

COMPANY VISIT NOTE

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MEP INFRASTRUCTURE DEVELOPERS LTD (MEP)**PRICE: Rs.38****RECOMMENDATION: NOT RATED**

MEP is an established and leading player in tolling operations in the road infrastructure sector, with a pan-India presence. It focuses on pure toll collection projects as well as OMT projects and has now ventured into Hybrid annuity projects. It has completed 95 projects, with an aggregate of 182 toll plazas and 1086 lanes, and had an overall experience of over 13 years in this business across 8 states in India. Its portfolio consists of long term and short term projects and going ahead company plans to increase the proportion of long term projects in its project portfolio. Currently, nearly 67% of revenues come from long term projects.

Till now, MEP had focused on an asset light business model by focusing on pure toll collection as well as OMT projects on operational roads constructed by third parties. Now with recent award of five hybrid annuity model projects (HAM), its business mix would change towards asset heavy projects. Along with this, company would also have revenues and margins coming from execution of these HAM projects which would be jointly done by MEP along with its JV partner.

In past 5 years, company's revenues have grown at a CAGR of 35% while it just turned profitable in FY16 led by improvement in margins and lower debt. Going ahead, we expect revenue growth would be boosted also by EPC revenues from HAM projects. With business turning profitable from FY16, its ROE and ROCE would improve as its networth would turn positive going forward.

Key highlights about the company**Asset light business model - business mix to change post execution commences for Hybrid annuity model project**

MEP's ongoing projects can be classified into three types - (i) Operate, Maintain and Transfer (OMT) (ii) Toll collection - comprising of both short term and long term toll collection (iii) Hybrid annuity projects. MEP currently has 21 operational projects-16 toll collection projects (24 toll plazas) in 8 states, 4 OMT projects (covering 2,334 lane kms and 13 toll plazas) and 1 BOT project (covering 42 lane km and 5 toll plazas). It has also recently won 5 HAM projects (4 in Maharashtra and 1 in Gujarat) in March-April 2016, covering 788.3 lane-km worth Rs 32,323.1 mn.

For OMT long term projects, no upfront payment is required to be paid to NHAI but it is to be paid for certain state projects. One of the key OMT projects of MEP is Mumbai Entry points project housed in the SPV MIPL which required an upfront payment of Rs 21 bn to MSRDC with five entry points located on Sion-Panvel highway, Western Express Highway, Eastern Express Highway, LBS marg and Airoli Bridge corridor. This project has contributed 28%/19.1%/20.6% to the overall revenues during FY14/15/16 respectively. Regarding waiver of toll at key entry points in Maharashtra, MEP sounded confident that no such decision is likely to come for its key project - Mumbai entry point as firstly it was not a part of the concession agreement and secondly, it would require huge compensation to the concessionaire which the government may not be willing to compensate.

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OMT Projects

Particulars	Madurai - Kanyakumari	Hyderabad - Bangalore	Rajiv Gandhi Sea Link	Mumbai Entry Points
Description	Four-lane carriage way located on NH-7 which is a major highway running through U.P, M.P, Maharashtra, Andhra Pradesh, Karnataka & Tamil Nadu	Four-lane carriage way located on NH-7, passes through industrial districts such as Kurnooland Anantapur in Andhra Pradesh	Links Bandra in the Western Suburbs of Mumbai with Worli in South Mumbai	Five entry points located on <ul style="list-style-type: none"> • Sion-Panvel Highway • Western Express Highway • Eastern Express Highway • Airoli Bridge Corridor in Mumbai
SPV	RTRPL	MEP HB	MEP RGSL	MIPL
Authority	NHAI	NHAI	MSRDC	MSRDC
Company's Stake	100.00%	100.00%	100.00%	99.99%
State	Tamil Nadu	Andhra Pradesh	Maharashtra	Maharashtra
Concession Commencement	September 22,2013	May 16,2013	February 6,2014	November 20,2010
Tenure	9 years	9 years	156 weeks	16 years
No. of Toll Plazas	Four	Three	One	Five
Amount Paid to Authority	Rs 1,108.7 mn for the first year of the concession period with 10% escalation every year to be paid in 12 equal monthly instalments	Rs 1,059.3 mn for the first year of the concession period with 10% escalation every year to be paid in 12 equal monthly instalments is subject to 10% escalation for second year & 20% for third year, to be paid in 12 equal monthly instalments	Rs 690 mn for first year of concession period along with an additional one time payment of Rs 5 mn. The annual payment	Upfront Payment of Rs 21,000 mn
Projects are located in major cities or on the road connecting major metropolitan cities of India				
U.P – Uttar Pradesh	NH – National Highway	M.P – Madhya Pradesh	LBS - Lal Bahadur Shastri Marg	

Source: Company

For Toll collection projects - short term as well as long term projects, company is not required to do any capex and is required to collect toll for projects which are mostly under defect liability period. During the defect liability period, the project contractor is responsible for the maintenance of the project. These short term toll collection projects provide the visibility for future pipeline of long term OMT projects. MEP currently has 16 long term and short term toll collection projects.

Long Term Toll Collection Projects

	IRDP Solapur	Vidyasagar Setu	Kini Tasawade	Rajiv Gandhi Salai	Kalyan Shilphata
Description	Located in Solapur district	18 lane toll plaza at Vidyasagar Setu, links Howrah to Kolkata	Located on Satara - Kolhapur section of NH-4	Previously known as the IT corridor	Connecting Mumbai Pune Highway (NH-4) at Shilphata & Mumbai - Nashik Highway (NH-3) at Bhiwandi
SPV	MEP Solapur	RTBPL	RTIPL	NA	NA
Authority	MSRDC	HRBC	MSRDC	ITEL	MSRDC
Company's Stake	100.00%	100.00%	100.00%	NA(*)	NA(*)
State	Maharashtra	West Bengal	Maharashtra	Tamil Nadu	Maharashtra
Concession Commencement	January 2,2013	September 1,2013	May 29,2014	March 8,2014	September 27,2013
Tenure	156 weeks- currently running on extension	5 years	104 weeks-currently running on extension	3 years	156 weeks
No. of Toll Plazas	Four	One	Two	Five	Two
Amount Paid to Authority	Rs 208 mn, to be paid in three equal annual instalments	Rs 2,610 mn to be paid in five equal annual instalments consisting of upfront payment of Rs 522 mn and payment of remaining amount in four equal instalments in advance	Rs 2,270.70 mn, to be paid in upfront monthly instalments	Rs14.62 mn for the first year with escalation of 5% per annum during each subsequent year for a period of two years	Rs 633.60mn, to be paid in upfront monthly instalments

*MEPIDL is the concession operator for the project and we are paid by the authorities for providing manpower services

Short Term Toll Collection Projects

Sr. No	Toll Plaza	State	Client	Term
1	Surajbari	Gujarat	NHAI	October12, 2015 to October12, 2016
2	Athur	Tamil Nadu	NHAI	March 26,2016 to March 25,2017
3	Paduna	Rajasthan	NHAI	May17,2016 to May 16,2017
4	Garau	Uttar Pradesh	NHAI	July 22,2015 to July 21,2016
5	Semri	Uttar Pradesh	NHAI	October28, 2015 to October 27, 2016
6	Dasna	Uttar Pradesh	NHAI	November27, 2015 to November 26,2016
7	Surjapur	West Bengal	NHAI	November27, 2015 to November 26,2016
8	Brijghat	Uttar Pradesh	NHAI	January 4, 2016 to January 3, 2017
9	Pundag	Jharkhand	NHAI	March29, 2016 to March 29, 2017
10	Lalsat Kota	Rajasthan	NHAI	April1, 2016 to March 31, 2017
11	Alwar Sikandra	Rajasthan	NHAI	April1, 2016 to March 31, 2017

Dastan in Maharashtra has been foreclosed by NHAI as on 30thApril 2016 after being operated for 5 months

Hybrid annuity projects - MEP Infrastructure (MEP) has won 5 hybrid annuity projects with a combined size of INR32bn in a JV with Sanjose India. It has also received an in-principle approval for financial closure of 2 packages. Out of these five projects, four projects are based out of Maharashtra while fifth is from Gujarat.

Hybrid Annuity Model Projects

Project Asset	Arawali Kante	Kante Wakad	Nagpur Package I	Nagpur Package II	Talaja Mahuva*
Scope of Project	Four-laning of NH66 (km 241.3 –281.3) underNHDP Phase-IV	Four-laning of NH66 (km 281-332) under NHDP Phase IV	Four-laning standalone Ring Road / Bypass (km 0.5-34.0) for Nagpur city package	Four-laning standalone Ring Road / Bypass (km 34.5-62.035) for Nagpur city package	Four laning of the Talaja-Mahuvasection of NH-8E (Km53.6-100.1)
Authority	MoRTH	MoRTH	NHAI	NHAI	NHAI
State	Maharashtra	Maharashtra	Maharashtra	Maharashtra	Gujarat
Bidder	MEPIDL – San Jose India JV	MEPIDL – San Jose India JV	MEPIDL – San Jose India JV	MEPIDL – San Jose India JV	MEPIDL – San Jose India JV
MEPIDL's Stake	74%	74%	74%	74%	60%
BidProject Cost (BPC)	Rs 5,929.8 million	Rs8,262.8 million	Rs 5,310.0 million	Rs 6,390.0 million	Rs6,430.5 million
Construction Period	2 years	2 years	2.5 years	2.5 years	2.5 years
Concession Period	15 years	15 years	15 years	15 years	15 years

* MEPIDL –Sanjose India JV recently won projects in Hybrid Annuity mode. The projects are currently in process of achieving financial closure; Sanjose India: Sanjose India Infrastructure & Construction Pvt. Ltd.

Hybrid annuity model (HAM) and challenges in the same

Government has come up with a new hybrid annuity model to improve private participation in the road sector. For FY17, MoRTH and NHAI have lined up 40% of total road projects to be awarded on HAM requiring an investment of ~ Rs 600 billion. Under HAM, 60% of the total project costs to be contributed by developer and balance 40% to be invested by the Government during construction period in five equal instalments linked to project milestones. The Government / NHAI will collect the toll under HAM model and pay the developer annuity payments over 15 years along with interest thereon (at bank rate + 3% payable on reducing balance of completion cost) as 30 bi-annual annuity payments. The developer will also receive bi-annual O&M payments. All project payments are inflation indexed. Till now, government has awarded 17 projects worth Rs 123.5 bn covering a length of 634 km.

We discussed with the company a few challenges which are still there in the Hybrid annuity model regarding -

- a) **Land acquisition** - Under HAM, government is offering 80% of prior land acquisition and forest clearance. However, land acquisition still continues to remain a challenge as the overall land cost has increased and government is taking time to acquire full 100% of the land required for the project.

- b) Banks are little reluctant to lend under HAM** - Although 40% of the project costs would be invested by Government in HAM, but it is linked to the project milestones such as first tranche to be given out of 20% EPC work is over. Banks are little reluctant to take exposure to the initial 20% capex to be funded by a mix of debt and equity.
- c) Bank rate and base rate** - Developer gets the annuity payments along with interest thereon at bank rate plus 3% payable on reducing balance of completion cost while the loans that they get from banks are given on the basis of base rate. The difference is nearly 3% and reduces the attractiveness of the project to that extent.
- d) Model is still new** - As of now, none of the projects have commenced construction and companies/lenders/bidders still have to understand how the model is going to work.

However, despite all these challenges, we believe that HAM projects would attract developers' interest in terms of lower risks related to traffic as well as lower equity requirements.

Funding required by MEP for recently awarded HAM projects

Out of the total order book of Rs 32 bn in these HAM projects, assuming D/E mix of 70/30, MEP would require an equity investment in the range of Rs 5-6 bn. It expects to fund it through internal accruals as well as fund raising through InVIT. EPC order book from these projects would form nearly Rs 28 bn excluding the interest cost during construction. MEP, with its JV partner, expects to earn 10-12% margin ie around Rs 2.8 bn in EBITDA during construction.

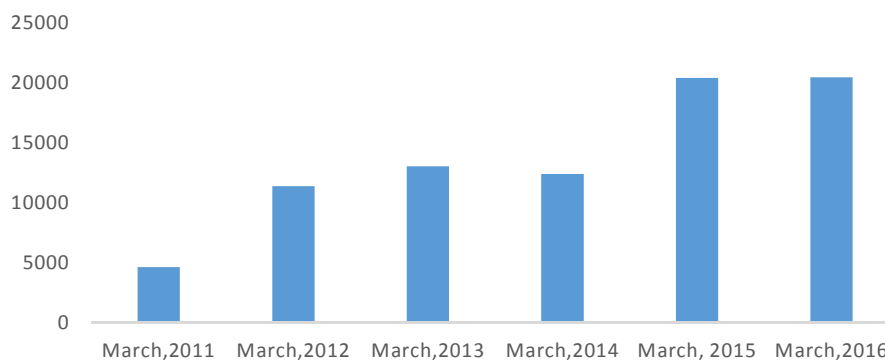
Remaining amount is expected to be raised through InVITs and thus we believe that capital raising through InVITs is crucial for timely completion of these projects without incurring any cost overruns.

Financials

In the past 5 years, MEP's consolidated revenue and operating profit grew at a CAGR of 35% and 45% respectively led higher order inflows and improvement in EBITDA margins. EBITDA margins of the company improved from 19.8% in FY11 to 29.1% in FY16. The company is targeting to increase the proportion of long term projects in its portfolio.

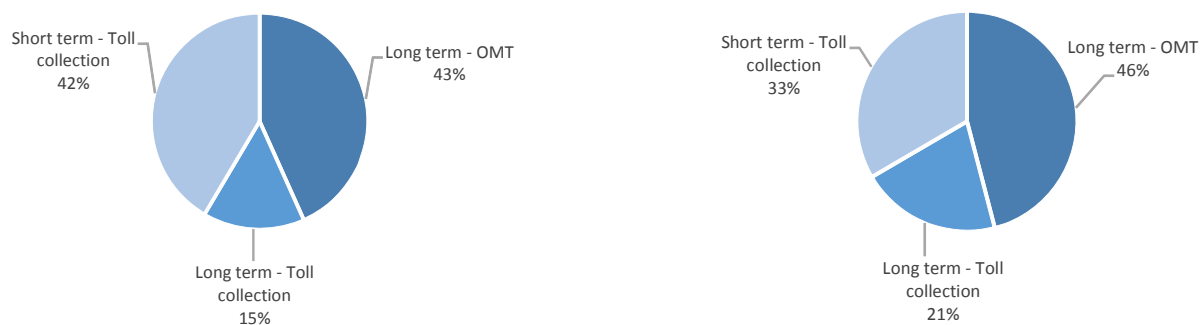
ROE/ROCE would start improving going forward once its networth would become positive. Borrowings have come down post the IPO as proceeds were utilized for repaying part of its debt.

Total Revenue (Rs mn)



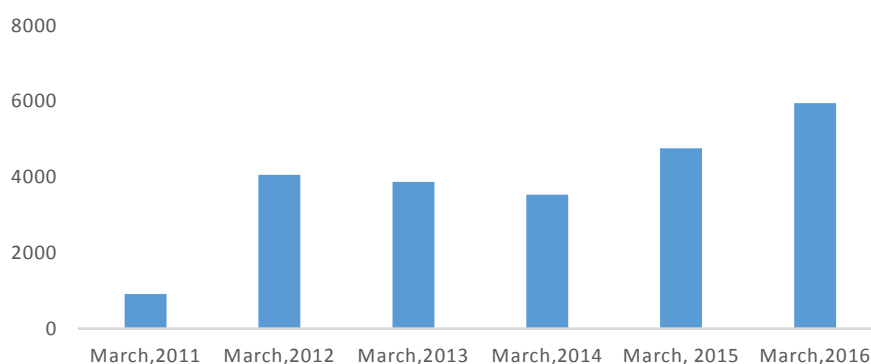
Source: Company

Revenue break up - FY15 & FY16



Source: Company

EBITDA (Rs mn)



Source: Company

Risks and concerns

- Delays in financial closure of hybrid annuity projects may result in slower growth in revenues going forward
- Delays in fund raising through InVIT or other equity issuance may impact timely completion of these projects.
- Regulation of tolls in its key operating regions
- Related party loans stand at Rs 3.6 bn which is a loan given to Ideal Toll and Infra for a power project.

Outlook

We expect MEP Infrastructure to benefit from upcoming OMT/Hybrid annuity projects in terms of higher order inflows and enhanced revenue visibility. Going ahead, execution of HAM projects is also likely to aid revenue and margin growth. We believe that its current portfolio of short term and long term toll projects is largely expected to get completed in one year while OMT projects are likely to provide revenue visibility. Long term sustainable improvement in revenues, profitability and return ratios would depend upon how company is able to scale up its HAM project execution with adequate funding as well as add new projects in its portfolio.

MEP is continuously focusing on increasing the proportion of long term projects in its portfolio and has currently an asset light business model. However, post the recent order wins in Hybrid annuity segment, we expect it to become asset heavy. Concerns may remain regarding execution of EPC due to lack of expertise in the same as well as funding of HAM projects.

Consolidated profit and loss account

(Rs mn)	March,2011	March,2012	March,2013	March,2014	March, 2015	March,2016
Revenues from operations	4,494	10,801	12,800	11,979	20,088	20,068
Other income	142	565	220	433	325	407
Total revenue	4,636	11,366	13,021	12,412	20,413	20,475
Operating and maintenance exp	3,215	6,679	8,332	8,015	14,570	13,333
Employee benefits	154	413	525	499	761	775
Other expenses	351	219	294	360	321	411
Total expense	3,720	7,311	9,151	8,874	15,652	14,519
EBITDA	916	4,055	3,870	3,538	4,761	5,956
EBITDA margin %	0	0	0	0	0	0
Depreciation and amortization	387	947	990	1,303	1,799	1,706
EBIT	529	3,108	2,880	2,235	2,962	4,250
Interest expense	1,299	3,766	3,765	3,797	4,036	3,832
EBT	(770)	(658)	(885)	(1,562)	(1,074)	418
Tax	46	(127)	45	(236)	79	154
Loss before minority interest	(815)	(531)	(929)	(1,326)	(1,153)	264
Minority interest & other adj	53	54	0	34	-	-
Loss for the year	(762)	(477)	(929)	(1,292)	(1,153)	264

Source: Company

Consolidated Balance sheet

(Rs mn)	March,2011	March,2012	March,2013	March,2014	March, 2015	March,2016
Equity and Liabilities						
Shareholder's funds						
- Share capital	113	1,000	1,000	1,000	1,115	1,626
- Reserves and surplus	98	(379)	(1,308)	(1,878)	(3,379)	(613)
Share application money	-	453	453	-	-	-
Minority interest	54	0	0	8	-	-
Non current liabilities						
- Long term borrowings	26,422	29,864	29,128	28,663	29,568	26,570
-Other long term liabilities	-	-	2	1,566	1,044	522
- Long term provision	6	9	12	15	23	31
Current liabilities						
- Short term borrowings	1,261	449	388	1,387	2,072	2,506
- Trade payables	93	241	222	1,464	2,663	3,344
- Other current liabilities	5,488	1,675	2,842	3,115	3,247	2,855
- Short term provisions	1	2	3	3	2	26
Total	33,535	33,313	32,742	35,343	36,355	36,867
Assets						
Non current assets						
- Fixed assets	22,543	22,074	21,513	23,695	21,722	20,360
- Non Current investments	940	0	30	6	216	217
- Deferred tax assets	41	286	349	756	942	1,070
- Long term loans and advances	2,135	2,660	7,027	7,519	8,934	8,983
- Other non current assets	756	753	263	219	387	412
Current assets						
- Current investments	4	28	0	0	106	-
- Trade receivables	285	45	384	287	258	-
- Cash and bank balances	608	824	1,539	1,623	1,348	1,499
- Short term loans and advances	6,206	6,519	1,579	915	1,812	3,280
- Other current assets	18	124	57	322	630	1,046
Total	33,535	33,313	32,742	35,343	36,355	36,867

Source: Company