Power Mech Projects Ltd. (PML). : "SUBSCRIBE " 6th August, 2015

Power Mech, incorporated in 1999, founded by Mr Kishore Babu, (a first generation entrepreneur) is one of the leading integrated power infrastructure services companies in India providing comprehensive erection, testing and commissioning of boilers, turbines and generators ("ETC-BTG") and balance of plant ("BOP") works, civil works and operation and maintenance (O&M) services. Power Mech's operations include three principal business lines: (i) Erection Works; (ii) Operation & Maintenance (O&M) Services; and (iii) Civil Works.

Established track record - The company has a established track record of successfully executing ETC –BTG and BOP contracts for large power projects including for 800MW unit capacity super – critical projects. It has been engaged on ETC-BTG 134 projects for the first two ultra-mega power projects in India as well as for 16 super-critical power projects in India as of June 30, 2015. PML has carried out the overhauling of a super-critical 660 MW turbine and provided AMC services for an ultra-mega power project. According to the Central Electricity Authority, the aggregate thermal power plant capacity addition in India was approximately 88,048 MW during FY11-15. In the same period, PML was engaged on ETC-BTG and BOP Works aggregating 33,801 MW. In fiscal 2015, PML executed Erection Works contracts of aggregate tonnage of approximately 355,000 metric tones. Since commencement of the O&M business in 1999, PML has been engaged on more than 400 O&M contracts and 23 AMC services contracts for power plants with an aggregate unit capacity of 32,835 MW. In addition to operations in India, it has also executed various international power projects in the Middle East, North Africa, South Asia and South America.

Large order book – PML's aggregate Order Book as of March 31, 2015 was Rs. 34,062.68 million, comprising Order Book in the Erection Works, O&M Services and Civil Works businesses of Rs. 23,028.66 million, Rs. 5,904.28 million and Rs.5,129.74 million, respectively.

Long term relationship with clients – PML has developed long term relationships with various Indian and international power utilities, governmental organizations and other power sector intermediaries. These clients include public sector undertakings and private sector clients. It has also established strong relationships with large EPC companies that operate in the power sector as well as other infrastructure and allied sectors. PML significant clients include BHEL, NTPC, Doosan Power Systems India Private Limited, Adani Power Limited, Larsen & Toubro Limited-Thermal Power Plant Construction BU, Thermal Powertech Corporation India Limited, GE Power Services (India) Private Limited, CLP India Private Limited, BGR Energy Systems Limited, Thermax, Siemens etc.

Strong Financial Performance - The company has reported robust total revenue CAGR of 29.07% and a decent profit after tax (PAT) CAGR of 17.38% over FY2011-15.

Outlook, Valuation and Recommendation -
At the upper band of the issue price, PML is valued at 11x at FY15 Pre Issue EPS of Rs. 57.5 and 13x at post issue FY15EPS of 48.5. With due consideration to factors like a) integrated power infrastructure services provider, b) established track record with strong execution capabilities, c) diversified and marquee client base, d) strong past financial performance with strong return ratios and historical trend of positive cashflow, e) favorable capital structure, we believe the Company's valuation is fairly priced as compared to its peer BGR Energy Systems (PML has a better return profile compared to BGR with FY15 ROE of 20.13% (vs 2.29%). we recommend "SUBSCRIBE" to the issue.

Issue date	August 07- 09, 2015
Issue size	Rs. 2732.2 mn at upper end of the price band
Face Value	Rs.10
Price Band	Rs. 615 - 640 per share
Lot size	20 equity Shares and in multiples thereof
Issue structure	QIB: 50%, Retail: 35% Non – Institutional: 15%
Type of issue	Offer for sale: 2.14 mn shares Fresh issue: 2.12 mn shares
Equity shares post issue	14.7 mn equity shares
Post issue market cap.	Rs. 9,408 mn at upper price band
Book Running Lead Managers	Kotak, IIFL and Motilal Oswal Investment Advisors
Registrar to the issue	Karvy Computershare Pvt. Ltd.

Y/e 31 Mar (Rs. mn.)	FY15	FY14	FY13	FY12
Total income	13,662	12,003	9,358	7,051
Growth (%)	13.8	28.3	32.7	43.4
EBITDA	1,728	1,662	1,268	1,175
EBITDA Margin (%)	12.6	13.8	13.5	16.6
Reported PAT	714	1,067	512	524
PAT margin (%)	5.2	5.6	5.4	7.4
Post issue EPS (Rs.)	57.5	54.7	40.7	41.6
Equity Capital	125.83	109.4	107.53	107.53
Networth	3,547.2	2,736.1	2,043.2	1,544.4
RoE (%)	20.1	23.9	23.4	33.9

Shareholding Pattern (%)	Pre Issue	Post Issue
Promoters group	75.7	64.75
India Business Excellence Fund I	14.92	1.28
India Business Excellence Fund	4.97	1.27
Others	4.41	-
Public	-	32.7
Total	100	100

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Objects of the issue

1) The funds from the Offer for sale (net of issue related expenses for the Selling Shareholders) shall be received by the Selling Shareholders and PML shall not receive any proceeds from the Offer for sale.
2) Objects of the fresh issue:
   a) Funding working capital requirements
   b) General Corporate Purposes

Business Strategy

Consolidate leadership position in power infrastructure services sector in India
PML continues to consolidate its leadership position as an integrated infrastructure services provider particularly focused on the power sector in India by strategically expanding its service offerings and targeting higher margin thermal and hydropower contracts where it hase a competitive advantage as a result of its superior technical capabilities, track record and experience. The Company continues to focus on potential projects and service offerings, including longer term AMC contracts, where it believes it can be competitive and improveprofitability. In addition to the wide range of its service offerings, it continues to focus on developing integrated and comprehensive O&M solutions and have in this regard entered into a joint venture agreement with Chengdu to set up a joint venture entity in Hong Kong for manufacturing and distribution of equipment and spare parts, including boilers, turbines and generators, for O&M projects in India. PML is in the process of setting up a large heavy engineering facility at Noida for non-critical equipment and spare parts. It also has a Cooperation Agreement with Shanghai Electric Power Generation Service Co. with respect to repair and overhauling contracts in the power sector in India. In addition to its extensive experience on thermal power projects in India, PML through its subsidiary Hydro Magus increased its strategic focus on providing renovation, modernization, upgradation and installation services for hydropower projects, including re-engineering of highefficiency turbine runners and hydro-generators as well as the design, supply, erection, testing andcommissioning of hydro-turbines and hydro-generators. PML continues to explore strategic partnerships with international equipment suppliers for hydropower projects to jointly bid for new hydropower projects as well as renovation and maintenance works for hydropower projects.

In selecting contractors for major projects, clients generally limit the tender to contractors (or sub-contractors) they have pre-qualified based on several criteria including experience, technical and technological capacity, previous performance, reputation for quality, safety record, the financial strength of the bidder as well as its ability to provide performance guarantees. The Company continues to focus on further developing its pre-qualification status through client development efforts and entering into strategic joint partnerships and pre-bid arrangements with other service providers. PML also continue to evaluate strategic consortium opportunities with large EPC companies, including international infrastructure service providers, with the resources, skills and strategies complementary to PML and likely to enhance its business opportunities.

Expand its international business
Historically although most of its revenues has been from projects executed in India, PML has also executed several international power projects in the Middle East, North Africa, South Asia and South America. In fiscal 2014, revenue from projects executed outside India was Rs.763.13 million, representing 6.43% of its Company's total revenues from operations (on a standalone basis) in such period. In fiscal 2015, revenue from projects executed outside India was Rs. 844.72 million, representing 6.23% of the Company's total revenues from operations (on a standalone basis) in such period. PML continues to focus on identifying opportunities to bid for and win international projects, including through strategic partnerships with large EPC contractors and power utilities. The Company intends to leverage its experience and track record of working on complex power projects in India to increase its operations internationally, particularly in the Middle East, North Africa and South Asia. The Company has recently bid for projects in Bangladesh as well as in the Middle East and North Africa. It also continues to actively evaluate opportunities to bid for projects in Sri Lanka, Central Asia and South East Asia.

Diversify into allied infrastructure sectors
The company plans to leverage its construction capabilities and strong track record and experience in ETC- BTG and BOP works, civil and structural works and O&M services in the power sector to strategically diversify into other infrastructure and allied sectors including the petrochemicals, steel and cement industries. Diversifying service offerings into other infrastructure and allied sectors will enable the Company to further grow its business operations, reduce the risk of dependency on the power sector and strategically target higher margin opportunities.

Further grow its O&M services offerings and focus on higher margin AMC services

PML believes that the significant increase in capacity addition of IPP projects in India and the aging of several large power plants in India will result in a significant increase in demand for its O&M Services business, particularly opportunities for AMCs as well as contracts for repairs, renovation and modernisation, residual life assessment, scheduled shutdowns, retro-fits, overhauling, maintenance and upgradation services for power plants. Revenues under O&M division has increased from Rs. 424 million in FY12 to Rs. 2,765 million in FY15, thereby increasing its share of overall revenues from 6.02%to 20.24% over the same period. PML has experienced a significant growth in its O&M Services business in recent years which grew at a CAGR of 59.76% between fiscal 2011 and fiscal 2015. PML expects the relative proportion of revenue from O&M Services to increase in the future. In addition, the level of competition for O&M contracts is relatively lower than the Erection Works projects it bids for as large EPC contractors do not typically bid for such contracts and smaller engineering construction companies that compete with PML have limited technical and financial resources. Further it carried out its first AMC project in 2004 and its revenue from AMC services was Rs.47.93 million, Rs.208.53 million, Rs. 595.16 million and Rs. 1,541.73 million in fiscal 2012, 2013, 2014 and 2015, respectively. PML expects the relative proportion of its revenues from the O&M Services business to significantly increase in future as it increases its focus on relatively higher margin O&M contracts, particularly AMCs.

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Key risks and concerns

Order Book does not represent future revenues and its actual income may be significantly less than the estimates reflected in Order Book, which could adversely affect results of operations.

Order Book calculation may vary across industries and companies, and the manner in which the Company calculates its Order Book may be subjective and vary from that followed by other companies including its competitors. PML's Order Book as of a particular date comprises estimated revenues from (i) the unexecuted portions of existing contracts as of such date; (ii) contracts for which definitive agreements have been executed; and (iii) contracts for which letters of intent/ award have been issued by the client, although definitive agreements have not yet been executed as of such date. PML's Order Book includes estimated revenues from certain contracts that it has identified as suspended projects, i.e. contracts on which no operations have been conducted for a period exceeding six months resulting from factors beyond its control. The portion of the work that has been completed, but awaiting certification by the customer, is recognized as unbilled revenue. However, any claims, variations and incentives are recognized as revenue only on certification or confirmation by the customer. PML's estimated Order Book as of March 31, 2015 was Rs. 34,062.68 million, including Rs. 1,896.68 million of OrderBook related to projects that have been suspended for more than six months.

Order Book does not necessarily indicate future earnings related to the performance of that work, as cancellations or unanticipated variations or scope or schedule adjustments may occur. Due to changes in project scope and schedule, PML cannot predict with certainty when or if contracts in its Order Book will be performed. In addition, even where a project proceeds as scheduled, it is possible that contracting parties may default and fail to make the payments due. The Company cannot guarantee that the income anticipated in the Order Book will be realized, or, if realized, will be realized on time or result in profits. Any project cancellations or scope adjustments, which may occur from time to time, could reduce the amount of its Order Book and the income and profits that it ultimately earn from the contracts. Any delay, cancellation or payment default could have a material adverse effect on its business. For some of the contracts in Order Book, its clients are obliged to perform or take certain actions, such as acquiring land, securing the right of way, clearing forests, providing owner supplied material, securing required licenses, authorizations or permits, making advance payments or opening of letters of credit, approving designs, approving supply chain vendors and shifting existing utilities. If a client does not perform such actions in a timely manner, and the possibility of such failure is not provided for in the contract, PML's projects could be delayed, modified or cancelled. Accordingly, the realization of its Order Book and the effect on its results of operations may vary significantly from reporting period to reporting period depending on the nature of such contracts, actual performance of such contracts, as well as the stage of completion of such contracts as of the relevant reporting date as it is impacted by applicable accounting principles affecting revenue and cost recognition. In addition, other than relatively stable revenues from its AMCs, there can be no assurance regarding the period in which such Order Book will be realized. The composition of its Order Book also affects anticipated operating margins relating to such contracts. Furthermore, there are various risks associated with the execution of large-scale projects particularly in the case of Ultra Mega Power Projects ("UMPPs"). Larger contracts may represent a larger part of its portfolio, increasing the potential volatility of its results and exposure to individual contract risks. Managing large-scale projects including UMPPs may also increase the potential relative size of cost overruns and negatively affect its operating margins. The Company believes that its contract portfolio will continue to be relatively concentrated and if it does not achieve expected margins or suffer losses on one or more of these large contracts, this could have a material adverse effect on the results of operations and financial condition.

Company is exposed to time and cost overrun risks on its lump-sum price and item rate contracts, resulting in reduced profits or losses.

Although some of its projects are cost-reimbursable contracts that allocate the risk of time and cost overruns to its clients, a significant proportion of its contracts are lump-sum or item rate contracts where PML bears the risk of time and cost overruns unless contractually excluded under certain circumstances such as changes in scope of work. In the Erection Works business, most of its gas and steam turbine contracts are lump-sum contracts while most contracts in O&M business, other than AMCs, are usually a combination of lump-sum and item rate contracts. PML's expenditure in executing a lump-sum contract may vary substantially from the assumptions underlying its bid for several reasons, including unanticipated changes in engineering design of the project, unanticipated increases in the cost of equipment, material or manpower, delays associated with the delivery of equipment and materials to the project site, unforeseen construction conditions, including inability of the client to obtain requisite environmental and other approvals, delays caused by local weather conditions and suppliers' or subcontractors' failure to perform.

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