



Stock Note

September 06, 2010

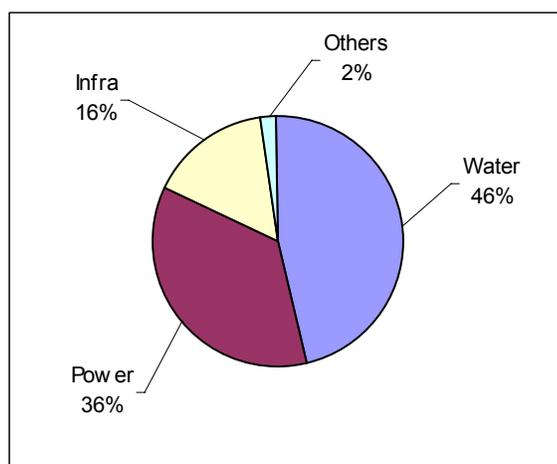
| HDFC Sec Scrip code | Industry | CMP (Rs.) | Recommended Action | Averaging Price Band (Rs.) | Target (Rs.) | Time Horizon |
|---------------------|----------------|-----------|----------------------------|----------------------------|--------------|--------------|
| SUBPROEQNR | Infrastructure | 243.1 | Buy at CMP and add on dips | Rs. 218-226 | Rs. 290 | 1-2 quarters |

Business Profile

SPML Infra Ltd (SPML), formerly Subhash Projects And Marketing Ltd., is a leading infrastructure development company with more than three decades of multi-disciplinary experience in Water, Power, Environment, Infrastructure, Manufacturing and Technology. Promoted by the Sethi family, SPML was incorporated as a public limited company in August 1983. The company is ISO - 9001: 2008 certified and has executed more than 400 projects across India and has established its leadership in the contracting business.

SPML is a solution provider for various multi disciplinary engineering and infrastructure services from conceptualisation to maintenance in water, power, environment and infrastructure projects on a public private partnership (PPP) and build-own-operate-transfer (BOOT) basis. The break-up between the traditional contracting business and PPP/BOOT would be approx. 82:18. SPML's vision to become a force in the global infrastructure sector is supported by its core strengths – pan India presence, 30 years of experience in turnkey projects, innovative in-house designs and engineering solutions, highly skilled team of over 2000 professionals; complimented by its focus on innovation and cutting edge technology. Almost all the business of the company currently comes from Government projects. Almost 70% of the business comes from states like Rajasthan, Maharashtra, Karnataka, Bihar & Delhi.

FY10 Revenue Breakup (Standalone)



SEZ & Port projects currently on hold

SPML has diversified into Ports & SEZ, which provides a huge opportunity for the company, as these are high margin businesses. The company has bagged the Pondicherry Port and Pondicherry SEZ project to be developed on a BOT basis. However, these projects are currently kept on hold due to slowdown in the industry. A brief description of these projects are given below:

Pondicherry Port Ltd: The company is a SPV jointly promoted by SPML and Om Metal Infraprojects Limited in which SPML has 50% stake for the development of the port. The total project cost of the port is pegged at ~Rs. 27.9 bn & the debt-equity ratio would be ~4:1. The company has signed a 30-year Concession Agreement with the Government of Pondicherry. The port is designed to cater to 20 MNTPA cargo consisting of containers, liquid and general cargo along with facilities such as cruise terminal station, associated accommodation, retail shopping area, offices, a recreational centre, parking area, serviced apartments, a three and four star hotel for operators and tourists, meetings and exhibition centre. However the financial closure is yet to be achieved.

Pondicherry SEZ Company Ltd: The company is a SPV promoted by Pondicherry Industrial Promotion Development & Investment Corporation (PIPDIC), in a public private partnership with Subhash and Om Metals Infraprojects Ltd. Along side the port, the company is planning to develop a Multi-Product Special Economic Zone (spread over 860 acre) - an exclusive integrated industrial and residential township, christened as SEZ DE PONDY. The SEZ would be marketed as a fashion,

education, biotech, IT and ITeS SEZ. Om Metals & SPML hold around 18.5% stake each, the Pondicherry Government holds 26% & Urban Infrastructure Ltd holds 37%. The project cost is estimated at ~Rs. 5 bn, which would be funded through a mix of debt-equity (~70:30).

Though, nothing is happening in the above two projects currently, in the long run, they could turn out to be value creators for the company.

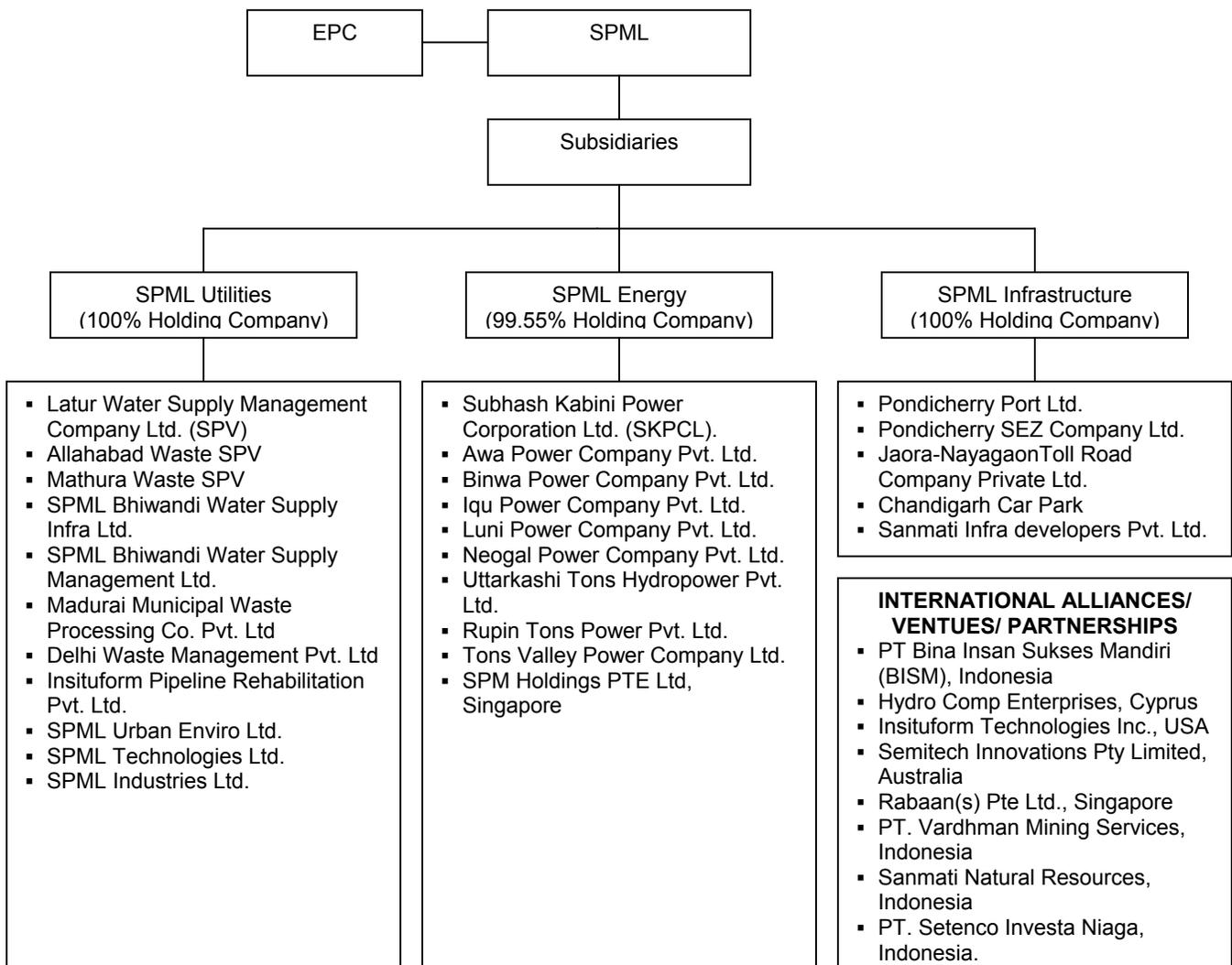
Shareholding Pattern: (As on June 30, 2010)

| Particulars | No of Shares (In Mn) | % Holding |
|--------------------------------|----------------------|------------|
| Institutions | 3.1 | 8.4 |
| Non Promoter Corporate Holding | 8.3 | 22.6 |
| FII | 0.5 | 1.5 |
| Promoters | 21.5 | 58.6 |
| Public & Others | 3.3 | 8.9 |
| Total | 36.7 | 100 |

Some Major Institutional / FII Shareholding:(more than 1%)

| Name | % Holding |
|--|-----------|
| Reliance Capital Trustee Co Ltd - Reliance Infrastructure Fund | 8.4 |

SPML & its Group Companies:





Investment Rationale

Capitalizing on the available opportunity in the Indian construction sector

SPML is a solution provider for various multi disciplinary engineering and infrastructure services from conceptualisation to maintenance in water, power, environment and infrastructure projects on a public private partnership (PPP) and build-own-operate-transfer (BOOT) basis. SPML has 2.5-3 decades of experience in executing water related projects and electricals transmission & distribution projects successfully. Government of India is looking for revamping and developing all round infrastructure like Roads, Bridges, Canals, Dams, Water, Railway Terminals, Ports, Airports, SEZs as well as Rural and Urban Infrastructure and has planned a total outlay of Rs. 20,562 bn as per the 11th Five Year Plan. The Government has also aimed to expedite infrastructure through PPP model by implementing requisite changes in policy framework like introducing competitive bidding process, setting up regulatory authority, rationalization of customs and excise duties etc.

With the government stepping up infrastructure spending through various schemes / programs like National Highways Development Programme (NHDP), Bharat Nirman, RIDF, Accelerated Power Development and Reform Programme (APDRP), Jawaharlal Nehru National Urban Renewable Mission (JNNURM) and Accelerated Irrigation Benefit Programme (AIBP), we believe that an established player like SPML is well placed to capitalize on the opportunity available in construction industry.

Expertise in water management & power distribution projects, established leader in infra / civil projects

SPML has been executing water related projects and T&D projects successfully for the past 2.5-3 decades. With increased focus on power sector through Accelerated power development and reform program (APDRP), Rural electrification (RE) projects and water related projects, SPML would be one of the key beneficiaries in terms of strengthening the order book.

EPC Competency – Water: Water and Environmental Engineering, are the predominant contributors to SPML’s revenue flow and this trend is likely to continue in the near future. Water and irrigation related projects today constitute about 65% of the total order book. SPML has laid over 2500 kms of pipeline across cities and towns of India. The company has a high capability in executing large water projects individually. SPML provides turnkey water management solutions to distribution system - comprising aspects such as i) Canals, Irrigation network, Hydrology; ii) Reservoirs, storage facilities and distribution; iii) Intake water structures, weirs, pumping machinery, pipeline, works, pipeline distribution networks and associated civil works.

EPC Competency – Power: Over two lacs rural households across India have benefited through SPML’s Power Generation, T&D initiatives. The company is one of the largest contributors to rural electrification in India & provides Turnkey solutions viz; i) T & D Power Project Capabilities; ii) Up to 220 kV substation and transmission lines; iii) 33 / 11 kV feeder development & reconductoring works; iv) Rural Load Management System (RLMS) works; v) HT UG cable works. Going forward the company is looking at power plants as an upcoming sector.

EPC Competency – Infra: SPML is also an established leader in infrastructure/civil projects like i) Roads, Flyover, Bridges, Terminals; ii) Rail Over/Under Bridge; iii) Industrial Infrastructure – Balance of plant and iv) Urban Infrastructure Solutions, Automated Car Parking solutions.

Signature projects – Water, Power & Infra

| Water | Power | Infra |
|--|---|--|
| <ul style="list-style-type: none"> ▪ Pranahita Chevella Lift Irrigation Scheme (Rs. 5,860 mn) ▪ Underground Sewerage – Mira Bhayandar (Rs. 5260 mn) ▪ Pokaran-Falsund-Balotra-Siwana Lift Project (Rs. 3180 mn) ▪ Chambal Sawaimadhopur Nadatai Project (Rs. 2693 mn) ▪ Jawai PaliWater Supply Project (Rs. 2669 mn) ▪ Rithala Effluent Pumping Station (Rs. 770 mn) | <ul style="list-style-type: none"> ▪ Transmission & Distribution Works, Karnataka (Rs. 6463 mn) ▪ Power Projects - PGCL (Rs. 4154 mn) ▪ Rural electrification work, Jharkhand (Rs. 4140 mn) ▪ Maharashtra [MSEDCL] (Rs. 1101 mn) ▪ Rural Electrification – Supaul, Bihar (Rs. 1080 mn) | <ul style="list-style-type: none"> ▪ Mainworks, CW & offsite CW [Bongaigaon] (Rs. 3295 mn) ▪ State Highways - Supaul, Saharsa (Rs. 1137 mn) ▪ State Highways - Bihar (Rs. 1083 mn) ▪ Station Piping Package - Simhadri TPP (Rs. 1050 mn) ▪ Korba Main Plant CW - Chattisgarh (Rs. 676 mn) |

Big opportunity in the water management business

The foreseeable water management business is huge, since water is a very precious commodity and one needs to conserve it and ensure sustenance. Therefore, it is unavoidable that water is managed efficiently in India, where the losses in transmission & distribution is huge, apart from the untapped losses at the consumer end.

SPML's capabilities include Integrated Water Management Solutions: Water Treatment, Water Transmission & Pumping, Water Distribution Solutions, End to-end water management solutions, Performance Assessments, Asset Management, Demand management, Non-revenue water reduction, Utility management, Network analysis and Metering solutions. Water being one of the major strength and growth areas for SPML over the years, there is a focus on projects in this domain apart from the other areas of operation like infrastructure, power & environmental engineering. Water related projects and water management initiatives would always be a core competence area and also a significant part of SPML's business dynamics. SPML has focused its energies and resources in the water management domain. The company is building its already proven domain expertise in the area, by adding to its talent pool. The company is one of the few players or probably the first one to be executing a project in water management on a PPP basis in Latur. In its earlier projects, SPML has tied up with some of the leading water management solution companies, who have IT assets and technologies and this effort is an ongoing one to integrate the best option for an identified water management opportunity. These are SPML's few of the initiatives in place to augment the expansion and readiness in this segment. By FY12, SPML expects the water segment's revenue share to increase to 80%.

Boot / PPP based business - maintaining focus in high-value water, energy and infrastructure initiatives

In order to diversify, SPML has entered the Build-Own-Operate-Transfer/Public-Private Partnership (BOOT/PPP) based businesses. The company has maintained its focus in the high-value water, energy and infrastructure initiatives. The diversification has consolidated SPML's position by leveraging its technology expertise to penetrate into new areas of growth.

Water management projects

| Entity | Concession Authority | Scope of Work | Project Cost (Rs. in Mn) | Debt - Equity | Concession Period | COD* | IRR (%) | Ownership Interest of SPML (%) |
|--|--|--|--------------------------|---------------|-------------------|------|---------|--------------------------------|
| SPML Bhiwandi Water Supply Infra Ltd. | Bhiwandi Nizampur Municipal Corporation | Study, Design & Construction, Operation & Maintenance (O&M) of the water supply infrastructure | 6700 | 1.33 | 30 yrs | FY13 | - | 99.94 |
| SPML Bhiwandi Water Supply Management Ltd. | Bhiwandi Nizampur Municipal Corporation | i) Implementation of integrated information system consisting of customer information, O&M, demand management & network asset management system. ii) Conduct Hydraulic Modeling | 546 | 0.82 | 35 yrs | FY13 | 12.3 | 99.94 |
| Latur Water Supply Management Company Ltd. | Latur Municipal Council / Maharashtra Jeevan Pradhikaran | Management Contract for 24 by 7 water supply to Latur City. 40000 nos. water connections, 600 kms distribution systems, metering, billing & collection of water charges from 50000 plus consumers & managing 3 water supply schemes, 6 pumping stations, 6 electrical installations, 95 kms of transmission pipelines & 2 master balancing reservoirs. | 244 | 3 | 10 yrs | FY11 | 13.2 | - |

(Source: Company)

*COD - Commercial Operation Date

Hydropower Projects

SPML's Hydro Power Projects under PPP model include i) Kabini Power project with capacity of 20MW in Karnataka; ii) 5 projects in Himachal Pradesh with total capacity of 22.5 MW; iii) 3 projects in Uttarakhand with total capacity of 42 MW.

Kabini power project is operational since FY04. SKPCL generated 36.2 mn units of Electricity in FY09 & 48.5 mn units in FY10. The company's turnover & PAT stood at Rs. 220 mn & Rs. 91 mn in FY10. 4 projects in HP viz; Awa, Luni, Iqu & Neogal are 80-90% complete and are expected to be operational by mid-FY11, while the 5th project, Binwa (4.5 MW) is still under development and is expected to commence in FY13.

3 Small Hydel power generation projects in Uttarakhand are in the name of RupinTons, Tons Valley and Uttarkashi Tons. The projects have been awarded by the Government of Uttarakhand for a concession period of 10 years. All of them are currently under development (Clearance & Approval for Project development awaited). DPR has been prepared and submitted to the Government. Geological & Geo technical investigations are due to be conducted and environmental & forest clearances are still awaited.

| Entity | Concession Authority | Project Cost (Rs. in Mn) | Debt - Equity | Concession Period | COD* | IRR (%) | Ownership Interest of SPML (%) |
|---------------------|-----------------------|--------------------------|---------------|-------------------|------------|---------|--------------------------------|
| SKPCL | Govt. of Karnataka | 910 | 1.9 | 30 yrs | 24-06-2003 | 19.00 | 56.70 |
| Awa Power Company | HP Energy Dev. Agency | 315 | 1.42 | 40 yrs | FY11 | 16.77 | 81.18 |
| IQU Power Company | HP Energy Dev. Agency | 311.2 | 1.47 | 40 yrs | FY11 | 18.61 | 81.46 |
| Luni | HP Energy Dev. Agency | 291.4 | 1.5 | 40 yrs | FY11 | 17.72 | 87.40 |
| Neogal | HP Energy Dev. Agency | 310.7 | 1.5 | 40 yrs | FY11 | 15.49 | 81.74 |
| Binwa Power Company | HP Energy Dev. Agency | - | - | 40 yrs | FY13 | - | 83.97 |
| Rupin Tons | Govt. of Uttarakhand | - | - | 10 yrs | - | - | 59.99 |
| Tons Valley | Govt. of Uttarakhand | - | - | 10 yrs | - | - | 59.99 |
| Uttarkashi Ton | Govt. of Uttarakhand | - | - | 10 yrs | - | - | 59.99 |

(Source: Company)

*COD - Commercial Operation Date

Infrastructure Projects:

| Entity | Concession Authority | Scope of Work | Project Cost (Rs. in Mn) | Debt - Equity | Concession Period | COD* | IRR (%) | Ownership Interest of SPML (%) |
|--------------------------------------|--|--|--------------------------|---------------|-------------------|------|---------|--------------------------------|
| Chandigarh Car Parking | Chandigarh Municipal Corporation | <ul style="list-style-type: none"> Project with the capacity of 1200 equivalent car spaces. Commercial space: 25,700 sq. ft. available for lease | 600 | 3 | 9 yrs 11 months | FY12 | 17.4 | Not available |
| Jaora-Nayagaon Toll Road Co. Pvt Ltd | Madhya Pradesh Road Development Corporation Ltd. | Reconstruction, strengthening and rehabilitation of Jaora-Nayagaon Toll road in MP for 128 Kms. | 8513 | 1.97 | 25 yrs | FY11 | 18.7 | 11.5 |

(Source: Company)

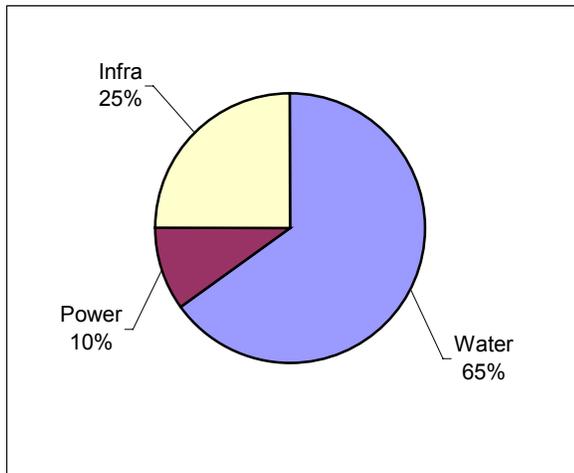
*COD - Commercial Operation Date

The timely commencement of the above projects could boost SPML's consolidated financial performance going forward. While SPML is consolidating its EPC prowess, it is continuously exploring value generating PPP/BOT models. Going forward the management is confident of bagging more water, hydro & infra projects under BOOT / PPP model.

Robust order backlog provides strong revenue visibility

SPML's current order backlog (standalone) stands at Rs. 37 bn, which is 2.6x FY10 revenue (standalone) and is largely dominated by water and irrigation related projects, which constitute about 65% of the total order book. Power T&D accounts for 10%, while civil work related projects account for 25%. Almost 85% of the orders are covered under the price escalation clause. The execution cycle is ~24-30 months. Besides this, the company also enjoys the lowest bidder status on projects worth Rs. 4 bn. SPML has also submitted bids for orders worth Rs. 25 bn and is likely to bid for another Rs. 50 bn in remaining period of FY11. The consolidated order book of SPML (including BOOT projects) currently stands at Rs. 45 bn. Healthy order book and huge live bids provide SPML strong revenue visibility over the next two years.

Standalone Order book breakup (As on June 30, 2010)



SPML's order book (standalone) has grown at a CAGR of 15.2% over the last four years. However, much of the growth came during the construction boom in FY06-FY08. Over the last two years, the growth in order book (till date) has been marginal at ~3%. The slowdown in the order inflows was mainly due to liquidity crunch, financial crisis & general slowdown in the economic activity during 2008 & early 2009. Also the company witnessed slowdown in its execution in FY09 & 9MFY10, which has been disappointing. However, a turnaround has been witnessed in the company's execution over the last two quarters (in Q4FY10 & Q1FY11). SPML has guided smooth execution in FY11.

The Indian economy has witnessed gradual recovery with improvement in confidence level of consumers and businesses. Expansion plans, which got delayed due to global slowdown, have been now put back on track, thus creating opportunities for established construction players like SPML. With the easing of liquidity, revival in demand along with improving economic outlook and the government's increasing focus on the infra space, we expect SPML's order inflows to improve over the next two years. Since April 01, 2010, the company has already bagged three new orders worth Rs. 8.87 bn, the details of which are given below:

- **Order from the state of Rajasthan:** SPML, in association with Om Metals Infra Projects, bagged a significant project amounting to Rs. 4.57 bn in the state of Rajasthan. The order entitles the construction of civil, hydro-mechanical and electrical works of the Kalisindh Gravity Dam in Jhalawar District.
- **Bihar Water Management:** SPML has won an order for the design, construction and commissioning of 1500 mini water supply schemes in Bihar. The order worth Rs. 2.2 bn involves work that would be carried out in 26 drought affected areas of the state. Additionally, there will be provision to set up electrical pumping sets on turnkey basis with 12 months of O&M after trial run of 3 months. The total completion time of the project is slated to be 18 months.
- **Complete BOP Order - Ramgarh:** SPML won an order for Complete Balance of Plant (BOP) package of Gas based Combined Cycle Power Project - 160 MW - stage III based at Ramgarh District, Jaisalmer, awarded by Rajasthan Rajya Vidyut Utpadan Nigam Limited (RRVUNL). The value of the project is pegged at Rs. 2.1 bn.

Betting Big on Solid Waste management

SPML is currently executing solid waste management contracts in Mathura, Allahabad, New Delhi (also airport) and Madurai. It is also bidding for similar projects in Bangalore, Jalandhar, Amritsar, Dehradun and Ranchi. Solid waste management in India has a multi-bn dollar business potential. Indian at present produces around 42 mn tonnes of municipal solid waste annually at present and this is expected to more than double to 100 mn tonnes by 2025. SPML feels that out of the municipal solid waste, ~50% is compostable / bio-degradable matter, inert materials constitute around 40-45% and the share of recyclable materials is just 5-10%. With major metros and towns lacking planning, infrastructure or manpower for waste management, there lies a big scope in solid waste management. Also hardly any funds are spent on the treatment & disposal of waste. Estimates say that around 175,000-200,000 tonnes of waste per day needs to be treated and the PPP model is the best way forward.

**Status on Waste management projects:**

| Entity | Concession Authority | Scope of Work | Project Cost (Rs. in Mn) | Capital Subsidy (Rs. in Mn) | Debt - Equity | Concession Period | COD* | Ownership Interest of SPML (%) |
|---|---------------------------------|--|--------------------------|-----------------------------|---------------|------------------------------------|----------|--------------------------------|
| Delhi Waste Management Ltd. | Municipal Corporation of Delhi | Waste collection, segregation & transportation | 273 | 212 | 3:1 | 9 yrs | 31-01-05 | 56% |
| Madurai Municipal Waste Processing Co Pvt. Ltd. | Madurai Municipal Corporation | Development, construction & maintenance of integrated municipal solid waste processing | 736 | 401 | 2:3 | 20 | FY11 | 100% |
| Allahabad Waste Management Company | Allahabad Municipal Corporation | Development of integrated solid waste management facilities | 640 | 319 | 2:1 | 30 yrs + 8 months for construction | FY12 | 100% |
| Mathura Waste Management Company | Mathura Nagar Palika Parishad | Development of integrated solid waste management facilities | 248.3 | 82.3 | 2:1 | 30 yrs + 8 months for construction | FY12 | 100% |

(Source: Company)

*COD - Commercial Operation Date

The Delhi waste management project is in operation since the last five years and manages in excess of half a million tonnes of waste and recyclables p.a. The project has 843 Waste Storage Depots (WSD) covering over 270 sq. km of area and has over 60 hydraulic Vehicles - compactors, dumper placers and hook loaders. In FY10, Delhi Waste Management Ltd. generated revenues Rs. 417 mn and PAT of Rs. 78 mn and is expected to do well going forward. Once the Madurai, Allahabad & Mathura waste management projects become operational, SPML's revenues & profits from this segment are expected to increase significantly. As per the management, IRR of the Madurai project is estimated at 18.7%, while that of Allahabad & Mathura is estimated to be around 37.5% & 25.2% respectively. With the huge opportunity available in the solid waste management, the company is confident of bagging some more projects in this segment going forward.

Coal mining operations in Indonesia to boost the earnings

SPML's 56.7% subsidiary, Subhash Kabini Power Corporation Ltd. (SKPCL), through its 100% subsidiary, SPM Holdings PTE, Singapore (SPMH), holds 45% interest in Bina Insan Sukses Mandiri (PT BISM). SPML had acquired the coal mines with power equipment maker Emco in 2008 for \$40 mn. EMCO holds 35%, while others (local) hold the balance 20%. Acquisition funds were infused by SKPCL through SPMH. The mine is spread over an area of close to 5000 hectares with estimated reserves of 107.5 mn tonnes. The concession period is 20 years. It has also set up a jetty loading capacity of 2.5mn MT.

The mining operations have already commenced and it is targeted for export to most Asian countries, including India apart from taking care of the regional requirements in Indonesia. By end of September 2010, the sales volume is expected to touch 50,000 tonnes / month & by end of FY11, it would touch 1 lac tonnes / month. From FY12, SPML expects the production capacity to increase to 2.5 lacs tonnes / month. Since SPML holds sizable stake in this mine, it is expected to benefit from the increase in the production & sale of coal going forward. The management expects to earn a PAT margin of ~10% from this venture going forward.

Emco & SPML had plans to develop 2200 MW coal fired power plant in Orrisa or AP, but the project has been kept on hold.

Strong growth expected from international JV - Insituform Pipeline Rehabilitation Private Limited (IPRPL)

IPRPL is a 50:50 JV between SPML and Insituform Technologies Inc. (ITI), USA. ITI is an expert in sewer rehabilitation technologies and projects and is the holder of the patented & globally acclaimed cured-in-place-pipe (CIPP) technology for pipeline rehabilitation.

Important features of CIPP technology:

- 'No-dig technology process' - eliminates the need for replacing existing sewers
- Strengthens the life of the sewer lines by another 50 years.

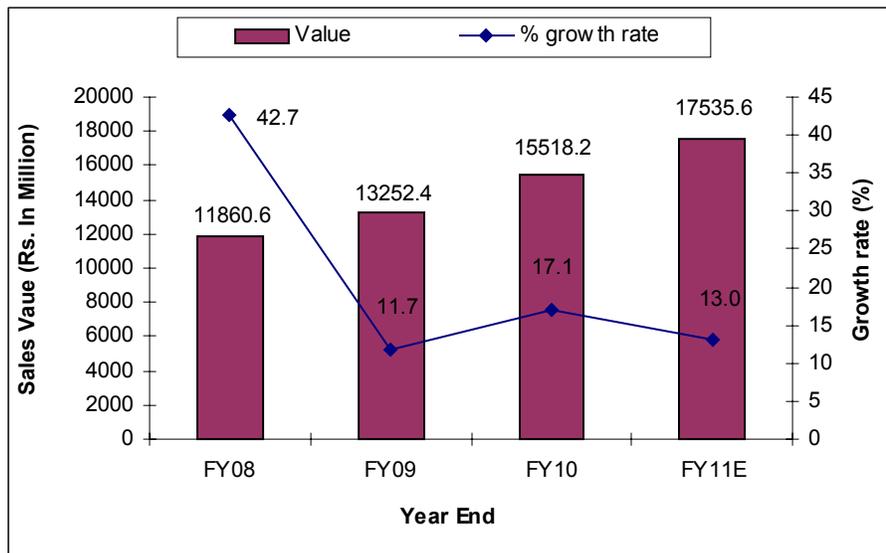
At present, three different projects worth Rs. 1.12 bn from Delhi Jal Board are being implemented and projects worth Rs. 1.5 bn are under stages of tendering / identification.

In FY10, the JV's turnover & profits increased significantly by 98.9% & 64.3% to Rs. 913 mn & Rs. 69 mn respectively. We expect the robust growth momentum to continue going forward, which would benefit SPML to the extent of its interest & accordingly boost its consolidated turnover & profits.

Decent growth expected in revenue & profits; cost rationalization, execution of high margin projects to improve the margins

With the easing of liquidity, revival in demand along with improving economic outlook and the government's increasing focus on the infra space, we expect SPML's order inflows to improve significantly over the next two years. The company's strong order backlog provides good revenue visibility over the next two years. In FY11, we expect SPML's consolidated net sales to grow by 13%.

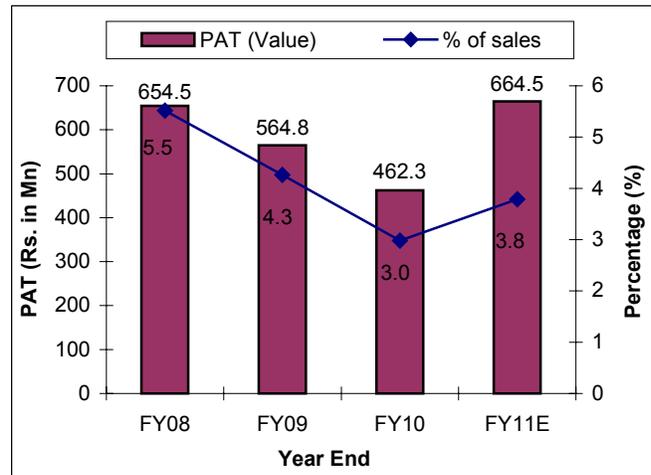
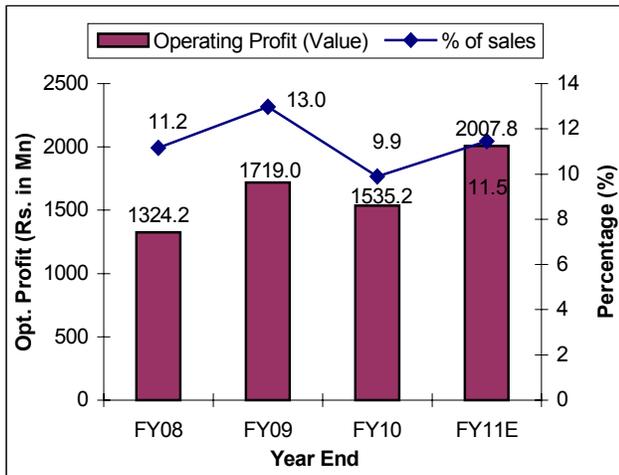
The chart below gives an overview of SPML's consolidated net sales since FY08 along with our projections for FY11:



SPML's consolidated operating profit has grown at a CAGR of 24.3% over FY07-10. The growth could have been better but for slowdown in profitability witnessed in FY10 on the back of higher input cost and losses from power projects due to execution delays. The OPM increased from 11.2% in FY08 to 13% in FY09, but fell sharply in FY10 to 9.9%. In FY11, we expect the operating profit to grow by 30.8%, while the OPM is likely to improve substantially to 11.5% on the back of high margin orders likely to be executed.

SPML's consolidated net profit has de-grown by 10.3% on a CAGR basis over FY07-10, while PAT margins declined from 5.5% in FY08 to 3% in FY10, mainly on the back of lower OPM, higher interest & depreciation cost. However, in FY11, we expect the PAT to increase sharply by 44%, while the PAT margins are expected to improve to 3.8%, mainly due to higher operating margins & marginal increase in the interest cost. The effective tax rate on PBT is estimated at 20% for FY11.

The charts below give an overview of SPML's operating & net profit (conso) since FY08 along with our projections for FY11:

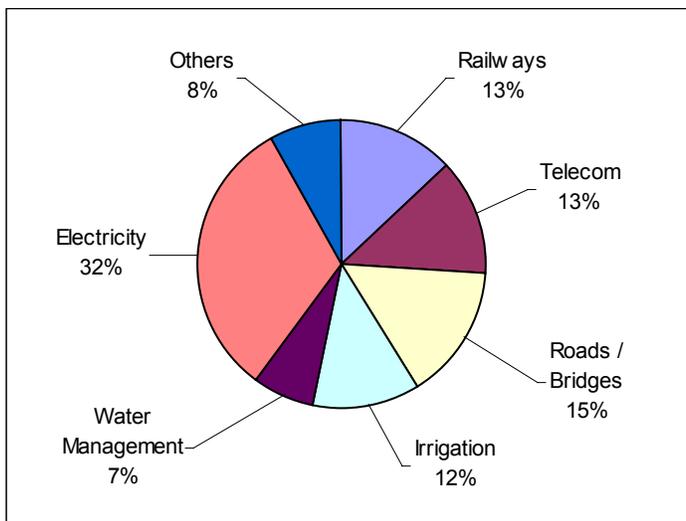


Industry Outlook

After passing through economic slowdown, since May 2009, Indian Economy has started gradual recovery with improvement in confidence level of consumers and businesses. In the face of the global financial crisis and economic downturn, many countries turned to infrastructure development to provide fiscal thrust. Infrastructure spending is used as a counter balance against slowing economy and lower consumption.

The Government has also aimed to expedite infrastructure through public-private partnership by implementing requisite changes in policy framework like introducing competitive bidding process, setting up regulatory authority, rationalization of customs and excise duties etc.

Government is looking for revamping and developing all round infrastructure like Roads, Bridges, Canals, Dams, Water, Railway Terminals, Ports, Airports, SEZs as well as Rural and Urban Infrastructure. The total planned infrastructure outlay by the Government as per the 11th Five Year Plan amounts to Rs. 20,562 bn the breakup of which (in % terms) is given below:



PPP model would to continue to increase for infra projects. Stability in new government and policy actions would mean acceleration in Award of projects involving model concession agreements, viability gap funding, 100% FDI under automatic route, increase in ECB limit to US\$ 500 mn, 100% IT exemption for 10 years.

**Electricity**

- 11th plan has set a target for augmenting India's Capacity by 78,700 MW.
- Planned outlay doubled in the plan to Rs. 6,665 bn, with the center expected to contribute 38.3% and states 33.39%.
- Capacity additions ~100GW generation and 60,000 ckm transmission lines with investments of US\$200 bn.
- Peak deficit ~12%, AT&C losses ~30%.

Water Management

- Renewed focus on urban water and sanitation infra-addressing the investment backlog.
- Total investment during the 11th plan is projected at Rs. 1,437 bn.
- Development of 16mha major & minor works in irrigation.
- Projects propagated by JNNURM through Urban Local Bodies.

Infra, Roads & Airports

- Major projects include 6 laning of 6,500 kms - Golden Quadrilateral.
- New capacity: 485 mmt in major ports; 345 mmt in minor ports.
- Modernization of 35 non-metro airports

Riding high on public private partnerships, the sentiments look positive and the Indian Infrastructure sector is expected to provide robust growth to the Industry and Economy. There are ample opportunities available for the construction sector. Sustained focus of the government to improve infrastructure especially roads, ports, power, housing and increased allocation to various schemes such as National Highways Development Programme (NHDP), Bharat Nirman, RIDF, Accelerated Power Development and Reform Programme (APDRP), Jawaharlal Nehru National Urban Renewable Mission (JNNURM) would result in continued growth for Construction Industry. Allocation for the NHDP being increased by 23%, JNNURM by 87% and APDRP by 160% are a definite welcome signal for renewed growth across the board. The Accelerated Irrigation Benefit Programme (AIBP) has seen an increase in allocation from Rs. 200 bn to Rs. 350 bn. Since its inception, AIBP has been instrumental in contributing 50-55% of the irrigational potential created in the country year-on-year. It is anticipated that funds in the JNNURM and other schemes will also be allocated to environment related projects.

However, shortages in skilled workmen, construction professionals, mega project managers and absence of equitable and quick dispute resolution mechanisms are still challenges for the Industry.

Competitive Profile:

The competitive intensity is increasing in the infrastructure industry with the increasing Government thrust on infrastructure activities like Roads, Bridges, Canals, Dams, Water, Power, Railway Terminals, Ports, Airports, SEZs as well as Rural and Urban Infrastructure. SPML has a large presence in the water related projects, which account for 65% of the company's total order backlog. Competition is intense in water related projects like sewage systems, supply, and irrigation with players like IVRCL, Nagarjuna Constructions, L&T and Pratibha having sizeable orders from the segment. In Power segment, SPML faces competition from Alstom, Jyoti Structures, ABB, etc. Some other infrastructure players competing with SPML include Madhucon Projects, Unity Infra (similar sized players), Simplex Infra (larger player) etc.

It is to be noted that SPML currently trades at a discount to some of its peers like IVRCL, Madhucon, Simplex Infra & Nagarjuna Constructions. The company's focus on water and environment-related projects gives it a unique competitive strength to achieve decent growth in the coming years. With its diversified business model and unique bouquet of BOOT projects, SPML has today emerged as one of the leading players in the water & environment infrastructure segment. SPML was an early adopter of technology and innovation in its project delivery. Therefore the alignment of the domain expertise with technology and innovation is a clear differentiator while developing water management solutions in myriad complex environments and situations. SPML's enduring relationships with its various clients and collaborators over the last three decades gives it the additional edge. Considering its future growth prospects and robust infrastructure story, we feel that SPML deserves to trade at better valuations.

Peer Comparison:

| Company Name | FY11E | | | | | | | |
|-------------------------|---------|---------|-----------|-----------|------|-----------------------|-------------------|-------------|
| | OPM (%) | NPM (%) | EPS (Rs.) | CMP (Rs.) | PE | Mark. Cap (Rs. in Mn) | Sales (Rs. in Mn) | Mkcap/Sales |
| Madhucon Projects | 10.2 | 3.3 | 7.6 | 145.9 | 19.2 | 10796.6 | 17000.0 | 0.6 |
| Unity Infra | 12.8 | 5.4 | 13.2 | 114.6 | 8.7 | 8491.9 | 18100.0 | 0.5 |
| Simplex Infra | 9.8 | 3.1 | 33.1 | 477.0 | 14.4 | 23706.9 | 53100.0 | 0.4 |
| IVRCL | 9.4 | 3.6 | 8.8 | 158.1 | 18.0 | 42212.7 | 65000.0 | 0.6 |
| Nagarjuna Constructions | 12.3 | 4.1 | 11.4 | 160.4 | 14.1 | 41158.6 | 71500.0 | 0.6 |

| | | | | | | | | |
|---------------------|------|-----|------|-------|------|--------|---------|-----|
| Pratibha Industries | 13.2 | 4.5 | 7.0 | 81.8 | 11.7 | 6826.2 | 13000.0 | 0.5 |
| SPML Infra | 11.5 | 3.8 | 18.1 | 243.1 | 13.4 | 8915.1 | 17535.6 | 0.5 |

(Consensus, HDFC Sec Estimates)

Risks and concerns

- Except in Q4FY10, SPML has witnessed slowdown in its execution in FY09 & FY10, which is a disappointment. Though the company has guided smooth execution in FY11, any slowdown could impact SPML's sales & profitability growth and could put pressure on the funding arrangements.
- Delays in recovery of dues could directly impact the liquidity position & affect the operations and earnings of SPML.
- SPML would be required to raise money for working capital related issues (as the industry is highly capital intensive) & also for investments in the BOOT projects where the company has equity stake. Incremental borrowings could worsen the debt-equity ratio and increase the interest liability (especially in the rising interest rate scenario), while equity dilution could make the valuations expensive.
- The ability of the company to meet future business challenges depends on the strength of the company to attract, recruit and retain talented, skilled and experienced professionals. Skilled and experienced manpower is the key to execution of projects in this industry.
- The infrastructure sector in India is highly regulated. The industry outlook looks robust due to favourable Government policies and its thrust on infrastructure development. However, any change in this scenario could significantly impact the company's performance going forward.
- Cement & Steel are two major inputs for SPML. Any abnormal rise in these raw materials may cause cost overruns and put pressure on SPML's margins going forward, since ~15% of SPML's projects are still not covered under the price escalation clause.
- SPML faces stiff competition from other larger established construction players like IVRCL, NCC, Simplex Infra, L&T etc. In order to maintain its growth, profitability and market share, it is essential for SPML to continue to bag orders on periodical basis. To bag large sized orders, company would have to increase its net worth. Heightened competition (with huge opportunity available in the infrastructure sector) & smaller size could make it difficult for SPML to bag high margin large sized projects.
- A deceleration in the general economic conditions can adversely affect the company's business and its earnings.
- Despite the withdrawal of 80IA benefits, SPML continues to claim tax benefits for its water projects executed on behalf of various departments/agencies of different State Governments. The tax dispute regarding the same is going on. If the company loses the case & is asked to pay full tax on these projects, then it could have a significant impact on its net profits.

Q1FY11 Result Update: (Standalone)

Quarterly

Y-o-Y:

In Q1FY11, SPML's Net sales increased by 26.7% to Rs. 3565.1 mn [Q1FY10: Rs. 2813.9 mn], which was largely driven by better execution of the projects and new order inflow worth Rs. 18 bn in the past nine months. The average order size of SPML increased to Rs. 850-950 mn during Q1FY11 as compared to Rs. 350-400 mn in Q1FY10. However, the operating profit rose marginally by 2.1% to Rs. 366.7 mn [QFY10: Rs. 359 mn], while the OPM contracted by 247 bps Y-o-Y to 10.3% mainly on the back of increase in the material cost as a percentage of sales from 78% in Q1FY10 to 81.4% in Q1FY11. Losses from power projects due to execution delays were booked in this quarter. While depreciation cost rose 43% Y-o-Y, higher other income (up from Rs. 2.3 mn in Q1FY10 to Rs. 31 mn in Q1FY11), lower interest & tax expense (down 0.3% & 20.8% Y-o-Y respectively) boosted the net profit, which grew by 37.5% to Rs. 145.8 mn [Q1FY10: Rs. 106 mn]. PAT margins improved by 32 bps Y-o-Y to 4.1%. The effective tax rate decreased to 23.5% in Q1FY11 as compared to 34.8% in Q1FY10 as the larger proportion of the revenue is from the water related projects where the company enjoys tax benefits under section 80 IA. EPS for the quarter stood at Rs. 4 vs. Rs. 2.9 in Q1FY10.

Q-o-Q:

Sequentially, the results were disappointing on the sales & net profit front mainly due to seasonality factor, as Q4 is generally the best quarter for infrastructure companies. While Net Sales declined by 41.2% Q-o-Q, Operating Profit grew marginally by 0.7%, while the OPM improved substantially by 428 bps Q-o-Q, supported by significant decline in the material cost, employee & other expenses (down 43.8%, 30% & 54.6% Q-o-Q respectively). However, tax outflow in Q1FY11 (vs. tax credit in Q4FY10) suppressed the net profit, which declined by 46.1% Q-o-Q. PAT margins fell by 37 bps from 4.5% in Q4FY10.

Conclusion & Recommendation:

While SPML's consolidated sales growth is expected to be 13% in FY11 on the back of strong order backlog & better execution, operating & net profit growth (conso) are likely to be much higher at 30.8% & 44% respectively. We expect the OPM to improve significantly due to execution of high margin projects likely this fiscal. This coupled with marginal increase expected in the interest cost is likely to improve the PAT margins. By FY12, the management expects the revenues contribution from water management business to increase to ~80%, which could improve the margins (both Operating & PAT) since water business offers better margins as compared to power & infra business.

With its diversified business model and unique bouquet of BOOT projects, SPML has emerged as one of the leading players in the water & environment infrastructure segment. Strong order backlog (consolidated) of Rs. 45 bn and huge live bids provide good revenue visibility over the next two years. Further, the company's order book is also well diversified in terms of geography. With increased focus on power sector through Accelerated power development and reform program (APDRP), Rural electrification (RE) projects, water related and infra projects, SPML would be one of the key beneficiaries in terms of strengthening its order book going forward. SPML has been executing water related projects and T&D projects successfully for the past 3 decades.

At CMP of Rs. 243.1, SPML trades at 13.4x FY11E EPS, which is at a discount to some of its peers like IVRCL, Simplex, Madhucon Projects & Nagarjuna Construction. This discount in valuations could be due to its inconsistent past track record and lack of broker coverage of the stock. However, we expect a turnaround in the business over the next two years. With expertise in the water management & power projects, increasing net worth, good presence in the BOOT projects and robust infrastructure story, SPML deserves to trade at better valuations. Further SPML has good presence in the solid waste management & with huge opportunity available in this segment, the company is confident of bagging some more projects in this segment going forward.

We feel that SPML could trade at 16x FY11E EPS, which gives a price target of Rs. 290. We recommend investors to buy this scrip at the current levels and average it on dips in the price band of Rs. 218-226 for the above mentioned price target over the next 1-2 quarters.

Quarterly Financial Performance: (Standalone)

| Particulars | (Rs. In Million) | | | | | | | | | |
|---------------------------|------------------|---------------|--------------|---------------|--------------------|---------------|--------------------|---------------|---------------|--|
| | Q1FY11 | Q1FY10 | VAR [%] | Q4FY10 | VAR [%] (Q-o-Q) | Q4FY09 | VAR [%] (Y-o-Y) | Q3FY10 | Q2FY10 | |
| Net Sales | 3565.1 | 2813.9 | 26.7 | 6066.3 | -41.2 | 3779.1 | 60.5 | 2509.8 | 2613.1 | |
| Other Income | 31 | 2.3 | 1247.8 | 13.0 | 138.5 | 18.1 | -28.2 | 10.9 | 35.8 | |
| Total Income | 3596.1 | 2816.2 | 27.7 | 6079.3 | -40.8 | 3797.2 | 60.1 | 2520.7 | 2648.9 | |
| Total Expenditure | 3198.4 | 2454.9 | 30.3 | 5702.0 | -43.9 | 3395.7 | 67.9 | 2210.1 | 2339.1 | |
| Cost of Materials | 2900.5 | 2195.1 | 32.1 | 5161.5 | -43.8 | 3032.6 | 70.2 | 1891.9 | 2051.3 | |
| Employee Cost | 149.1 | 125.4 | 18.9 | 212.9 | -30.0 | 102.1 | 108.5 | 129.5 | 132.4 | |
| Other Expense | 148.8 | 134.4 | 10.7 | 327.6 | -54.6 | 261.0 | 25.5 | 188.7 | 155.4 | |
| PBIDT | 397.7 | 361.3 | 10.1 | 377.3 | 5.4 | 401.5 | -6.0 | 310.6 | 309.8 | |
| Interest | 177.5 | 178.0 | -0.3 | 155.9 | 13.9 | 253.6 | -38.5 | 170.4 | 190.9 | |
| PBDT | 220.2 | 183.3 | 20.1 | 221.4 | -0.5 | 147.9 | 49.7 | 140.2 | 118.9 | |
| Depreciation | 29.6 | 20.7 | 43.0 | 46.9 | -36.9 | 20.1 | 133.3 | 21.4 | 22.0 | |
| PBT | 190.6 | 162.6 | 17.2 | 174.5 | 9.2 | 127.8 | 36.5 | 118.8 | 96.9 | |
| Tax Rate (incl. DT & FBT) | 44.8 | 56.6 | -20.8 | -96.1 | -146.6 | 30.8 | -412.0 | 45.1 | 28.7 | |
| Tax | 38 | 33.6 | 13.1 | -46.3 | -182.1 | 22.4 | -306.7 | 19.9 | 66.5 | |
| Fringe Benefit Tax | 0 | 1.3 | -100.0 | -4.0 | -100.0 | 6.8 | -158.8 | 0.0 | -1.3 | |
| Deferred Tax | 6.8 | 21.7 | -68.7 | -45.8 | -114.8 | 1.6 | -2962.5 | 25.2 | -36.5 | |
| PAT | 145.8 | 106.0 | 37.5 | 270.6 | -46.1 | 97.0 | 179.0 | 73.7 | 68.2 | |
| EPS (Rs.) | 4.0 | 2.9 | 37.5 | 7.4 | -46.1 | 2.6 | 179.0 | 2.0 | 1.9 | |
| Equity | 73.3 | 73.3 | 0.0 | 73.3 | 0.0 | 73.3 | 0.0 | 73.3 | 73.3 | |
| Face Value | 2 | 2.0 | 0.0 | 2.0 | 0.0 | 2.0 | 0.0 | 2.0 | 2.0 | |
| OPM (%) | 10.29 | 12.76 | -19.4 | 6.01 | 71.3 | 10.1 | -40.8 | 11.9 | 10.5 | |
| PATM (%) | 4.09 | 3.77 | 8.6 | 4.46 | -8.3 | 2.6 | 73.8 | 2.9 | 2.6 | |

(Source: Company)

**Yearly Financials (Standalone)**

(Rs. In Million)

| Particulars | FY08 | FY09 | VAR [%] | FY10 | VAR [%] |
|--------------------------|----------------|----------------|--------------|----------------|--------------|
| Net Sales | 11671.1 | 12572.2 | 7.7 | 14003.1 | 11.4 |
| Other Income | 73.6 | 98.8 | 34.2 | 62.0 | -37.2 |
| Total Income | 11744.7 | 12671.0 | 7.9 | 14065.1 | 11.0 |
| Total Expenditure | 10509.5 | 11124.4 | 5.9 | 12706.1 | 14.2 |
| Cost of Materials | 9489.6 | 9906.7 | 4.4 | 11299.8 | 14.1 |
| Employee Expenses | 410.2 | 480.2 | 17.1 | 600.2 | 25.0 |
| Other Expenses | 609.7 | 737.5 | 21.0 | 806.1 | 9.3 |
| PBIDT | 1235.2 | 1546.6 | 25.2 | 1359.0 | -12.1 |
| Interest | 357.7 | 796.5 | 122.7 | 695.2 | -12.7 |
| PBDDT | 877.5 | 750.1 | -14.5 | 663.8 | -11.5 |
| Depreciation | 105.3 | 86.1 | -18.2 | 111.0 | 28.9 |
| PBT | 772.2 | 664.0 | -14.0 | 552.8 | -16.7 |
| Tax (including DT & FBT) | 190.1 | 132.3 | -30.4 | 34.3 | -74.1 |
| PAT | 582.1 | 531.7 | -8.7 | 518.5 | -2.5 |
| EPS (Rs.) | 15.9 | 14.5 | -8.7 | 14.1 | -2.5 |
| OPM (%) | 10.6 | 12.3 | 16.3 | 9.7 | -21.1 |
| PATM (%) | 5.0 | 4.2 | -15.2 | 3.7 | -12.5 |

(Source: Company)

Financial Estimations: (Consolidated)**Profit & Loss A/c**

(Rs. In Million)

| YE March | FY08 | FY09 | FY10 | FY11E |
|---|--------------|--------------|--------------|--------------|
| Net Sales | 11861 | 13252 | 15518 | 17536 |
| Other Income | 69 | 242 | 63 | 75 |
| Total Income | 11929 | 13494 | 15581 | 17611 |
| Material Cost | 9371 | 10042 | 12237 | 13529 |
| Employee Cost | 448 | 596 | 688 | 807 |
| Other Manufacturing, Admin & Selling Expenses | 718 | 896 | 1059 | 1192 |
| Total Operating Expenses | 10536 | 11533 | 13983 | 15528 |
| EBITDA (incl. other inc) | 1393 | 1961 | 1598 | 2083 |
| EBITDA (excl. other inc) | 1324 | 1719 | 1535 | 2008 |
| Interest | 265 | 954 | 826 | 900 |
| Depreciation | 192 | 206 | 247 | 340 |
| Profit Before Tax | 935 | 801 | 526 | 843 |
| Tax (including FBT & DT) | 197 | 150 | 57 | 169 |
| PAT (bef. Minority Int. & Profit / Loss in share of Assc.) | 739 | 651 | 469 | 675 |
| Minority Interest | 84 | 86 | 6 | 10 |
| PAT (net of Min. Int. & Profit / Loss in share of Assc.) | 655 | 565 | 462 | 665 |

(Source: Company, HDFC Sec Estimates)

Key Ratios

| YE March | FY08 | FY09 | FY10 | FY11E |
|------------------|------|-------|-------|-------|
| FD EPS (Rs.) | 17.8 | 15.4 | 12.6 | 18.1 |
| PE (x) | 13.6 | 15.8 | 19.3 | 13.4 |
| Book Value (Rs.) | 95.4 | 110.2 | 122.1 | 139.3 |
| P/BV (x) | 2.5 | 2.2 | 2.0 | 1.7 |
| OPM (%) | 11.2 | 13.0 | 9.9 | 11.5 |
| PBT (%) | 7.9 | 6.0 | 3.4 | 4.8 |
| NPM (%) | 5.5 | 4.3 | 3.0 | 3.8 |
| RONW (%) | 18.7 | 14.0 | 10.3 | 13.0 |
| Mcap/Sales (x) | 0.8 | 0.7 | 0.6 | 0.5 |
| Debt-Equity | 0.8 | 1.2 | 1.3 | 1.4 |

(Source: Company, HDFC Sec Estimates)

Note: We have not projected SPML's consolidated balance sheet, since the company's Annual Report for FY10 is not yet available.

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