Patel Engineering

Operator: Good afternoon, everyone. I am Bala from Arihant Capital. Today is the third day of the Bharat Connect conference. I would like to welcome everyone to Patel Engineering Ltd.'s session. From the management side, we have Mr. Rahul Agarwal, CFO of the company. The session has two parts: an introduction and recent business updates by management, followed by a Q&A session. Participants can raise their hands or submit questions in the Q&A chat box. I now hand over the session to management. Rahul, you can take it over.

Rahul Agarwal – CFO: Thank you, Bala. Thank you, everyone, for joining this conference call. I will start with a brief overview of the company.

We are a 7-decade-old infrastructure company. We are involved in the construction of hydropower projects, irrigation projects, and tunneling projects. We specialize in these areas. Our main clients are NEEPCO, NHPC, NTPC, and SJVNL, so they are all central PSUs.

Our order book is around 14,000 crore plus, out of which approximately 65% is from central PSUs. The balance 30-35% is from state governments or entities such as MCGM, PMC, and others. That is how our clientele is split.

As regards the sector-wise split, around 60-65% is from the hydro segment. Tunneling and irrigation combined with hydro account for 90% of the order book. The balance 10% is urban infrastructure, roads, and other segments.

We have been consistently growing in terms of revenue and profits. Over the last 5 years, our revenues have grown at a CAGR of more than 15%, and profits have also seen a similar kind of growth.

This year, we are targeting around 8,000-10,000 crores of new orders. We expect this order inflow to continue because there is a lot of scope and a lot of push due to the Indus Water Treaty and other hydropower projects expected to come up in Arunachal Pradesh and other areas.

With the push for hydropower and pumped storage, we expect order inflows of 8,000-10,000 crores to continue for the next 4-5 years. Accordingly, our revenues are expected to grow again at a CAGR of more than 10-12%. We can take questions now.

Operator: We will begin the Q&A session. Participants can raise their hands or submit questions in the Q&A chat box. We will take the first question from Viraj.

Viraj: You are on mute. Hi, Rahul, how are you?

Rahul Agarwal – CFO: Hi, how are you? I am good.

Viraj: Good. Rahul, I have a question. In your last call, I think you mentioned that you monetized a land parcel outside Hyderabad or in Telangana, of approximately 27 acres, for 27 or 26 crores, if I recollect.

Rahul Agarwal – CFO: Correct.

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Viraj: This is out of the 500 and 430 acres that are in Telangana? Is this all one contiguous land parcel?

Rahul Agarwal – CFO: It is not contiguous, but it is one of those land parcels.

Viraj: But the 27 acres sold plus the 430 acres are all in the same area, right?

Rahul Agarwal – CFO: It is spread across different locations, but not exactly in the same area. However, it is in the outskirts of Hyderabad.

Viraj: Understood. Given that it is almost 1 crore an acre in the outskirts of Hyderabad, are there any plans or efforts underway to monetize the balance 400-odd acres?

Rahul Agarwal – CFO: We are in discussions to monetize it.

Viraj: So that is being actively pursued?

Rahul Agarwal – CFO: Correct.

Viraj: That land is of no use to us. Especially if it is in rural Hyderabad, it is difficult to determine what value it has, and at this realization, the absolute impact on the balance sheet can still be significant. Are there any other updates across the other land parcels, such as Panvel or the 1,500 acres?

Rahul Agarwal – CFO: We are also in discussions regarding Bangalore. Let us see whether we can close the transaction this financial year.

Viraj: Okay, great. Regarding the 1,500 acres in Tamil Nadu, is there any update, or is that still pending?

Rahul Agarwal – CFO: Regarding Tamil Nadu, we are in discussions with various parties to jointly undertake a project there. If we sell it immediately, we will not get enough value. If we can convert it into a project and then probably try to hive it off, that would be better.

Viraj: Understood. In terms of your borrowing costs, are there any discussions with banks to reduce them further, given the improvement in your credit rating and the fact that your debt continues to come down?

Rahul Agarwal – CFO: That has already happened. Earlier, our borrowing costs averaged between 11% and 11.5%. They have now come down to between 10.5% and 11%.

Viraj: Is that already in effect?

Rahul Agarwal – CFO: Yes.

Viraj: Are you consolidating any of your banking relationships as you pay down this debt, and hopefully moving to a narrower set of banks to support you going forward?

Rahul Agarwal – CFO: That is an ongoing discussion. Recently, we also reduced the pledge, which was one of the concerns.

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Viraj: Yes, I saw that. Has that been reduced across all banks or only with one or two banks in particular?

Rahul Agarwal – CFO: No, it has been reduced across the banks. The pledge is now reduced to approximately 66%.

Viraj: How many banking relationships do you have on the term-loan side?

Rahul Agarwal – CFO: We have around 14-15 banks.

Viraj: Was the pledge across all 14-15 banks?

Rahul Agarwal – CFO: The pledge is held through a trustee, basically for a pool of lenders.

Viraj: Understood. So it is for the entire pool. The entire pool has essentially reduced the pledge by 20%.

Rahul Agarwal – CFO: Yes, although that may be a separate pool of lenders.

Viraj: Understood. I do not think I have anything else. Thank you.

Operator: Thank you. We have received a few questions from the chat box.

Rahul Agarwal – CFO: I am reading them.

Operator: The first question is: We seem to be bullish on hydro projects, as you said in your remarks. Can you tell us the status of the MOUs formed with the government?

Rahul Agarwal – CFO: Regarding the government side, I will explain what is happening. The government has announced many projects. We have already bid for more than 20,000 crores of work in the last few months. Another 30,000-40,000 crores is in the pipeline, which we are going to bid for by the end of this year.

Accordingly, we have set a target of 8,000-10,000 crore order inflow. If you look at the NHPC websites, they have announced several large projects, such as Sawalkote, Kamla, Kalai, and Italin, which is also in the pipeline. There is also Subansiri and Upper Subansiri, which they expect to come up. The Lower and Upper Siachen projects are also there.

There are multiple projects in the pipeline, mainly from NHPC, SJVNL, and NTPC. NEEPCO is now part of NTPC. These are the 3 entities from which we expect many projects to come.

If you consider the hydropower pipeline, approximately 30 gigawatts is expected to come up in the next couple of years, which represents an opportunity of almost 1.5 lakh crores. Pumped storage is another 2 lakh crore opportunity, with another 40-50 gigawatts of projects expected there. In pumped storage, apart from PSUs, private entities are also involved.

Coming to tunneling, there are many tunneling projects coming up in places such as Maharashtra, J&K, and Arunachal Pradesh. There are also river-linking projects and others. Overall, we see an opportunity of 8-10 lakh crores of work. Out of this, we need to identify 2-3 lakh crore worth of

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projects to bid for, based on risk parameters and margins.

Over the next 4-5 years, we need 8,000-10,000 crores of orders each year, or approximately 50,000 crores over the next 5 years. That should be sufficient for us to achieve good growth. We expect to continue maintaining margins of 13-14%.

Operator: The second question is regarding segment-wise margins, retention money as a percentage of the order and the release timeline, the bank guarantee limit, and the current finance cost on bank guarantees.

Management {? Rahul ?}: Regarding segment-wise margins, the average margin is 13-14%. Hydro margins are around 15%, irrigation and tunneling margins are approximately 12-13%, and the margins in other segments are between 8% and 10%. The average is in that range because hydro accounts for more than 60% of the order book. In hydro, we are able to maintain a margin of between 13% and 14%.

Coming to retention, retention is generally 5% of the project. Some projects have clauses under which a portion of the retention can be drawn against bank guarantees. We have bank guarantee limits of almost 4,000 crores, of which 3,000 crores is utilized.

We have sufficient bank guarantees for upcoming projects. These limits are assessed every year based on the project pipeline. With surety bonds coming into play for bid bonds and performance guarantees, insurance companies with larger balance sheets and multi-trillion-dollar balance sheets are able to provide good surety limits with the support of reinsurers. We are seeing a lot of traction there as well, so there is no issue on that front.

As far as the finance cost on bank guarantees is concerned, bank guarantees are generally charged at between 1% and 1.5% per annum. That is the cost of bank guarantees.

Operator: The next question is: Trade payables keep growing every year. Why is this happening? What kind of payment terms do we receive, and are we short of funds to pay them and obtain cash discounts?

Management {? Rahul ?}: If you look at trade payables in terms of days, they are not increasing significantly because our revenues have increased, which is why trade payables have also increased. Trade payables include not only suppliers; suppliers are one part, and there are also subcontractors and labor contractors. We retain some amount for them as well, so that also forms part of trade payables.

This is not an issue in terms of cash flow. It is more a matter of managing the cash flows on a project-by-project basis. We generally utilize each project's cash flows for that project and fund those projects for working capital purposes only when it is absolutely necessary. Otherwise, we try to maintain that separation of project-wise cash flows.

Coming to contingent liabilities, the contingent liabilities of 3,000 crore that I mentioned mainly relate to bank guarantees for performance and retention that we have provided to clients.

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Regarding plans to increase promoter equity, there is nothing at present. If there is anything, we will let you know.

Operator: The next question is about the 150-200 crore monetization target in FY21 across land, arbitration, and other non-core assets. Will this monetization temporarily repair our balance sheet, or is it a permanent capital-recycling strategy? Would the company consider monetizing completed project SPVs, annuity receivables, or minority stakes?

Management {? Rahul ?}: We have a plan to generate cash flow from non-core assets of approximately 150-200 crores every year. We are on target for that this year. We have already completed one land sale and sold our equity in one of the road projects. We have already realized approximately {? 70-80 crores ?}.

We are still in discussions regarding the realization from some land. If that happens in March, or if some money is realized from arbitration awards, we will use that money to repay debt.

For any new projects we obtain, even if we have to take additional working capital limits, our debt can be maintained at similar levels. That is our target.

Operator: The next question is: What opportunities do we have in pumped storage, nuclear, defense, and other emerging infrastructure segments?

Management {? Rahul ?}: There are multiple opportunities. As I mentioned, many private players have also entered pumped storage and are developing pumped storage projects. Immediately, there are almost 10,000-15,000 megawatts of projects available for bidding. Overall, we see 50-60 gigawatts coming up over the next 3-4 years.

As far as the other segments are concerned, we are still identifying opportunities. Whenever a good opportunity comes up, we will evaluate it.

Operator: The next question is: Earlier, a 60,000 crore near-term pipeline and approximately 9,000 crore of bids under evaluation were mentioned. How much have we bid for so far, how much are we planning to bid for, and what conversion ratio can we expect?

Management {? Rahul ?}: We have bid for approximately 20,000 crores so far, and another 40,000 crores is expected to be bid for by March. The conversion ratio will be between 15% and 20%. That has been our average in the past.

Operator: The next question is regarding debt reduction. I think we are focusing on debt reduction, but if we look at our consolidated debt, it has increased from the previous quarter by nearly 100 crore to 1,293 crore. This includes working capital debt of 969 crore and term debt of 324 crore. How do you view the debt profile over the next 2-3 years? Will it remain at the current level, or will it reduce through asset monetization?

Management {? Rahul ?}: As new projects come in, we may have to take new working capital limits for those projects. Our target is to keep debt below 1,500 crore. Even with new projects coming in, we can reduce some debt through monetization, and if we take some working capital debt for new projects, overall debt should still remain below 1,500 crore.

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Operator: The next question is from Sampriti: For a particular government project, what percentage of the bid value do we receive as an advance?

Sampriti: Generally, there is a mobilization advance of 5%, which we can take against the submission of bank guarantees. In addition, there are equipment advances. In some cases, these are against bank guarantees, and in some cases they are provided when the equipment reaches the site against hypothecation of that equipment. These advances can be between 5% and 10% of the project value.

Operator: Should we consider EBITDA for the next 3 years to be in the range of 13-15%? I think it has been in that range.

Management {? Rahul ?}: Yes, 13-14% is correct.

Operator: The next question is: Will the pledge come down to zero in the next 2 years or by FY29, or should we target zero pledge?

Management {? Rahul ?}: It is difficult to say that the pledge will come down to zero in 1 or 2 years. We have reduced it this year, as we had guided earlier, and we expect further reductions going forward depending on the company's performance.

Operator: Which are the non-core assets currently under monetization? I think the Telangana land sale of 20...

Management {? Rahul ?}: We have some land parcels, and our land bank is worth approximately 800-900 crores. Out of this, the Nagapattinam land is worth around 300-odd crores, and we are not immediately looking to monetize that land.

We will continue looking to sell the remaining land parcels. Apart from that, we have arbitration claims and awards of almost 3,000 crores. Approximately 700 crore has been awarded, and around 2,300 crores is under arbitration. We will continue looking for opportunities to monetize those assets.

Operator: The next question is from Priyank: We expect 150-200 crore of yearly monetization. How large is the non-core asset base, or for how many years do we expect to continue doing this? Do we have a dedicated team for this?

Priyank: As I already explained, we have non-core assets. Our target is to generate 150-200 crores every year for the next 4-5 years, and we have a dedicated team.

We have a dedicated arbitration team to work on arbitrations and recoveries, as well as a legal team for the awards. We also have a separate dedicated team for real estate to look at selling those assets.

Operator: The next question is: We have completed nearly 11.95 kilometers of tunnel, which is a strong demonstration of our TBM capability. Given the emerging pipeline in high-speed rail and Himalayan connectivity, what is the addressable tunneling opportunity for Patel Engineering Ltd.?

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Management {? Rahul ?}: Regarding the tunneling opportunity, almost 1,000–1,500 crores of tunneling work is expected in India. Several projects will be for railways, several will be for roads, and others will be for water projects.

We are looking to target all 3 segments. We will take projects selectively, based on whether they meet our margin requirements and other criteria.

Operator: The next question is: Beyond hydro, tunneling, and irrigation, India's emerging pipeline includes nuclear, defense and infrastructure, and water desalination. In these areas, are we evaluating entry organically or through consortium partnerships?

Management {? Rahul ?}: We are currently evaluating various other segments as well. Since many projects are already coming up in hydro and pumped storage, we initially focused on those areas. We have now started evaluating other segments as well.

It will depend on the project. If we need a consortium partner for a particular project, we will try to proceed accordingly. However, it will depend on the feasibility of the project, margins, risk criteria, and all other factors.

We have a separate team for business development and tendering that identifies and verifies all these aspects, and a decision is taken accordingly.

Operator: We will take the next question from Viraj. You are unmuted.

Viraj: Hi, Rahul. Thank you for taking my question. Assuming some of these non-core asset monetizations bear fruit over the next several months and reduce your term loan meaningfully, if not completely, is the company, the promoter group, and yourself open to the idea of stock buybacks?

Now that working capital has come under control and the scale of your business is increasing, you should generate meaningful free cash flows in the years to come. Your stock continues to be undervalued, and a buyback is also an elegant way for the promoter, if they do not participate, to increase their shareholding. Is this something that has been discussed among senior management and proposed to the board?

Management {? Rahul ?}: We have not proposed it yet, but we will take up the matter with the board.

Viraj: Okay, great. Thank you very much.

Operator: The next question is: 3,000 crore is under arbitration, of which 700...

Operator: The awards mean that there is a 2,300 crore balance. Please provide details and the timeline for receiving this money.

Rahul Agarwal - CFO: Regarding the amounts under arbitration, it generally takes a couple of years for arbitration to be completed. After that, there is a court process, unless we are able to withdraw money against bank guarantees earlier.

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The district court, high court, and Supreme Court processes can take another 3-4 years. Therefore, the overall timeline is around 5 years. However, the matters are at various stages of arbitration.

Some matters are on the verge of completion of arbitration. The awards will then be issued, and we will immediately try to recover the money against bank guarantees. Some matters relate to arbitration awards that have already been issued, including the 700 crores, and those matters will also be at various stages in the courts.

Once a matter crosses the High Court, there is a good chance of recovery because the Supreme Court generally does not take too much time for such matters.

Operator: The next question is: In hydro projects, who are our competitors, and what is our unique proposition that differentiates us from other players?

Rahul Agarwal - CFO: There are 4-5 competitors in hydro projects at present. Our unique advantage is that most of the projects are in areas such as J&K, Himachal Pradesh, and the Northeast, where we have been working for more than 7 decades.

Our team has an understanding of the geology, the local people, and the mindset of the people in those areas. We also have tie-ups with local contractors and crushers, which are very important because local connections are required.

These arrangements are already in place. In addition, we have a lot of equipment located in those areas for various projects that we are executing. Therefore, we can also implement an immediate equipment mobilization plan when we receive a project nearby.

Given all these factors, we have an advantage over various other players.

Operator: Sorry, am I audible?

Rahul Agarwal - CFO: Yes, sir.

Operator: Rahul, you can ask your question.

Viraj: Thank you. Rahul, can you hear me?

Rahul Agarwal - CFO: Yes, sure. Sorry.

Viraj: Is there any focus on desalination going forward, given what we have seen in Mumbai, the first desalination plant coming up, and the potential risks from unpredictable weather? Is desalination an area of focus? Have we looked at partnering with companies that have certain skill sets overseas, perhaps in the Middle East or Israel, to bring those capabilities and execute such projects?

Rahul Agarwal - CFO: We are looking for tie-ups with some overseas companies as well. We are also looking locally for companies that may have the capabilities or the pre-qualifications to execute this kind of work, while we have the balance sheet.

We are evaluating the combination of these 2 strengths.

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Viraj: Are you seeing many such orders coming into the desalination pipeline?

Rahul Agarwal – CFO: Yes. Apart from desalination, there are also STP plants. Multiple kinds of projects are coming up.

Our focus is to take some projects from our core areas, with around 60–70% coming from the core areas. For the balance, we will look at these other segments.

Viraj: Understood. Thank you very much. Good luck.

Rahul Agarwal – CFO: Thank you.

Operator: We have a question from {? Mukit ?}: Can you explain the difference between bank guarantees and surety bonds? How are their economics different from bank guarantees?

Rahul Agarwal – CFO: Surety bonds are bonds provided by insurance companies such as New India Assurance, ICICI Prudential, Bajaj Insurance, and others.

Like other insurance products, these insurance companies are generally backed by reinsurers. These include international reinsurers such as Swiss Re and Munich Re, which have very large balance sheets and can absorb the risks associated with a bond.

A surety bond is essentially a performance bond instead of a performance guarantee. Internationally, for EPC projects, there is generally no concept of bank guarantees. Instead, surety bonds are used, whether for performance, advances, or payments.

India is also gradually moving in that direction. Given the availability of surety bonds as an instrument, we now have opportunities to approach various insurance companies in addition to banks.

In terms of cost, the pricing is currently similar, at around 1%. However, we expect the cost of surety bonds to decline as more insurance companies enter the market.

Operator: We have answered most of the questions from the investor side. I would like to thank the management and participants on behalf of Arihant Capital for participating in the Bharat Connect conference.

Rahul, do you have any final closing remarks? We have one question from Priyank Kothari: What is our vision for the next 3–5 years, given the large opportunities opening up for us in terms of revenue and PAT? Since the death of Mr. Rupin Patel, how is the promoter family participating in terms of business growth and the plan of action? Is the Managing Director at the helm of all decisions regarding the business and projects?

Rahul Agarwal – CFO: At present, the wife of Mr. Rupin Patel, Janki Patel, is the chairperson and a non-executive director. She is involved in some of the strategic decisions that we take for the company.

Apart from that, for the day-to-day business, we have a board and a well-established team below the board as well. The business is handled professionally. No single person takes all the decisions.

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Decisions are taken collectively.

As far as our vision is concerned, we see many opportunities over the next 3-5 years. We expect our revenues and PAT to grow. If you ask me about the next 5 years, we see at least a CAGR of between 13% and 15%.

The cost of surety bonds vis-à-vis bank guarantees is similar, at around 1-1.5%.

Operator: Okay.

Rahul Agarwal - CFO: As a final closing remark, there is a lot of scope and many projects are coming up in the infrastructure space. We are very bullish about the economy and the country as far as infrastructure is concerned.

We see a lot of traction in projects coming to our company. We will continue to bid selectively, maintain our margins, and grow slowly but steadily. Thank you.

Operator: Thank you. Thank you, everyone. We are closing the session. Thanks.

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