

We recently met the management of Drake and Scull to understand the current business environment and competitive situation in the M. East. Drake and Scull is amongst the leading MEP and Civil contractors in the MENA region. Key takeaways are:

Orders in the MENA region improving lead by Saudi Arabia, Qatar, UAE and Kuwait. (a) Key sectors driving growth in orders are transport infrastructure (*metro, roads*), construction (*hospitals, housing, universities*) and O&G (b), The biggest market for contractors in the M.East is the Saudi Arabian market followed by UAE, Qatar and Kuwait (c) Tendering to order cycle which had elongated to 16-18 months has come down; moreover, receivable days for Drake & Scull are now at 120 days, down from 174 days earlier as developers push contractors to complete work faster, (d) management sees low risk of delays as new projects are well funded, (e) the key risk to a sustained revival in infrastructure spending in the *M. East lies in any political instability* arising in the region.

MEP orders for the Dubai World Expo 2020 and the Qatar World Cup 2022 expected only from mid to end CY15. (a) As per management, a pick up in MEP orders relating to the Dubai World Expo and Qatar World Cup are likely to happen only **from mid to end CY15 (6-7 months post the civil construction orders which are seen happening only by end CY14)**. While some private real estate developers have restarted projects in UAE, public sector projects are yet to take off in a big way; once these take off, orders from this region could see a sharp surge. Similarly, Qatar continues to go slow in ordering for the proposed 9 stadiums which are to be built for the FIFA World Cup with a decision on whether the event would take place in winter and /or summer still not being finalized; If the same is held in winter, it could entail much less MEP work vs. the same being held in summer on account of lower HVAC requirement. (b) We also note that the award of the MEP orders for the Riyadh and the Doha Metro have been delayed (*were to be placed by Dec, '13*) and now expected by mid CY14. **While Drake & Scull has been prequalified in the same, Voltas is not there in the list of bidders for the Riyadh metro MEP orders. The order opportunity is ~\$500-1000mn for MEP players.**

No let up in competition in the MENA region. (a) There has been no let up in the competitive intensity across the region; competition is mostly localized, (b) Drake and Scull has seen new competitors emerge from Turkey, Spain in the recent past while the Chinese remain largely absent, (c) Korean contractors primarily compete with large local contractors as they target civil contracts which are thereafter sub contracted to players like Drake and Scull, Voltas for the MEP portion, (d) competitive intensity from the Indian players has come down with Voltas and ETA seen more rationale and having a presence primarily in UAE and Saudi Arabia. Note that Blue Star is absent in the MENA region.

Gross margins at 10-11% for MEP, O&G contractors; lower for civil. (a) Management has stated that margins are lower in civil projects compared to the MEP/O&G projects; gross margins are in the region of 8-10% for civil contracts and 10-11% for MEP/O&G jobs. EBIT margins for the industry are in the range of 5-6% (*echoing views from Voltas*), (b) with the increase in the overall ordering activity in the M. East, margins are expected to stabilize around these levels.

In our view, a sustained revival in project orders from the M. East is in the offering over the next couple of years lead by **UAE, Saudi Arabia, Kuwait and Qatar**. We expect the overall project awards from the 6 GCC countries to stabilize at ~\$130bn over the next few years. Key beneficiaries of a revival in orders from the M. East are Voltas (*TP revised to Rs130 from Rs110 on 14x FY16e EPS*), Engineers India and L&T.

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Voltas	
CMP	Rs149
Reco	Neutral
Target Price	Rs130

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