

Retail Equity Research (South India Focus)

Power Mech Projects Ltd

Capital Goods

BSE CODE : 539302 NSE CODE: POWERMECH
BLOOMBERG CODE: POWM:IN SENSEX : 49,509

BUY

12M Investment period Rating as per Small Cap
CMP Rs.585 TARGET Rs. 727 RETURN 24% ↑
(Closing: 31-03-21)

Focus on O&M and Civil orders to drive growth

Power Mech Projects Ltd is a leading infrastructure-construction company based in Hyderabad with global presence.

- Company has an order backlog of Rs.7,353Cr (as on 16th Feb 2021), which shows revenue visibility for next 3 years.
- Company enjoys market leadership position in power O&M (Operations and Maintenance) and erection business with a market share of 55%-60%.
- Diversification of business to non power segment, especially civil (including railway, petro chemical, water etc) has helped the company to be in the growth track .
- We expect order backlog to grow at 14% with an average order intake of Rs.3,500Cr-4,000Cr per year.
- Revenue is expected to grow at a CAGR of 30% during FY21-23 and ROE to be at 16.3% by FY23E.
- We initiate coverage on POWERMECH with a BUY rating based on 6x FY23E earnings with a target price of Rs.727.

Market leader in power O&M and Erection business

PowerMech enjoys the leading position in power O&M and Erection business with market share of 55-60% in both the segments. Current order backlog in O&M segment is at Rs.820Cr and Erection segment at Rs.2,330Cr. Company aims to expand its O&M business further which will help in generating a consistent long term revenue along with higher margins. In erection segment, company has a track record of executing the first 2 Ultra Mega Power Plants (Mundra—Tata Power and Sasan- Reliance Power) and 19 Super Critical Power Projects in India.

Shift to non power segment

Company is in the process of diversifying its product mix to non power segments like civil, electrical, railway etc. The company has reduced its power mix from 77% of revenue in the beginning of FY19 to 59% in 9MFY20. It further plans to bring down the mix of power to 40% and increase non power to 60%. Major focus in non power orders will be on civil side including railways, water, petro chemical etc. This diversification has helped the company to gain new orders recently. Company plans for a revenue mix of 35% from O&M, 10% from railway, 15% from power, 15% from international, 5%-8% from electrical and remaining from other civil orders.

Working capital, a key factor to be watched

Company has reported decline in cash generation from operating activities from FY19 and a negative cash during FY20. It has resulted in a significant increase in debt level from FY20. Lower revenue recognition and increased receivables resulted in this working capital stress. However, the company has generated positive operating cash flow of Rs.52Cr as on Q3FY20. The improvement in working capital cycle will be a key factor to be watched.

Back in track from covid uncertainties

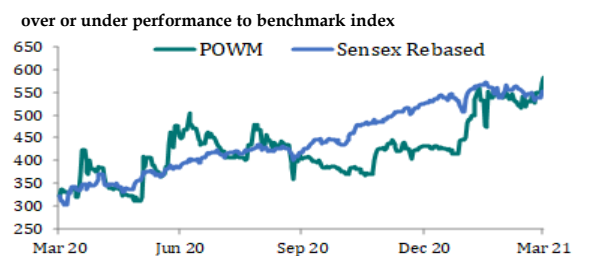
PowerMech Projects being a highly labour intensive business, were badly affected by the lockdown and restrictions in movement. All major projects were kept on hold. However, O&M projects stood as an exemption and contributed to the revenue generation. During Q1FY21, project executions were at 56% with O&M at 85% and other businesses at 45%. However, execution reached 100% level from December 2020 and expect to have a full fledged quarter from Q4FY21.

Valuation and Outlook

With strong order inflow, diversification to non power segment and increased focus in O&M segment, we expect the company to be in its growth trajectory from Q4FY21 as company reached full execution level in December. At current levels, the stock is available at a bargain. Considering these factors, we initiate coverage on Power Mech Projects with a BUY rating based on 6x FY23E earnings with a target price of Rs.727.

Company Data			
Market Cap (cr)	Rs.860		
Enterprise Value (cr)	Rs.1,285		
Outstanding Shares (cr)	1.5		
Free Float (%)	37.4		
Dividend Yield (%)	0.2		
52 week high	Rs.585		
52 week low	Rs.310		
6m average volume (cr)	0.01		
Beta	1.05		
Face value	Rs.10		
Shareholding (%)	Q1FY21	Q2FY21	Q3FY21
Promoters	62.6	62.6	63.1
FII's	2.9	2.7	2.7
MFs/Insti	11.2	10.0	9.8
Public	23.3	24.8	24.4
Total	100.0	100.0	100.0
Promoter Pledge	0.0	0.0	0.0

Price Performance	3 Month	6 Month	1 Year
Absolute Return	34.9%	43.8%	80.4%
Absolute Sensex	4.0%	28.3%	68.5%
Relative Return*	30.9%	15.5%	11.9%



Consolidated (cr)	FY21E	FY22E	FY23E
Sales	1,732	2,524	2,913
Growth (%)	-20.0	45.7	15.4
EBITDA	26	260	340
EBITDA Margins %	1.5	10.3	11.7
PAT Adj.	-58	115	178
Growth (%)	-145	-298	55
Adj.EPS	-46	91	142
Growth (%)	-	-	55%
P/E	-12.6	6.4	4.1
P/B	1.0	0.9	0.7
EV/EBITDA	46.8	4.5	3.2
ROE (%)	-6.3	12.1	16.3
D/E	0.6	0.4	0.3

Cyril Charly
Research Analyst

About the Company



POWER MECH PROJECTS LTD

Incorporation Year	1999
Promoter	S. Kishore Babu
Location	Hyderabad
Business Segments	Erection, Testing & Commissioning Civil & Construction Operations and Maintenance Electrical
Key Strengths	Track record of 21 years Largest O&M service provider with 520 contracts so far Engaged in 64,000 MW ETC works so far 2 ultra-mega power plants and 19 super critical power projects executed
Major Clients	NTPC, BHEL, Reliance Power, Siemens, L&T, Adani Power, Tata Power, Doosan etc.
Current Order Backlog	Rs.7353 Cr (as on 16th Feb, 2021)
Key Personnel	S. Kishore Babu- CMD S. Kodandaramaiah- Director, Business Development M. Rajendran- COO J. Satish- CFO

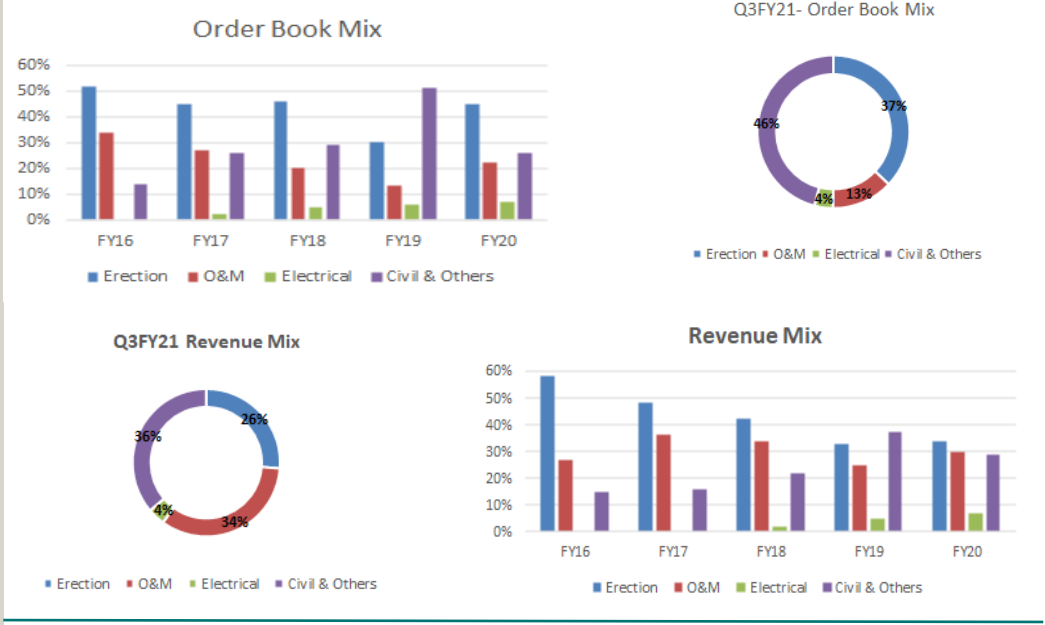
Business Segments

Erection	Civil	O&M	Electrical
Ultra Mega, Super Critical, Sub Critical & Combined Cycle Power Projects	Power Plants, Railway, Industrial Projects etc.	Overhauling and Maintenance of Boiler, Turbine & Auxiliaries	Extra High Voltage Substation Works
Nuclear, Refinery & Petro Chemicals, Steel Plant, Oil Pipe Line & Cement	Foundation, Decks, Plant Buildings, Chimney & Cooling Towers	Repair, Modification and Rehabilitation of Boiler	Construction of 33/11 Kv Substations and Strengthening of existing Substations
Erection, Testing & Commissioning of BTG (Boiler Turbine and Generator & BOP (Balance of Plant)	Minor & Major Bridges, Industrial Buildings, Track Linking	Coal Handling Plant, BOP packages, Rebuilds & Plant Relocation	Construction of 33 Kv & 11 Kv Lines, Construction of Transmission of Lines, Optical Fiber Networks

International Presence

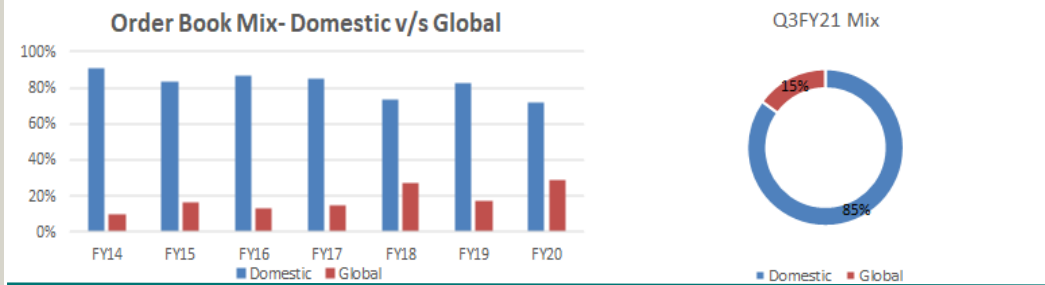


Segment wise mix



Source: Company, Geojit Research.

As of Q3FY21, PowerMech has an order backlog of Rs.6,284Cr with civil work constituting 46%, erection 37%, O&M 13% and electrical 4%. Company targets to keep mix at Erection- 25%, O&M-25%, Civil-20-22%, International 20% and rest in Electrical segment. Current revenue mix stands at Erection-26%, O&M 34%, Civil 36% and Electrical 4%. As of Q3FY21, order book constitutes 85% of domestic orders and 15% of International orders. Order book mix from power segment is at 59% whereas non power is 39%. Order backlog as on 16th Feb,2021 stands at Rs.7,353Cr.



Source: Company, Geojit Research.

Industry Outlook



Source: Ministry of Power



Growth in power generation in India

Year	Generation (Billion Units)	Growth %	Deficit in production (%)
2012-13	969.5	4.46	8.7
2013-14	1020.2	5.23	4.2
2014-15	1110.4	8.84	3.6
2015-16	1173.6	5.69	2.1
2016-17	1241.7	5.80	0.7
2017-18	1308.1	5.35	0.7
2018-19	1376.1	5.19	0.6
2019-20	1389.1	0.95	0.5
2020-21(Till Feb)	1249.8	-2.49	0.4

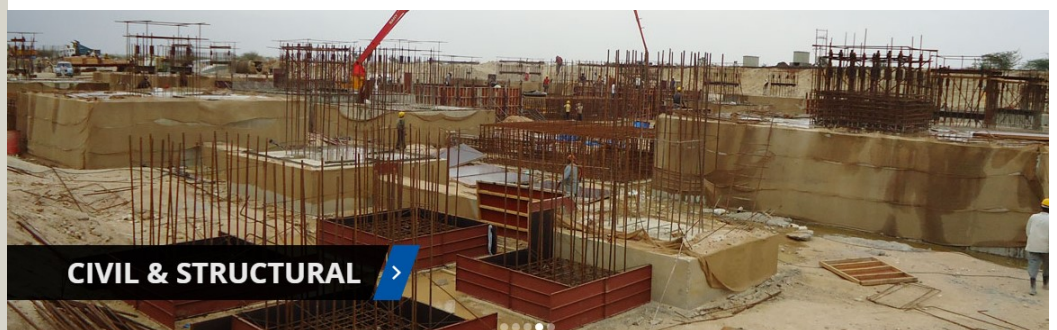
Source: Ministry of Power

India is the 3rd largest producer and 2nd largest consumer of electricity in the world with an installed capacity of 374.2GW as on November 2020. Per capita consumption is expected to be at 1,894.7 TWh by 2022 and current annual demand outstrips supply by about 7.5%. India's power segment is estimated to attract investment worth Rs.9-9.5 Tn (USD 128.24-135.37 Bn) between FY19-23. Total FDI inflow in the sector reached USD 15.23 Bn between April 2000 and June 2020. As per the Economic Survey 2019-20, energy sector projects accounted for the highest share (24%) in the Rs. 111 lakh crore (US\$ 1.4 trillion) in National Infrastructure Pipeline between 2019- 20 and 2024-25. NTPC, India's largest power utility with a capacity of 62,918 MW has plans to become a 130GW company by 2032.

Key Projects of PowerMech

Name of Project	Segment	Actual Order Size	% completion
BHEL		101.49	18
NHIDCL. Karnataka		55.51	-
BHOPAL	Civil	47.7	8
NHIDCL. Mizoram		44.6	-
Ramayampet Canal - Irrigation		37.3	28
BHEL		168.6	41
Engineers India Ltd		50.9	60
JSW Steel	ETC	39.4	40
Doosan		32.5	62
GE & Abener		23.6	91
Nigrie		13.9	14
CGPL		11.9	68
Raichur	O&M	10.9	11
TBSL Angul		7.34	-
Jhabua		6.8	18
Sadulpur		34.9	38
Railvikas Nigam	Electrical	30.3	91
Power Grid Coporation		15.4	44

Source: Company, Geojit Research.



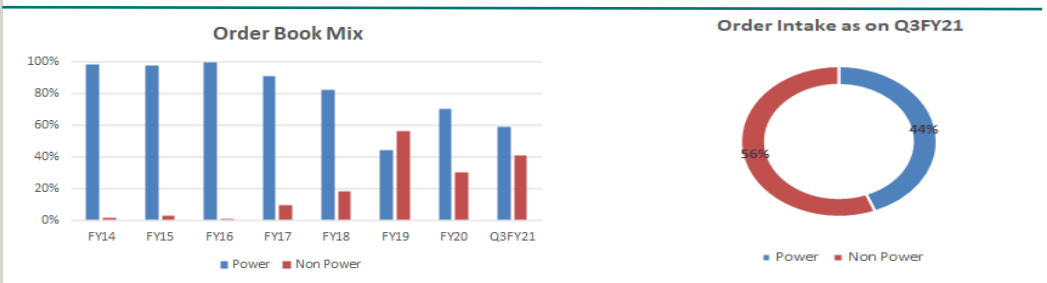
Rationale for Investing

Leading player in Power O&M and Erection business

Company is the leading player in Indian power O&M segment with 55-60% market share and in power erection segment with about 60% market share. Current order backlog in O&M segment Rs.992Cr and Erection segment at Rs.2,463Cr. Company has so far engaged in 520 O&M contracts since the commencement of O&M business. Power Mech has been focusing on O&M orders and expect good order intake in the coming quarters. Concentration on O&M projects that enjoys higher margins will help company to improve its EBITDA margin going forward. Company aims to have a revenue mix of 35% from O&M projects and 10-15% from erection business.

Diversification to Non Power

Company has diversified its portfolio to Non power segments resulting in an uptick in the order inflow. Order book as on 13th November 2020 consist of 59% power orders and 41% non power orders compared to 70% power and 30% non power as on FY20. Recent improvement in non power order book is due to higher order inflow in non power segment during H1FY20.



Source: Company, Geojit Research.

Healthy Margins

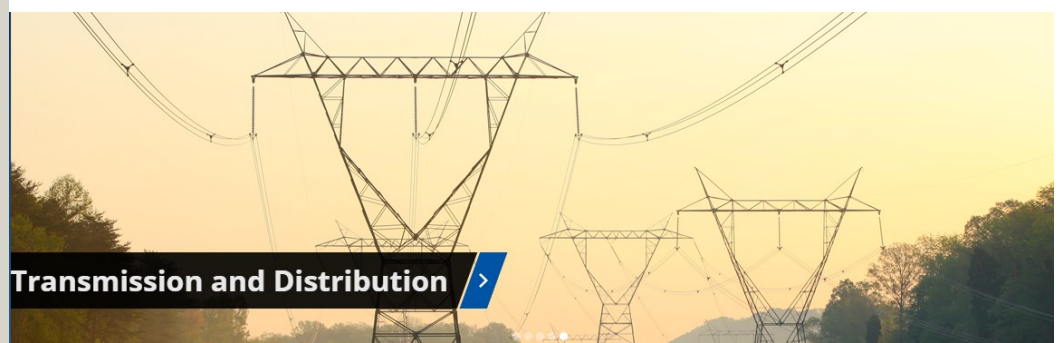
Company enjoys healthy EBITDA margin of 13%-13.5% and PAT margin in the range of 5.5% to 6.0%. Segment wise, O&M projects enjoy highest margin of about 18%, Erection projects at 13%, Civil and Electrical projects at 10-11%. Company is focusing on improving the margins by increasing the mix of O&M projects.

Segment	FY20 Mix (%)	Target Mix (%)	Margin Range(%)
Erection	34	15-20	13
Civil	28	30-35	10-12
O&M	30	35-40	18
Electrical	8	5-8	10-11

Source: Company, Geojit Research.

Labor Intensive Projects

The company which is in construction field has a labor intensive business model. Company has a total labour strength of about 18,700 employees including 8,700 direct labors and 12,000 indirect labors. Due to the higher dependence on labor, company had faced severe stress in project execution during lockdown due to restrictions in movement and temporary closure of work resulting in a weaker quarter during 9MFY21. However, as the country moved to unlock stage, progress was seen in execution and company expects to reach full execution level by Q4FY21.

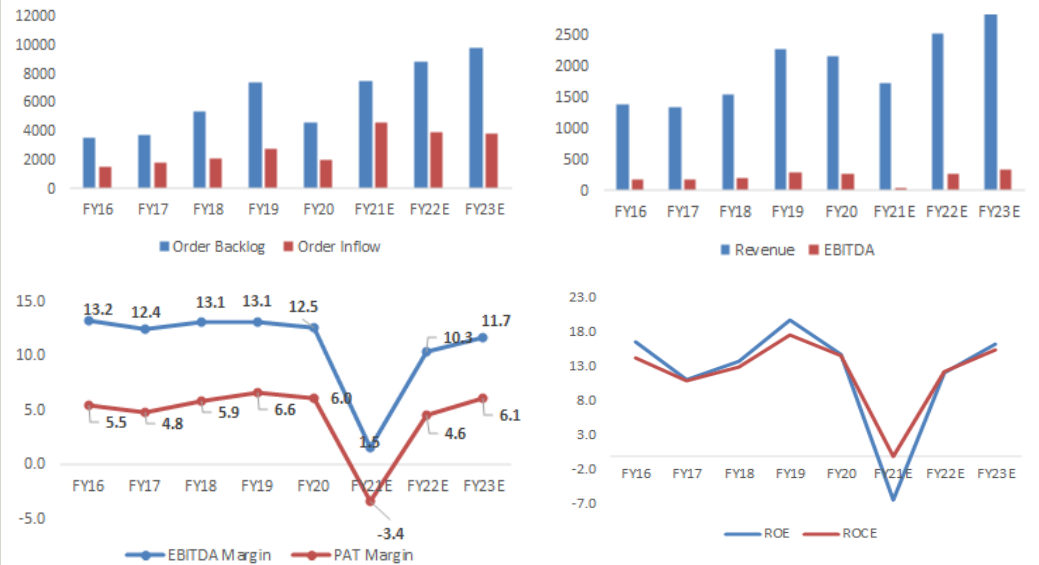


Covid Impact

PowerMech Projects being a highly labour intensive business, were badly affected by the lockdown and restrictions in movement. All major projects were kept on hold. However, O&M projects stood as an exemption and contributed to the revenue generation. During Q1FY21 when the restrictions were at its peak, project executions were at 56% with O&M at 85% and other businesses at 45%. As the restrictions were taken off, gradual pickup in the execution level were seen in Q3FY21 with over business at ~90%. Execution has reached 100% level in December witnessing revenue generation of more than Rs.200Cr. Management expects to be at 100% execution level from Q4FY21. Collections during Q1 stood at Rs.110-130 Cr/month while it improved to Rs.175-200 Cr/month in Q3. Management expects collections to normalize from Q4FY21

Financials

Strong order inflows to support revenue growth

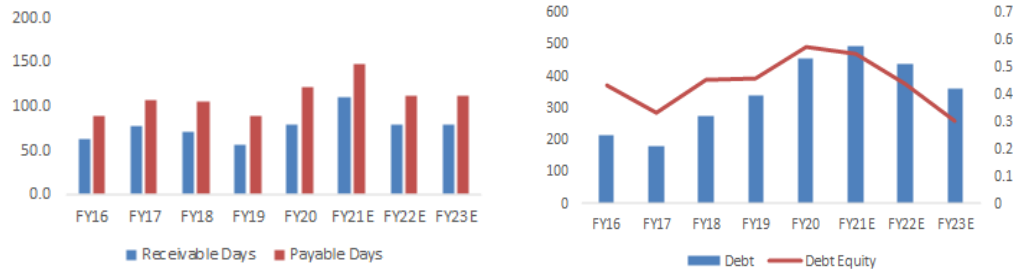


Source: Company, Geojit Research.

During the period FY16-FY20, revenue grew at a CAGR of 12% whereas PAT grew at 15%. Strong order intake during the period contributed to the revenue growth. Cancellation of project worth Rs.2,112Cr from Govt. of Andhra which was on hold impacted the order book size in FY20. However, company with its increased focus in O&M and Civil space is confident to have a strong order inflow in coming years. We expect order book to grow at 14% during FY20-23E and revenue at 30% during the same period. Increased focus on O&M orders will help company to have a consistent revenue flow for a longer period along with higher margins. ROE for FY20 stands at 14.8% against 19.7%, partially offset due to the impact of lockdown in the end of March 2020. We expect ROE to be at 16.3% and ROCE to be 15.3% by FY23.



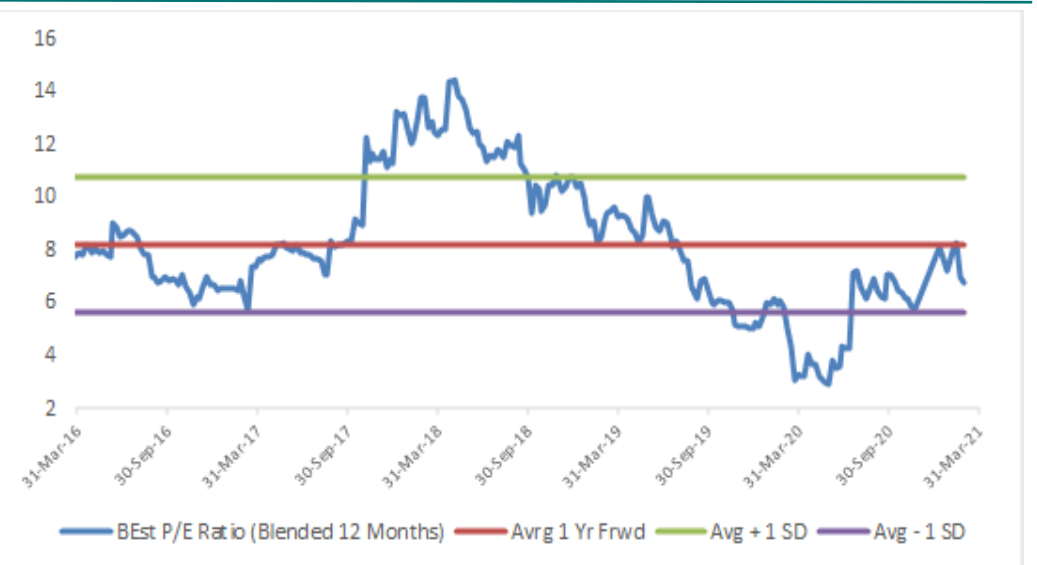
Stress in working capital seen in FY19-20



Source: Company, Geojit Research.

Company has reported decline in cash generation from operating activities from FY19 and a negative cash during FY20. It has resulted in a significant increase in debt level from FY20. Lower revenue recognition and increased receivables resulted in this working capital stress. Although the current levels doesn't add much concern, the improvement in working capital cycle will be a key factor to be looked upon. As of Q3FY21, company has generated operating cash flow of Rs.52Cr. Company currently has a long pending receivable for a project executed for Andhra government and the current receivable from the project stands at Rs.50Cr. We expect debt to remain elevated in FY21, however, expect it to improve in FY22-23.

Valuations



Source: Bloomberg, Geojit Research.

Company reported a flattish growth in revenue generation during FY15-17 with a CAGR growth of -1% which resulted in a correction in valuation from 11x in the beginning of FY17 to 6x during FY18. However, company's diversification strategy to focus more on non-power orders, especially in the civil segment helped company to gain traction in order intake and resultantly in revenue generation. Company was able to grow at a CAGR rate of 17.4% during FY17-20 due to its healthy order backlog. Higher concentration in O&M business also helped company to improve its margins and enjoys the market leadership position in the segment. We expect revenue to grow at a CAGR rate of 12% over FY20-23 backed by strong order intake and increased focus on non-power segments. During Covid lockdown, the business of the company was impacted negatively due to its labour intensive business model. Overall business were at 45% efficiency during Q1FY21 and it gradually improved to ~90% efficiency during Q3FY21. Company expects to reach full efficiency by Q4FY21. With strong order inflow, diversification to non power segment and increased focus in O&M segment, we expect the company to be in its growth trajectory from Q4FY21 once company reached full execution level. Considering these factors, we initiate coverage on Power Mech Projects with a BUY rating based on 6x FY23E earnings with a target price of Rs. 727.



Consolidated Financials

PROFIT & LOSS

Y.E March (Rs Cr)	FY19A	FY20A	FY21E	FY22E	FY23E
Sales	2261	2165	1732	2524	2913
% change	46.1	-4.3	-20.0	45.7	15.4
EBITDA	297	271	26	260	340
% change	47	-9	-90	893	31
Depreciation	46	39	38	41	45
EBIT	251	231	-12	219	294
Interest	55	74	78	77	68
Other Income	14	9	15	11	11
PBT	210	167	-75	152	237
% change	61	-21	-145	-304	56
Tax	62	37	-19	39	61
Tax Rate (%)	30%	22%	26%	26%	26%
Reported PAT	149	131	-58	115	178
Adj.*	0	0	0	0	0
Adj. PAT	149	131	-58	115	178
% change	65	-13	-145	-298	55
No. of shares (cr)	1.5	1.5	1.5	1.5	1.5
Adj EPS (Rs)	119	104	-46	91	142
% change	65%	-13%	-145%	-298%	55%
DPS (Rs)	1	1	0	1	1

BALANCE SHEET

Y.E March (Rs Cr)	FY19A	FY20A	FY21E	FY22E	FY23E
Cash	88	75	68	55	83
Accounts Receivable	389	542	502	592	672
Inventories	93	126	168	145	148
Other Cur. Assets	848	1067	1186	1273	1360
Investments	31	33	25	25	25
Gross Fixed Assets	340	355	365	385	405
Net Fixed Assets	187	176	148	130	113
CWIP	3	3	3	3	3
Intangible Assets	3	3	3	3	3
Def. Tax (Net)	6	8	32	6	6
Other Assets	280	285	299	329	362
Total Assets	1928	2327	2434	2560	2773
Current Liabilities	739	901	1024	1083	1199
Provisions	3	5	4	6	6
Debt Funds	336	455	491	438	358
Other Liabilities	30	14	22	27	27
Equity Capital	15	15	15	15	15
Reserves & Surplus	805	936	878	992	1169
Shareholder's Fund	819	951	893	1007	1183
Total Liabilities	1928	2327	2434	2560	2773
BVPS	557	647	607	684	804

CASH FLOW

Y.E March (Rs Cr)	FY19A	FY20A	FY21E	FY22E	FY23E
Net inc. + Deprn.	195	170	-20	156	224
Non-cash adj.	7	34	78	77	68
Changes in W.C	-195	-252	3	-125	-97
C.F-Operation	8	-48	61	108	195
Capital exp.	-27	-27	-10	-20	-20
Change in inv.	-19	0	8	0	0
Other invest.CF	-18	30	0	0	0
C.F - investment	-63	3	-26	7	-20
Issue of equity	0	0	0	0	0
Issue/repay debt	27	63	-42	-130	-148
Dividends paid	-18	-18	0	15	15
Other finance.CF	0	-2	0	0	0
C.F - Finance	25	59	-42	-128	-146
Chg. in cash	-30	14	-7	-13	28
Closing cash	22	30	68	55	83

RATIOS

Y.E March	FY19A	FY20A	FY21E	FY22E	FY23E
Profitab. & Return					
EBITDA margin (%)	13.1	12.5	1.5	10.3	11.7
EBIT margin (%)	11.1	10.7	-0.7	8.7	10.1
Net profit mgn.(%)	6.6	6.0	-3.4	4.6	6.1
ROE (%)	19.7	14.8	-6.3	12.1	16.3
ROCE (%)	17.6	14.6	0.0	12.2	15.3
W.C & Liquidity					
Receivables (days)	56.3	78.5	110.0	79.1	79.2
Inventory (days)	11.3	18.5	31.0	22.7	18.4
Payables (days)	89.0	120.8	146.5	111.3	111.7
Current ratio (x)	1.9	2.0	1.9	1.9	1.9
Quick ratio (x)	0.5	0.6	0.6	0.6	0.6
Turnover					
Gross asset T.O (x)	6.9	6.2	4.8	6.7	7.4
Total asset T.O (x)	1.3	1.0	0.7	1.0	1.1
Int. covge. ratio (x)	4.6	3.1	-0.1	2.9	4.3
Adj. debt/equity (x)	0.5	0.6	0.6	0.4	0.3
Valuation					
EV/Sales (x)	0.4	0.5	0.7	0.5	0.4
EV/EBITDA (x)	3.0	3.7	46.8	4.5	3.2
P/E (x)	3.6	4.1	-12.6	6.4	4.1
P/BV (x)	0.8	0.7	1.0	0.9	0.7

Recommendation Summary



Source: Bloomberg, Geojit Research.

Investment Rating Criteria

Ratings	Large caps	Midcaps	Small caps
Buy	Upside is above 10%	Upside is above 15%	Upside is above 20%
Accumulate	-	Upside is between 10% - 15%	Upside is between 10% - 20%
Hold	Upside is between 0% - 10%	Upside is between 0% - 10%	Upside is between 0% - 10%
Reduce/sell	Downside is more than 0%	Downside is more than 0%	Downside is more than 0%
Not rated	-	-	-

Definition:

Buy: Acquire at Current Market Price (CMP), with the target mentioned in the research note.

Accumulate: Partial buying or to accumulate as CMP dips in the future.

Hold: Hold the stock with the expected target mentioned in the note.

Reduce: Reduce your exposure to the stock due to limited upside.

Sell: Exit from the stock.

Not rated : The analyst has no investment opinion on the stock.

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

The recommendations are based on 12 month horizon, unless otherwise specified. The investment ratings are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term, there could be a temporary mismatch to rating. For reasons of valuations/return/lack of clarity/event we may revisit rating at appropriate time. Please note that the stock always carries the risk of being upgraded to BUY or downgraded to a HOLD, REDUCE or SELL.

General Disclosures and Disclaimers

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