

12 Jul, 2023

PICK OF THE MONTH

VOL-9, NO-02

Industry: Civil Construction

Patel Engineering Limited

BUY

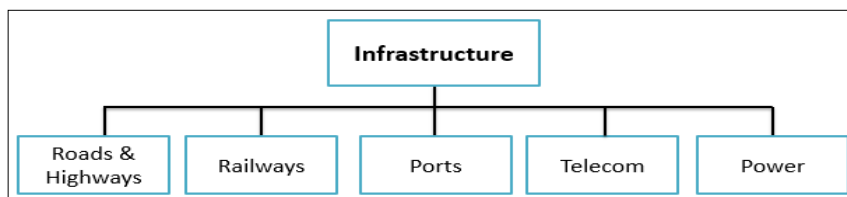
CMP: Rs.39

TARGET PRICE: Rs.50

TIME : 12 months

**Industry Overview:** The Infrastructure sector plays a pivotal role as a key engine accelerating the domestic economic growth. GOI has been incessantly working towards initiating various policies with strong emphasis on the sector, ensuring creation of world class infrastructure in a timely manner. In order to implement the infrastructure program on a large scale; the GOI has launched the National Infrastructure Pipeline (NIP) in 2019, wherein it has planned to invest about Rs111trn on Infra projects by 2025. At the time of the launch, NIP had 6,835 projects and as on date the same stands expanded to over 9,000 projects across 35 sub-sectors. As per the Economic Survey 2023, projects worth Rs108trn are currently under different stages of implementation.

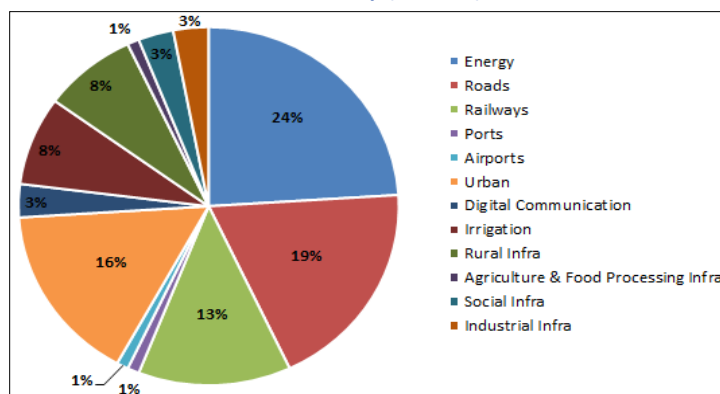
**Exhibit 01: Sub-Sectors of Infrastructure**



Source: Centre for Public Policy Research Report, Progressive Research

**Infrastructure Investments:** Developments in the infra sector compliment the overall demand and efficiency. The economic growth target of USD5trn by 2025 would be a function of increased investments paving the way for a much faster growth. In order to enable a smooth transitioning to achieve the set internal target, the Govt. in the budget 2023-24, enhanced the capital investment outlay for infrastructure by ~33% to Rs10lk-cr (USD122bn) which roughly accounts for 3.3% of the GDP. Out of the total allocated budget, ~Rs2.4lk-cr is attributed towards the railways (build new tracks, new coaches, electrification), while ~Rs2.7lk-cr is attributed towards roads. Historically, more than 80% of the country's infrastructure spending has been directed towards funding for transportation, electricity and water & irrigation. The sector is predicted to grow at a CAGR of 8.2% by 2027 backed by successful project executions.

**Exhibit 02: NIP Sector Wise Breakup (FY20-25)**



Source: NIP Task Force Report, Progressive Research

**Power Industry:** Being one of the most critical components of infrastructure, India's power sector underwent the transformation phase to become surplus from deficit after 9 years with the addition of more than 185MW of generation capacity. India is regarded as the third largest producer and consumer of electricity worldwide having an installed power capacity of 411.69GW as of 31st Jan'23 (as per IBEF). As per the Ministry commentary, the total installed power generation capacity is now close to double the peak demand and at the same time India is exporting power to the neighboring countries as well. The power industry can be broadly categorized as Thermal, Hydro, Nuclear and Renewable.

SNAPSHOT				
52 week H / L		Mcap (INR mn)		
39/13		30,550		
Face value: 1				
BSE Code		NSE CODE		
531120		PATELENG		
Annual Performance				
(Rs mn)	FY21	FY22	FY23	FY24E
Total Revenue	19,948	33,803	42,020	50,917
EBITDA	2,346	5,277	6,249	7,332
EBITDA (%)	11.8	15.6	14.9	14.4
Other Income	1,091	1,162	1,204	1,276
Interest	4,014	4,195	4,184	3,059
Depreciation	720	819	933	956
PBT	(1,296)	1,425	2,335	4,593
PAT	(2,907)	719	1,835	3,300
Equity ( Rs mn)	465	479	774	774
EPS (INR)	(6.8)	1.5	3.2	4.3
Quarterly Performance				
Parameters (Rs mn)	Jun-22	Sept-22	Dec-22	Mar-23
Sales (Net)	9,739	8,930	10,370	12,980
EBITDA	1,498	1,307	1,637	1,806
EBITDA (%)	15.4	14.6	15.8	13.9
Other Income	355	299	268	282
Interest	1001	1056	1067	1060
Depreciation	220	233	239	241
PAT	354	225	259	873
Equity ( Rs mn)	479	516	516	774
Ratio Analysis				
Parameters (Rs mn)	FY21	FY22	FY23	FY24E
EV/EBITDA (x)	21.8	9.6	7.4	6.1
EV/Net Sales (x)	2.6	1.5	1.1	0.9
M Cap/Sales (x)	1.5	0.9	0.7	0.6
M Cap/EBITDA (x)	13.0	5.8	4.9	4.2
Debt/Equity (x)	1.0	1.0	0.6	0.5
ROCE (%)	6.1	12.1	13.5	14.9
Price/Book Value (x)	0.8	0.8	1.1	1.0
P/E (x)	-	19.1	17.0	9.4
Shareholding Pattern as on 31st March, 2023				
Parameters	No of Shares		%	
Promoters	304,917,712		39.4	
Institutions	124,531,912		16.0	
Public	344,167,504		44.4	
TOTAL	773,617,128		100.0	

Source: Annual Report, Progressive Research

Note: Data calculated as on 11th July, 2023

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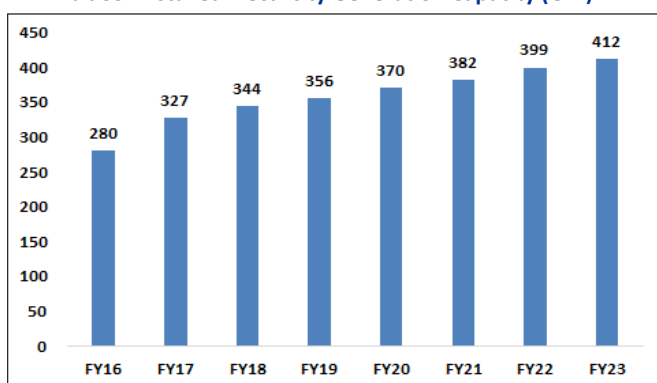
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## Industry Overview (contd.):

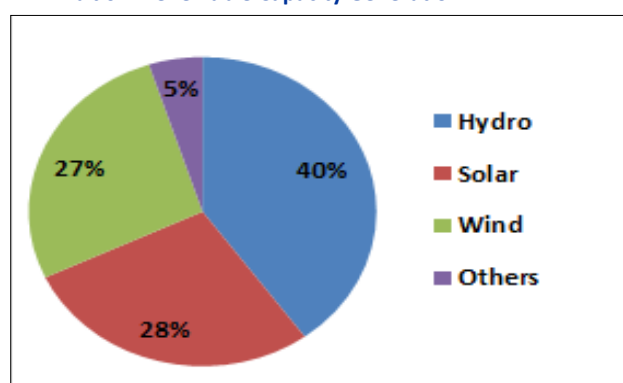
**Power Industry (contd.):** Hydropower/hydroelectric power is a form of clean, renewable energy that generates electricity using the movement of water to turn turbines which essentially power a generator. Hydropower is often regarded as an environmentally benign and non-polluting source of power and is most suitable for balancing renewables. One of the most important benefits of hydropower plants is that they possess the ability to run at a **zero load** and thus ensures no requirements from the outer sources of power in order to keep the plants functioning. **Some of the popular sources of hydroelectricity includes dams, diversions and pumped storage hydropower.** According to the National Electricity Plan 2022, in order to sustain 500GW of renewables in the grid, India would require 17GW additional hydro capacity during 2022-2031. So far of the 172GW capacity from non-fossil fuel sources; 46.85GW is from hydro. Though hydro as a resource comes in with benefits of flexibility and a clean power source; it has to even counter and overcome the challenges which include, geographic constraints, long construction times, delays on account of environmental clearances, difficulties in land acquisition, project over-runs and increased project costs. As per the Central Electricity Authority (CEA), India's assessed hydropower potential is about 145,320MW, of which 29% has been developed so far. In order to meet the renewable generation requirements, India will add 3,110MW hydro power generation capacity with an investment of Rs450bn this fiscal. This essentially means the opportunity in the total power space would be substantial going forward.

Exhibit 03: Installed Electricity Generation Capacity (GW)



Source: IBEF Feb'23 Report, Progressive Research

Exhibit 04: Renewable Capacity Generation



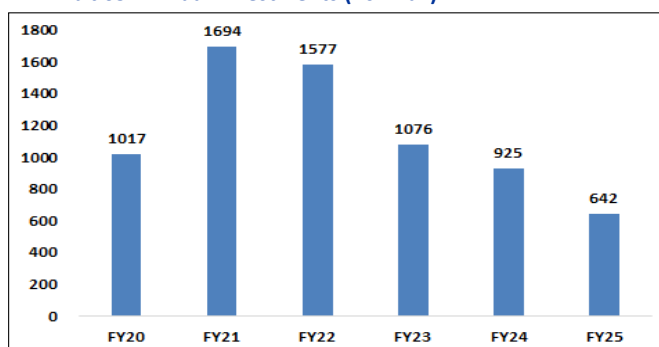
Source: Market Reports, Progressive Research

## Different Initiatives:

- Under the NIP, energy sector accounted for the highest share of ~24% of the total expected capex outlay of Rs111lk-cr
- PLI scheme allocation of Rs195bn is done to boost the manufacturing of high efficiency solar modules. Additionally, there is increased funding under the PLI scheme for domestic solar cells and module manufacturing to Rs240bn from the earlier Rs45bn
- Issuance of sovereign green bonds as well as infrastructure status conferred to energy storage systems (grid scale battery systems)
- Increased electrification via adoption of schemes viz; Deen Dayal Upadhyay Gram Jyoti Yojana (DDUGJY), Ujwal DISCOM Assurance Yojana (UDAY), and Integrated Power Development Scheme (IPDS)
- The Ministry of Power has identified 81 thermal units which will replace coal with renewable energy generation by 2026 in order to tackle the annual issue of coal demand-supply mismatch

**Irrigation Industry:** Key component of the any agrarian economy is the water supply segment. As a matter of fact, considering India's dependency on an increasingly erratic monsoon for its water requirements; the recurrent episodes of drought and declining groundwater all hint towards ensuring an efficient irrigation system which is of paramount importance for sustainable agriculture. As per the Ministry of Water Resources, the share of irrigation in the overall water demand is likely to moderate from 85% in 2010 to ~74% by 2050. In order to provide further impetus to the sector, the government has outlined a Vision 2025 (NIP Plan) which encompasses to generate a higher irrigation coverage (~61% from the current 49% of the total irrigated land), lay emphasis on efficient methods of irrigation and river interlinkages in order to increase the overall area under irrigation.

Exhibit 05: Annual Investments (Rs in bn)



Source: NIP Task Force Report, Progressive Research

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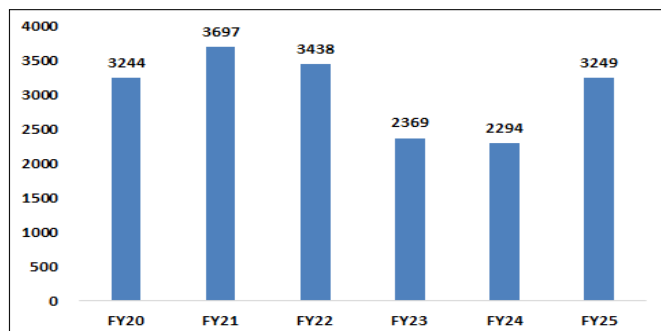
TARGET PRICE: Rs.50

TIME : 12 months

## Industry Overview (contd.):

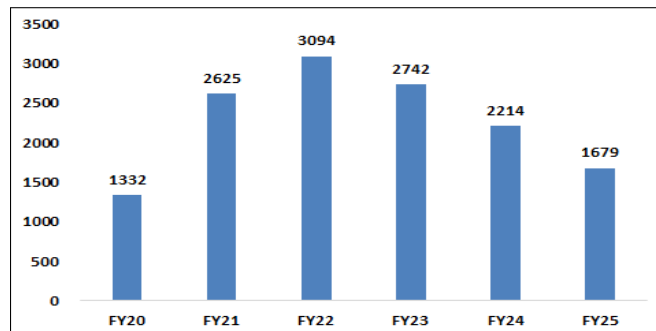
**Transportation Industry:** Steady economic growth is well reflected by a cohesive and a well-coordinated transportation network. The development of India's transportation infrastructure has accelerated dramatically in all areas not limited to roads, railways and ports. India is regarded of having second largest road network in the world (total length of 5.89 million kms). As per the NIP plan, the Vision for 2025 aims at increasing the share of private sector in NH from the present 15%, improve access to remote areas, opt for increased usage of RFID devices and FasTag to reduce the revenue leakage and congestion at toll plaza and enable advanced technologies such as automated traffic controllers, security and traffic management systems, speed regulators and digital message boards.

Exhibit 06: Road Sector Annual Investments (Rs in bn)



Source: NIP Task Force Report, Progressive Research

Exhibit 07: Railway Sector Annual Investments (Rs in bn)



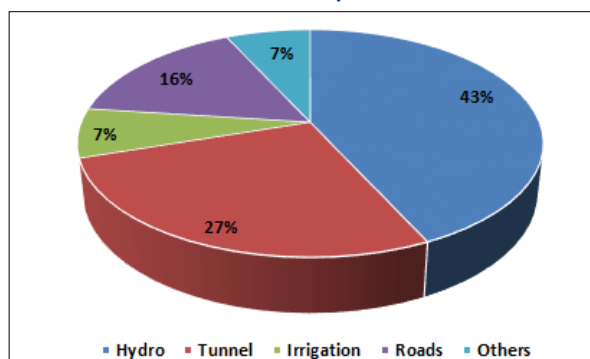
Source: NIP Task Force Report, Progressive Research

**About the Company:** Incorporated in 1949, Patel Engineering Ltd (PEL) is one of the oldest and established players in the civil engineering and construction segment. Over the years, PEL has successfully constructed various heavy civil engineering works such as dams, bridges, tunnels, roads, piling works and industrial structures. As on date, the company has completed construction of around 85+ dams, 12,000MW+ hydro projects, 300+kms of tunnels and irrigated over 5.5+ lakhs acres of land. PEL has been awarded IMS certificates (ISO 9001:2008 Quality Management System, ISO 14001: 2004 Environmental Management System, and OHSAS 18001:2007 Occupational, Health and Safety Management System) by UK based BSI, and is committed to the highest standards of quality, safety, health, and environment. Mr. Rupen Patel is the Managing Director of the company.

## Investment Rationale:

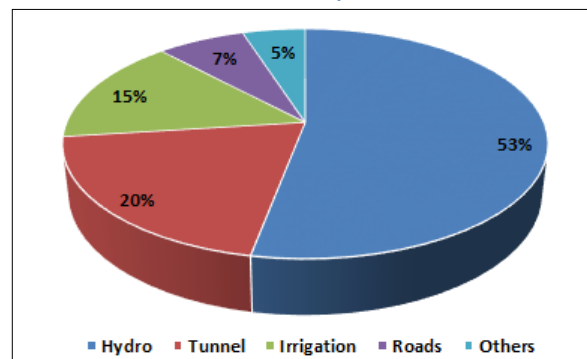
**(A) Businesses Catered:** The company has a breadth of experience encompassing different sectors of Hydropower, Irrigation, Tunneling, Roads and Others/Urban Infra.

Exhibit 08: FY22 Revenue Breakup



Source: Annual Reports, Progressive Research

Exhibit 09: FY23 Revenue Breakup



Source: Annual Reports, Progressive Research

**(a) Hydropower:** PEL's core competency was always in construction of civil structure works such as dams, powerhouse, surge chambers, intake structures, head race tunnel, etc. meant for hydro power projects. In order to meet the energy demand at a faster pace, development of hydropower projects is an essential requirement. Having the well-known benefits in terms of being regarded as the cleanest and sustainable form of energy and reduced risk of flooding; the hydropower projects come with its own set of challenges in terms of project costs with the largest component being the civil works (i.e. construction of dams, tunnels, canal, powerhouse as well as any other infrastructure needed to access the site), dealing with difficult geographical areas and harsh weather conditions. Construction of hydropower projects require immense precision and experience.

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## (a) Hydropower (contd.):

PEL possesses a strong presence and experience in the construction of hydroelectric power projects across the country that ranges from 3MW to more than 2000MW. Additionally, the company has also constructed powerhouse (*generation of electricity from generators driven by turbines*) of all types viz; underground, surface and sub-surface as well as associated structures such as intake, gate structures, penstocks, switchyards and affiliated services and buildings. Out of the total order book, almost 60% contribution is from the hydropower segment. Also the segment commands higher margins of ~14-15%. Some of the major completed projects include, Parbati Hydro Electro Project (800MW), Tuirial Hydro Electro Project Mizoram (60MW), Ghatghar Hydro Electric Project (250MW), Srisailem Left Bank Hydro Power Station (900MW) amongst others. As per Q4FY23 update, there are around 18 projects (worth Rs125.11bn) in this segment which are under the execution stage.

## Exhibit 10: Hydropower Projects

Major Projects Under Execution
Subansiri HEP (2000MW), Arunachal Pradesh
IRCON T15 (Railway Tunnel), J&K
Kiru HEP, J&K (624MW)
Luhri HE Project, Himachal Pradesh (210MW)
Arun HE Project, Nepal (900MW)
Teesta HEP (500MW)
Kwar HEP (540MW)

Source: Quarterly Reports, Progressive Research

## Potential Ahead:

As reiterated earlier, with clean energy being one of the focus areas of the government, and currently hydropower contributing ~11% to India's energy mix; it essentially implies there is still lot of untapped potential to capitalize on. Also, out of the total hydropower potential of about 145,320MW (for projects bearing capacity above 25MW), only 29% has been developed so far and 10.3% is under construction. Considering the unique capabilities, hydropower stations are found to be the most economical choice in order to meet the peak load in the grid. In order to support the vision to reduce the carbon emission intensity, several policy measures were undertaken by the government which includes financial assistance being extended to infrastructure which was earlier restricted to roads and bridges, support the north-eastern states by providing grants worth Rs40bn to acquire upto 24% equity in a project to assist in early commissioning. Although, hydropower generation is a highly capital incentive mode of electricity generation, it is a renewable source of energy with no consumables involved and as there is very little recurring cost, hence there is no high long-term expenditure. Possessing nearly 7 decades of experience in high margin and technology intensive area of hydropower, PEL so far has played a vital role in some of India's most prestigious and strategically significant projects, and has a rich pipeline of opportunities going forward.

**(b) Irrigation:** The scope of work for irrigation projects usually includes impounding the reservoir, construction of pump station, water conducting system and canals. PEL has also built earthen and concrete gravity dams, jetties, caissons, slipways, wet docks and other allied structures. Out of the total order book, nearly 21% contribution comes from irrigation segment. Some of the major completed projects include, Polavaram Project, Jawahar Lift Irrigation Project, Bhima Lift Irrigation Project, Indira Sagar Project, Vamsudhara Project Phase-I, SRSP Flood Flow Canal Project. As per Q4FY23 update, there are around 15 projects (worth Rs44.23bn) in this segment which are under the execution stage. In order to have a sustained growth in the agricultural sector, judicious utilisation of land and water resources is of paramount importance. Micro irrigation has been prioritized under the Pradhan Mantri Krishi Sinchayee Yojana (PMKSY) scheme with the goal of expanding irrigation coverage (Har Khet Ko Pani) and improving water use efficiency (Per Drop More Crop) to improve various water development and management activities. Under PMKSY for 2021-26 there has been an allocation of Rs930.68bn which would benefit about 22 lakh farmers. All of the above indicate huge potential works/projects from the irrigation space for PEL to explore in times to come.

## Exhibit 11: Irrigation Projects

Major Projects Under Execution
Slemanabad Carrier Canal
Morand & Ganjal Dam
Khalwa Micro Lift Irrigation
Jigaon Lift Irrigation
Parbati Irrigation Project

Source: Quarterly Reports, Progressive Research

**(c) Tunneling:** Microtunneling is an efficient technique for construction of small diameter tunnels for applications such as water supply, underground cabling and drainage systems without the need to dig into concrete or other roads. This is useful where digging the surface such as concrete road would be expensive and time consuming. The conventional methods of laying huge pipelines under busy streets and railway tracks in the city results in blockages of traffic in a city, causing a huge loss of public money. Furthermore, due to the small diameter of tunnels (approx. 500mm to 4000mm) it is not practical for an operator to drive the tunneling machine; and hence arises the need for a remotely controlled micro tunnel boring machine (MTBM). Realizing the need of specialised competencies in tunneling; back in 2000, PEL acquired Westcon Micro tunneling Inc. to get access to know-how about microtunneling. PEL has used micro tunneling to construct subterranean networks for sewage, water and storm water applications. 13% of the order book contribution comes from this segment and as on Q4FY23, the company has nearly 6 projects under execution with a value of Rs26.08bn.

## Exhibit 12: Tunneling Projects

Major Projects Under Execution
PVPG Tunnel Project
Kohima Tunnel Project, Manipur
Water Tunnel Project, Karnataka
Construction of Water Tunnel & Allied works
CIDCO- Water Tunnel Project

Source: Quarterly Reports, Progressive Research



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## Investment Rationale (contd.):

**(d) Roads:** This project contributes about ~4% of the overall order book. As per Q4FY23 update, the company has 4 projects which are under the execution stage with a value of Rs8.69bn. Till date, PEL has been a part of construction of more than 1200kms roads. Some of the notable projects undertaken so far include, Shimoga Highway, Karnataka, Sela Road Tunnel, Arunachal Pradesh, AS-15, Assam, Four laning, Madurai to Kanyakumari amongst others.

**(e) Others/Urban Infra:** This project contributes about ~2% of the overall order book. As per Q4FY23 update, the company has 5 projects which are under the execution stage with a value of Rs3.93bn. Some of the notable projects undertaken so far include, Dam for Shillong Water Supply, Meghalaya, Sewage Treatment Plant, Maharashtra, Indoor Sports Stadium, Surat BYTCO Hospital, Nashik amongst others.

## Exhibit 13: Road and Others/Urban Infra Projects

Major Projects Under Execution	
Roads	Others/Urban Infra
Shivane to Mhatre bridge	Amarmahal to Trombay Tunnel
Selapass Road and Tunnel	Hindoli - Nainwa Water Supply Project
Katraj Kondwa Road	RVNL Project
Up-gradation- Pimpla junction	
Construction of New BG Line Yavatmal for RVNL	

Source: Quarterly Reports, Progressive Research

**(B) Projects Overview:** Over the years, PEL has successfully completed different projects across the country having a clientele base for various government bodies as well as private contractors. Having a proven experience of almost 7 decades, PEL has established its position in the market, very well depicted through the operational track record. So far, the company has completed over 300 projects that includes work related to construction of around 12,000MW hydro projects, 85+dams, 300km of tunnels, over 1,200kms of roads and irrigation works of over 5.5+ lakhs acres of land. Going forward as well, the management has indicated of a strong pipeline of Rs800bn from hydro and tunneling segments put together whereas on the irrigation front, project potential worth Rs900bn is anticipated in the near future.

**(C) Order Book Status:** Over the past financial years, the order book position has improved from Rs102bn in FY19 to Rs208bn in FY23; a CAGR of ~19%; thereby generating a book to build ratio of 4.95x. PEL's current outstanding order book is well diversified with pan India presence and international operations (in Nepal). The order book spread across the States works as a de-risking business model for PEL. For FY23, the order book value of Rs208bn includes 6 projects which are L1 orders amounting to Rs32bn; of which 4 projects worth Rs8bn have been converted to LOAs in Q1FY24. As far as the client wise segmentation of the overall order book is concerned; ~55% is from Central Govt.; 42% from State Govt. and the balance 4% from International clients. The execution timelines for the high margin segments of hydropower generally takes 4-5 years and irrigation takes 3-4

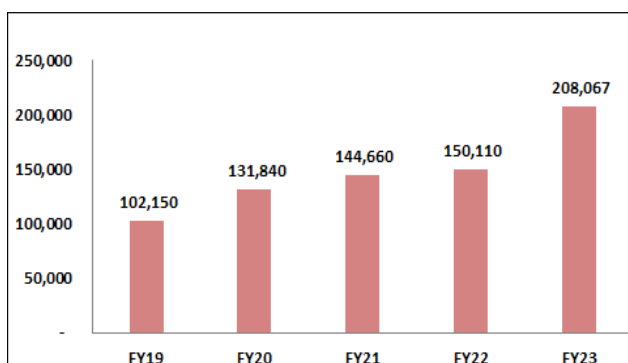
## Exhibit 14: Diversified Project Presence

State/Country	No. of Projects	Value (Rs mn)
Jammu and Kashmir	7	62,354
Himachal Pradesh	3	21,691
Madhya Pradesh	8	31,779
Maharashtra	10	18,766
Sikkim	1	12,120
Assam & Arunachal Pradesh	1	6,260
Nagaland	1	4,132
West Bengal & Sikkim	1	4,174
Tamil Nadu	2	2,568
Rajasthan	1	2,440
Karnataka	4	12,277
Arunachal Pradesh	2	19,238
Bihar	2	922
Chhattisgarh	1	446
Meghalaya	3	121
Nepal-International Presence	2	8,779
<b>Total</b>	<b>49</b>	<b>208,067</b>

Source: Q4FY23 Report, Progressive Research

years, so on an overall basis the strong order book position provides a revenue visibility over the next 4-5 years. Having said that, given the complexity of the nature of projects that the company undertakes, nearly ~45% of the projects are under the 10% completion stage as these are freshly received orders and as and when the project work paces up the execution eventually would pick-up. Going ahead, the management expects the order book position to improve further to Rs250bn in FY24 and ~12-15% growth a year after that.

## Exhibit 15: Order Book (Rs in mn)



Source: Q4FY23 Report, Progressive Research

## Exhibit 16: Completion Pipeline

Completion Stage	No. of Projects	Order book Value (Rsmn)
Below 10%	16	94,335
10-30%	7	54,898
30-50%	12	36,819
50-70%	4	14,258
70-90%	3	5,478
90-100%	7	2,259
<b>Total</b>	<b>49</b>	<b>208,067</b>

Source: Q4FY23 Report, Progressive Research

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## Investment Rationale (contd.):

### (D) Debt Reduction-Prime Focus Areas:

**(a) Non-Core Asset Monetisation:** One of the essential elements that the company is betting on to reduce the debt component is non-core asset monetization (*land sale*). Debt reduction is one of the key focus areas of the company; following which, in FY23, the company has sold three land parcels (~201 acres of land) located in Telangana. The realized amount of Rs670mn has been used for repayment of debt. The balance available land is around 2,150 acres with an approximate value of Rs10,000mn. The company has indicated that the titles of these land parcels are all clear and are mortgaged with the lenders. The company has been looking for appropriate buyers and plans to sell the land parcels over the period of next 2-3 years. Except for the 1500-acre land in Tamil Nadu which is in an industrial area (this investment was from the perspective of putting up a power plant which was later scrapped), all the other parcels are in or close to major cities of Mumbai, Hyderabad, Bangalore and Chennai, with most of them with the intend of residential construction. For FY24, the company expects to sell land to the tune of Rs800-1000mn, to reduce the debt levels further.

**(b) Arbitration Awards:** Another important aspect for reduction of debt burden is to receive funds against arbitration awards by submission of bank guarantees under NITI Aayog and other govt. initiatives. Due to the complex nature of the industry in which the company operates, there are bound to be various claims raised on the customers on account of additional costs, changes in the scope of work and increased timelines on account of the nature, complexity and length of the projects that the company undertakes. These claims are generally settled through arbitration. PEL has certain significant open legal proceedings under arbitration for various complex matters with the clients and other parties, continuing from earlier years, which are as under:

- Non acceptance of certain work by the client
- Cost overrun in certain contracts
- Reimbursement of the cost incurred by the company for the client

With the complexity involved in these litigation matters, the recognition of claims/variations are included in revenues when it is highly probable of recovery; based on estimates and assessment of each item by the management based on their experience of recovery. The company has realized arbitration awards money of Rs1,570mn in FY23 against bank guarantees. Furthermore, there is an amount of Rs12,063mn (which is a blend of 15-20 awards) which is in the favour of PEL; expected to get converted into cash over a period of 2 years. *The overall process of filing to winning the claim takes 18-24 months on an average.* The money that the company garners through awards is used for debt repayment and this should continue with a pipeline of arbitration as different stages being handled by the company.

**Exhibit 17: Available Land Parcels**

State/City	Available Area (acres)
Karnataka, Bangalore, Electronic City	15
Maharashtra, MMR, Panvel	11
Telangana	430
Tamil Nadu, Chengalpattu	200
Tamil Nadu	1500
<b>Total Available Land Bank</b>	<b>2,156</b>
<b>Approx. value in books (Rs in mn)</b>	<b>10,000</b>

Source: Q4FY23 Report, Progressive Research

**Exhibit 18: Arbitration Awards**

Non-Core Asset Monetisation (Arbitration Awards)	
Projects	Realised in FY23 (Rs in mn)
Sawrakuddu Package I	640
Parbati HEP	930
<b>Total</b>	<b>1,570</b>
Summary of Arbitration Awards and Claims as on Mar'23 (Rs in mn)	
Claims Pending With Client	4,633
Claims under Arbitration	14,446
Awards in favour of PEL	12,063
Claims Yet To Be Submitted	12,275
<b>Total Awards</b>	<b>43,417</b>

Source: Q4FY23 Report, Progressive Research

**(E) Engineering Capabilities with Technology Orientation:** Execution of hydropower and irrigation projects is long gestation, resource intensive and technically complex. Access to the use of sophisticated technologies works as an added advantage thus enabling superior and timely execution of projects. Some of the notable in-house technological initiatives at PEL are as under:

**Roller Compacted Concrete (RCC) Dams:** Construction of dams requires massive amount of concrete and larger usage of cement which leads to higher cost. In order to overcome this, an alternative method considered to minimize both the construction costs of dams and the usage of cement is RCC. RCC consists of same basic ingredients (cement, water and aggregates like gravel/crushed stone) as compared to conventional concrete but the only difference being the material proportion that are mixed to produce the concrete. RCC is a fast, efficient, economical and high quality way of constructing dams of any size. Compared to construction of conventional concrete dam which is usually built in large blocks; RCC dams are usually built in thin, horizontal lifts that allows rapid construction. PEL acquired ASI RCC, a US based engineering company known for its expertise in roller compacted concrete used in construction of dams. Using this to its advantage, PEL is one of the very few Indian companies having an experience in construction of RCC dams and hence could build the first three RCC dams in India for its Ghatghar Project in Maharashtra.

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## Investment Rationale (contd.):

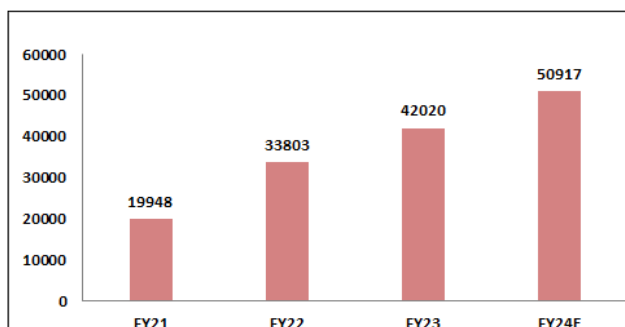
**Lake Tapping:** This involves excavating a tunnel at the lowest end of the lake. The final layer of rock is blasted with the help of a dynamite which provides inflow of water into the tunnel with more speed. After the blast, the water flows with extra pressure through the tunnel and is expected to have sufficient pressure to run the turbines. The increased flow of water is then driven to hydroelectric power generation plant for increased current production. The first lake tapping was carried out at Koyna HE Project in Maharashtra by PEL. The benefits of lake tapping are the establishment of waterways for hydro-power, making drinking water available, irrigation purpose, landing of oil and gas pipes from offshore fields.

**Microtunneling:** PEL was the first Indian company to have used microtunneling technology in India. *Microtunneling is an efficient technique for construction of small diameter tunnels for applications such as water supply, underground cabling and drainage systems without the need to dig into concrete or other roads.* This is useful where digging the surface such as concrete road would be expensive and time consuming. Realizing the need of specialised competencies in tunneling; back in 2000, PEL acquired Westcon Microtunneling Inc. to get access to the know-how of microtunneling. PEL has used microtunneling to construct subterranean networks for sewage, water and storm water applications.

**Financials:** After the SDR/OTR done, there has been gradual improvement seen across the P&L, with the focus being towards reducing the interest cost which would further improve the bottomline of the company. With the stalled/delayed projects, there was a drop in the revenues of the company from its benchmark. However, with the different reviving measures taken by the company and projects getting back on track; there has been a gradual uptick in the revenues. We expect CAGR growth of 19.08% over FY23-FY25E. For FY24, the company expects growth of 12-15%. The company has operating margins generally in the range of 14-15% and maintains the same going forward as well. There would be gradual improvement in the margins led by the value addition done during the project execution. The interest outgo of the company has been one of the key pain points in the P&L, denting the profits of the company. With the gradual debt reduction this should decrease gradually and should help in growth in the bottomline of PEL. There is no major capex going forward but for the maintenance or equipments needed towards the new projects received; for FY24, it is estimated to be in the range of Rs1bn, to be funded majorly by client advances.

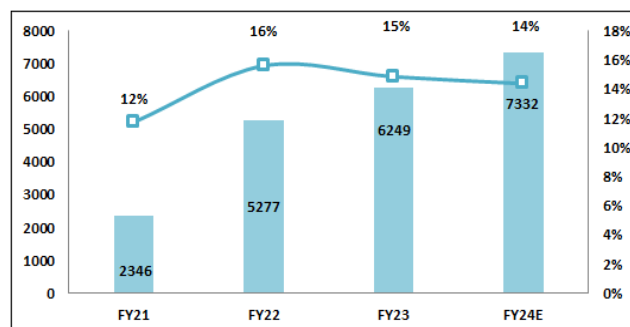
In FY23, there has been **repayment of Rs5bn of debt** which has led to improvement in the D/E ratio from 0.92x to 0.59x. This is further targeted to come down to 0.5x gradually based on the scheduled debt repayments.

Exhibit 19: Revenue Trend (Rs in mn)



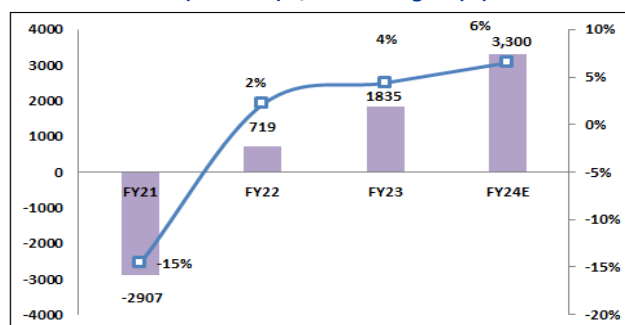
Source: Annual Reports, Progressive Research

Exhibit 20: Ebitda (Rs in mn) v/s Ebitda Margins



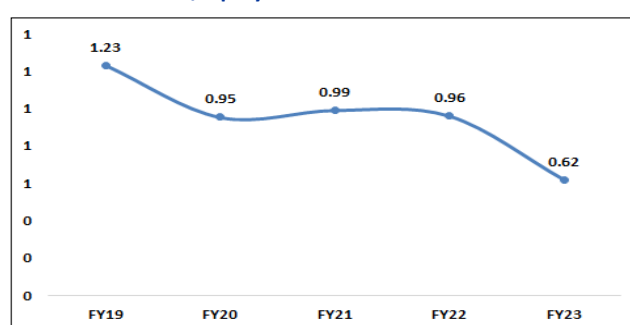
Source: Annual Reports, Progressive Research

Exhibit 21: PAT (Rs in mn) v/s PAT Margins (%)



Source: Annual Reports, Progressive Research

Exhibit 22: Debt/Equity Ratio Trend



Source: Annual Reports, Progressive Research

12 Jul, 2023

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VOL-9, NO-02

Industry: Civil Construction

Patel Engineering Limited

BUY

CMP: Rs.39

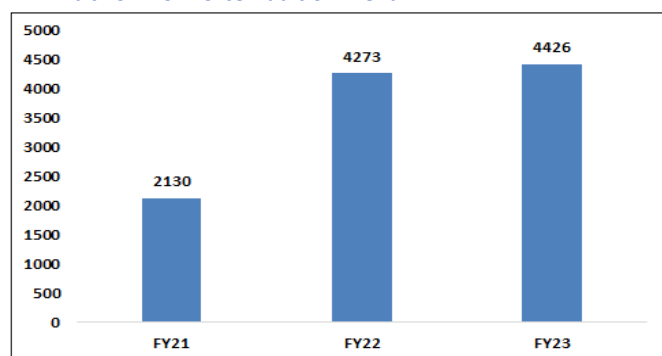
TARGET PRICE: Rs.50

TIME : 12 months

## Financials (contd.):

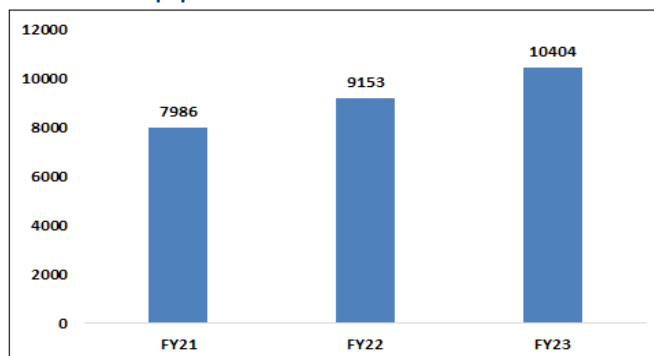
The company recently underwent a **rights issue to raise Rs3,500mn** (1:2 ratio at the offer price of Rs12.60) which was successfully subscribed with 40% infusion by the promoters (Rs1,300mn) and the balance (Rs1,950mn) from other shareholders. The major inflow is directed towards debt repayment. This clearly showed the intend of the company towards reducing the overall debt on the books, to strengthen the balance sheet going forward. There has been an **upgrade in credit ratings** (Long term ratings: ACUITE BBB to ACUITE BBB+; Short term: ACUITE A3+ to ACUITE A2). This improvement in the rating helps the company to maintain the interest rates in the external scenario of rate increases. The company has an **order book visibility** of atleast 4-5 years, which should give a decent 10-15% growth in revenues. But execution of these orders requires scalability which is what the company has been consistently working on. There are efforts on the employee front as well as the equipment base expansion to cater to the robust order book, for timely execution. Over a period of three years, from FY21 to FY23 there has been addition of 2000+ employees, indicating the robustness across the order book and execution scope.

Exhibit 23: Workforce Addition Trend



Source: Q4FY23 Report, Progressive Research

Exhibit 24: Equipment Base



Source: Q4FY23 Report, Progressive Research

## Risks and Concerns:

- **Elongated Working Capital Cycle:** There are receivables stuck under arbitration/claims pending with clients, any material deterioration in the working capital cycle can impact the company's liquidity profile.
- **Debt and Asset Monetisation:** Huge amount of debt and major interest outgo in the books is one of the key concerns for the company. PEL is trying its hands to reduce the burden (invariably increasing the profitability levels) which largely depends on the cash generated via non-core asset monetisation and arbitration awards/claims. Timely monetisation and recovery of claims remains one of the crucial pointers in order to boost the financial as well as the liquidity position of PEL.
- **Promoter Pledge:** Around ~88% of the promoters shares are pledged.
- **Execution Risk:** Being in a capital intensive industry, large portion of the revenues remain exposed to time and cost overrun risks, which is depicted by the ~45% of the outstanding order book in the preliminary stage with less than 10% completion stage and 26% falling under the 10-30% completion stage. This poses an execution risk for the company.

**Outlook and Recommendations:** The company has corrected many unfavourable decisions taken in the past (the last 5-6 years). One of the issues that the company faced were the repercussions of the move towards diversification into asset ownership and real estate development which blocked the working capital. There was financial distress due to lack of liquid assets. Having realized this, the company took corrective measures like slowing the operations, sale of non-core assets and land parcels in the restructuring phase while making EPC the only focus and single segment of the business. All these efforts have now brought the focus back on the growth path now. India has classified hydropower as renewable energy and sees it has a key in its transition away from coal as a source of energy. There is a huge potential in hydropower and tunneling sectors with more than Rs800bn of work coming up in next few years in this segment. Under the PMKSY scheme for 2021-2026, there has been an outlay allocation of Rs930bn, which would benefit about 22 lakh farmers. Hence, there is a huge potential of works expected in this segment also. PEL has always enjoyed a dominant positioning in these segments with a consistent track record in execution of projects. It is well depicted through the fact that the company has successfully completed over 85 dams, 40 hydroelectric projects and more than 300 kilometers of tunneling involved with generation of over 12,000MW of power capacity. It has irrigated over 5.5 lakh acre of land in India and constructed over 1200kms of roads. The hydropower capacity is expected to witness total installed capacity addition of 6.82GW (Installed capacity from large hydro projects at 46.85GW as on July 2022). The company has guided revenue growth of ~15% for the next 2 years with margins similar to FY23 (between 14-15%) and order book growth of 12-15%. The primary goal for the company is monetization of non-core assets and reduction of debt {reduced debt of Rs5bn in FY23 so the benefit of reduced interest cost should be seen from Q1FY24 (to the tune of Rs250-300mn per quarter)}. PEL has a strong client profile and order book which will be the core focus apart from monetization of land and resolution; resolution of arbitration cases will further add to the revenues of the company.



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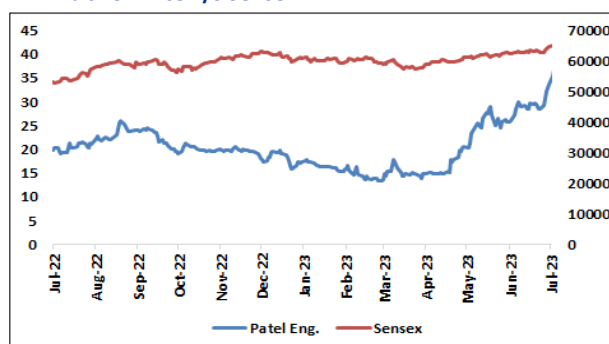
TARGET PRICE: Rs.50

TIME : 12 months

## Outlook and Recommendations (contd.):

Given the longer execution cycle needed for the high margin projects (hydropower, irrigation), lot of projects are still under the below 10% completion stage as these are the freshly received orders by PEL; but once the mobilisation phase for such projects is over the execution gradually picks up. The company does foresee good visibility from the high margin segments of hydropower and irrigation segment in the coming years. On the financials, the capex requirement is just the normal maintenance capex to the tune of ~Rs1bn which would be largely funded by the client advances. Reduction of debt and thereby increasing the profitability levels remains the crux for PEL over the next 3-4 years which would give the necessary push and a further enhanced credibility to reward the shareholders in the form of dividends (last dividend paid was in 2012). Overall, given the strong govt. focus on hydroelectric and irrigation infrastructure, robust order book pipeline providing a revenue visibility over the next 4-5 years, improving financial ratios and retaining its focus on reducing the debt burden, PEL has laid clear strategies in order to focus on growth and thus create value for its stakeholders. We thus initiate a buy on the stock for a target of Rs50.

Exhibit 25: Price v/s Sensex



Source: Ace Equity, Progressive Research

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