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Acumen at work

Engineers India
SELL

CHANGE IN STANCE | **ENGR IN EQUITY** | **September 11, 2014**

Not out of the woods yet

Whilst Engineers India (EIL) would retain its leadership in the hydrocarbon consulting segment, weak order pipeline of greenfield refining expansions would likely lead to moderate annual LSTK order intake of ₹6bn-7bn in FY15/16. The higher share of lower-margin international projects and brownfield projects would lead to consulting EBIT margin of 34% in FY15/16, lower than the FY09-14 average of 40.2%. Hence, we cut our FY15/16 EBITDA estimates by 38%/36% to ₹3.2bn/4.0bn, 25%/31% below consensus estimates. We downgrade EIL to SELL (from UNDER REVIEW), as it is trading at an expensive valuation of 17.3x FY16E EPS, given its marginal 4.2% EPS CAGR over FY14-17E and RoE decline of 130bps over FY14-17E to 18.9%.

Competitive position: STRONG   Changes to this position: STABLE

Weak pipeline of capacity expansion in greenfield refining

The key driver for the sharp rise in EIL's FY09-11 order intake was LSTK orders for greenfield expansions led by Government concessions. Refining expansion projects worth ₹725bn could be awarded over FY14-17, out of which the Barmer refinery is the only greenfield project in the pipeline. As a result, the higher ticket-size (₹2bn-3bn) LSTK order intake would remain weak, resulting in a moderate order inflow of ₹22.4bn in FY15 and ₹24.7bn in FY16.

Retains leadership position in low-competition consultancy segment

EIL will retain its leadership in the hydrocarbon project consultancy segment due to its well-established relationships with Government oil PSUs and due to its more than 3,000 engineers. International companies such as Toyo Engineering, Foster Wheeler and Uhde do not bid for standalone consultancy projects (₹0.5bn-1.0bn), as they incur higher staff costs than EIL. However, the competition would continue to be high in the higher ticket-size (₹2bn-3bn) private sector LSTK orders.

Operating leverage limited by order book mix deterioration

EIL's lowest-in-the-cycle FY15 EBITDA margins of 16.9% would increase to 21.8% in FY17, due to higher employee utilisation and higher share of the consulting segment. However, increase in the share of lower-margin international orders and brownfield consulting projects would lead to consulting EBIT margins of ~34% in FY16/17 vs FY09-14 average of 40.2%.

Expensive valuations given marginal EPS growth and decline in RoE

We cut our FY15/16 revenue estimate by 6%/19%, as we expect weak order intake of ₹22bn-24bn over FY14-16. We have reduced our FY15/16 EBITDA estimates by 38%/36% due to lower consulting EBIT margins and higher share of the LSTK segment, resulting in moderate 4.2% EPS CAGR over FY14-17. EIL is trading at 17.3x FY16E EPS, 15% higher than its five-year average.

Key financials

Year to March	FY13	FY14	FY15E	FY16E	FY17E
Net Revenues (₹ mn)	25,290	18,465	18,852	19,891	23,663
Operating Profits (₹ mn)	5,986	3,873	3,178	4,010	5,154
Net Profits (₹ mn)	5,867	4,857	4,061	4,677	5,511
Diluted EPS (₹)	17.4	14.4	12.1	13.9	16.4
RoE (%)	28.0%	20.2%	15.6%	16.9%	18.9%
P/E (x)	14.5	16.9	19.9	17.3	14.7
EV/EBITDA (x)	9.3	14.3	16.3	12.4	9.3

Source: Company, Ambit Capital research

Engineering & Construction

Recommendation

Mcap (bn):	₹81/US$1.4
6M ADV (mn):	₹178/US$3.0
CMP:	₹240
TP (12 mths):	₹230
Downside (%):	4

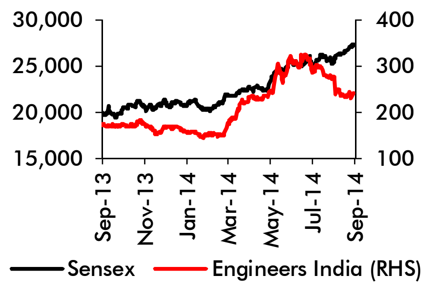
Flags

Accounting:	AMBER
Predictability:	AMBER
Earnings Momentum:	AMBER

Catalyst

- EBITDA margins in international consulting orders lower than domestic consulting orders
- Higher competitive intensity in the LSTK segment
- Misallocation of ₹25.4bn cash and investments

Performance



Source: Bloomberg, Ambit Capital research

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Weak pipeline of capacity expansion in greenfield refining

Refining projects worth ₹725bn could be awarded in the next three years by Government oil marketing companies (with only one greenfield project in the pipeline – the Barmer refinery)

Our analysis suggests that projects worth ₹725bn could be awarded in the next three years by Government Oil Marketing Companies (OMCs) such as IOCL, BPCL, HPCL and MRPL (with only one greenfield project in the pipeline – the Barmer refinery). Along with the greenfield ₹200bn Barmer refinery project by HPCL, the other major refining project in the pipeline is the brownfield ₹150bn Vizag refinery project also by HPCL. Engineers India's order intake increased sharply over FY09-11 due to LSTK orders for greenfield expansions led by Government concessions. Since the pipeline of greenfield refining expansion projects is weak currently, **we estimate moderate annual LSTK order intake of ₹6bn-7bn over FY14-17.**

Barmer refinery: Deadlock between HPCL and the state government

HPCL plans to set-up a greenfield refining capacity (of 9mmtpa) at Barmer, Rajasthan. The erstwhile Government in Rajasthan under the leadership of Mr Arun Gehlot had committed an interest-free loan of ₹560bn to be repaid in 15 years as well as the land and resources for the Barmer refinery project in return for a 26% stake in the project. The terms and conditions of the Barmer refinery project would be renegotiated, as the new BJP Government in Rajasthan has put the project on hold. The Government believes that the 26% stake is too low for the financial sops and the land offered by the Government, leading to uncertainty on project execution.

The land has been acquired for the Barmer refinery project, and HPCL has commenced the design work for the project. The Rajasthan state government has sanctioned ₹4.3bn equity to be invested in FY15 for the Barmer refinery project. However, the Government has not finalised the details of the agreement such as the Government's stake in the project and the financial incentives for the project. Engineers India was the front-runner to win the ~₹10bn consultancy project for the Barmer refinery. **We had earlier estimated that EIL would win this project in FY15. However, the project has been delayed and could be awarded in FY16**.

Vizag refinery: Expansion plan revived due to pick-up in demand and delay in Barmer refinery

The Vizag refinery project expansion from 8.3mmtpa to 15mmtpa was earlier scheduled to be completed in FY16. However, the project was delayed due to weak demand and environment issues. **Due to a pick-up in demand, HPCL has revived the plan to expand the capacity of the Vizag refinery.** HPCL will now set-up a brownfield refinery plant at Vizag to increase capacity from 8.3mmtpa to 15mmtpa. Engineers India had conducted the feasibility study for the project. The project is in the initial stages and HPCL has not yet acquired land for the project.

Exhibit 1: List of refining project pipeline of Government oil marketing companies over FY14-18

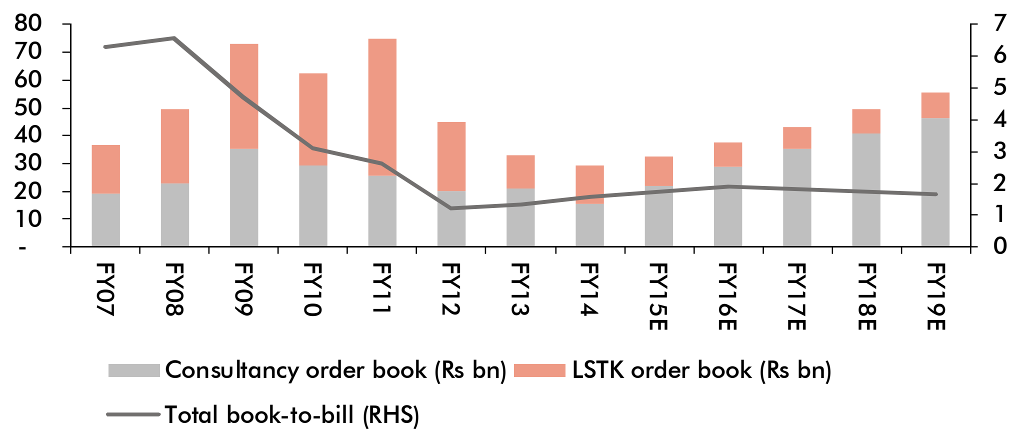
Company	Expansion plan	Type of expansion	Total Capex (₹ bn)	Location	Timeline	Status
Projects awarded						
BPCL	To increase Kochi refinery capacity from 6mmtpa to 15.5mmtpa	Brownfield	150	Kochi	Dec-15	
IOCL	15mmtpa Paradip Refinery Project	Brownfield	298	Paradip	Dec-14	
Refining expansion projects in the pipeline						
BPCL	To increase capacity from 3mmtpa to 9mmtpa	Brownfield	88	Numaligarh, Assam	Jun-16	
BPCL	Increase capacity from 6mmtpa to 8.85mmtpa	Brownfield	28	Bina, Madhya Pradesh	Jun-16	The project completion would be delayed by 2 years
MRPL	60,000 barrel-a-day delayed coker	Brownfield	18		Mar-18	
MRPL	44,000 barrel-a-day fluidic catalytic cracker	Brownfield	20		Mar-18	
HPCL	**Expand capacity from 8.33mmtpa to 15mmtpa**	**Brownfield**	**150**	**Vizag**	**Mar-18**	**Initial stages of execution; not yet acquired land**
HPCL	To expand Mumbai refinery from 6.5mn to 10mn tonnes	Brownfield	20	Mumbai	Mar-18	
HPCL	**9mmtpa refining capacity**	**Greenfield**	**200**	**Barmer**		**Deadlock between HPCL and the new state government**
IOCL	Distillate Yield Improvement (Coker) at Haldia	Brownfield	31	Haldia	Sep-17	
IOCL	Paradip Petrochemicals Phase-I, Polypropylene Project	Brownfield	32	Paradip	Sep-17	
IOCL	Brownfield Capacity Expansion by 4.3mmtpa	Brownfield	49	Koyali	FY21-22	
IOCL	Brownfield Capacity Expansion by 3mmtpa	Brownfield	30	Mathura		
IOCL	Brownfield Capacity Expansion by 3 to 6 mmtpa	Brownfield	60	Panipat		
	Total refining expansion projects in pipeline		**725**			

Source: Companies, Ambit Capital research

Note that order intake had increased sharply in FY09-11 due to Lumpsum Turnkey (LSTK) projects for greenfield expansion, as the Government of India offered a seven-year tax holiday for all the refineries commissioned before March 2012. In order to avail the tax holidays, petrochemical refining companies aggressively expanded capacity prior to 2012. However, since 2012, domestic supply has outstripped domestic demand, leading to a decline in investment in refining capacities in India. Our Oil and Gas analyst expects refining capacity to record 5.3% CAGR in FY14-16 (vs 9.5% CAGR in FY08-12), as the refining capacity is higher than domestic demand.

In order to avail the tax holidays, petrochemical refining companies aggressively expanded capacity prior to 2012

Exhibit 2: FY09-11 order intake driven by the LSTK segment

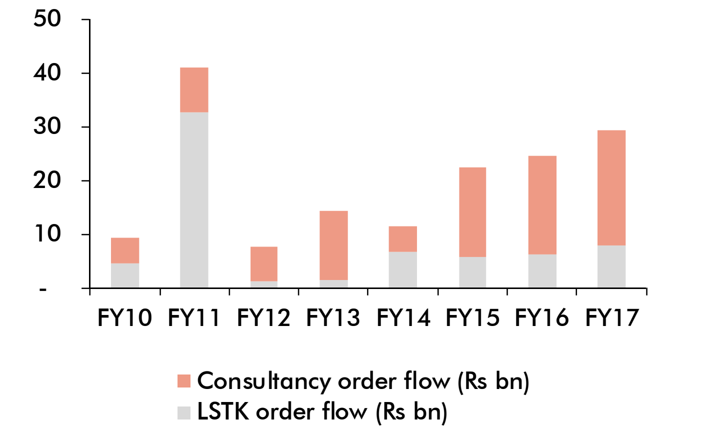


Source: Company, Ambit Capital research

Refining capacity expansion, especially greenfield expansion, declined materially post FY12 due to excess capacity in India. As a result, EIL's LSTK order book declined sharply from ₹49bn in FY11 to ₹13.3bn in FY14. The total order book of Engineers India declined from ₹75bn in FY11 to ₹29bn in FY14 (i.e. decline of 27% CAGR). We estimate that the FY15 order intake of ₹22.5bn would likely be led by ₹12.9bn orders won in 1QFY15—the US$139mn consulting order from the Dangote Group (Nigeria) for a 20mmtpa refinery and a US$127mn consulting order in Bahrain. Since the project pipeline for greenfield refining expansion is limited, we estimate moderate annual LSTK order intake of ₹6bn-7bn over FY14-17.

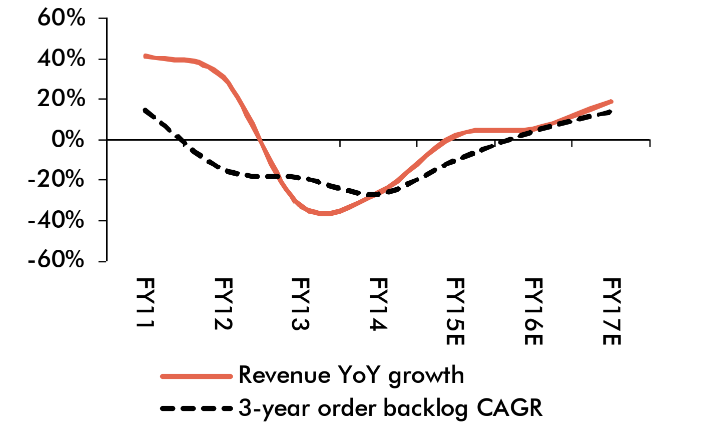
As a result of the weak order book at the end of FY14, we estimate a moderate revenue growth of 2% YoY in FY15 led by execution of the Chennai refinery LSTK order worth ₹6.7bn won in FY14. Execution of consulting projects won in 1QFY15 would lead to consulting revenue growth of 10% YoY in FY16 and 33% YoY in FY17.

Exhibit 3: Moderate LSTK order intake due to weak pipeline of greenfield capacity expansions



Source: Company, Ambit Capital research

Exhibit 4: Pick-up in consulting revenue in FY16



Source: Company, Ambit Capital research

Market leader in project consultancy

Engineers India (EIL) has retained its market leadership in winning orders from Government oil marketing companies, as EIL's revenues to the capex of oil refining companies increased over FY08-12 due to the execution of the LSTK order book. **Post the completion of the Paradip refinery in FY14, our Oil and Gas analyst expects a sharp drop in the capex of Government OMCs in FY15 due to excess refining capacity.** As a result, the domestic order intake of EIL would continue to be weak over FY14-16.

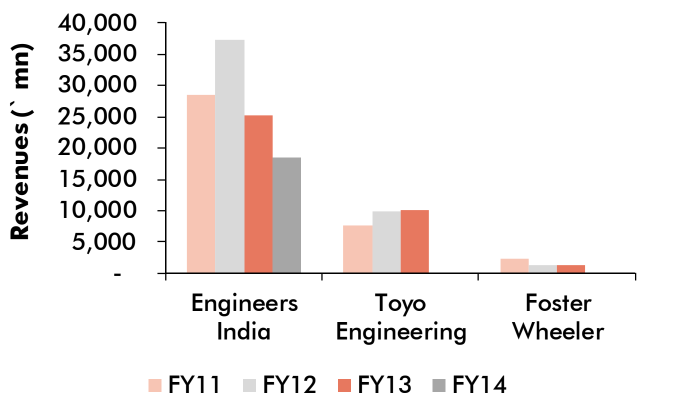
Exhibit 5: Capex of refining companies

Capex (₹ bn)	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E
IOCL	57	75	138	138	101	113	114	307	106	112
HPCL	60	30	36	73	80	80	65	58	37	43
BPCL	21	33	49	55	51	40	51	71	41	40
MRPL	-2	2	3	15	23	45	28	50	28	27
Total capex of refining companies	**136**	**140**	**226**	**280**	**255**	**278**	**257**	**487**	**212**	**222**
EIL revenues	5.8	7.5	15.5	20.1	28.5	37.2	25.3	18.5	18.9	19.9
EIL revenues as % of refining companies capex	**4.3%**	**5.4%**	**6.9%**	**7.2%**	**11.2%**	**13.4%**	**9.8%**	**3.8%**	**8.9%**	**9.0%**

Source: Company, Ambit Capital research

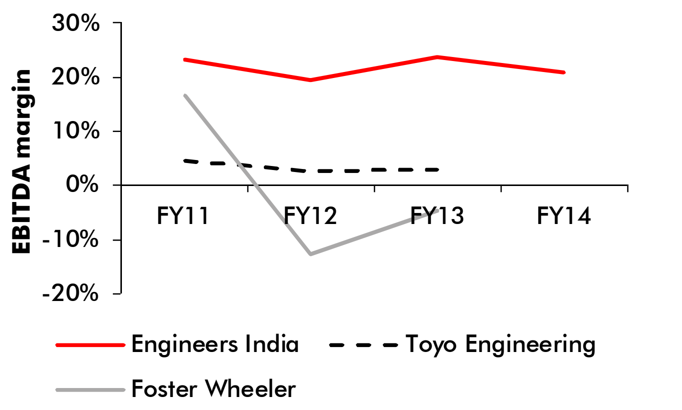
We believe EIL will retain its market leadership in the hydrocarbon project consultancy segment due to its well-established relationship with Government oil PSUs and low-cost technical staff of more than 3,000 engineers. The subsidiaries of international players such as Toyo Engineering, Saipem, Foster Wheeler, and Uhde have higher staff costs than EIL. Hence, these international companies do not bid for smaller size (₹500mn-1,000mn) standalone consultancy projects. Note that the competitive intensity from international players is relatively higher in the higher ticket-size LSTK segment (₹2bn-3bn).

Exhibit 6: EIL – the market leader in hydrocarbon project management



Source: Company, Ambit Capital research

Exhibit 7: EIL's EBITDA margins are higher than its peers

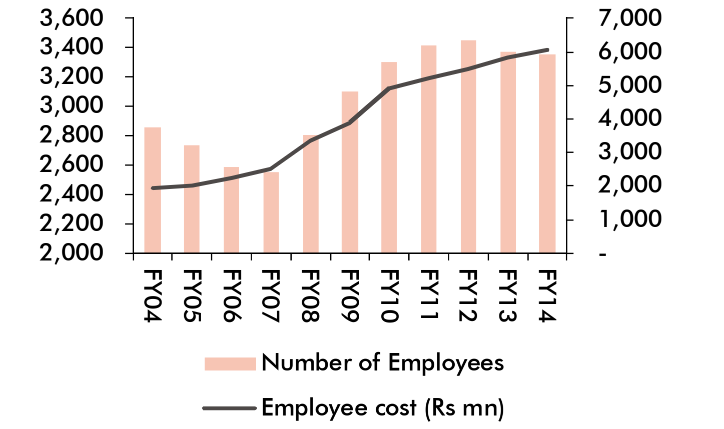


Source: Company, Ambit Capital research

Operating leverage limited by deterioration of order book mix

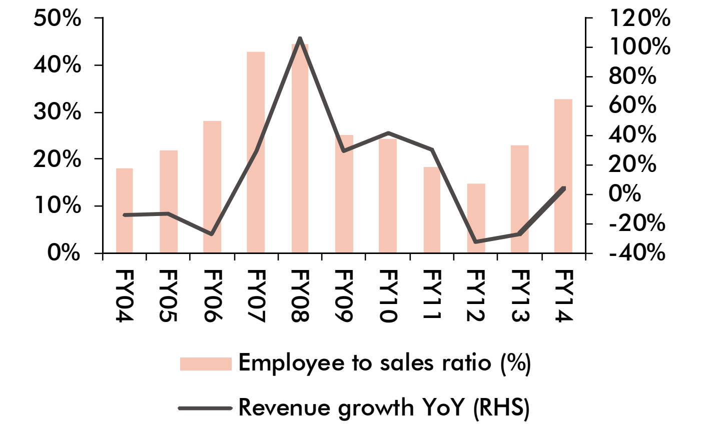
EIL's employee costs increased by a moderate 3.7% over FY10-14, as EIL's number of employees were flat over FY10-14 (3,357 employees in FY14 vs 3,301 in FY10). However, **EIL's employee cost to sales ratio increased from 18.4% in FY11 to 32.8% in FY14 due to the sharp 46% LSTK revenue CAGR decline over FY12-14, resulting in under-utilisation of EIL's employees**. We expect EIL's lowest-in-the-cycle EBITDA margins of 16.9% in FY15 to recover to 20.2% in FY16, as execution of consulting orders won in 1QFY15 would lead to a higher share of the higher-margin consulting segment.

Exhibit 8: Despite the moderate employee cost CAGR of 3.7% over FY10-14 …



Source: Company, Ambit Capital research

Exhibit 9: …the employee cost to sales ratio increased to 33% in FY14

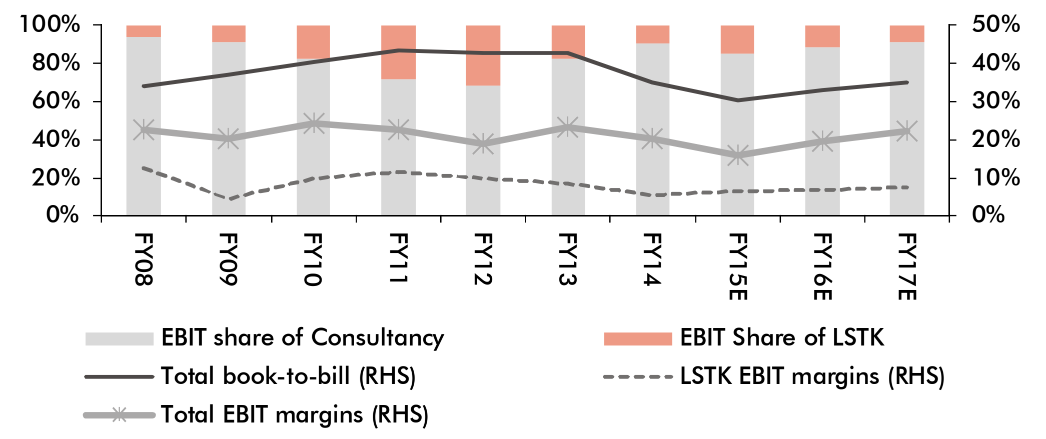


Source: Company, Ambit Capital research

In our opinion, the consulting EBIT margins for international projects are lower than the domestic consulting EBIT margins by 300-400bps due to the higher travel costs involved in international projects. In addition, **the competitive intensity is higher for brownfield projects from the back offices of global majors such as Toyo, Linde and Uhde.** Thus, a continued slowdown in greenfield project expansions would limit the recovery in consulting EBIT margins to 34% in FY16 and 34% in FY17 vs the average consulting EBIT margin of 40.2% over FY09-14.

Consulting EBIT margins for international projects are lower than domestic consulting EBIT margins by 300-400bps due to higher travel cost

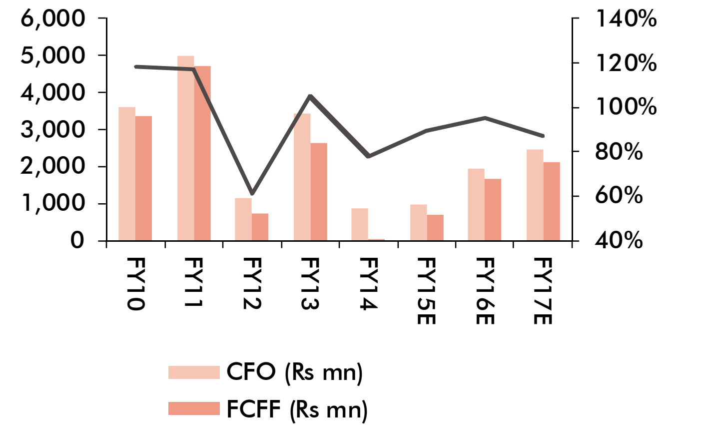
Exhibit 10: Order book mix deterioration would limit consulting EBIT margin recovery



Source: Company, Ambit Capital research

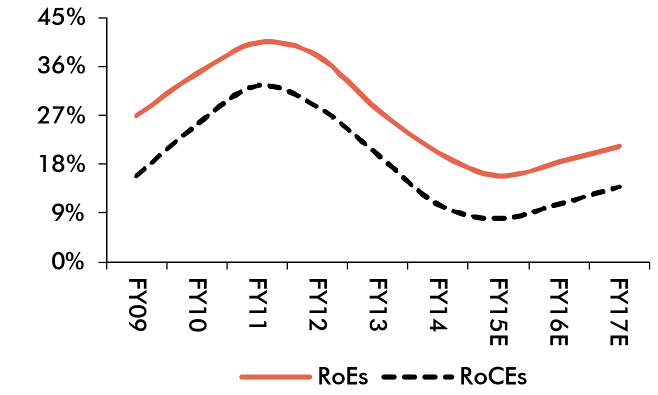
EIL's working capital days increased 7 days in FY14 due to a sharp decline in advances from customers to ₹2.1bn in FY14 vs ₹4.2bn in FY13. Whilst EIL continued to report negative working capital days in FY14, we estimate a marginal 70bps increase in RoCE over FY14-17 due to inefficient capital allocation. EIL had cash and short-term investments of ₹25.4bn as on FY14, 1.0x of FY14 capital employed and 33% of market capitalisation. The cash on EIL's balance sheet is surplus cash, as EIL has an asset-light business model. The management has not articulated its plan to utilise the cash through special dividend, share buyback or acquisition.

Exhibit 11: Sustained high pre-tax CFO/EBITDA



Source: Company, Ambit Capital research

Exhibit 12: Inefficient capital allocation to restrict increase in RoCE



Source: Company, Ambit Capital research

Key assumptions

Exhibit 13: Change in estimates (₹ mn)

Key assumptions	Old Estimates			New Estimates			Change in Estimates			Comments
Particulars	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	
Order book	39,425	42,303	45,175	32,710	37,518	43,260	-17%	-11%	-4%	We have cut our FY14-17 LSTK order intake estimates due to the weak greenfield refining expansion pipeline. The Barmer refinery expansion by HPCL is the only large greenfield project yet to be awarded. We expect EIL to win the ₹10bn consulting order for this project.
YoY growth (%)	9.3%	7.3%	6.8%	12.4%	14.7%	15.3%	312bps	791bps	852bps	
Consultancy segment	25,240	27,411	29,435	22,018	28,949	35,230	-13%	6%	20%	
YoY growth (%)	10.8%	8.6%	7.4%	40.1%	31.5%	21.7%				
LSTK segment	14,185	14,892	15,740	10,692	8,569	8,031	-25%	-42%	-49%	
YoY growth (%)	6.6%	5.0%	5.7%	-20.2%	-19.9%	-6.3%				
Order flow	23,475	27,390	31,971	22,454	24,699	29,405	-4%	-10%	-8%	
Consultancy Segment	15,600	17,940	20,631	16,692	18,361	21,482	7%	2%	4%	
LSTK segment	7,875	9,450	11,340	5,762	6,338	7,923	-27%	-33%	-30%	
Revenues	20,135	24,512	29,099	18,852	19,891	23,663	-6%	-19%	-19%	We expect revenue growth to be flat in FY15 due to the weak FY14 order book. Revenue growth would pick-up in FY16 led by execution of international consulting projects.
YoY growth (%)	14%	22%	19%	2%	6%	19%	-1237bps	-1320bps	25bps	
Consultancy segment	13,141	15,769	18,607	10,391	11,430	15,201	-21%	-28%	-18%	
LSTK segment	6,994	8,743	10,492	8,461	8,461	8,461	21%	-3%	-19%	
EBITDA	5,132	6,300	7,439	3,178	4,010	5,154	-38%	-36%	-31%	We have cut our EBITDA margin estimates due to increase in the share of lower-margin brownfield expansion consulting projects and increase in the share of lower-margin international projects. International projects have lower margins due to higher travel costs.
EBITDA margin	25.5%	25.7%	25.6%	16.9%	20.2%	21.8%	-863bps	-541bps	-378bps	
Net depreciation	177	238	255	220	248	265	24%	4%	4%	
EBIT	4,955	6,062	7,184	2,959	3,762	4,889	-40%	-38%	-32%	
Consultancy Segment	4,993	5,992	7,071	3,052	3,886	5,168	-39%	-35%	-27%	
LSTK segment	420	612	734	548	592	635	31%	-3%	-14%	
(Less): unallocated expense	458	542	621	641	717	914				
EBIT margin(%)	24.6%	24.7%	24.7%	15.7%	18.9%	20.7%	-891bps	-578bps	-403bps	
Consultancy Segment	38.0%	38.0%	38.0%	29.4%	34.0%	34.0%	-862bps	-400bps	-400bps	
LSTK segment	6.0%	7.0%	7.0%	6.5%	7.0%	7.5%	48bps	0bps	50bps	
Other Income	2,949	3,018	3,836	3,031	3,167	3,276	3%	5%	-15%	
PBT before EO	7,900	9,074	10,789	5,990	6,929	8,165	-24%	-24%	-24%	The cut in our EPS estimates is due to downward revision in our revenue and EBITDA margin estimates
PBT margin	39.2%	37.0%	37.1%	31.8%	34.8%	34.5%	-746bps	-224bps	-257bps	
Adjusted PAT	5,363	6,125	7,282	4,061	4,677	5,511	-24%	-24%	-24%	
Net margin	26.6%	25.0%	25.0%	21.5%	23.5%	23.3%	-509bps	-151bps	-174bps	
EPS (₹.)	15.9	18.2	21.6	12.1	13.9	16.4	-24%	-24%	-24%	
Working capital turnover (x)	2.3	2.5	2.7	2.2	2.2	2.4				
Gross block turnover	6.0	5.7	6.3	5.3	4.4	4.9				

Source: Company, Ambit Capital research

Ambit vs consensus

Exhibit 14: Below consensus estimates

	Consensus	Ambit	Divergence	Comments
Revenue (₹ mn)				Our revenue estimates are below consensus estimates, as we expect an 8% YoY revenue decline in consulting revenues in FY15 and weak domestic order inflow over FY14-16.
FY2015	19,746	18,852	-4.5%	
FY2016	23,197	19,891	-14.3%	
EBITDA (₹ mn)				Our EBITDA margins are below consensus estimates due to increase in the share of low-margin brownfield consulting projects and low-margin international projects.
FY2015	4,218	3,178	-24.6%	
FY2016	5,796	4,010	-30.8%	
EPS (adjusted) (₹)				Our PAT estimates are below consensus estimates despite the higher-than-consensus other income.
FY2015	14.5	12.1	-16.8%	
FY2016	17.9	13.9	-22.3%	

Source: Bloomberg, Ambit Capital research

Forensic accounting

Exhibit 15: Engineers India on our forensic accounting score

Field	Score	Comments
Accounting	**AMBER**	EIL scores high on CFO/EBITDA and other loans and advances as percentage of net worth. However, the company scores poorly on contingent liability as a percentage of net worth and average advances recoverable cash or kind as a percentage of revenue.
Predictability	**AMBER**	EIL's order inflows are highly volatile and its management does not conduct a post results conference call.
Earnings momentum	**AMBER**	In the last six months, consensus has downgraded its FY15 and FY16 estimates.

Source: Company, Ambit Capital research

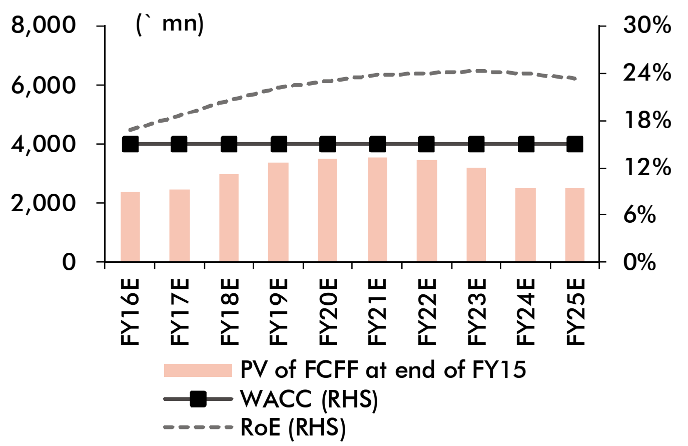
DCF-based valuation

We believe that DCF is the best method to value project management companies given that the key value drivers in a DCF-based valuation are free cash flows based on revenue growth, operating profitability, working capital and gross block turnovers and a discount rate apt for the risks inherent to the industry.

DCF-based value of ₹230/share

Our valuation of ₹230/share for the consolidated business uses DCF-based valuation. Our DCF-based valuation for the consolidated business implies a valuation of 16.6x for FY16E earnings. We use a WACC of 15% and a terminal growth rate of 3% (applied from FY25 onwards). We have cut our FY14-17 LSTK order intake estimates due to the weak greenfield refining expansion pipeline. The Barmer refinery expansion by HPCL is the only large greenfield project yet to be awarded. We expect EIL to win the ₹10bn consulting order for this project in FY16. We expect moderate revenue CAGR of 8.5% over FY14-17E, due to the weak FY14 order book and weak order intake in the LSTK segment. We have cut our EBITDA estimates by 38% for FY15 and 36% for FY16 due to increase in the share of lower-margin brownfield expansion consulting projects and increase in the share of lower-margin international projects. International projects have 300-400bps lower margins than domestic consulting projects due to higher travel costs. We expect 15%% revenue CAGR over FY17-22E led by 15% CAGR in the FY17-22E order book. We estimate stable EBIT margin of ~21% over FY17-22, as a decline in consulting EBIT margin to 32% in FY22 vs 34% in FY17 would be offset by increase in the share of the consulting segment.

Exhibit 16: DCF value of the consolidated business



Source: Company, Ambit Capital research

Exhibit 17: DCF Valuation sensitivity

		Terminal growth rate				
		2.0%	2.5%	3.0%	3.5%	4.0%
WACC	14.0%	237	240	243	246	250
	14.5%	231	233	236	239	242
	15.0%	225	227	**230**	232	235
	15.5%	219	221	224	226	229
	16.0%	214	216	218	220	223

Source: Company, Ambit Capital research

Relative valuation

In India, EIL is the only listed player which has a presence across the entire hydrocarbon value chain, and thus, it has no direct Indian peers. In the absence of such direct peers, we compare EIL with other project management companies such as VA Tech, Voltas and Blue Star. Engineers India is trading at 17.3x FY16E EPS, in line with VA Tech despite its lower revenue growth over FY14-16. We also compared EIL with global E&C players, which are large project management companies and which also have a presence in the Indian hydrocarbon market. Based on the FY16 P/E multiple, we observe that EIL is trading at a significant premium to its international peers such as Worley Parsons, Toyo Engineering, Fluor and Technip, due to its higher EBITDA margins and RoCEs.

Exhibit 18: Relative valuation

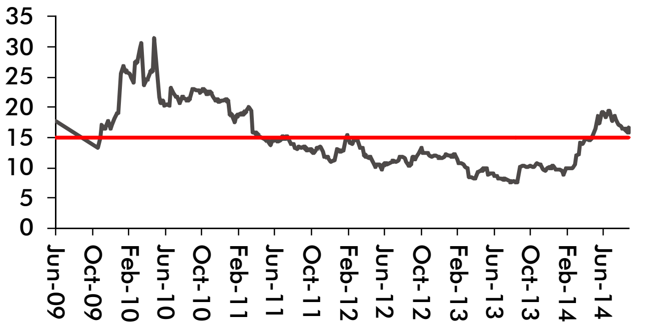
Companies	Mcap	Revenues (US$mn)	Revenues	Revenues	EBITDA margin (%)	EBITDA margin (%)	PAT margin (%)	RoE	RoE (%)	PE (x)		EV/EBITDA (x)	
	US$ mn	FY14	CAGR FY12-14	CAGR FY14-16	FY14	FY15	FY15	FY14	FY15	FY15E	FY16E	FY15E	FY16E
Engineers India	1,351	306	(30)	3.8	21.1	16.9	21.5	20.2	15.6	19.9	17.3	16.3	12.4
VA Tech	619	371	25	27.0	9.4	9.5	5.6	15.9	17.8	23.0	17.6	12.2	9.4
Voltas	1,444	868	1	8.8	5.1	6.7	5.3	14.2	15.3	29.0	22.4	21.4	16.2
Blue Star	544	483	2	1.7	5.1	5.2	3.3	18.0	19.1	31.1	21.8	22.6	16.2
Average										**25.7**	**19.8**	**18.1**	**13.5**
Global Players													
Fluor Corp	11,601	27,352	(8)	9.3	5.7	5.7	2.9	17.5	17.8	17.3	14.5	6.3	5.8
Technip	10,042	12,401	13	6.4	10.6	10.6	5.3	12.6	15.6	14.9	11.0	5.1	4.9
Saipem	9,882	16,280	(1)	0.3	11.2	11.2	2.5	6.6	11.4	24.1	12.5	7.0	6.3
Jacobs Engineering	7,093	11,818	8	8.8	5.9	5.9	3.3	8.3	10.5	16.9	13.9	7.7	6.9
WorleyParsons Limited	3,635	9,051	(2)	1.7	8.4	8.4	4.2	13.4	13.4	13.2	13.2	7.4	7.0
Foster Wheeler	3,218	3,306	1	16.7	9.4	9.4	5.3	21.2	23.6	18.1	14.6	7.6	7.1
Toyo Engineering	905	2,298	21	17.6	1.5	1.5	0.4	1.4	8.1	97.8	15.8	4.4	3.7
Global Average										**28.9**	**13.6**	**6.5**	**6.0**

Source: Bloomberg, Ambit Capital research

Cross-cycle valuation

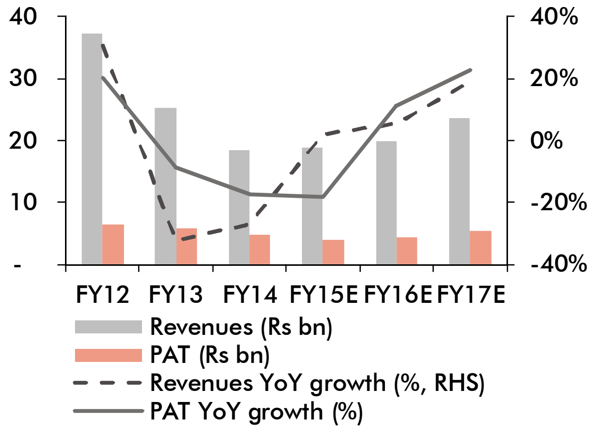
Engineers India is trading at an expensive 17.3x FY16E EPS, a 15% premium to its five-year average one-year forward P/E of 15.0x, given a moderate FY14-17E EPS CAGR of 4.2% and a 130bps decline in RoE over FY14-17 to 18.9% in FY17.

Exhibit 19: EIL is trading at a 15% premium to its five-year average one-year forward P/E



Source: Bloomberg, Ambit Capital research

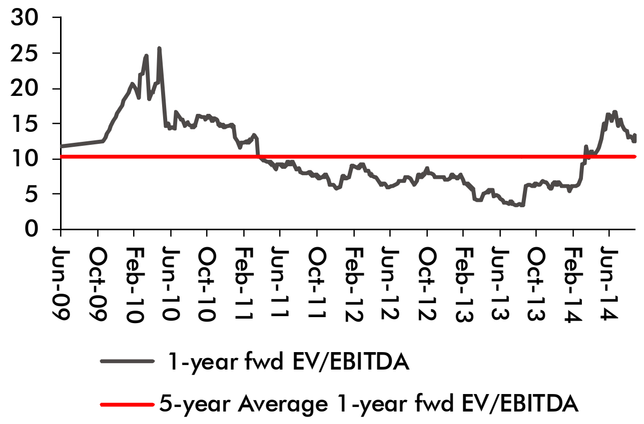
Exhibit 20: Moderate 4.2% EPS CAGR over FY14-17



Source: Bloomberg, Ambit Capital research

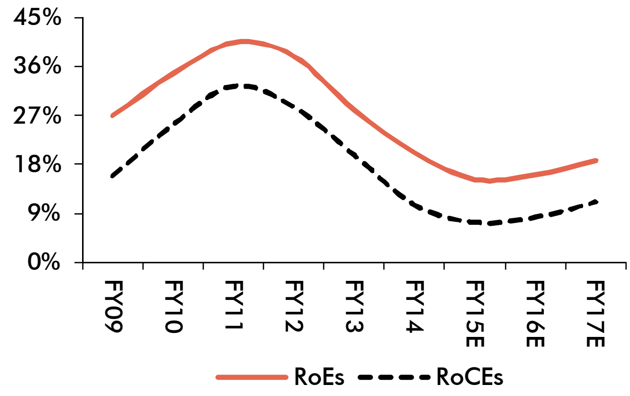
Engineers India is trading at 13.4x one-year forward consensus EV/EBITDA, a 30% premium to its five-year historical average of 10.3x. The decline in the EBITDA margin and RoCE profile is due to the lower share of the higher-margin consulting greenfield refinery expansion projects and higher share of the lower-margin international consultancy projects.

Exhibit 21: EIL is trading at a 30% premium to its one-year forward EV/EBITDA



Source: Company, Bloomberg, Ambit Capital research

Exhibit 22: RoEs would likely decline 150bps over FY14-17



Source: Company, Bloomberg, Ambit Capital research

Catalysts for our SELL stance

- **EBITDA margins in international consulting orders lower than domestic consulting orders:** We expect international EBITDA margins to be 300-400bps lower than domestic EBITDA margins, as international consulting projects have higher travel costs
- **Higher competitive intensity in LSTK segment:** The competition intensity is high in the LSTK segment for private sector projects. EIL has a preferred contractor status due to its execution track record and strong relationships with Government oil marketing companies.
- **Misallocation of ₹25.4bn cash and investments:** The management highlighted during the analyst meet that the cash and investment on the balance sheet worth ₹25.4bn would be used to: (a) set-up regional hubs in Abu Dhabi, South East Asia and Africa, (b) to meet working capital requirement for the upcoming projects, and (c) increase the dividend payout ratio. The reasons mentioned by the management are not sufficient to deploy ₹25.4bn of cash and investments.

Risks

- **Announcement of greenfield refinery expansion:** Whilst we expect ₹725bn petrochemical refining projects to be awarded over FY14-17, we expect the Barmer refinery expansion by HPCL to be the only domestic greenfield project to be awarded over FY14-17. The announcement of greenfield refining projects by PSUs would be a risk to our stance, as EIL has a high probability of winning a consulting project. Further, greenfield projects have higher EBITDA margins than brownfield projects.
- **Increase in dividend payout ratio**: EIL's business model is not capital-intensive (FY14 gross block turnover of 7.7x). The current dividend payout ratio (including dividend distribution tax) of 45% could improve, as the company has ₹25,442mn of cash and investments (equivalent to 33% of total market cap).

Consolidated income statement

Particulars (₹ mn)	FY13	FY14	FY15E	FY16E	FY17E
Order book (total)	33,175	29,108	32,710	37,518	43,260
Order inflow (total)	14,380	11,548	22,454	24,699	29,405
Operating Income	25,290	18,465	18,852	19,891	23,663
Consultancy	*12,573*	*11,320*	*10,391*	*11,430*	*15,201*
LSTK	*12,717*	*7,145*	*8,461*	*8,461*	*8,461*
Total expenses	19,304	14,592	15,673	15,881	18,508
EBITDA	5,986	3,873	3,178	4,010	5,154
EBITDA margin	23.7%	21.0%	16.9%	20.2%	21.8%
Net depreciation / amortisation	111	148	220	248	265
EBIT	5,875	3,725	2,959	3,762	4,889
Interest Expense/(income)	14	13	-	-	-
Other income	2,668	3,359	3,031	3,167	3,276
Adjusted PBT	8,529	7,071	5,990	6,929	8,165
Provision for taxation	2,663	2,214	1,929	2,252	2,654
Adjusted consolidated PAT	5,867	4,857	4,061	4,677	5,511
EPS (Adjusted) (₹.)	17.4	14.4	12.1	13.9	16.4

Source: Company, Ambit Capital research

Consolidated balance sheet

Particulars (₹ mn)	FY13	FY14	FY15E	FY16E	FY17E
Share capital	1,685	1,685	1,685	1,685	1,685
Reserves and surplus	21,268	23,533	25,226	26,630	28,286
Total Networth	**22,952**	**25,217**	**26,910**	**28,315**	**29,970**
Loans	-	2	2	2	2
Sources of funds	**22,952**	**25,219**	**26,912**	**28,317**	**29,972**
Gross Block	1,980	2,801	4,358	4,658	4,983
Net block	536	1,209	2,547	2,599	2,659
Capital work-in-progress	1,355	1,318	60	60	60
Investments	6,474	7,317	7,317	7,317	7,317
Cash and bank balances	18,908	18,125	21,761	23,828	25,504
Sundry debtors	3,439	3,537	3,357	3,270	3,890
Inventories	8	10	11	12	13
Loans and advances	1,141	1,053	1,182	1,296	1,586
Other Current Assets	4,168	3,216	3,742	3,978	4,716
Total Current Assets	28,335	26,006	30,330	32,664	35,985
Current Liabilites	11,142	8,297	9,824	9,901	11,042
Provisions	4,978	4,653	5,838	6,743	7,327
Current liabilities and provisions	**16,121**	**12,951**	**15,662**	**16,644**	**18,369**
Net current assets	12,214	13,055	14,668	16,020	17,616
Deferred Tax Assets	2,373	2,320	2,320	2,320	2,320

Source: Company, Ambit Capital research

Consolidated cash flow statement

Particulars (₹ mn)	FY13	FY14	FY15E	FY16E	FY17E
PBT	9,029	7,070	5,990	6,929	8,165
Depreciation	111	151	220	248	265
Interest expense/ (income)	(1,871)	(1,848)	(2,231)	(2,417)	(2,591)
Direct taxes paid	(2,820)	(2,127)	(1,929)	(2,252)	(2,654)
Change in working capital	(488)	(1,957)	838	(191)	(503)
CFO	**3,421**	**823**	**2,088**	**1,567**	**1,998**
Purchase of fixed assets	(799)	(820)	(300)	(300)	(325)
Investment	(1,769)	483	-	-	-
Dividend received	48	16	800	750	684
Interest Income	1,860	1,993	2,231	2,417	2,591
CFI	**(658)**	**1,673**	**2,731**	**2,867**	**2,951**
Dividends paid	(1,566)	(1,183)	(1,011)	(2,030)	(2,806)
CFF	**(2,741)**	**(2,562)**	**(1,183)**	**(2,368)**	**(3,272)**
Net Cash	22	(37)	3,636	2,067	1,676
Free cash flow	**2,625**	**33**	**1,788**	**1,267**	**1,673**

Source: Company, Ambit Capital research

Key ratios

Particulars	FY13	FY14	FY15E	FY16E	FY17E
EBITDA margin (%)	23.7%	21.0%	16.9%	20.2%	21.8%
EBIT Margin (%)	23.2%	20.2%	15.7%	18.9%	20.7%
Net margin (Adj)	23.2%	26.3%	21.5%	23.5%	23.3%
Dividend payout ratio (%)	37.3%	45.0%	50.0%	60.0%	60.0%
Net debt/Equity	(0.8)	(0.7)	(0.8)	(0.8)	(0.9)
Working capital turnover (x)	4.5	2.4	2.2	2.2	2.4
Gross block turnover (x)	13.0	7.7	5.3	4.4	4.9

Source: Company, Ambit Capital research

Key valuation ratios

Particulars	FY13	FY14	FY15E	FY16E	FY17E
ROCE	19.7%	10.6%	7.7%	9.2%	11.3%
ROE	28.0%	20.2%	15.6%	16.9%	18.9%
Adjusted EPS diluted (₹)	17.4	14.4	12.1	13.9	16.4
BVPS	68	75	80	84	89
DPS (₹)	6.0	6.4	6.0	8.3	9.8
Dividend yield	2.5%	2.7%	2.5%	3.5%	4.1%
P/E (x)	13.8	16.6	19.9	17.3	14.7
P/B (x)	3.5	3.2	3.0	2.9	2.7
EV/EBITDA (x)	9.3	14.3	16.3	12.4	9.3

Source: Company, Ambit Capital research

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