August 11, 2022

Patel Engineering Limited : Rating assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Fund based facilities (long - term)	260.00	[ICRA]BBB (Stable); assigned
Total	**260.00**	

**Instrument details are provided in Annexure-I*

Rationale

The assigned rating favourably factors in Patel Engineering Limited's (PEL) strong order book position (order book to OI ratio of 4.7 times after adjusting for slow moving orders), which provides medium-term revenue visibility. PEL has witnessed healthy order inflows in the last one year (Rs. 4,261 crore, including escalation in FY2022), which has improved its order book position. The rating favourably factors in PEL's diversified order book across segments, geography and clientele. In the past, PEL had faced financial challenges which had also impacted its operations; however, with the successful implementation of the resolution plan by lenders, the company's operational and financial performance has improved, which is expected to continue.

PEL is one of the largest engineering company in India's hydropower sector – a segment which has seen healthy traction with increased Government's focus. The rating also draws comfort from the long track record of PEL's operations of over seven decades, supported by an experienced management and demonstrated capabilities in executing relatively complex hydro and tunnelling projects at geographically diverse locations.

The rating, however, is constrained by PEL's elongated working capital cycle, primarily due to sizeable receivables/work in progress being stuck in arbitration or under claims pending with the clients, resulting in high NWC/OI of 62% as on March 31, 2022. However, the company has been able to manage the working capital requirements, partly by availing credit period from suppliers/sub-contractors and mobilisation advances from clients. This has resulted in relatively higher TOL/TNW, which stood at 2.4 times as on March 31, 2022. ICRA notes that the working capital intensity has improved over the last one year with the realisation of claims and monetisation of land bank, and the management expects this to improve further in FY2023. ICRA draws comfort from the cushion available in the form of unutilised arbitration BG/court BG that could be used to realise some of the awards pending in the higher courts. Going forward, any material deterioration in the working capital cycle from the anticipated levels over the medium term can impact PEL's liquidity position/credit profile and will be a key rating sensitivity.

The ratings also note the stiff competition in the construction sector and the company's exposure to sizeable contingent liabilities in the form of bank guarantees, mainly for contractual performance, mobilisation advance and security deposits. The rating is also constrained by execution risks as about 52% of the order book as on March 31, 2022 is in preliminary/early stage of execution with less than 15% progress.

ICRA has noted that PEL has sizeable claims awarded by arbitration tribunal/courts but pending in higher courts which can be realised in the interim by providing bank guarantees (BG). While the company's operating margin is expected to remain healthy at around 12-14% in the near to medium term, the coverage indicators are likely to remain modest on account of a leveraged capital structure. The company is planning to monetise some of its non-core investments to deleverage its capital structure and improve its liquidity position. Going forward, the timely monetisation of the non-core assets and improvement in the working capital intensity remains remain crucial to boost its financial performance and liquidity position.

The Stable outlook reflects ICRA's opinion that the company will continue to benefit from its healthy order book position, strong execution capabilities, and improved liquidity position.

Key rating drivers and their description

Credit strengths

Strong order book position provides healthy medium-term revenue visibility – The company had a strong order book position of Rs. 15,012 crore as on March 31, 2022, which has grown at a CAGR of 15.15% over the last five-year period. The new order inflows (including escalation) have been healthy at Rs. 4,261 crore in FY2022. Adjusting for slow moving orders, the OB/OI ratio was comfortable at 4.7 times the operating income of FY2022, providing healthy medium-term revenue visibility. Timely commencement and execution of these orders is critical to sustain the revenue visibility, going forward.

Diversified order book - PEL's current outstanding order book is well-diversified in terms of geography with a pan-India presence, along with international operations in Nepal, across multiple segments such as hydroelectric power, irrigation, roads, real estate, tunnels & urban Infrastructure projects. The hydroelectric power segment formed 62% of the un-executed order book as on March 31, 2022, given the company's technical expertise and lucrative operating margin in this segment. Further, the order book is fairly diversified in terms of projects and clients, with the top-three clients contributing 39% to the total unexecuted order book and the top-10 orders accounting for 72% to the unexecuted order book as on March 31, 2022.

Established track record and extensive experience of management team in civil construction sector –PEL has an established track record of operations of over seven decades, supported by an experienced management and demonstrated capabilities in executing relatively complex hydro and tunnelling projects at geographically diverse locations. The company has proven its execution capabilities by constructing large-value and technologically complex long-duration projects. The company has a fleet of well-maintained specialised equipment in its portfolio, a qualified and experienced senior management and technical collaborations, boosting its project execution capabilities.

Credit challenges

Execution risk as about half of order book is in early stages of execution - PEL's revenue remains exposed to time and cost overrun risks, given the complex nature of the projects being executed; moreover, ~52% of its outstanding order book is in preliminary stage with less than 15% progress. About 7% of the orders were yet to start billing as of March 2022. Further, 60% of the outstanding order book as on March 31, 2022 have been extended beyond original schedule by client, which could result in cost escalations or penalties, impacting profitability. Notwithstanding PEL's strong execution capabilities, any sizeable invocation of performance guarantees (BG) would affect the company's liquidity and financial risk profile. ICRA takes comfort from the history of extension of project deadlines from the clients/authorities for most of the projects where there have been delays for reasons beyond the company's control.

Elongated working capital cycle – As a substantial amount of receivables is stuck in arbitration or under claims pending with the clients, PEL's working capital intensity has remained high with NWC/OI being 62% as on March 31, 2022. However, the company has been able to manage the working capital requirements, partly by stretching its creditors and availing mobilisation advances. This has resulted in relatively higher TOL/TNW, which stands at 2.4 times as on March 31, 2022. ICRA notes that the working capital intensity has improved over the last one year with the realisation of claims and monetisation of land bank, and the management expects this to improve further in FY2023. ICRA draws comfort from the cushion available in the form of unutilised arbitration BG/court BG that could be used to realise some of the awards pending in the higher courts. Going forward, any material deterioration in the working capital cycle from the anticipated levels over the medium term can impact PEL's liquidity position/credit profile and will be a key rating sensitivity.

Dependence on asset monetisation - The company plans to monetise some of its non-core investments to deleverage its capital structure and improve its liquidity position. Going forward, timely monetisation of the non-core assets and an improvement in the working capital intensity remain crucial to boost its financial performance and liquidity position.

ICRA has taken note of the company's improved coverage indicators and liquidity position post the implementation of the resolution plan (RP) on May 29, 2021. An equity infusion of Rs. 25 crore by promoters, asset monetisation of Rs. 140 crore and additional sanctions of fund-based and non-fund-based facilities have helped the company to improve its liquidity position and its execution capabilities that were impacted before RP. PEL's interest coverage ratio improved to 1.2 times as on March 31, 2022 (from 0.46 times as on March 31, 2021) with unencumbered cash and bank balance of Rs. 191.4 crore as of March 31, 2022. While the company's operating margin is expected to remain healthy at around 12-14% in the near to medium term, the coverage indicators are likely to remain modest on account of a leveraged capital structure.

Heightened competition, input cost spike could exert pressure on profitability - The domestic civil construction industry is fragmented and highly competitive, evident from the moderate bid to success ratios. Garnering adequate number of projects and ensuring their movement remains key for the optimal use of resources and ultimately profitability. The competition has further increased because of the relaxation in the bidding criteria. This, coupled with the increase in input cost, could exert pressure on PEL's profitability. ICRA notes that there is a built-in price escalation clause in majority of the contracts, which protects the operating margin from raw material price fluctuation risk to some extent.

Liquidity position: Adequate

The company had unencumbered cash and bank balance of Rs. 191.4 crore and unutilised working capital limits of Rs. 154 crore as on March 31, 2022. The average working capital utilisation in the last 12-month period ended April 2022 remained at 90% and the non-fund based utilisation at 67%. The company had a near-term debt obligation of Rs. 202.5 crore in FY2023 (which includes Rs. 113.8 crore of NCDs from LIC due in Sep-2022). Timely realisation of claims, asset monetisation and improvement in the working capital intensity will remain crucial for the company to maintain its liquidity.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the company demonstrates a significant improvement in its working capital intensity, debt coverage metrics and liquidity profile while maintaining its overall scale of operations and operating profitability.

Negative factors – Negative pressure on PEL's rating could arise if a lower-than-anticipated billing or a deterioration in operating profitability impacts the company's liquidity or overall financial profile. Other factors impacting the financial profile, and hence the rating, include a delay in asset monetisation or inability to improve the working capital cycle.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Construction Entities Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	ICRA has fully consolidated PEL's subsidiaries. ICRA has factored in the need-based capital support towards two of the associates — Raichur Sholapur Transmission Co. Ltd and Bellona Estate Developers Ltd. Similarly, for all the joint ventures, ICRA has followed the equity method of consolidation. The list of all the subsidiaries/associates/JVs that are consolidated under the above-mentioned approach to arrive at the PEL's ratings are given in Annexure II.

About the company

Patel Engineering Limited (PEL), incorporated in 1949, is involved in the engineering and construction of infrastructure projects. The company constructs and develops diversified projects, including dams, tunnels, micro-tunnels, hydroelectric projects, irrigation projects, roads, bridges, railways, refineries, real estate and townships. It has completed over 85 dams, 40 hydroelectric projects, over 300 km of tunnelling projects, over 1200 km of roads and irrigation projects for more than 5.5 lakh acres of land. The PEL Group's principal business areas can be classified into four broad verticals: 1) engineering and construction (E&C), 2) asset ownership, 3) real estate and 4) technology and innovation. While the E&C vertical is undertaken by PEL, the rest of the activities are carried out through separate subsidiary companies. Apart from the pan-India presence, PEL has international operations in Nepal.

Key financial indicators (audited)

PEL Consolidated	FY2021	FY2022
Operating income	1,990.9	3,380.3
PAT	-276.9	68.6
OPBDIT/OI	12.2%	15.6%
PAT/OI	-13.9%	2.0%
Total outside liabilities/Tangible net worth (times)	2.3	2.4
Total debt/OPBDIT (times)	9.4	4.3
Interest coverage (times)	0.6	1.3

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY20221	Date & rating in FY2020
					Aug 11, 2022	-	-	-
1	**Fund-based working capital facilities**	Long term	260.0	-	[ICRA] BBB (Stable)	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based Long term	-	-	-	260.00	[ICRA]BBB (Stable)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA]

Annexure II: List of entities considered for consolidated analysis (As on March 31, 2022)

Company Name	PEL Ownership	Consolidation Approach
Patel Energy Resources Limited	100.00%	Full Consolidation
Patel Engineering Inc	100.00%	Full Consolidation
Patel Engineering (Mauritius) Limited	100.00%	Full Consolidation
Patel Engineering (Singapore) Pte. Limited	100.00%	Full Consolidation
Patel Engineering Infrastructure Limited	100.00%	Full Consolidation
Patel Concrete and Quarries Private Limited	100.00%	Full Consolidation
Friends Nirman Private Limited	100.00%	Full Consolidation
Zeus Minerals Trading Private Limited	100.00%	Full Consolidation
Patel Patron Private Limited	100.00%	Full Consolidation
Patel Engineers Private Limited	100.00%	Full Consolidation
Pandora Infra Private Limited	100.00%	Full Consolidation
Patel Engineering Lanka Limited	100.00%	Full Consolidation
Shashvat Land Projects Private Limited	100.00%	Full Consolidation
Vismaya Constructions Private Limited	100.00%	Full Consolidation
Bhooma Realties Private Limited	100.00%	Full Consolidation
Patel Lands Limited	100.00%	Full Consolidation
Energy Design Private Limited	100.00%	Full Consolidation
Shreeanant Construction Private Limited	100.00%	Full Consolidation
Hampus Infrastructure Private Limited	100.00%	Full Consolidation
Arsen Infra Private Limited	100.00%	Full Consolidation
PBSR Developers Private Limited	100.00%	Full Consolidation
Lucina Realtors Private Limited	100.00%	Full Consolidation
Waterfront Developers Limited	100.00%	Full Consolidation
Patel KNR Infrastructures Limited	60.00%	Full Consolidation
Michigan Engineers Private Limited	51.00%	Full Consolidation
Hera Realcon Private Limited	97.30%	Full Consolidation
Patel Michigan JV	10.00%	Equity Method
CICO Patel JV	99.90%	Equity Method
Patel SEW JV	60.00%	Equity Method
PATEL –KNR JV	50.00%	Equity Method
KNR – PATEL JV	49.00%	Equity Method
PATEL – SOMA JV	50.00%	Equity Method
Patel – V Arks JV	65.00%	Equity Method
Patel VI JV	51.00%	Equity Method

Company Name	PEL Ownership	Consolidation Approach
Patel – Avantika – Deepika – BHEL	52.83%	Equity Method
Patel – V Arks – Precision	60.00%	Equity Method
Age Patel JV	49.00%	Equity Method
PEL - UEIPL JV	60.00%	Equity Method
PEL-PPCPL-HCPL JV	51.00%	Equity Method
Onycon Enterprises	60.00%	Equity Method
PEL-Gond JV	45.00%	Equity Method
HES Shuthaliya JV	45.00%	Equity Method
PEL-Parbati JV	52.00%	Equity Method
NEC-PEL- JV	45.00%	Equity Method
PEL - Ghodke	51.00%	Equity Method
PEL-ISC-PRATHMESH JV	50.00%	Equity Method
ISC Projects-PEL JV	49.00%	Equity Method
PATEL-SA JV	75.00%	Equity Method
Era Patel Advance Kiran JV	47.06%	Equity Method
Patel APCO JV	50.00%	Equity Method
Era Patel Advance JV	30.00%	Equity Method
Patel – Siddhivinayak JV	51.00%	Equity Method
Patel -Civet-Chaitra Micro(KA) JV	51.00%	Equity Method
Ceigall - PEL JV	40.00%	Equity Method
VPRPL PEL JV	51.00%	Equity Method
Mokharbardi Micro Irrigation JV	51.00%	Equity Method
ACP Tollways Private Limited	32.00%	Equity Method
Patel KNR Heavy Infrastructure Private Limited	42.00%	Equity Method
Raichur Sholapur Transmission Co. Ltd	33.34%	Limited Consolidation
Bellona Estate Developers Ltd	49.00%	Limited Consolidation

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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