

CMP: Rs. 167 Weight: 5%

16/02/2018



STOCK DATA

Market Cap (In Cr)	2463
Debt	278
Cash	916
Enterprise Value	1825
Promoters Holding	44.56%
52 week high/low	197.65/60.40
Shares outstanding	14.75

KEY FINANCIALS

(Rs. in cr)

Y/E March	2014	2015	2016	2017
Revenue	275	900	291	415
Operating exp	234	838	235	344
EBITDA	41	62	56	71
Depreciation	35	88	27	21
Interest Expense	40	138	13	10
Share of associate/JV	-	-	3	(2)
Exceptional Item	(34)	174	23	23
PBT	-68	10	(4)	15
Taxes	7	(10)	5	(10)
PAT	-61	0	1	5

VALUATION

We are buying Welspun Enterprise at 4x EV/EBITDA vs an industry average of 10-14x with a lot of margin of safety. We believe that they should report an ebitda of 312-336 Cr for FY19 assuming 13-14% ebitda Margins on estimated FY19 sales of 2400 Cr.

WELSPUN ENTERPRISES

Thesis –

At Stallion Asset we have a consistent investment philosophy of buying companies that can:

- 1) **Grow more than 25%**
- 2) **Huge Opportunity Size**
- 3) **High Return on Equity**
- 4) **Smart and Ethical Management**

Welspun Enterprise (formerly known as Welspun Projects Ltd.) is a pure HAM infrastructure player along with investments (500 Cr.) in the oil and gas exploration business. The company has been created by merging 4 group companies into one and divested all non-core assets to become a focused Infra player in 2015.

Why Welspun Enterprise?

- Disproportionate Growth
- Undervalued Infra company
- Huge Opportunity Size
- Superb Execution
- Asset Light Model - 100% subcontracting
- Healthy Balance Sheet – Eligible to bid for more projects

In 2015-16, a new company was born named “Welspun Enterprise” by divesting all the non-core assets and merging 4 group companies (Welspun enterprise, Welspun Infratech, Welspun Private projects and Welspun Infra Projects) resulting in strong balance sheet and simplified company structure. The huge cash reserve created due to the non-core sale (1000 Cr.) made their balance sheet strong enough to bid aggressively for new projects and take a pie of the huge 3 lakh Crore (Bharat Mala) infra opportunity. Company already has 4100 Cr order book as on 31st Dec and looking to increase this number to 8000 Cr by next fiscal end.

Since the gestation period of these projects are approx. 2-2.5 years and execution is robust, we believe that this company will report disproportionately high growth in the next 2 years which is not priced in the current valuation. It came with a Buyback of 2.7 Cr shares (15% of share capital) at a price of 62 per share in March 2017. Since then the company has not looked back.

About the Business – Welspun has two main Businesses 1) Infrastructure Business and 2) Oil Assets

Infrastructure Business – Welspun Enterprise has five HAM Projects and five BOT Projects (all operational). Delhi Meerut Express Highway was the first HAM project awarded by NHA in which Welspun was the lowest bidder. The contract period for this project was 30 months and the company has already completed 86% till 31st December, 2017 in 13 months showing their robust execution skills. They will therefore be entitled for bonus as well. As on 31st Dec, 2018 their order book stood at 4100 Cr and the management has guided for 8000 Cr by end of next year.

Name of the Project	Project Cost	Type	Project Status
Delhi Meerut Express Highway Package 1	841 Cr	HAM	86% completed as on 31 st December, 2017
Gagalheri-Saharanpur-Yamunanagar	1184 Cr	HAM	Appointment date – 3 rd February, 2018
Chutmalpur-Ganeshpur & Roorkee-Chutmalpur-Gagalheri	942 Cr	HAM	Appointed date for the project is expected by end-February 2018.
Aunta-Simaria	1161 Cr	HAM	Appointed date is expected in Q1FY19
Chikhali-Tarsod	1048 Cr	HAM	Acquired 49% stake from Vishvaraj Group in January 2018. Appointed date is expected in Q1FY19

BOT Portfolio – Total Investment of 123 Cr.

Project Name	Value on Books (Mar 17)	Debt on Books (Mar 17)	COD	Concession End
Himmatnagar Bypass	2	Nil	Apr-06	Jun-20
Hoshangabad- Khandwa	11	Nil	May-05	Feb-18
Kim - Mandvi	43	23	Aug-10	Feb-26
Raisen- Rahatgarh	11	Nil	Mar-06	Aug-18
Dewas Water	56	56	Sep-08	Jun-37
Total	123	79		

Dewas Water is a water supply BOT Project which has not got the financial closure yet. The construction is expected to start by Q1FY19. All BOT Projects are operational and not all are operationally positive.

Company also has other small projects like ARSS Bus Terminal (100%) and Dewas Bhopal Road Project (13% stake) where the company is looking for a complete exit and in the process it expects a cash flow of 50 Cr.

Oil Business –

Block Name	Location	Welspun's Stake
MB-OSN-2005/2	Mumbai High	35%
GK-OSN-2009/2	Kutch	10.50%
GK-OSN-2009/1	Kutch	8.75%
CB-ONN-2005/4	Palej	35%
B9 CLUSTER	Mumbai High	35%

Revenue will come from FY19-20

Welspun Enterprise has entered in 35:65 JV with Adani and owns 5 oil blocks i.e.2 each in Kutch and Mumbai High and one in Palej with a total investment of 500 Cr. Management expects to report revenue from the block in FY19-20. The management intends to divest their oil business in the near future.

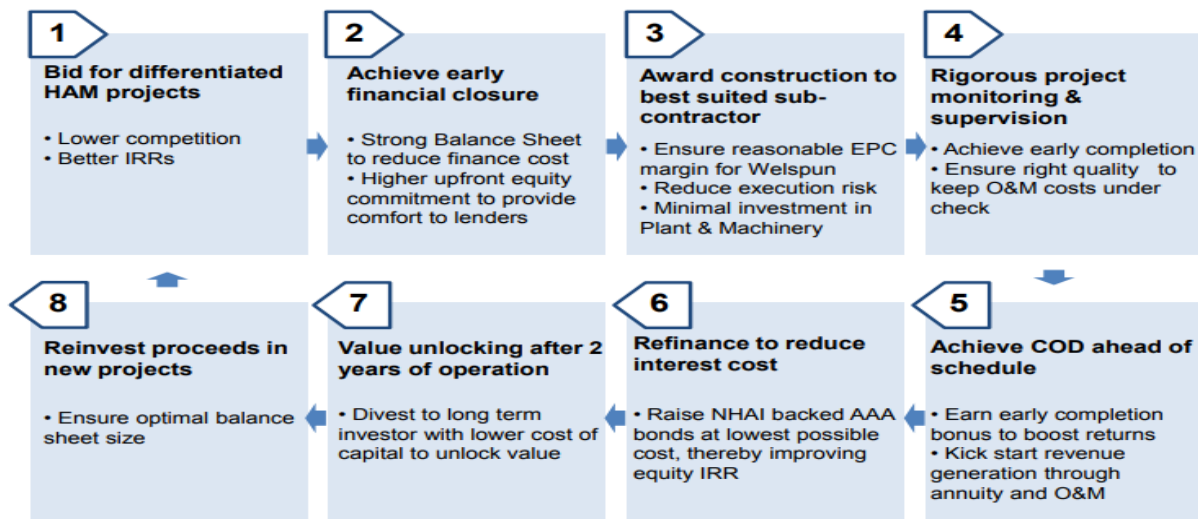
The Business Model – Welspun’s Business model is very different from its peers like Dilip Buildcon or KNR Construction. Welspun works on an Asset Light business model where they bid for a HAM Project and after winning the project they outsource it to a local subcontractor. We at Stallion were initially sceptical about this business model but after our meeting with the management we believe that in an Upcycle this kind of business model can be scaled up a lot.

Let us understand the Advantages and Disadvantages of This business model

- 1) **Geographical Reach** – A clustered based Infrastructure company like PNC infrastructure (in UP) or J Kumar (In Mumbai) can only bid projects in their core domain area whereas Welspun can bid anywhere in the country where it has a tie up with a local subcontractor.
- 2) **Asset Light** – There is no Investment in Manpower or Equipment, this is an asset light business model and the success of the business model is because small Subcontractors don’t have the balance sheet strength to bid for HAM Projects and this is where Welspun comes into picture.

Asset Light Model - 100% sub contracting

Unlike other EPC Infra players, Welspun Enterprise follows an asset light approach by using a 100% subcontracting model. They give away the project to a contractor whom they think has the ability to execute on time. Welspun Enterprise concentrates on bidding HAM Projects and to ensure that they attain best operational efficiency while executing the projects. **Faster they execute the projects, more no. of projects they will be able to bid.** Below is the business model Welspun typically works on which ensures value unlocking for the company in 2 years’ time with major focus on early completion.



A typical HAM Project for Welspun works like this –

Say it is a 1000 Cr project, 400 Cr is funded by the NHAI and for the rest 600 Cr, Welspun takes loan for 48% and 12% via equity infusion. **So the biggest advantage of bidding for a HAM project is -**

- Lesser Execution of risk
- Low competition as all are not eligible to bid for the same
- Higher IRR
- Lower outlay of capital

The Disadvantage of this model is that if a lot of work from Bharat mala comes, these small Subcontractors may not be available at a decent price to complete the project.

Why Welspun Enterprise?

1) Disproportionate Growth –

Company started the year with one HAM Project and already has 5 projects in Hand as on 31st December, 2017. They have already bid for 4800 Cr. (5 Projects) out of which the management is confident to get 2-3 projects. Management has guided for 1200 Cr and 2400 Cr revenue for FY18 and FY19 respectively against revenues of just 314 crores in FY2017.

HAM Projects - Current Portfolio	Expected to start	Project Cost
Delhi Meerut Express Highway Package 1	Ongoing	841 Cr
Gagalheri-Saharanpur-Yamunanagar	Q4FY18	1184 Cr
Chutmalpur-Ganeshpur & Roorkee-Chutmalpur-Gagalheri	Q4FY18	942 Cr
Aunta-Simaria	Q1FY19	1161 Cr
Chikhali-Tarsod	Q1FY19	1048 Cr

Company raises bills on monthly basis as and when the work is done. Since a large chunk of its order book will become operational in next two quarters, we believe that they will report disproportionately high revenues next fiscal year.

The growth has already started reflecting in the financials in the last four quarters. Company has reported strong numbers in Q3FY18 with highest quarterly sales and profit of 273 Cr and 21 Cr respectively. **Delhi – Meerut Express Highway was the largest contributor of these numbers as 86% of the project is completed by 31st December, 2017 (in a span of only 13 months) well before their 30 month deadline. We strongly believe that this pace of execution will be maintained by the company for the new projects starting next year as well.**

Welspun Enterprises	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Sales (Cr)	61.67	73.03	31.13	35.04	50.05	181.49	206.33	145.37	273.41
Operating Profit (Cr)	-11.24	-26.74	-19.69	-18.00	-8.14	0.62	13.13	8.71	21.53

2) Opportunity Size –

NHAI is expected to bid out 95 HAM Projects in the next 3-6 months which in value terms is an opportunity of 1 lakh crore. Company has submitted bids for 4800 Cr (154 Km.) and will continue to bid for HAM Projects as they have prompt execution capabilities. They are going to bid for 25000 Cr worth orders next year.

The table given below clearly shows how the pace of the construction and given out new orders have risen since the change in Government took place in 2014. The fact that all infra companies do not have the balance sheet strength to be eligible for bidding for new projects from NHAI specifically. Welspun has a massive opportunity to take a sizable pie.

Particulars	FY15	FY16	FY17	Dec-17
Projects Awarded (Km)	7980	10098	16036	22100
Projects Constructed	4410	6061	8142	9000*
Construction Per Day	12.08	16.61	22.31	24.65

*FY18E estimated

Project awarded and construction per day has grown at a 3 year CAGR of 40% and 26% respectively. We strongly believe that this momentum in the execution of infra projects is not going to stop here.

3) Strong Balance sheet –

Company has made a smart move by selling off its non-core business to concentrate on the core Infrastructure business and creating a strong cash reserve of 1000 Cr (current cash balance of 900 Cr). The large cash reserve on the books with a debt of 278 Cr (consol) made their balance sheet strong enough to bid for HAM Projects from NHAI.

	*Sales (Cr)	Order Book 31 Dec, 2017	Order Book/ Sales
Welspun Ent (Consol)	861	4100	4.76
KNR Construction	1,789	3333	1.86
PNC Infratech	1448	7976	5.51
Gayatri Projects	2,792	12700	4.55
Dilip Buildcon	6,938	12357	1.78

* Standalone TTM

Along with the cash advantage, since all projects are HAM, they do not require a large outlay of funds in the start of the project and as soon as the project starts, they can raise bills for the proportionate work done on monthly basis so the cash flows start coming in in the first year itself. **Company in its latest concall has said that they will bid for 25,000 Cr Projects next fiscal year and will end FY19 with 8000 Cr (Approx) order book against the current order book of 4100 Cr.**

Treasury Income – Company has earned a treasury income of 58.5 Crs for 9MFY18 at a rate of 8.5-9% p.a. This is their return on investment of 900 odd crores of cash in short term investments which forms part of other income and will continue to come in books until the whole cash is not used in the business in the coming few years.

4) Ebitda Margins -

	*Sales (Cr)	EBITDA (%)
Welspun Ent (FY2018)	1200	14%
KNR Construction	1,789	20.12%
PNC Infratech	1448	16.02%
Gayatri Projects	2,792	16.33%
Dilip Buildcon	6,938	18.73%

* Standalone TTM

Company's Margins are one of the best in the Industry. Since the company is into sub- contracting, these margins are not sustainable as a portion of their profits goes to the sub –contractors (which varies from contractor to contractor and project to project). Management has guided for 13-14% EBITDA Margins.

Valuation

Welspun Management has guided for 2400 Cr of Revenue from Road Construction business with EBITDA Margin of 13-14%. Welspun should do an EBITDA of 312-336 Cr in FY2019. The company has a lot of margin of safety with very low debt, 900 Cr. cash, 500 Cr in Oil Assets at book, 122 Cr Book value Investments in BOT and high expected revenue growth due to the robust execution of projects i.e. we are paying 1203 Cr for the Infrastructure business. **We are buying the Infrastructure business at 4x EV/EBITDA FY2019.** Average EV/EBITDA of the Industry is between 10-14 x hence we are getting the company at much lower valuation as compared to peers.

* Standalone TTM	EV/EBITDA (TTM)	Order Book 31 Dec, 2017
KNR Construction	13	3333
PNC Infratech	19	7976
Gayatri Projects	12	12700
Dilip Buildcon	12	12357

Risks –

Major Risk which we foresee is surrounding the Sub- contracting model. Though this is a strength of the company today as it makes the business model asset light but if they do not get a sub- contractor at favourable terms or execution is not done on time, then the project might get delayed for a long time and it might become too late to arrange another sub-contractor. Selecting the right sub-contractor is the key.

Conclusion

Welspun Enterprise has restructured its business to emerge as a top HAM player of the country to tap the 3 lakh crore Bharatmala opportunity with major focus and concentration on bidding more projects and execution before time. **We strongly believe that the company is at a point where if things go right i.e. if they are able to finish the projects on time or before time just like what they did for Delhi – Meerut Project, they will show a phenomenal growth in the coming quarters. They can easily do an ebitda of 312-336 Crs even if we assume Ebitda margins of 13-14% and sales of 2400 Cr as guided by the management.** Strong balance sheet with low investment nature of HAM where they are primarily present in will ensure more orders from NHAI thus strong revenue visibility.

Analyst Positions – Amit Jeswani and Family have no positions.

Analyst Disclosures – No Positions

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