Patel Engineering (PATEN)

CMP: ₹ 59 | Target: ₹ 80 (36%) | Target Period: 12-18 months | BUY

April 22, 2024

Huge Opportunity ahead ...

About stock: Patel engineering is an EPC player which specialises in technology-intensive areas like hydro, tunnelling, irrigation, water supply, urban infrastructure, and transport.

- The company enjoys an order book of ₹ 19,134 crores (Including L1 Orders) as of Q3FY24, implying 4.3x book to bill.

Investment Rationale

- **Strong Presence in segment like Hydro Power, Irrigation which has big opportunity:** Hydro power, tunnelling and irrigation segment constitute ~93% of the Company's Orderbook. The company foresees a strong ordering opportunity ahead in the above-mentioned segments such as a) 19 GW of HEP projects concurred by CEA b) State-run hydropower major pursuing pumped storage projects (PSPs) of more than 20,000 megawatts (MW) capacity across states c) huge pipeline of 875 tunnels, spanning a length of around 2,600 km. and d) Pradhan Mantri Krishi Sinchayee Yojana (PMKSY) for 2021-26 outlay allocation of ₹ 93,068 crore.

- **Huge opportunity to translate into healthy inflows and revenue growth ahead:** We highlight that order inflow momentum had slowed down in H2FY24, amid elections. We expect the order momentum to pick up post Q1FY25 (post-election results). We expect the company to receive order inflows of ₹ 6000 crore and ₹ 10,000 crore in FY25 and FY26, respectively. Given the robust inflow potential, we expect strong revenue CAGR of ~16.3% over FY23-26E to ₹ 6612 crore

- **Stable margins; interest costs to drive strong earnings growth ahead:** The company expects similar levels of margins at 13-14%. With strong execution, stabilised raw material prices, we expect margins to remain stable at 14.2%. Strong topline growth coupled with stable margins and lower interest expense is likely to drive 32.4% earnings CAGR over FY23-26E

- **Non-core asset monetisation and arbitration claims could help the company to lighten the balance sheet:** In the near term, it has guided for receipt of ₹ 150-200 crore from the arbitration claim awards. Furthermore, it has major land parcels across Maharashtra, Tamil Nadu, Bangalore and Telangana encompassing ~2150 acres and worth ₹ 1000 crore which it is looking to monetise in the long-term horizon.

Rating and Target Price

- Given the strong opportunity from the key segment driving the topline and earnings growth visibility coupled with stable balance sheet, **we initiate coverage with a BUY rating on the stock**.

- We assign a **target price of ₹ 80,** thereby valuing it at 16x FY26 P/E.

Patel Since 1949

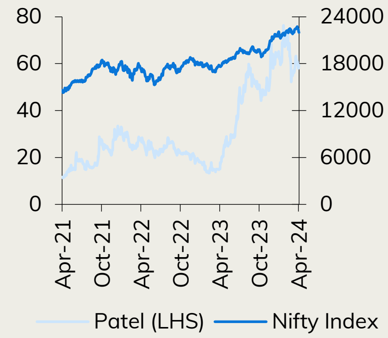
Particulars

Particular	Amount
Market Cap (₹ crore)	4,564
Debt (FY23) (₹ crore)	1,966
Cash (FY23) (₹ crore)	120
EV (₹ crore)	6,410
52 week H/L (₹)	78 / 15
Equity capital (₹ crore)	77.4
Face value (₹)	1.0

Shareholding pattern

	Jun-23	Sep-23	Dec-23	Mar-24
Promoters	39.4	39.4	39.4	39.4
DII	9.2	6.3	5.6	4.5
FIIs	2.1	2.4	2.8	3.4
Other	49.3	52.0	52.2	52.7

Price Chart



Key risks

- Key Risk: (i) delay in ordering in Hydro space (ii) Any variability in raw material prices

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Key Financial Summary

(₹ Crore)	FY21	FY22	FY23	5 Year CAGR (FY18-23)	FY24E	FY25E	FY26E	3 Year CAGR (FY23-26E)
Net Sales	1,994.8	3,380.3	4,202.0	13.3	4,803.1	5,547.6	6,612.5	16.3
EBITDA	234.6	527.7	624.9	3.3	680.8	785.7	935.9	14.4
EBITDA Margin (%)	11.8	15.6	14.9		14.2	14.2	14.2	
Net Profit	(302.7)	62.2	167.2	11.2	250.3	280.4	387.9	32.4
EPS (₹)	(6.5)	1.3	2.2		3.2	3.6	5.0	
P/E (x)	(14.8)	72.2	26.9		18.0	16.0	11.6	
EV/EBITDA (x)	28.0	12.3	9.7		9.1	8.1	6.7	
RoCE (%)	6.1	12.4	14.4		13.2	14.6	16.5	
RoE (%)	(3.8)	3.9	5.8		6.7	8.3	10.3	

Source: Company, ICICI Direct Research

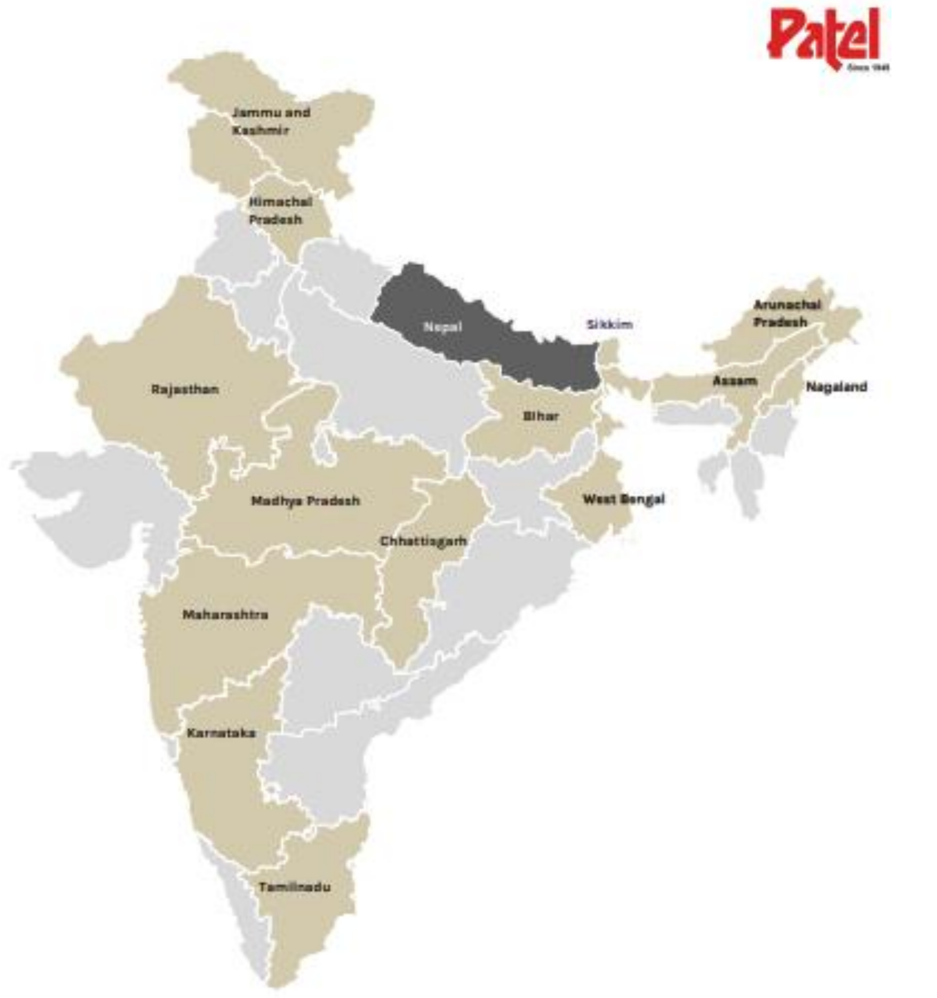
Company Background

Patel Engineering, founded in 1949 and headquartered in Mumbai is one of the prominent players in the civil engineering construction segment. With over seven decades of experience, the company has successfully constructed various heavy civil engineering works such as dams, bridges, tunnels, roads, piling works, and industrial structures

Patel Engineering Limited specializes in technology-intensive areas like hydro, tunnelling, irrigation, water supply, urban infrastructure, and transport. Hydro power, tunnelling and irrigation segment constitute around 90% of the Company's Orderbook and the company has valuable non-core assets. Currently, the company's order book as of 31st December 2023 stands at about ₹ 19,134 crores (Including L1 Orders), implying 4.3x book to bill on TTM basis.

Geographically, it has presence in 14 States and has undertaken various projects such as the Kameng Hydro Electric Project, SRSP Canal project, Raichur Sholapur Transmission project, Rampur Electric project and High-Altitude Road projects. The company has completed 87+ dams, 15000+ MW Hydro projects, 5.5 lakhs Acres irrigated, 300+ kms of tunnels and 1200+ kms Roads.

Exhibit 1: Geographical presence of Patel Eng



Source: Company, ICICI Direct Research

State	No. of projects	Project value
Jammu and Kashmir	7	5921.8
Madhya Pradesh	9	3238.1
Himachal Pradesh	3	1828.9
Maharashtra	12	1773.8
Arunachal Pradesh	2	1831.6
Sikkim	1	1129.6
Karnataka	4	1041.7
Nagaland	1	390.3
West Bengal & Sikkim	1	279.5
Assam & Arunachal Pradesh	1	394.5
Tamil Nadu	2	284.6
Rajasthan	1	232.5
Bihar	2	84.5
Chhattisgarh	1	69.5
Total	**47**	**18500.9**

Source: Company, ICICI Direct Research

Investment Rationale

Emerged strongly from Strategic Debt Restructuring

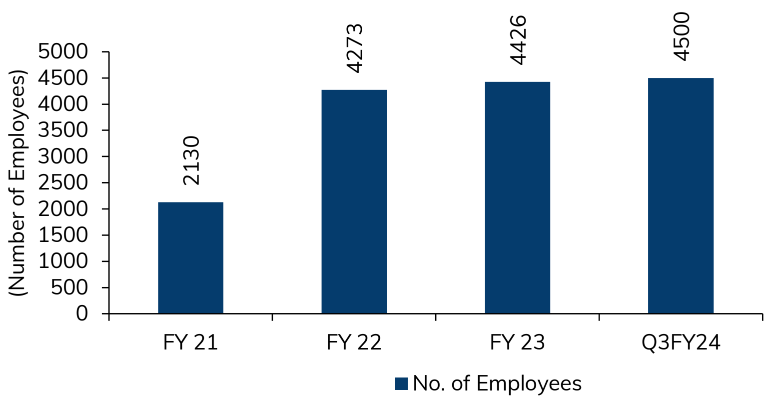
Patel Engineering went through Strategic Debt Restructuring (SDR) and Scheme for Sustainable Restructuring of Stressed Assets (S4A) in FY17 and FY18. Under the same, part of debt was converted into equity and OCDs. The promoters had also infused ₹ 150 crore then, as part of the scheme.

In order to improve capital structure and liquidity, company, in the past, has undertaken rights issue of ~₹ 201 crore in FY20 and ~₹ 325 crore in FY23. Furthermore, it also monetised non-core assets and utilised claims for reduction of debt. We highlight that these measures have resulted in the company reducing debt by ~₹ 3,000 crore in the past 6-7 years, to current levels of ₹ 1966 crore as of Q3FY24.

Scaling up capability

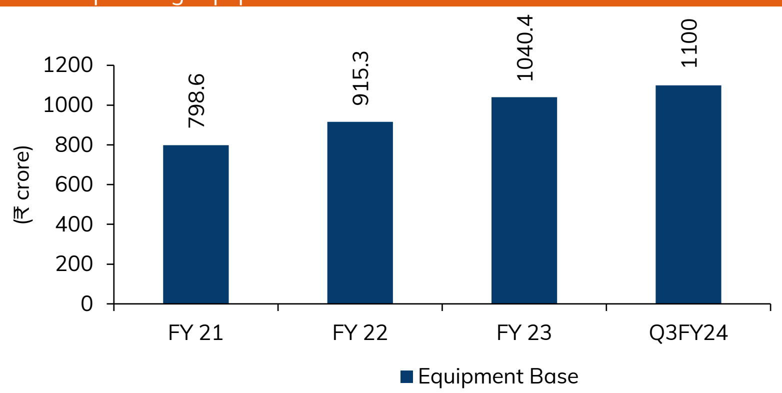
Patel has scaled up capability in terms of equipment gross block and number of employees since FY21. This has largely been done to ensure that increasing order inflows can be executed. We highlight that the company was operating on relatively lower scale amid balance sheet troubles since FY17 as it went into debt restructuring.

Exhibit 2: Expanding employee base



Source: Company, ICICI Direct Research

Exhibit 3: Expanding equipment base



Source: Company, ICICI Direct Research

Strong opportunities in the core segments it operates

Patel Engineering Limited specializes in technology-intensive areas like hydro, tunnelling, irrigation, water supply, urban infrastructure, and transport. **Hydro power, tunnelling and irrigation segment** constitute ~93% of the Company's Orderbook. If we look at the key segments, we foresee a strong ordering opportunity ahead

Hydro Power

- With government promoting investment in renewable energy notably hydropower sector, Patel engineering is likely to be one of the beneficiaries as the company focuses on hydroelectric power (HEP) projects with 15 ongoing projects making up ₹ 11689 crores of the order book value.
- As of December 2023, there are 19 GW of HEP projects concurred by CEA and yet to be taken up for construction and another 18 GW under Survey & Investigation stage
- Another ancillary opportunity in Hydro space is in the **Hydro Pumped Storage Projects**, which are necessary to achieve Government of India's commitment of 500 GW installed capacity from non-fossil fuel sources by the year 2030 and Net Zero carbon emissions by the year 2070. State-run hydropower major NHPC is pursuing pumped storage projects (PSPs) of more than 20,000 megawatts (MW) capacity across states such as Maharashtra, Odisha and Andhra Pradesh. **Patel Engineering is also planning to foray into the pump storage projects. The company expects order inflows potential of ~₹ 15000 crore from the overall Hydro segment over the next 12-18 months.**

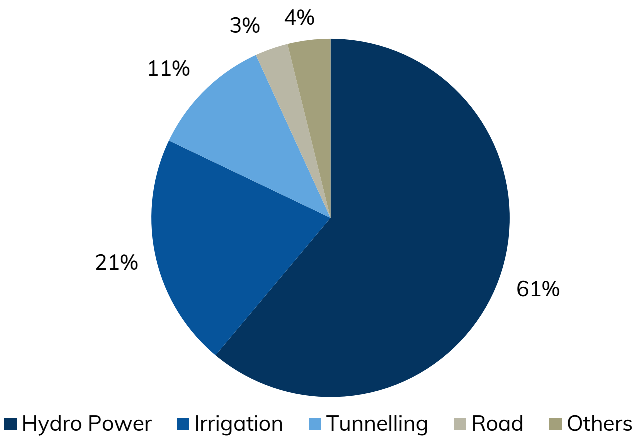
Irrigation

- Micro-irrigation has been prioritised in the Pradhan Mantri Krishi Sinchayee Yojana (PMKSY) with the goal of expanding irrigation coverage and improving water use efficiency to improve various water development and management activities.
- **Under the Pradhan Mantri Krishi Sinchayee Yojana (PMKSY) for 2021-26 there has been an outlay allocation of ₹ 93,068 crore**.
- Patel Engineering has an order book of ₹ 4020 crores (~21% of the total) from the irrigation segment in the 17 ongoing projects and is poised to capture the further opportunity in the segment.

Tunnelling

- The company has outlined that Tunnel construction offers a significant opportunity for contractors. **There is a huge pipeline of at least 875 tunnels, spanning a length of around 2,600 km.**
- Patel Engineering has an order book of ₹ 2167 crore (~11% of the total) from the tunnelling segment across 6 projects

Exhibit 4: Order Book – Segmental Breakup



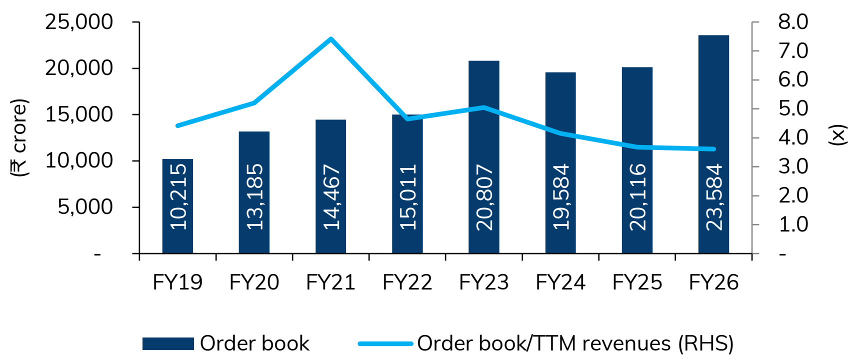
Source: Company, ICICI Direct Research

Order book healthy and diversified, to witness strong inflows ahead

Currently, the company's order book as of 31st December 2023 stands at about ₹ 19,134 crores (Including L1 Orders), implying 4.3x book to bill on TTM basis. Of the total order book, ~61% is from hydro sector, ~21% is from irrigation sector, ~11% from tunnelling project and ~3% is road and rest ~4% from other. Out of that ~62% of the order book is from central government PSUs and ~35% is from state government and balance ~3% is for projects in Nepal.

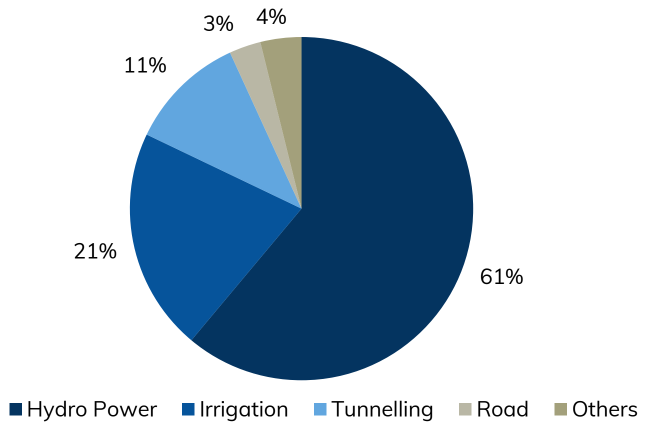
As stated above, there are strong opportunities in the core sector of Hydro, Irrigation and Tunnelling. We highlight that order inflow momentum had slowed down in H2FY24, amid elections. We expect the order momentum to pick up post Q1FY25 (post-election results). We expect the company to receive order inflows of ₹ 6000 crore and ₹ 10,000 crore in FY25 and FY26, respectively. The order inflow is likely to improve the revenue visibility ahead.

Exhibit 5: Order Book trend



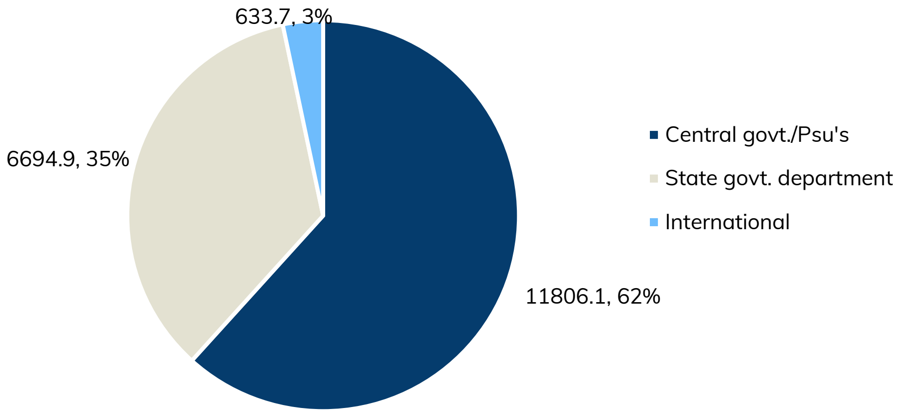
Source: Company, ICICI Direct Research

Exhibit 6: Order Book – Segmental Breakup



Source: Company, ICICI Direct Research

Exhibit 7: Order Book – Client Type



Source: Company, ICICI Direct Research

Non-core asset monetisation and Claims could aid in debt reduction

Over the past few years, the company has monetised non-core assets for reduction of debt, which it intends to continue to do in the future as well. In FY23, it had received ₹ 157 crore as claims which was used for debt prepayment. The company, currently, has arbitration awards in its favour worth ₹ 1338 crore. It expects the same to be realised over the next 3-4 years.

The company has filed for various settlement amounts under the Vivaad Se Vishwas scheme which was launched for the settlement of pending disputes related to government contract which were under ongoing arbitration. It expects to realise some of these arbitration awards through this scheme and/ or release few bank guarantees which were given earlier for part release of arbitration awards earlier. I**n the near term, it has guided for receipt of ₹ 150-200 crore from the arbitration claim awards. Receipt from this scheme will help the company to lighten the balance sheet and also augment working capital requirements for upcoming fresh orders**

Exhibit 8: Summary of Awards and Claims as on Q3FY24

Status	₹ crore
Claims pending with Client	1086
Claims under Arbitration	1300
Arbitration awards in Patel Engineering favour	**1338**
Claims yet to submitted	747

Source: Company, ICICI Direct Research

The company has major land parcels across Maharashtra, Tamil Nadu, Bangalore and Telangana encompassing ~2150 acres and worth ₹ 1000 crore. We highlight that during FY23, it had monetised 3 Land Parcel Size ~ 201 Acres worth ₹ 67 crore, which was utilised for debt repayment.

Currently, the company has indicated that while it is looking at land parcel monetisation, it is not focusing on it too much. However, if it gets good offers for upfront payment then the company may look at it.

Exhibit 9: Details of major Land Parcels

State/City	Locality	Available Area
Karnataka, Bangalore	Electronic City	15 acres
Maharashtra, MMR	Panvel	11 acres
Telengana	Outskirts of Hyderabad	430 acres
Tamil Nadu	Chengalpattu	200 acres
Tamil Nadu	Nagapattinum	1500 acres

Source: Company, ICICI Direct Research

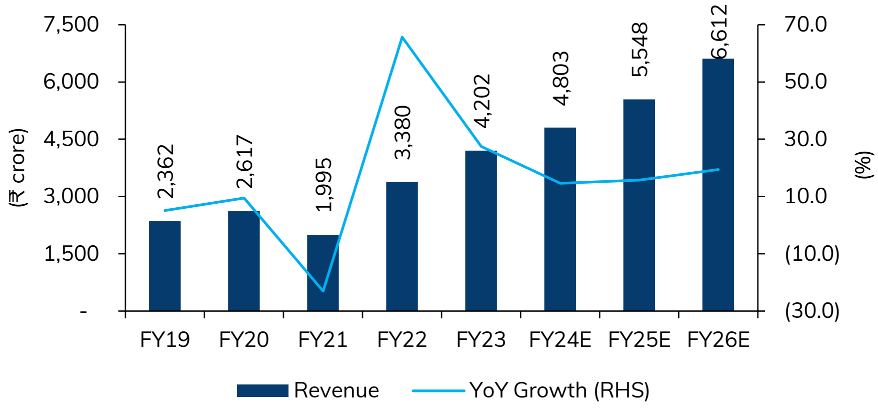
Key Financial Summary

Healthy Revenue growth likely ahead

Patel reported topline CAGR of ~13.3% over the last 5 years despite covid impacted years. **We expect the company to receive order inflows of ₹ 6000 crore and ₹ 10,000 crore in FY25 and FY26, respectively**. The order inflow is likely to improve the revenue visibility ahead. We highlight that the company has guided for ~15% revenues growth in the medium term ahead.

Given the robust inflow potential, we expect strong revenue CAGR of ~16.3% over FY23-26E to ₹ 6612 crore.

Exhibit 10: Healthy revenue growth ahead

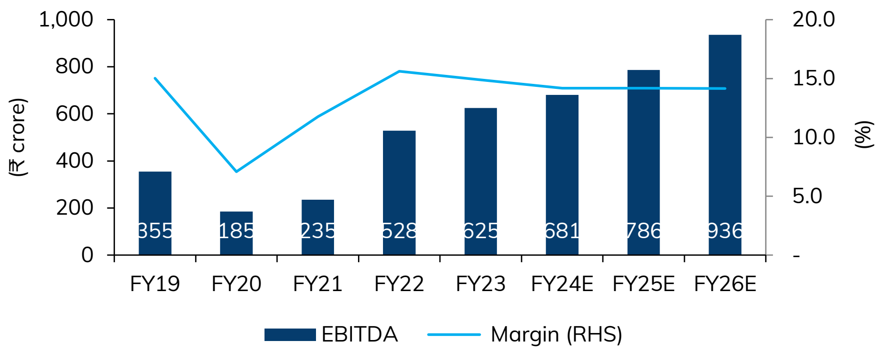


Source: Company, ICICI Direct Research

Margins to remain stable; Strong earnings CAGR ahead

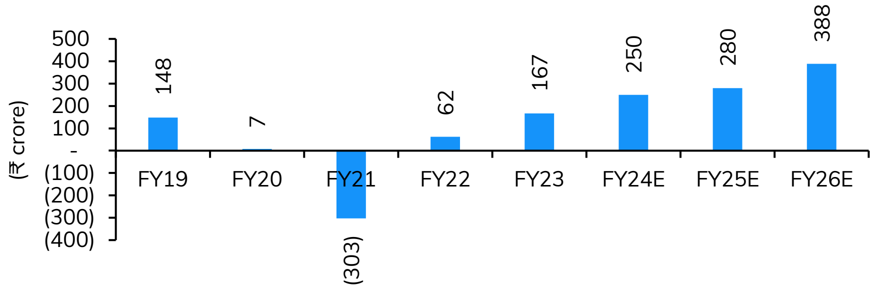
Going ahead, the company has guided for similar levels of margins at 13-14%. With strong execution, stabilised raw material prices, we expect margins to remain stable at 14.2%. Strong topline growth coupled with stable margins and lower interest expense is likely to drive 32.4% earnings CAGR over FY23-26E.

Exhibit 11: EBITDA & EBITDA margin trend



Source: Company, ICICI Direct Research

Exhibit 12: PAT trend

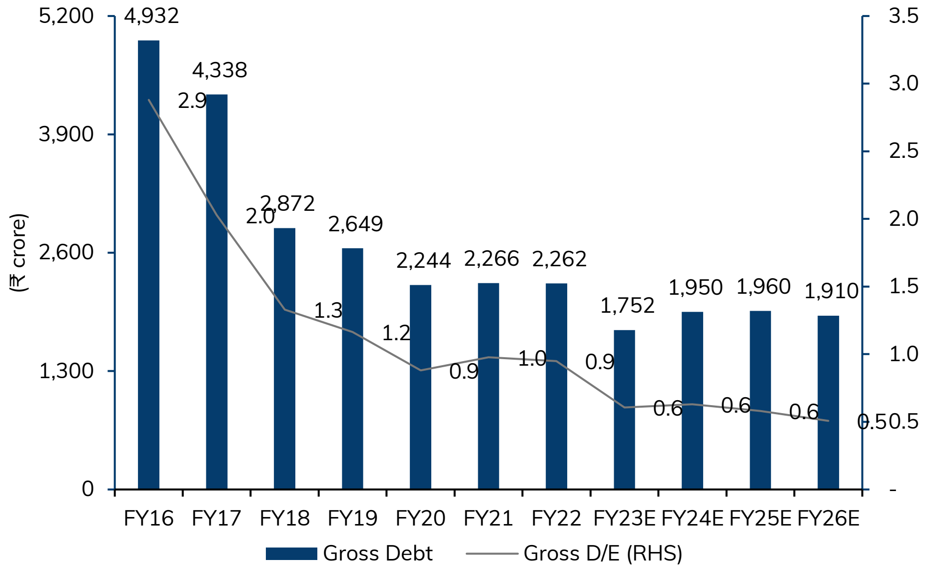


Source: Company, ICICI Direct Research

Stable Debt and improving return ratios ahead

The company has reduced debt by ~₹ 3,000 crore in the past 7-8 years, to current levels of ₹ 1966 crore as of Q3FY24. Going ahead, we expect the debt to remain stable. We highlight that we have not baked in any proceeds from claims or real estate monetisation and thus, the same could drive further reduction in debt.

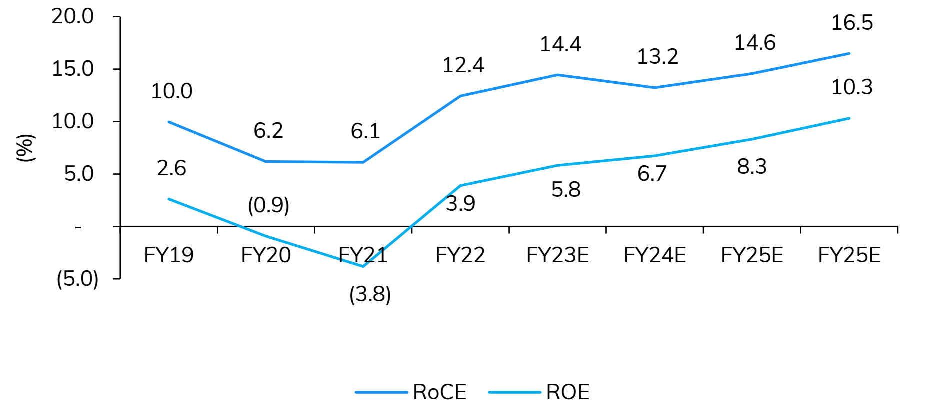
Exhibit 13: Debt to remain stable



Source: Company, ICICI Direct Research

We expect strong earnings growth to translate into improvement in return ratios for Patel.

Exhibit 14: Return ratios trend



Source: Company, ICICI Direct Research

Risk and Concerns

Slower execution could impact revenues

Slower execution be it from the company front or any delays at client end could impact overall revenue growth potential.

Any delay in major orders ramp up or new ordering

Any delay in ground breaking, ramp-up could lead to lower revenues. Furthermore, the delay in ordering of Hydro projects would lower the revenue growth visibility

Raw material volatility

The EPC companies in FY22 and H1FY23 witnessed an impact on margins owing steep rise in raw material prices including cement and steel. Nonetheless, the raw material prices have eased since then. However, any steep volatility in raw material prices could impact margins

Increase in competitive environment

While Patel operates in a moderate competitive industry, any competitive bidding led mistake could impact margins for certain projects.

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Financial Summary

Exhibit 15: Profit and loss statement ₹ crore

(Year-end March)	FY23	FY24E	FY25E	FY26E
Operating Revenues	**4,202.0**	**4,803.1**	**5,547.6**	**6,612.5**
Growth (%)	24.3	14.3	15.5	19.2
Construction Expenses	3,061.4	3,506.3	4,049.7	4,827.1
Employee Cost	340.8	408.3	471.5	562.1
Other Expenditure	174.9	207.8	240.6	287.4
Total Operating Exp.	3,577.1	4,122.4	4,761.8	5,676.6
EBITDA	**625**	**681**	**786**	**936**
Growth (%)	18.4	8.9	15.4	19.1
EBITDA Margin (%)	**14.9**	**14.2**	**14.2**	**14.2**
Other income	120.4	74.0	85.1	97.9
Depreciation	93.3	104.1	111.6	119.1
EBIT	651.9	650.6	759.2	914.6
Interest	418.4	371.9	385.3	397.3
PBT	232.7	320.9	373.9	517.3
Tax	53.9	70.6	93.5	129.3
Rep. PAT	**167**	**250**	**280**	**388**
Growth (%)	169%	50%	12%	38%
EPS (₹)	**2.2**	**3.2**	**3.6**	**5.0**

Source: Company, ICICI Direct Research

Exhibit 16: Cash flow statement ₹ crore

(₹ Crore)	FY23	FY24E	FY25E	FY26E
Profit after Tax	167	250	280	388
Depreciation	93	104	112	119
Interest	418	372	385	397
Others	(137)	(74)	(85)	(98)
Cash Flow before wc changes	542	652	692	807
Net Increase in CA	(14)	(713)	(879)	(868)
Net Increase in CL	229	468	569	785
Net CF from op. activities	**757**	**407**	**383**	**723**
Net purchase of Fixed Assets	(219)	(150)	(150)	(150)
Others	(13)	(17)	(27)	(63)
Net CF from Inv. Activities	**(232)**	**(167)**	**(177)**	**(213)**
Proceeds from share capital	337	(42)	0	0
Proceeds/Repayment of Loan	(509)	198	10	(50)
Interest paid	(418)	(372)	(385)	(397)
Other	16	-	-	-
Net CF rom Fin Activities	**(574)**	**(216)**	**(375)**	**(447)**
Net Cash flow	**(49)**	**24**	**(170)**	**62**
Opening Cash	261	212	236	66
Closing Cash	**212**	**236**	**66**	**128**

Source: Company, ICICI Direct Research

Exhibit 17: Balance Sheet ₹ crore

(Year-end March)	FY23	FY24E	FY25E	FY26E
Liabilities				
Equity capital	77.4	77.4	77.4	77.4
Reserves & Surplus	2,810.6	3,018.7	3,299.2	3,687.1
Networth	2,888.0	3,096.1	3,376.5	3,764.5
Non Controlling interests	87.8	87.8	87.8	87.8
Loan Funds	1,752.1	1,950.1	1,960.1	1,910.1
Deferred Tax liability	(213.7)	(213.7)	(213.7)	(213.7)
Total Liabilities	**4,514.2**	**4,920.3**	**5,210.7**	**5,548.7**
Assets				
Net Block	1,249.7	1,295.6	1,333.9	1,364.8
Capital WIP	294.4	294.4	294.4	294.4
Right of use asset	15.1	15.1	15.1	15.1
Intangible assets	29.4	29.4	29.4	29.4
Non-current Investments	124.2	124.2	124.2	124.2
Othe non-current assets	930.2	1,021.6	1,134.1	1,295.2
Inventories	3,743.5	4,292.7	4,969.3	5,548.1
Trade Receivables	892.1	1,022.9	1,184.1	1,414.8
Cash & Bank Balances	212.2	235.9	65.9	128.2
Loans & Advances	94.8	94.8	94.8	94.8
Other current assets	950.6	984.0	1,025.2	1,084.1
Total current assets	5,893.1	6,630.4	7,339.4	8,270.1
Total Current liabilities	4,022.1	4,490.5	5,059.9	5,844.6
Net Current Assets	1,871.1	2,139.9	2,279.4	2,425.5
Total Assets	**4,514.2**	**4,920.3**	**5,210.7**	**5,548.7**

Source: Company, ICICI Direct Research

Exhibit 18: Key ratios

(Year-end March)	FY23	FY24E	FY25E	FY26E
Per share data (₹)				
Reported EPS	2.2	3.2	3.6	5.0
Cash EPS	3.4	4.6	5.1	6.6
BV per share	37.3	40.0	43.6	48.7
Operating Ratios (%)				
EBITDA Margin	14.9	14.2	14.2	14.2
EBIT/ Net Sales	12.7	12.0	12.2	12.4
PAT Margin	4.0	4.3	5.1	5.9
Inventory days	325.2	326.2	327.0	306.2
Debtor days	77.5	77.7	77.9	78.1
Creditor days	188.5	189.3	189.3	187.8
Return Ratios (%)				
RoE	5.8	6.7	8.3	10.3
RoCE	14.4	13.2	14.6	16.5
RoIC	13.4	13.3	14.0	16.1
Valuation Ratios (x)				
P/E	27.2	18.2	16.2	11.7
EV / EBITDA	9.7	9.2	8.2	6.8
EV / Net Sales	1.4	1.3	1.2	1.0
Price to Book Value	1.6	1.5	1.3	1.2
Solvency Ratios (x)				
Debt / EBITDA	2.8	2.9	2.5	2.0
Net Debt / Equity	0.5	0.6	0.6	0.5

Source: Company, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavours to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according -to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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ANALYST CERTIFICATION

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