E and FY10E respectively.

Acquisitions has given PEL access to advanced technologies

The company's acquisitions in the US have given it entry into the US construction market and access to advanced technologies like Roller Compacted Concrete, Double Lake tap and Microtunnelling in the field of construction, thereby leading to cost efficiency and faster execution of projects.

Entry into BOT businesses

PEL has bagged two road projects on a BOT (Annuity) basis from NHAI in Karnataka (commissioning in March 2009) and in Andhra Pradesh (commissioning in March 2010) and is expected to generate annual revenues of about Rs1.0bn from FY11E. The company is also setting up a 1200 MW thermal power plant in Gujarat and a 120 MW hydropower plant in Arunachal Pradesh.

Unlocking value of the huge land bank

PEL holds a land bank of over 1127 acres spread in and around major cities, viz., Mumbai, Hyderabad, Bangalore and Chennai. The company, in Phase I, would develop 1.08mn sq ft (commercial) in Mumbai, 12.0mn sq ft (commercial and residential) in Bangalore and 2.47mn sq ft (IT SEZ) in Hyderabad.

Rising raw material prices and higher cost of borrowing

Though price escalation clauses have been built into about 90% of the contracts, the incremental costs of raw materials on the fixed price contracts and the BOT projects would put pressure on operating margins in the near future, while the rising interest rates will lead to higher cost of borrowing.

Valuation: At the current price of Rs370, assuming full tax rate of 33%, the stock trades at a P/E multiple of 17.4x its FY09E consolidated EPS of Rs21.2 and at 14.3x its FY10E consolidated EPS of Rs25.9. On an EV/EBIDTA basis, it trades at 8.8x FY09E and 7.7x FY10E. We value the real estate subsidiary at Rs185 per share, BOT subsidiaries at Rs13 per share and assign a conservative 12x P/E multiple to its core construction business's standalone FY10E EPS of Rs24.4. Thus, arriving at an SOTP value of Rs490 per share (an upside of 32% from the current level), we recommend a BUY on the stock.

Prakash Rao

Securities Research,

Tel: 91-22-30273353

Email: prakash.rao@sbicapsec.com

SBICAP Securities Limited

191, Maker Tower F, Cuffe Parade

Mumbai 400005, India

Email: sbicapresearch@sbicapsec.com

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Please refer to our disclaimer given at the back cover page

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INVESTMENT CASE

CORE CONSTRUCTION BUSINESS

One of the leading players in the Hydropower construction sector

One of the leading players in the hydropower construction space in India

Patel Engineering Ltd (PEL) is one of the leading players in the hydropower construction segment in India (the segment accounts for 59% of the company's current order book) and has executed around 7000 MW out of the total 35909 MW in the country. The construction of hydropower plants is technically intensive in nature which requires specialized technical skills, equipments, manpower, and engineering capability. This creates a high entry barrier and limits competition and hence the operating margin earned by construction companies in the segment is higher at around 18-20% as compared to about 7-8% in road projects, 10-15% in irrigation projects and about 10-11% in building construction projects.

PEL, with access to advanced technologies like RCC (Roller Compacted Concrete), Double Lake tap and Microtunneling is able to execute the projects faster and with better cost efficiency. Given the growth potential of the hydropower sector, PEL plans to continue to focus on the hydropower segment as its core area of operations.

Capitalizing on the growth potential of hydropower sector

Enormous growth potential of the hydropower sector

The potential for growth in the hydropower segment is enormous, given the shortage of power in India, coupled with an increase in raw material prices of fuel, thereby leading to a shift in focus towards sources like hydropower generation. Of the country's 135,000 MW power generation capacity, 37,085 MW is based on hydropower sources. The government plans to add about 50,000 MW of hydropower capacity over the next 12 years, through public sector companies like NTPC, NHPC, NEEPCO and the Satluj Jal Vidjyut Nigam.

Of the planned capacity addition, about 16,553 MW is likely to be added in the Eleventh plan with a total capex outlay of around US\$24bn. This gives players like PEL huge opportunity to bag large orders in the hydropower segment.

The hydropower projects likely to be awarded over the next 3 years:

Hydropower project	MW
NHPC	
Subansiri (Lower)	2000
Parbati - II & III	1320
Kotli Bahal	1045
Pakal Dul	1000
Kishenganga	330
Uri - II	240
Chamera - III	231
NTPC	
Etalin HP	4000
Loharinag Pala	520
Lata-Tapovan	171
Bihar State Hydroelectric	
Hatiadah	1600
Telahar Kund	400
Sinafdar	345
Jaypee Karcham	1000
Tehri Hydropower development	1000
Uttranchal Jal Vidyut Nigam	480
TOTAL	15682

Source: NTPC, NHPC, Industry

Hydropower projects of over 15000 MW capacity expected over the next 3 years

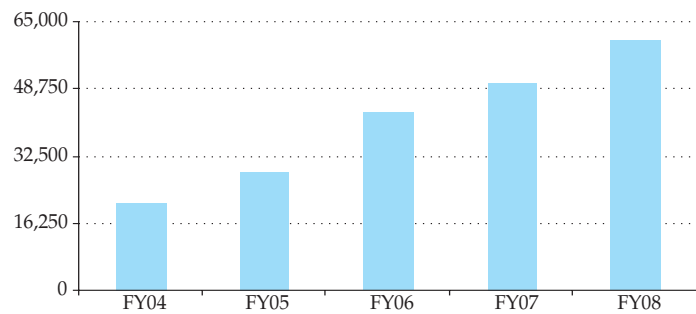
Strong order position at Rs60.5bn

Strong order book gives revenue visibility in the near future

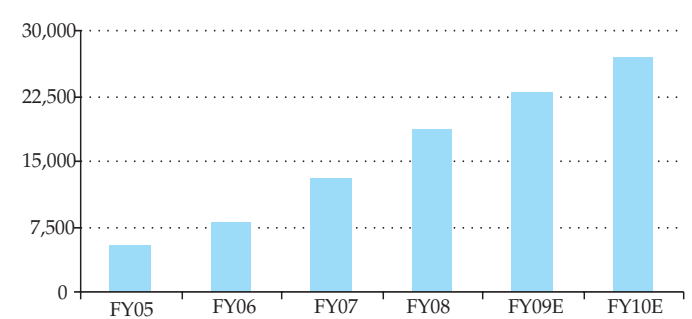
The company's order book currently stands at Rs60.5bn (order book to sales ratio of 4.5x FY08 Standalone revenues). The current order book mix comprises of hydropower (58%), irrigation (17%), transportation (15%) and urban infrastructure (10%) segments. The average execution period of the order book is about 30 months. The company's order book has increased by a CAGR of 28% from Rs21.05bn in FY04 to Rs58.0bn in FY08, while the average ticket size of orders has also witnessed a robust increase from Rs1.0bn in FY05 to about Rs3.5bn in FY08.

With a focus on the hydropower, irrigation and roads segments, the company's orders flow from the central and state governments and other government organizations like NHAI, NTPC, ICAD of Andhra Pradesh and NHPC. With the increase in investments in hydropower and irrigation sectors by the government, we expect the company to bag larger orders in the future and expect the consolidated revenues to grow at a CAGR of 20% over the FY08 - FY10E period.

Order backlog (Rs mn)



Net sales (mn)



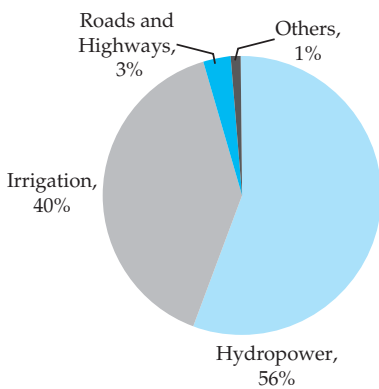
Source: SBICAP Securities Research

Operating margins higher as compared to that of the peers

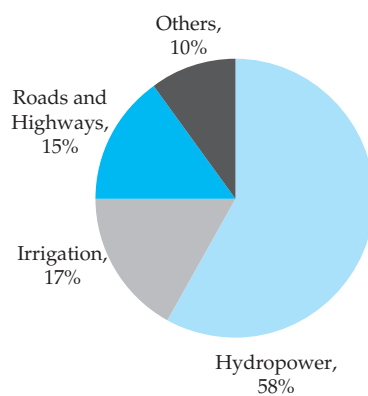
Higher margins compared to peers - led by higher exposure to hydropower

PEL, with a higher exposure to the hydropower segment in its order book earns higher operating margins than its peers in the construction industry. The standalone operating margins have improved from 11.8% in FY05 to 15.5% in FY08. We believe that the company would be less affected in the near future by the increasing raw material prices compared to its peers as 90% of its contracts have built in escalation clauses in the cash contract projects, while the BOT project revenues would commence only post FY10E. The pressure on margins would come from the 10% fixed price contracts and the BOT projects. Keeping in mind the rising raw material prices, we expect a minor decline in margins of the core construction business at 15.3% and 15.0% in FY09E and FY10E.

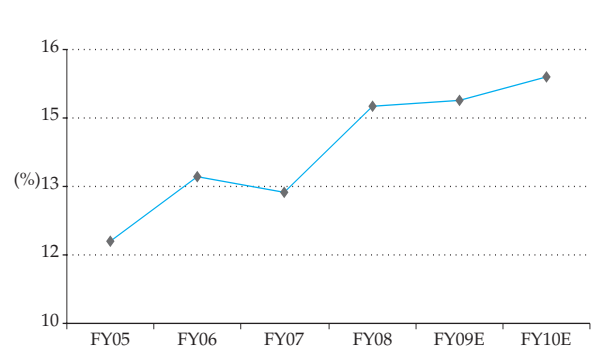
% of Order Book (FY05)



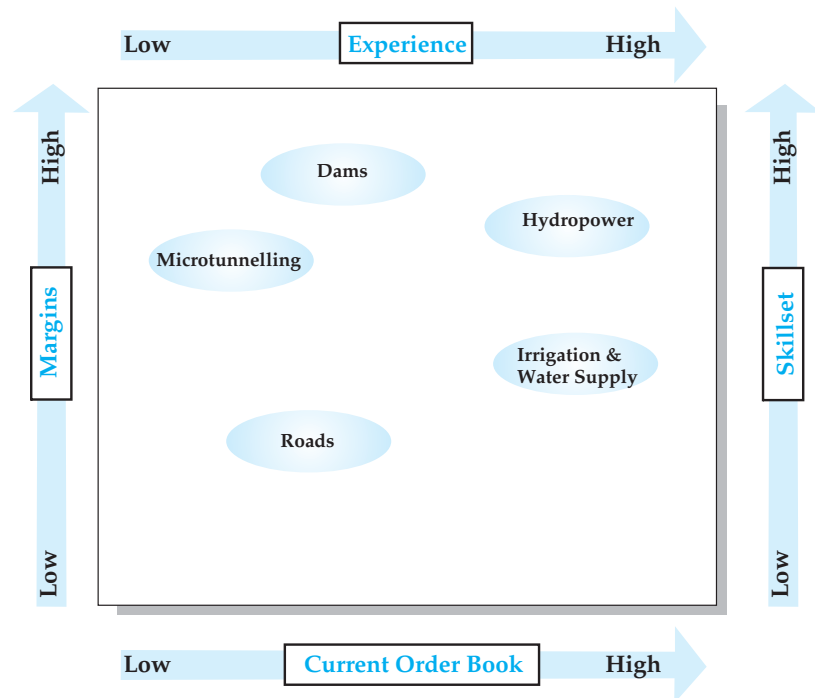
% of Order Book (FY08)



Operating Margins (%)



Source: SBICAP Securities Research



Source: Company, SBICAP Securities Research

Gaining global presence through the Inorganic route

PEL is the only Indian construction company with a presence in the technologically advanced market in US and it has executed projects in various countries including US, Greece, Sri Lanka, Bhutan, Qatar and Northeast Africa. The company currently has two subsidiaries in the US - ASI RCC Inc and Westcon Microtunneling Inc.

- **ASI RCC Inc**

PEL acquired ASI RCC Inc, a construction company based in Colorado, USA, with operations throughout United States, in 1997. PEL got access to the RCC (Roller Compacted Concrete) technology from this acquisition and in collaboration with ASI RCC, has constructed more than 50 dams globally using the RCC technology.

- **Westcon Microtunneling Inc**

PEL acquired 51% of Westcon Microtunneling Inc, a company based in Utah, USA, in 2001 to gain access to microtunneling technology. The market for microtunneling in India though small, is highly profitable as the market is totally untapped, and PEL being the pioneer in the microtunneling market in India, commands more than 98% market share. PEL has transferred most of the microtunneling machinery and equipments from Westcon Microtunneling Inc from the US to Michigan Engineers Pvt Ltd in India to expand its microtunneling operations in India.

- **Michigan Engineers Pvt Ltd**

PEL acquired 51% stake in Michigan Engineers Pvt Ltd (MEPL) in FY07. MEPL, with an order book position of Rs5.0bn, is a Mumbai based construction company specializing in underground works and foundations and specialized sewer rehabilitation works. The company has over the years created a niche in high technology projects such as Rehabilitation of sewer systems using glass polymers, pipe jacking, soil stabilization and other technology driven urban infrastructure projects.

Acquisitions have provided PEL access to the international markets

98% market share in India in Microtunneling

Adapting niche technologies for cost efficiency and faster execution

The acquisitions made by PEL in the US have been the company's strategy to enter the American construction market and to gain access to the latest advanced technologies used in the field of construction. The company has gained access to sophisticated technologies like RCC (Roller Compacted Concrete), Microtunneling and Double Lake Tap, leading to company cost efficiency, better use of equipments and faster execution of projects.

Ghatgar dam was the 10th fastest construction of dam in the world

Access to advanced construction technologies through the acquisitions

- **RCC (Roller Compacted Concrete):** PEL is the only Indian construction company with access to the RCC technology, which enables companies to construct dams 30% cheaper and 40% faster compared to the conventional method. The RCC method, using a special blend of concrete, places the concrete on a continuous basis in layers, which is then compacted with the vibratory rollers, enabling the dam to be constructed layer upon the layer from one end to the other. The benefits of using the RCC technology are reduced time of project execution, lower cost of construction, more efficient use of machinery and fly ash. The technology was first used by PEL in India in the Ghatghar Dam project in Maharashtra, which was the 10th fastest dam construction project in the world.
- **Microtunneling:** PEL is the only Indian construction company with Microtunneling technology. The Microtunneling technology is used in water, sewerage and tunneling projects in urban locations. The technology enables laying of micro tunnels underground for pipes and cables without the disruption of existing roads. It is being applied in the urban infrastructure segment to avoid excavation of newly built roads and to avoid traffic disruptions. The company is currently executing projects for municipal corporations of Mumbai, Delhi and Kolkata.
- **Double lake tap:** PEL is the first construction company in Asia to implement the double lake tap technology. Double Lake Tap is a proven solution for establishing waterways for hydropower projects. It involves running a tunnel towards and under a lake, leaving a short rock plug to the lake floor beneath the tapping level, which is then blasted, piercing the lake floor from below. This enhances the capacity of the hydroelectric projects without disrupting existing facilities. The technology was implemented by PEL at the Koyna dam project in Maharashtra. PEL has received a repeat order of Rs1.2bn for the Stage IV of the Koyna dam from the same client.

Entry into Road projects on a BOT basis

PEL had earlier been focused on road construction projects only on a cash contract basis, but has recently entered into construction of road projects on a BOT basis. The company, through a JV with KNR Constructions Ltd has bagged two road BOT projects for a concession period of 18 years, on an annuity payment basis. PEL would earn Rs396mn in FY10E and Rs924mn per annum from FY11E as annuity from the two BOT projects from the NHAI.

2 road projects on BOT basis will give annual revenues of Rs924mn

- Project - NH7 in Karnataka (Bangalore to Hyderabad highway)**
 The length of the road project, awarded in June 2006, is 60kms and the construction is expected to be completed by March 2009. The cost of the project is Rs4.0bn, and the contractors would receive Rs660mn per annum (Rs330mn semi annual payments); PEL, with a 60% stake in the JV, would receive Rs396mn per annum.
- Project - AP7 in Andhra Pradesh (Nagpur to Hyderabad highway)**
 The length of the road project, awarded in May 2007, is 48kms and the construction is expected to be completed by March 2010. The cost of the project is Rs5.2bn, and the contractors would receive Rs880mn per annum (Rs440mn semi annual payments); PEL, with a 60% stake in the JV, would receive Rs528mn per annum.

Foray into becoming an Independent power producer (IPP)

PEL has entered the power generation segment on a BOOT basis and is in the process of setting up and operating two power plants in Gujarat and Arunachal Pradesh.

Setting up two power plants of 1200 MW and 120 MW capacities

- The company is setting up a 1200 MW (in 4 phases) thermal power plant at Bhavnagar in Gujarat. The power project is likely to start in the next five years. The company is finalising the purchase of a coal mine in Indonesia. The cost of the project is Rs60bn, including an equity infusion of Rs12.0bn.
- The company has finalised a MoU with Government of Arunachal Pradesh for setting up a 120 MW hydropower plant at Gogri in Arunachal Pradesh. The cost of the project is Rs5.1bn and the construction of the hydropower plant is likely to start in the next two years.

IPP power plant details

Particulars	Plant I	Plant II
Type of project	BOOT	BOOT
Source of power	Thermal	Hydro
Location	Gujarat	Arunachal Pradesh
Capacity (MW)	1200	120
Cost of the project (Rs bn)	60	5.1
Debt (Rs bn)	48	4.1
Equity (Rs bn)	12	1.0
Expected commissioning year	2013	2013

Source: SBICAP Securities Research

REAL ESTATE BUSINESS

Huge land bank of 1127 acres

PEL has, over the years accumulated a strong land bank of over 1127 acres spread in and around four major cities, viz., Mumbai, Bangalore, Hyderabad and Chennai. The company plans to develop the land bank in phases and is looking at various possibilities at monetizing the land bank through the lease rental model and the outright sale model. The company's real estate projects are being executed in phases (11% of the land bank in Phase I) under its wholly owned subsidiary - Patel Realty (India) Ltd. The land bank is held in the books of PEL, which has given the development rights to its subsidiary - Patel Realty (India) Ltd.

Land Bank details

Location	Acres
MUMBAI	27.1
Jogeshwari	7.1
Panvel	20.0
HYDERABAD	811.3
Gachibowli	11.4
Shamshabad	82.1
Maheshwaran (Srisailam Road)	16.2
Mominpet	460.0
Sadashivpet	120.0
Chewella	26.4
Yadaram	60.1
Kollur	17.6
Vattinagulapally	17.5
BANGALORE	89.3
Electronic City	64.3
Whitefield	18.0
Devenhalli	7.0
CHENNAI	200.0
Total Land bank	1127.6

Land at prime locations in and around tier-one cities

Source: Company

The following are the real estate projects currently being executed by the company:

Mumbai (27 acres)

The company is developing two projects - Patel Corporate Park (a commercial office centre measuring 80,000 sq ft) and Patel Estate (1 mn sq ft space of commercial complex (3 office buildings) in Jogeshwari, Mumbai. The company also owns 20 acres of land near the Mumbai-Pune Expressway in Panvel, Mumbai.

Hyderabad and neighboring towns (811 acres)

The company owns 2.47mn sq ft of built up space in Gachibowli (the IT hub of Hyderabad) and would develop the project as a sector specific SEZ. The area houses many leading IT companies and financial institutions.

Bangalore (89 acres)

The location of the company's land at Bangalore comprises of head offices of many leading companies. It is one of the IT centers of the country and the company is developing an integrated township with residential complexes, 2 SEZ's, hotels, retail malls, apartments and villas.

Chennai (200 acres)

The location of the land is close to the Chennai International Airport.

Phase I development of Land bank

Developing 15.8mn sq ft of land bank in Phase I

Location	Area (mn sq ft)	Completion
Mumbai		
Corporate Park, Jogeshwari	0.08	FY10
Corporate Tower, Jogeshwari	1.0	FY12
Hyderabad		
Gachibowli	2.7	FY12
Bangalore		
Electronic City - Residential	4.0	FY12
Electronic City - Commercial	8.0	FY15
TOTAL	15.8	

Source: Company

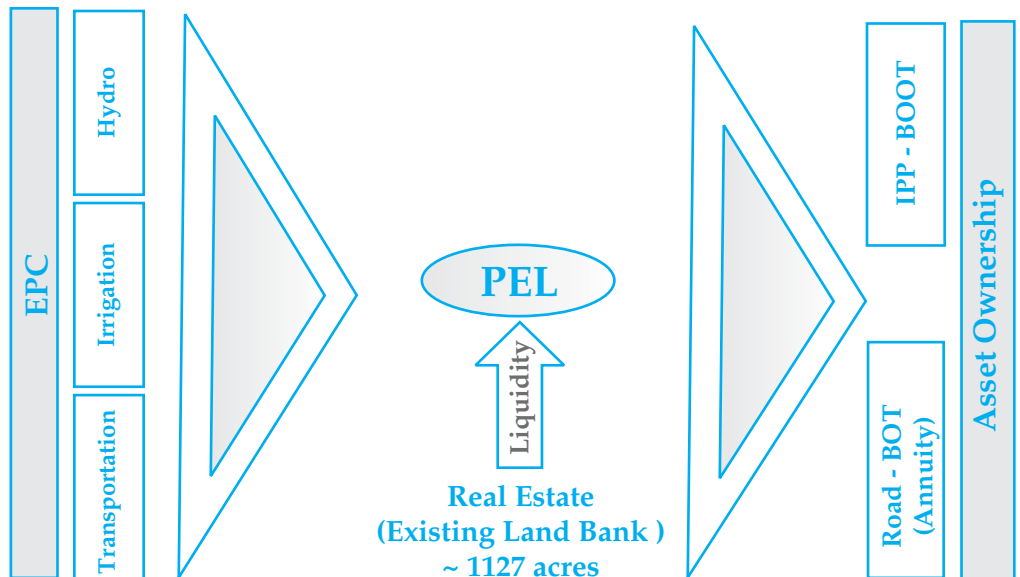
Funding at the SPV level

Real estate projects are now typically funded by floating SPV's (Special Purpose Vehicles) that are FDI compliant in order to broaden the scope and scale of funding. PEL also plans to fund the real estate projects through the induction of an equity partner at the SPV level.

Liquidating land bank to fund the asset ownership

Since the new initiatives of the company, i.e., road projects on a BOT basis and the power projects as an Independent power producer, are capital intensive in nature, the company plans to liquidate its historical land bank of 1127 acres and infuse part of the funds into the asset ownership (Road BOT and IPP) projects.

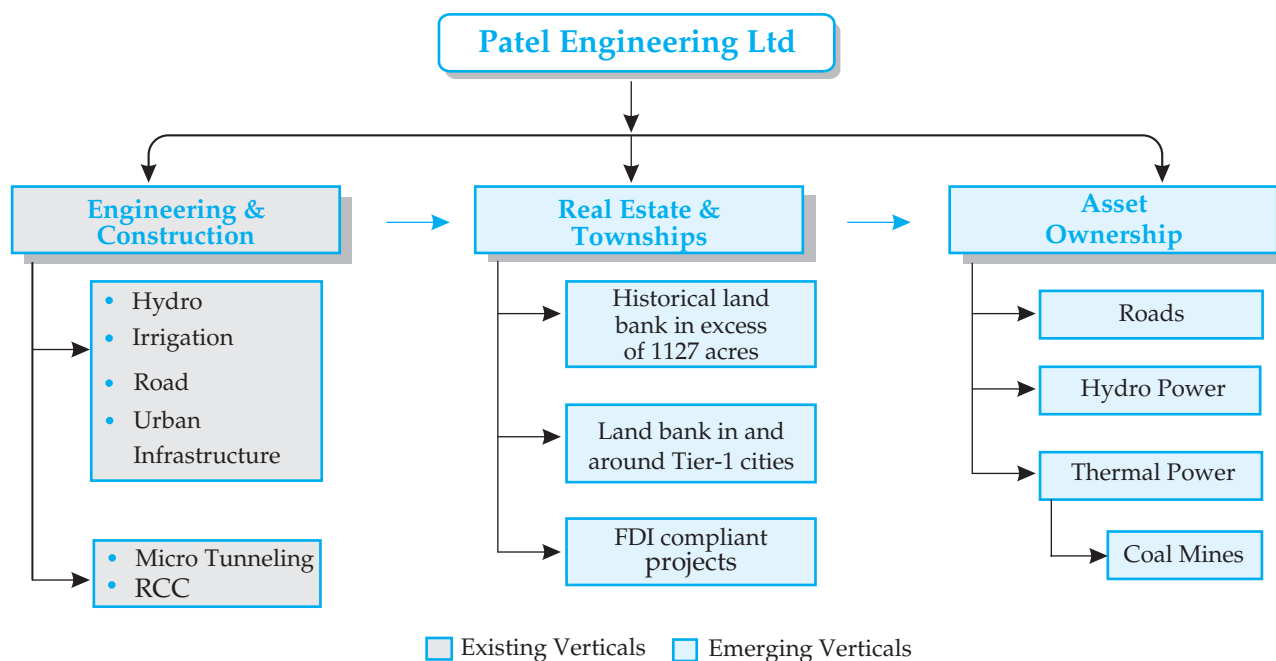
Funds from land bank to be infused in Road BOT and IPP projects



Source: Company, SBICAP Securities Research

Future Strategy

PEL plans to continue to focus on its core business of construction of hydropower and irrigation projects. It also plans to grow through the inorganic route with acquisitions of companies locally and globally and thereby incorporate the latest advanced technologies in the field of construction. The company had until recently been only an EPC player and executed construction projects on a cash contract basis, but has now entered the asset ownership business of road projects (on BOT Annuity basis) and power projects (on BOOT basis as an Independent Power Producer).



Source: Company, SBICAP Securities Research

Capex and Funding

In order to execute its incremental orders, the company incurred a capex of Rs1.25bn in FY08 and the management has guided capex plans of Rs1.3bn and Rs1.5bn for FY09E and FY10E respectively.

PEL raised Rs4.25bn in FY07 through a FPO issuing 9.65mn shares at Rs440 per share (of face value Rs1 each).

FPO Issue details

Instrument	Month - Year Issued	Shares issued (mn)	Share price	FV	Premium	Amount Raised (Rs bn)
FPO	May'06	9.65	440	1	439	4.25

Source: SBICAP Securities Research

FPO issue funds of Rs4.25bn fully utilised

The FPO issue proceeds utilized as of Mar'08 are as follows:

Particulars	Rs mn
Investment in Capital Expenditure	700
Repayment of Contractee Advances / Debt	793
Investments in subsidiaries, acquisitions and Joint ventures	1,375
General corporate purposes	1,382
TOTAL	4,250

Source: SBICAP Securities Research

Concerns

Slowdown in order flow

The company being focused on hydropower, irrigation and highways projects, is dependent on the government and government organizations like NHPC, ICAD of Andhra Pradesh, NHAH and NTPC for its orders.

- The rising fiscal deficit could lead to a reduction in the infrastructure spending by the government thereby leading to a decline in order flows to the company.
- The projects in the hydropower, irrigation and water management segments require land acquisitions and environmental approvals which could potentially delay the awarding of the contracts.

Possibility of delays in awarding of contracts by the government

Pressure on operating margins

Price escalation clauses have been built into about 90% of the contracts, enabling the company to pass on the increase in raw material costs like steel, cement and bitumen to the clients. But the incremental raw material costs on the fixed price contracts and the BOT projects would not be able to be passed on, thereby putting pressure on operating margins.

High cost of borrowing

The increasing interest rate scenario will lead to higher costs of borrowing and could also lead to postponement of projects awarded by the clients.

Shortage of manpower

An industry wide concern among the infrastructure and construction companies in India is the shortage of skilled manpower. The company's exposure to hydropower projects requires highly skilled technically qualified manpower and we believe that with the additional orders flowing in, the shortage of skilled manpower would continue.

COMPANY BACKGROUND

Experience in construction of projects for over 58 years

Patel Engineering Ltd (PEL), setup in 1949, is one of the leading construction companies in India with an established track record in the domestic and international market. The company's focus is on providing an entire range of civil engineering services including design and construction of power houses, hydroelectric plants (largest hydropower construction player in India), irrigation, commercial building, industrial complexes, dams, tunnels, underground structures, steel and concrete structures, microtunnelling (largest microtunnelling contractor in the world), bridges, marine works, flyovers and national highways. The company has constructed over 350 projects including over 75 dams, 30 hydropower projects, 30 microtunneling projects and 160 kms of tunneling projects.

With majority of the order book comprising of hydropower and irrigation projects, the company caters to the central and state governments and also government bodies like NHPC, NEEPCO, NHAI, and ICAD of Andhra Pradesh. The company has a manpower strength of over 1600 employees as of June 2008 (78% technically qualified).

PEL has a presence in the US market and has incorporated two subsidiaries - ASI RCC Inc and Westcon Microtunneling Inc, which gives it access to advanced technologies like RCC (Roller Compacted Concrete), Double Lake Tap and Microtunneling. PEL also owns over 1127 acres of land bank in and around tier-one cities like Hyderabad, Bangalore, Chennai and Mumbai.

Some of the Milestones of the company are:

- One of the few Indian companies to construct more than 26 hydropower projects (totaling about 7000 MW)
- First construction company in Asia to execute Double lake tap works (Koyna dam project)
- Constructed largest under ground Cavern (Surge chamber) in Asia (Srisailem dam project)
- First Indian company to execute microtunneling projects under Tunnel Boring Machine in India
- First Indian company to construct dam using Roller Compacted Concrete (RCC) technology (Ghatgar dam project)
- Market leader in microtunneling technology with 98% share in India
- Among the first few companies in India to execute lift irrigation project
- One of the few Indian Infrastructure companies to have a presence in the technologically advanced US construction market

BUSINESS MIX

CORE CONSTRUCTION BUSINESS

Hydropower projects (58% of the current order book and 61% of FY08 revenues)

PEL's core focus is in the construction of hydropower projects, including civil structures like dams, tunnels, powerhouse, surge chambers, barrages, intake structures and headrace tunnels. Having executed projects over 7000 MW of hydropower plants of the total 35909 MW capacity in India, the company commands a 22% share of the hydropower construction industry in the country. Construction of hydropower plants and dams are technically intensive projects typically in difficult terrains, which requires advanced technological skills, experience, equipment and manpower, thereby restricting the number of players bidding for the projects. This restricted competition enables companies to earn high operating margins at about 20%, making hydropower construction projects one of the most profitable construction segments.

22% market share in
hydropower construction in
India

Leading Dam and Hydropower projects constructed / under construction:

Project	Location
Koyna hydroelectric project Stage IV	Maharashtra
Srisailem hydroelectric project	Andhra Pradesh
Teesta Project Stage V	West Bengal
Balimela hydroelectric project	Orissa
Platonovrissi dam and hydroelectric project	Greece
Hack dam and reservoir project	USA
Stagecoach dam and reservoir project	USA
Token river water supply project	Northeast Africa
Bowetanna dam	Srilanka
Chukha hydroelectric project	Bhutan

Source: SBICAP Securities Research

Irrigation (17% of the current order book and 26% of FY08 revenues)

Within the Irrigation segment, the company undertakes projects including construction of reservoir, pump stations, water conducting systems and water canals. In order to capitalize on its expertise in construction of dams, tunnels and pump houses for the hydropower projects, the company has also entered into EPC and LSTK contracts in lift-irrigation projects.

Leading Irrigation projects constructed / under construction:

Project	Location
Bhima lift irrigation project, Stage I	Andhra Pradesh
Kalwakurthy lift irrigation project, Stage I	Andhra Pradesh
Jawahar lift irrigation project, Stage I & II	Andhra Pradesh

Source: SBICAP Securities Research

Roads, Highways and Tunnels for railways (15% of the current order book and 8% of FY08 revenues)

PEL has executed construction projects in the transportation segment such as roads, bridges, railways and road tunnel contracts both in India in the overseas market. The company has also taken up Road projects on a BOT basis and currently is in the process of constructing 2 BOT road projects in Andhra Pradesh and

Karnataka on an Annuity basis. The margins earned in the roads and highways segment is typically the lowest among the different construction segments. The road projects on a BOT basis would earn even lower margins in the current increasing raw material scenario due to fixed price contracts on the BOT projects.

Leading Road and Highway projects constructed / under construction:

Project	Location
Badrachalam bridge	Andhra Pradesh
Flyover on Surat ring road	Gujarat
Ramvadi Naka to Municipal corp	Maharashtra
Alnavar to Yellapur road	Karnataka
Uddampur-katra railway tunnel project	Jammu
East west corridor (EW-II)	Assam
Madurai to Kanyakumari highway	Tamil Nadu

Source: SBICAP Securities Research

Others (Urban infrastructure) (10% of the current order book and 5% of FY08 revenues)

The company has also undertaken marine engineering projects including construction of ports, jetties and dredging activities as well as industrial projects involving the construction of thermal power plants and civil construction such as buildings.

Other leading projects constructed / under construction:

Project	Location
Centaur Hotel	Maharashtra
Barauni Oil refinery	Bihar
Durgapur steel plant	West Bengal
Indoor stadium	Gujarat
Impounded wet dock	Maharashtra
Conference centre and secretariat complex	Bhutan
General post office	Qatar
Wholesale market center	Qatar

Source: SBICAP Securities Research

OTHER BUSINESSES

Power generation (Independent power producer)

The company has signed a MoU with the Government of Gujarat to setup a 1200 MW thermal power plant in three phases of 400 MW each. The company has also signed a MoU with Government of Arunachal Pradesh to setup a hydropower plant of 120 MW.

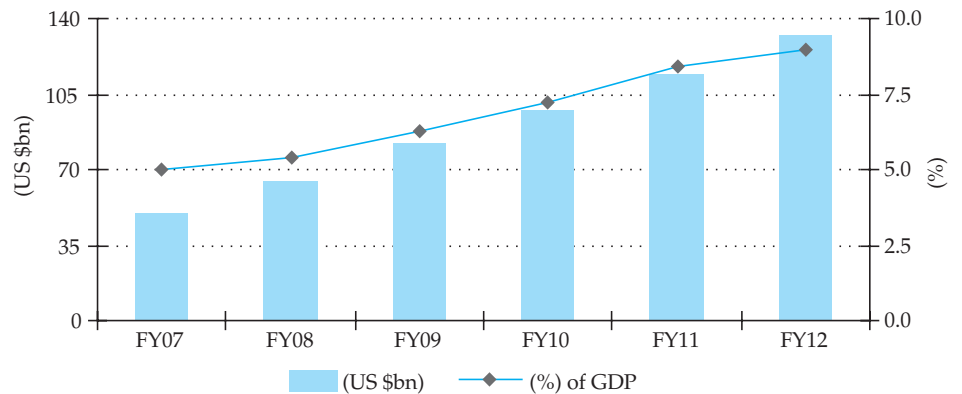
Real Estate

PEL over the years have accumulated a strong land bank of over 1127 acres spread in and around major cities, viz., Mumbai (27 acres), Bangalore (89 acres), Hyderabad and neighboring towns (811 acres) and Chennai (200 acres). The company plans to develop the land bank in phases and is looking at the lease rental model and the outright sale model to monetize the land bank.

INDUSTRY SCENARIO

The construction industry in India has been witnessing impressive growth in the past few years led by increased focus on infrastructure development by the government and the increased capex by the private sector firms. The investment in the infrastructure industry in India is expected to be about US \$750bn over the next five years. This opens up huge opportunity for construction players involved in the construction of roads, highways, industrial plants, power plants, buildings and urban infrastructure.

Annual Infrastructure spending in India



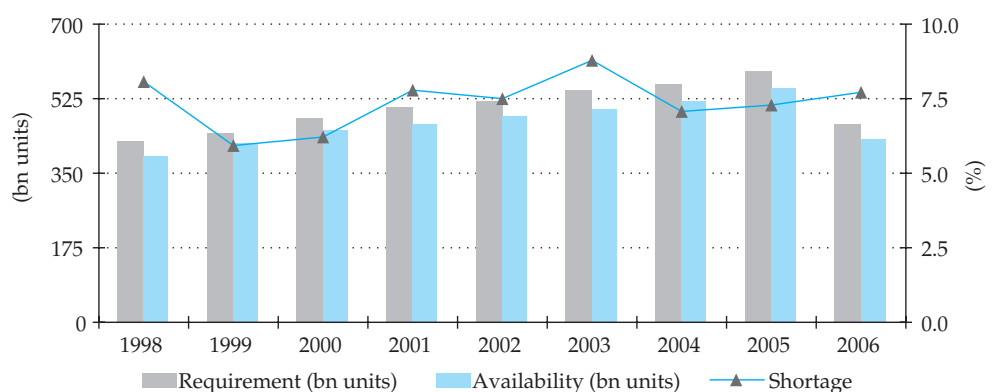
Enormous growth potential of the hydropower sector

Source: Planning Commission, GoI

Power sector

The gap between power availability and power supply is increasing in India, necessitating the government to increase its focus and investments in the sector. With an aim to achieve the NEP (National Electricity policy) of providing "Power for All" by 2012 (increasing the per capita availability of power to over 1000 MW from the current level of 631 units), the government during the Eleventh plan has planned a total investment in the power sector of US \$175bn, involving an addition of 78,577 MW power capacity (including about 16,553 MW in Hydropower capacity).

Energy Requirement v/s Availability



Rising gap between demand and supply of power

Source: Ministry of Power, GoI

Investments of US \$54bn expected in the Irrigation sector

Irrigation sector

The government has increased the efforts to ensure adequate supply of water for agricultural purposes and for personal consumption through various schemes like Accelerated Irrigation Benefit Programme (AIBP), Jawaharlal Nehru National Urban Renewal Mission (JNNURM) and Bharat Nirman. The investment in the irrigation and water supply management sector is expected to increase to US\$54bn in the next five years, developing 16m hectares through major, medium and minor irrigation works. This in turn would benefit construction companies catering to irrigation, lift irrigation, water supply management, restoration of water bodies and water harvesting projects.

Roads and Highways sector

The central government has increased its attention towards expanding and improving the road network in India from the last decade. The National Highways in India comprise about 2% of the total road length and yet carry over 40% of total traffic. One of the major steps initiated was the National Highways Development Programme (NHDP) - comprising the construction of Golden Quadrilateral (GQ) and North-South-East-West (NSEW) corridor and other highways in seven phases, with the aim to improve the network across the country. The Eleventh Five year plan envisages a total expenditure of US\$76bn for the roads sector during FY08-12, which is double the envisaged investment of US\$32bn during the previous five year plan.

National Highway Development Programme (NHDP)

Phase	Description	Length (kms)	Target for completion
Phase I	GS, NSEW	7509	Dec'08
Phase II	NSEW	6649	Dec'08
Phase III	Four - laning	12231	Dec'13
Phase IV	Two - laning	20000	-
Phase V	Six -laning	6500	Dec'12
Phase VI	Expressway	1000	Dec'15
Phase VII	Ring road, bypasses	-	-

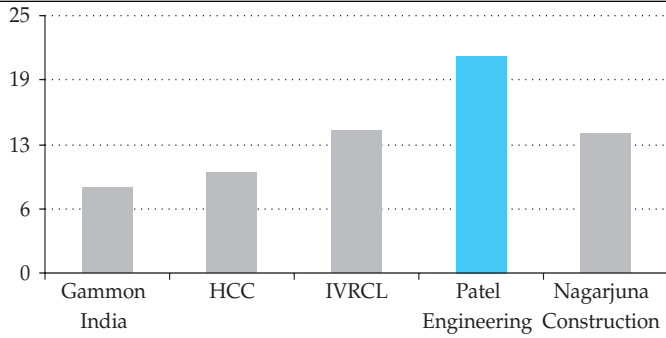
Source: NHAI

Investments in roads and hydropwer expected to double to US \$76bn over FY08 - 12

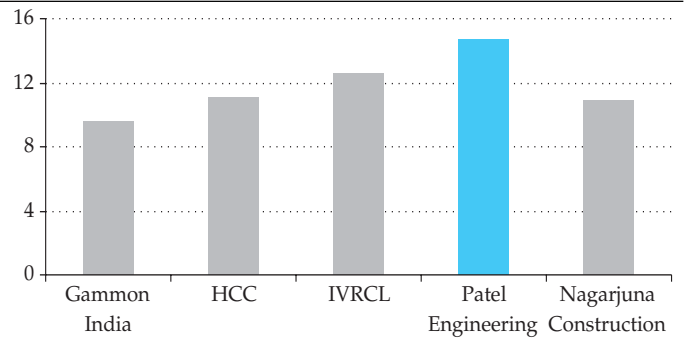
Though the long term outlook for the construction companies remains positive, in the near term the rising interest rate scenario and increasing fiscal deficit of the government could lead to possible slowdown in order flows in some sectors due to delays and postponement in capex plans by the corporate and decline in infrastructure spending by the government.

PEER COMPARISON

ROE (%)



OPM (%)



Source: SBICAP Securities Research

Financial Comparison

Company	Net Sales	Net Profit	NPM (%)		ROCE(%)		D/E (x)	
	(Rs mn)	(Rs mn)	FY07	FY08	FY07	FY08	FY07	FY08
Gammon India	26,435	713	1.5	2.7	3.1	4.7	0.3	0.4
HCC	29,947	889	1.4	3.0	2.0	5.8	1.5	1.8
IVRCL	38,496	2,834	6.5	7.4	10.3	10.1	0.7	0.6
Patel Engineering	18,596	1,628	9.1	8.8	16.3	14.7	0.5	1.2
Nagarjuna Const.	36,354	1,675	3.3	4.6	6.5	8.5	0.6	0.6

Source: SBICAP Securities Research

Stock performance of PEL v/s its peers



Source: SBICAP Securities Research

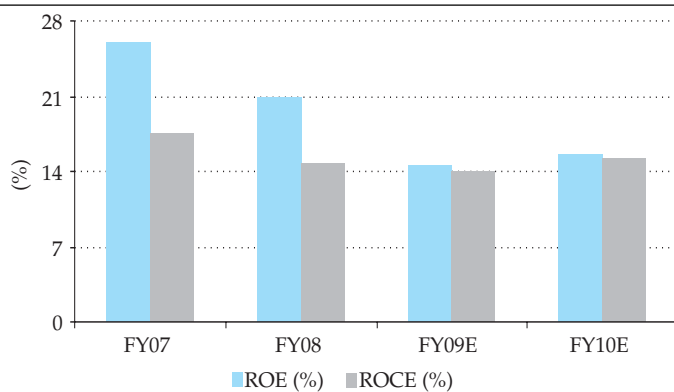
FINANCIALS

Net sales expected to grow at a CAGR of 20% over FY08 - FY10E

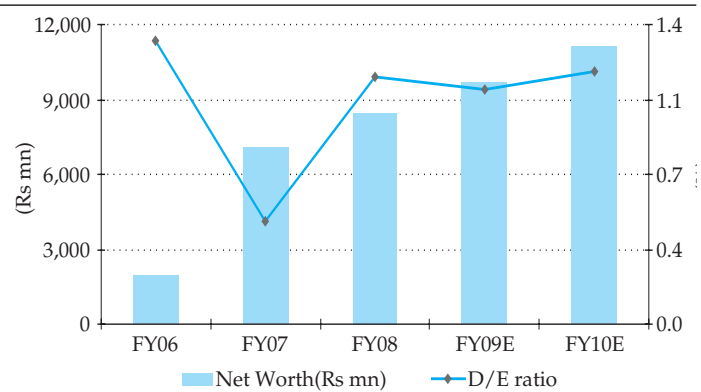
Assumed tax rate of 33%

- The consolidated revenues of the company has increased by 44% to Rs18.6bn in FY08 from Rs12.9bn in FY07, while in Q1FY09 it increased by 20% to Rs5.58bn from Rs4.15bn in Q1FY08. Given the strong order book position of the company, we expect the consolidated revenues to increase to Rs22.80bn in FY09E and Rs26.91bn in FY10E.
- The consolidated operating margins have increased to 14.7% in FY08 as compared to 12.9% in FY07. For the quarter Q1FY09, the operating margin was at 11.08% as compared to 11.13% in Q1FY08. About 90% of the contracts have price escalation clauses built in, and hence we do not expect major pressure on margins due to the rising prices of raw materials like cement, steel and bitumen. We expect the consolidated operating margins in FY09E and FY10E to be 14.9% and 15.4% respectively.
- The company's net profit has increased by 39% to Rs1.62bn in FY08 from Rs1.17bn in FY07; while in Q1FY09 it increased by 33% to Rs381mn from Rs287mn in Q1FY08. Assuming full tax rate of 33% for the future, we expect the consolidated net profit to be at Rs1.26bn in FY09E and Rs1.54bn in FY10E.
- The EPS was at Rs27.3 in FY08 as compared to Rs19.6 in FY07. Our consolidated EPS estimates (assuming full tax rate of 33%) for FY09E and FY10E are at Rs21.2 and Rs25.9 respectively. *At the current tax rate of 12%, the consolidated EPS would be at 27.9 and 34.0 for FY09E and FY10E respectively.*
- The D/E ratio for FY08 was at 1.2x and the management has stated that there are no further plans for equity dilution and future fund requirements for capex and working capital purposes would be funded through debt and internal accruals. The ROE was at 21% in FY08 to expect it to be at 14.0% in FY09E and at 15.0% in FY10E, while the ROCE was at 17.5% in FY08 and expect it to be at 13.8% in FY09E and at 14.8% in FY10E.

ROE (%) and ROCE (%)



Net Worth (Rs mn) and D/E ratio (x)

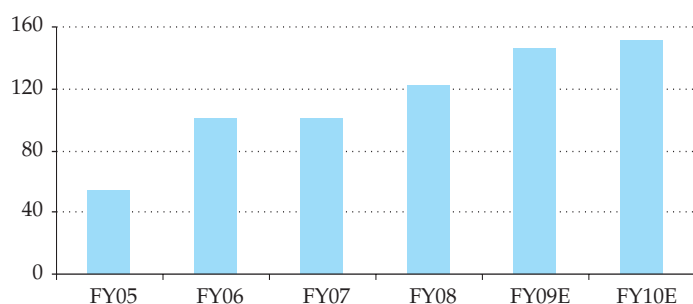


Source: SBICAP Securities Research

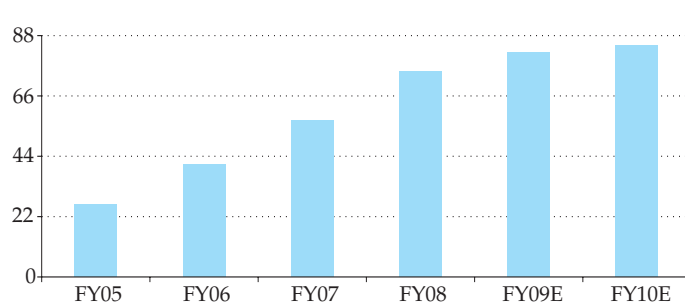
Tax benefits under Section 80 IA

PEL continues to avail Section 80IA tax benefits even after the FY07 Union Budget which made the tax deduction under the section available only to the Infrastructure developers and not the construction contractors. The tax rate for FY07 and FY08 was 10.7% and 12.2% respectively. **We have assumed full tax rates at 33% in our future estimates and any decision on tax benefits under Section 80IA in favor of the company will lead to an upside from our earnings estimates.**

Average Inventory days



Average Debtors days



Source: SBICAP Securities Research

Valuation

At the current price of Rs370, the stock trades at a P/E multiple of 17.4x its FY09E consolidated EPS of Rs21.2 and at 14.3x its FY10E consolidated EPS of Rs25.9. On an EV/EBIDTA basis, it trades at 8.8x FY09E and 7.7x FY10E. We value the real estate subsidiary at Rs185 per share, BOT subsidiaries at Rs13 per share and assign a conservative 12x P/E multiple to its core construction business's standalone FY10E EPS of Rs24.4. Thus, arriving at an SOTP value of Rs490 per share (an upside of 32% from the current level), we recommend a BUY on the stock.

SOTP value of Rs 490 per share

SOTP Valuation

Businesses	Valuation method	Value per share (Rs)
Core Construction projects	12x P/E multiple	292
BOT projects	NPV	13
Real Estate (Land Bank)	50% discount to NAV	185
Total		490

Source: SBICAP Securities Research

FINANCIALS STATEMENTS

Income Statement

(Rs. mn)

Year to 31st March	FY06	FY07	FY08	FY09E	FY10E
Net Sales	10,223	12,900	18,596	22,805	26,915
<i>Growth (%)</i>	43.5	26.2	44.2	22.6	18.0
EXPENDITURE					
Operating Expenses	7,921	10,218	13,798	16,899	20,052
Staff Costs	982	1,022	2,058	2,509	2,71
Total Expense	8,903	11,240	15,856	19,407	22,770
EBIDTA	1,321	1,660	2,740	3,398	4,145
<i>EBIDTA margins (%)</i>	12.9	12.9	14.7	14.9	15.4
Other Income	60	319	347	321	303
Depreciation	311	349	627	753	855
Interest	261	319	605	1,078	1,290
PBT	808	1,312	1,855	1,889	2,303
Taxes	66	141	227	623	760
<i>Effective Tax Rate (%)</i>	8.1	10.7	12.2	33.0	33.0
PAT	742	1,171	1,628	1,266	1,543
<i>PAT margins (%)</i>	7.3	9.1	8.8	5.5	5.7

Source: SBICAP Securities Research

Cashflow Statement

(Rs. mn)

Year to 31st March	FY06	FY07	FY08	FY09E	FY10E
Profit before Tax	808	1,316	1,855	1,889	2,303
Depeciation	311	349	627	753	855
Other Operating Activities	285	42	456	1,078	1,290
Operating Profit before WC changes	1,404	1,707	2,938	3,719	4,448
(Increase) / Decrease in WC	(2,190)	(3,019)	(3,960)	(2,556)	(4,125)
Income Tax	(98)	(297)	(452)	(623)	(760)
Cash Flow From Operating Activities	(884)	(1,609)	(1,474)	540	(437)
Capex	(695)	(788)	(4,821)	(801)	(508)
Changes in Investments	39	66	(259)	0	0
Other Investing Activities	(12)	259	564	0	0
Cash Flow From Investing Activities	(668)	(463)	(4,516)	(801)	(508)
Issue / (Redemption) of Capital	1	4,250	0	0	0
Increase / (Decrease) in Debt	1,590	292	7,030	1,170	3,025
Dividend	(77)	(92)	(81)	(122)	(140)
Interest	(318)	(315)	(565)	(1,078)	(1,290)
Cash Flow From Financing Activities	1,196	4,135	6,385	(30)	1,596
Net Changes in Cash	(357)	2,063	395	(290)	651

Source: SBICAP Securities Research

■ Balance Sheet

(Rs. mn)

Year to 31st March	FY06	FY07	FY08	FY09E	FY10E
Sources of Funds					
Equity share capital	50	60	60	60	60
Share premium	8	4,070	4,070	4,070	4,070
Other Reserves	1,949	2,945	4,330	5,473	6,876
Total Reserves and Surplus	1,957	7,015	8,399	9,543	10,946
Total Shareholders funds	2,007	7,074	8,459	9,602	11,006
Total Loans	3,578	3,420	9,764	10,564	13,164
Contractee Advances	1,976	1,492	2,178	2,548	2,973
Minority Interest	254	74	405	405	405
Deferred Tax Balance	168	118	151	151	151
Total Liabilities	7,982	12,178	20,957	23,271	27,699
Applications of Funds					
Gross Block	2,650	3,568	6,152	7,452	9,002
Depreciation	266	1,145	1,801	2,554	3,409
Net fixed assets	2,384	2,423	4,351	4,898	5,593
Capital WIP	46	113	2,352	1,852	810
Total non-current assets	2,430	2,536	6,702	6,750	6,403
Total Investments	284	1,714	361	361	361
Current Assets					
Inventories	3,031	4,241	8,148	10,122	12,241
Sundry debtors	1,714	3,031	4,617	5,623	6,784
Cash & bank balances	722	1,047	2,882	2,592	3,243
Loans and Advances	2,569	2,939	4,701	5,770	7,536
Other Current Assets	0	23	11	23	27
Total current assets	8,035	11,282	20,360	24,129	29,831
Total current liabilities	2,788	3,375	6,465	7,969	8,895
Total provisions	25	6	23	23	23
Misc exp w/o	32	27	23	23	23
Net Current Assets	5,222	7,901	13,871	16,137	20,913
Total Assets	7,982	12,178	20,957	23,271	27,699

Source: SBICAP Securities Research

■ Ratios

Year to 31st March	FY06	FY07	FY08	FY09E	FY10E
Per Share data (Rs)					
EPS	14.8	19.6	27.3	21.2	25.9
EPS after EOI	14.7	18.9	25.5	19.4	24.0
CEPS	21.1	25.5	37.8	33.8	40.2
BVPS	40.1	118.6	141.8	161.0	184.5
DPS	1.3	1.3	1.5	1.8	2.0
Return / Profitability Ratio (%)					
EBIDTA margins	12.9	12.9	14.7	14.9	15.4
NPAT margins	7.3	9.1	8.8	5.5	5.7
RONW	45.0	25.8	21.0	14.0	15.0
ROCE	29.3	16.3	14.7	13.8	14.8
Dividend Payout	9.1	7.7	6.4	9.7	9.0
Dividend Yield	0.4	0.4	0.4	0.5	0.5
Valuation Ratios (x)					
P/E	24.9	18.8	13.6	17.4	14.3
P/CEPS	17.6	14.5	9.8	10.9	9.2
P/BV	9.2	3.1	2.6	2.3	2.0
EV/EBIDTA	16.2	14.7	10.6	8.8	7.7
M-Cap / Sales	1.8	1.7	1.2	1.0	0.8
EV / Sales	2.1	1.9	1.6	1.3	1.2
Operating Ratios					
Construction costs / Sales (%)	77.5	79.2	74.2	74.1	74.5
Effective Tax Rate (%)	8.1	10.7	12.2	33.0	33.0
NWC / Total Assets (%)	65.4	64.9	66.2	69.3	75.5
Average Inventory Turnover (days)	82	103	122	146	152
Average Receivables (days)	44	67	75	82	84
Average Payables (days)	50	77	77	93	92
D/E Ratio (x)	1.8	0.5	1.2	1.1	1.2
Interest Coverage ratio (x)	3.9	4.1	3.5	2.5	2.6
Growth Ratios (%)					
EBIDTA	67.2	37.9	42.2	44.1	33.5
NPAT	97.3	56.9	34.0	-19.0	21.8
EPS	-65.4	32.3	39.0	-22.3	21.9
CEPS	-55.7	21.0	48.3	-10.5	18.8

Source: SBICAP Securities Research

Bowetanna Dam - Sri Lanka



Tons Hydroelectric - MP



Water Supply Scheme - Shillong



Srisaillam Hydroelectric - AP



Koyna Tunnel - Maharashtra



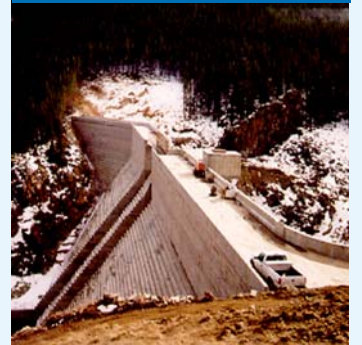
Ghatghar RCC Dam



Indoor Stadium - Gujarat



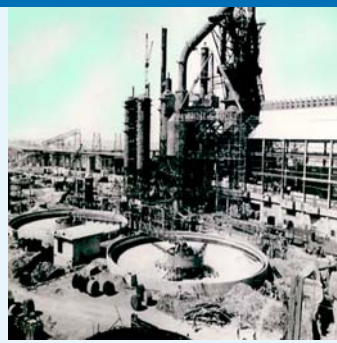
Hack dam and reservoir - USA



Centaur Hotel - Mumbai



Durgapur Steel - West Bengal



Betwa Bridge - Uttar Pradesh



Recent Reports

Date	Company Name	Recommendation	Recommended Price	Target Price
16-Sep-08	IDFC	Buy	81	104
16-Sep-08	Piramal Healthcare	Buy	309	360
29-Aug-08	Great Eastern Shipping	Buy	380	470
24-Jul-08	Corn Sector Report			
	Riddhi Siddhi Gluco Biols	Buy	185	336
	Anil Products	Not Rated	97	-
21-Jul-08	Hotel Sector Report			
	Indian Hotels Company	Buy	84	146
	East India Hotels	Outperform	120	138
	Hotel Leelaventure	Marketperform	31	-
	Taj GVK Hotels & Resorts	Buy	91	157
	Sayaji Hotels	Outperform	76	105
10-Jul-08	Orbit Corporation	Buy	262	363
9-Jul-08	L&T	Buy	2,397	2,976
26-Jun-08	Oriental Bank of Commerce	Buy	136	223
30-Apr-08	FMCG Sector Report			
	GSK Consumer Healthcare	Buy	646	896
	Colgate Palmolive	Buy	405	624
	Nestle India	Buy	1,625	2,055
	Britannia Industries	Buy	1,342	2,071
	P&G Hygiene & Healthcare	Buy	750	1,114
29-Apr-08	Unity Infraprojects	Buy	560	790
24-Apr-08	B L Kashyap & Sons	Buy	1,590	1,884
17-Apr-08	Banking Sector Report			
	HDFC Bank	Buy	1,315	1,588
	Axis Bank	Buy	775	921
	Bank of Baroda	Buy	293	450
	Bank of India	Buy	304	381
	Punjab National Bank	Buy	519	650
	Union Bank of India	Buy	155	200
	Corporation Bank	Buy	306	452

Key to investment Ratings: Guide to the expected return relative to market over the next 12 months. 1=Buy (expected to outperform the market by 15 or more percentage points); 2=Outperform (expected to outperform the market by 5-15 percentage points); 3=Marketperform (expected to perform in line with the market); 4=Underperform (expected to underperform the market) by 5-15 percentage points); 5=Sell (expected to underperform the market by 15 or more percentage points)

SBICAP Securities Limited

Corporate Office: 191, Maker Tower 'F', Cuffe Parade, Mumbai 400005. Tel.: 91-22-30273340 Fax: (022) 30273420
Web: www.sbicapsec.com

Name	Designation	Phone	E-mail
Research		(022) 2218 4301	sbicapresearch@sbicapsec.com
Anil Advani	Head ((Institutional Research)	(022) 30273339	anil.advani@sbicapsec.com
Equity Sales		(022) 22165204	
Equity Dealing		(022) 22160112	
Jignesh Desai	Head (Institutional Sales)	(022) 30273302	jignesh.desai@sbicapsec.com

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