

MEP Infrastructure

IPO Note – Limited Upside to IPO price; NEUTRAL

Company background: MEP Infrastructure Ltd (MEP) is promoted by the Mhaiskar Family. MEP operates 18 toll collection projects (as of 19 March, 2015) with an aggregate of 33 toll plazas, 5 Operate-Maintain-Transfer (OMT) projects covering 2,530 lane kms with an aggregate of 15 toll plazas and 1 BOT project covering 42.0 lane kms with 5 toll plazas. These ongoing projects are located across 10 states in India.

Pros: (1) Traffic growth and escalations from existing projects to lead to improvement in the cash flow profile, (2) Strong OMT pipeline (as highlighted by management), with possibility of new order wins, could lead to re-rating.

Cons: (1) Weak financials (negative networth of ₹224.5cr; debt of ₹3,218.3cr; net loss of ₹117.5cr for FY2014 and ₹97.3cr in 7mFY2015), (2) loans and advance of ₹357.6cr made to promoter entity.

Outlook and Valuation: We have valued MEP's projects using the free cash flow to equity holders (FCFE), applying a 14% discount rate. Considering (1) toll rate hike across Mumbai 5 Entry points project, (2) regular churn of new shorter duration projects, and (3) 5 projects getting completed by September 2016, we arrived at a consolidated FCFE value of ~₹850cr. In absence of data, our estimates do not capture any FCFE value for (1) Jammu-Udhampur OMT project (NHAI has announced MEP as H1), and (2) Delhi Entry points OMT projects.

MEP post-issue would have market capitalization of ~₹1,042cr - ₹1,065cr (at price band of ₹63-65/share), which is higher than MEP's FCFE value of ~₹850cr. Considering limited data for 2 recently won projects, we see **limited upside for the stock from its issue price and hence recommend NEUTRAL on the issue.**

Key Financials

Y/E March (₹ cr)	FY10	FY11	FY12	FY13	FY14	7mFY15
Net Sales	328	449	1,080	1,280	1,198	1,114
% chg		36.9	140.4	18.5	(6.4)	
Net Profit	(1)	(85)	(55)	(62)	(118)	(97)
% chg		NA	NA	NA	NA	
EBITDA (%)	1.7	17.2	32.3	28.5	26.8	17.3
EPS (Rs)	(0)	(8)	(5)	(6)	(11)	(9)

Source: Company; Note: NA- Not Ascertainable

NEUTRAL

Issue Open: April 21, 2015
 Issue Close: April 23, 2015

Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹111.5cr

Fresh Issue**: 5.4cr Shares

Offer for Sale: 0.0cr Shares

Post Eq. Paid up Capital**: ₹165.5cr

Issue size (amount): ₹340cr

Price Band: ₹63-65

Lot Size: 225 shares

Post-issue implied mkt. cap:
 ₹1,042cr- 1,065cr

Promoters holding Pre-Issue: 97.2%

Promoters holding Post-Issue: 65.5%

Note:**at Lower-end of the price band

Book Building

QIBs	75% of issue
Non-Institutional	15% of issue
Retail	10% of issue

Post Issue Shareholding Pattern

Promoters Group	65.5
MF/Banks/Indian Fls/FIIs/Public & Others	34.5

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Issue Details

MEP Infrastructure is offering fresh issue of 5.4cr equity shares of ₹10 each via book building route in a price band of ₹63-65. This issue would constitute 32.6% of the post-issue paid-up equity share capital of the company (at the lower end of the price band).

Exhibit 1: Shareholding Pattern

Particulars	Pre-Issue		Post-Issue	
	No. of Shares	(%)	No. of Shares	(%)
Promoter Group	108,341,107	97.2	108,341,107	65.5
Retail & HNI Investors	3,153,143	2.8	16,645,206	10.0
Institutional Investors			40,476,190	24.5

Source: Company, Angel Research

Objects of the Offer

- Utilize the fund for debt repayment of ₹262cr.
- General Corporate Purposes.

Key Investment Rationale

Negative Net worth, with substantial Debt

Even though MEP is in the toll collection business, it has a sticky revenue model and we are concerned about their consolidated level negative net worth and higher debt. Higher interest expenses (reported lower interest coverage ratio of 0.62x in FY2014) are eating into the company's consolidated profitability. MEP reported a consolidated net loss of ₹117.5cr in FY2014 (and ₹97.3cr in 7MFY2015).

As of 7MFY2015-end, MEP (on consol. basis) is sitting on a debt of ₹3,218.3cr and having a negative net worth of ₹224.5cr. Given that ₹262cr of the total ₹340cr raised from the IPO would be used towards debt repayment, the consol. debt post the IPO would decline to ₹2,956.3cr. After the debt repayment, MEP would continue to report losses for the next 1-2 years, as there would be no big relief at interest expense level.

Over ₹126cr of claims related to Chennai Bypass (related to loss of revenues), as per the 3CGM Committee Arbitration proceedings are awarded to MEP and this is likely to be booked in FY2015E financials. On adding-up the claim reversal and IPO proceeds, the net worth of the company would turn positive. Still, the consolidated D/E ratio would be at ~45.1x.

Near-term concerns over Debt repayment

As of 7MFY2015-end, MEP (on a consolidated basis) reported negative net worth of ₹224.5cr and debt of ₹3,218.3cr. During FY2012-2014, it generated average Cash Flow from Operations (CFO) to the tune of ₹410cr. On adjusting for yearly capex and interest payments, MEP would be left with hardly any cash flows to repay meaningful debt. Unless MIPL (its 100% subsidiary) reports revenues of over ₹500cr (which we expect by FY2018E), considering churn of new short-term projects into the portfolio, it would be tough for MEP to start meaningful debt repayment in the near-term.

Good Times ahead for MIPL, meaningful debt re-payment to start in FY2018E

Consolidated debt of MEP is on account of its flagship project, Mumbai 5 entry points (ie MIPL; accounted for 18.5% of 7MFY2015 consol. revenues), for which it made an upfront payment of ₹2,100cr. In our view, despite the ~18% toll rate hike in October 2014 (translating to 16.1% yoy increase in FY2015E revenues), higher interest expenses would lead to net losses at the project level. However, on considering ~5% yearly traffic growth and ~18% toll hike once every 3 years (assumed 8.7% revenue CAGR during FY2012-2026E), we expect MIPL to report a net profit only in FY2018E. On the back of toll income growth, we expect MIPL to start substantial debt repayment from FY2018E and complete the debt repayment by FY2025E. Based on our calculations, we arrive at FCFE value of ₹357.3cr for MIPL.

Concern over related party transactions

Since FY2013-end, MEP, despite having negative net worth and deteriorating financials, has made loans to one of its promoter entities, Ideal Toll & Infrastructure Private Limited (ITIPL). As of 7MFY2015-end, MEP made loans to its promoter entity to the tune of ₹357.6cr and in return it gets meager interest on these loans. The **Management clarified that loans and advance to the parent have been for business purpose only and fell short of providing further details.**

Tolling Industry yet to mature

In 2014, 62 toll booths were abolished by NHAI. Also, in recent times, toll booth politics across few regions has gained prominence, where concessionaires are forced to either terminate or abolish toll collection contracts. Notably, Maharashtra government announced termination of 12 tolling projects and exempted light motor vehicles and state transport corporation buses from tolling at 53 toll plazas, without providing any details. 3 projects of MEP in Maharashtra (excluding MIPL) have been partially affected by this ruling; however these 3 combined contribute less than 2.6% of revenue (7MFY2015 consolidated revenues). Also, the Management highlighted that for these projects a possibility of (1) extension on project duration, and (2) levy of higher toll on heavy vehicles is being worked, and discussions with concessionaire would soon start. On a whole the toll collection company is protected, as an assurance of outstanding debt and equity reimbursement is outlined (reimbursement details vary from project to project, on case to case basis). Given that the industry is at a nascent stage, it would take a few years for regulatory set-up to evolve and address these issues at larger level.

High competition to emerge, given the low entry barriers

Toll collection industry in our view is characterized by minimal capital requirements (given the concession fee sharing arrangement to authority), which lowers the entry barriers. With overall pie expected to grow, we expect the bidding intensity to further increase from here-on. On the back of higher bidding intensity, there exists a possibility of MEP losing its market share as well as new wins coming at lower IRRs (vs. the ongoing projects).

Outlook and Valuation

We have valued MEP's projects using the free cash flow to equity holders (FCFE), applying a 14% discount rate. Considering (1) toll rate hike across Mumbai 5 Entry points project, (2) regular churn of new shorter duration projects, and (3) 5 projects getting completed by September 2016, we arrived at a consolidated FCFE value of ~₹850cr. In absence of data, our estimates do not capture any FCFE value for (1) Jammu-Udhampur OMT project (NHAI has announced MEP as H1), and (2) Delhi Entry points OMT projects.

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Risks

Uptick in OMT award activity: MEP's Management sounded optimistic on the huge NHAI award opportunity in OMT space (Management expects ~20,000kms of OMT award activity in next 3 years) and future revenue growth visibility. We differ from the Management's view on emerging opportunity owing to factors such as (1) minimal business entry barrier, given the asset light business model, (2) higher bidding intensity, and (3) lower profitability. Risk to our assumptions could be a scenario, where the OMT space sees huge NHAI award activity.

Exhibit 2: Profit & Loss Statement (Consolidated)

Y/E March (₹ cr)	FY10	FY11	FY12	FY13	FY14	7mFY15
Net Sales	328	449	1,080	1,280	1,198	1,114
% Chg		36.9	140.4	18.5	(6.4)	
Total Expenditure	323	372	731	915	877	921
Operation & Maintenance Exp.	313	321	668	833	802	857
Employee Expenses	6	15	41	53	50	41
Other Expenses	4	35	22	29	26	24
EBITDA	5	77	349	365	321	193
% Chg		1,313	351	5	-12	
EBITDA %	1.7	17.2	32.3	28.5	26.8	17.3
Depreciation & Amortization	0	39	95	99	126	106
EBIT	5	39	254	266	194	87
% Chg		673	557	5	-27	
Interest and Financial Charges	5	130	377	377	380	232
Other Income	1	14	56	22	42	27
PBT	0	(77)	(66)	(89)	(143)	(119)
Tax	2	14	(5)	(26)	(24)	(21)
% of PBT	360.0	(17.7)	(8.1)	(29.5)	(16.4)	(17.3)
PAT before Minority Interest	(1)	(91)	(60)	(62)	(120)	(98)
Minority Interest	(0)	(5)	(5)	(0)	(2)	(1)
PAT	(1)	(85)	(55)	(62)	(118)	(97)
% Chg		NA	NA	NA	NA	
PAT %	(0.4)	(19.0)	(5.1)	(4.9)	(9.8)	(8.7)
EPS (on Pre-IPO shares o/s)	(0.1)	(7.6)	(4.9)	(5.6)	(10.5)	(8.7)
% Chg		NA	NA	NA	NA	

Source: Company, Angel Research

Exhibit 3: Balance Sheet (Consolidated)

Y/E March (₹ cr)	FY10	FY11	FY12	FY13	FY14	7mFY15
Sources of Funds						
Equity Capital	11	11	100	100	100	111
Reserves Total & MI	86	15	7	(85)	(251)	(336)
Networth	97	26	107	15	(151)	(225)
Total Debt	113	2,768	3,031	2,952	3,005	3,218
Other Long-term Liabilities	0	1	1	1	158	106
Deferred Tax Liability	0	0	0	0	0	0
Total Liabilities	211	2,795	3,140	2,967	3,012	3,100
Application of Funds						
Net Block	2	2,254	2,207	2,151	2,320	2,223
Capital WIP	0	0	0	0	0	0
Investments	0	94	3	3	1	32
Current Assets						
Inventories	0	0	0	0	0	0
Sundry Debtors	29	28	4	38	29	12
Cash and Bank Balance	20	61	82	154	162	169
Loans & Advances	179	834	918	861	841	1,038
Other Current Asset	0	2	12	6	32	38
Current Liabilities	19	558	192	307	458	537
Net Current Assets	209	367	825	752	606	719
Other Assets	0	80	104	61	85	126
Total Assets	211	2,795	3,140	2,967	3,012	3,100

Source: Company, Angel Research

Exhibit 4: Cash Flow Statement (Consolidated)

Y/E March (` cr)	FY10	FY11	FY12	FY13	FY14	7mFY15
Profit before tax	0	(77)	(66)	(89)	(143)	(119)
Depreciation & Oth. Adj.	(0)	25	39	78	102	88
Change in Working Capital	(117)	(608)	(30)	65	41	(168)
Interest & Financial Charges	5	130	377	377	380	232
Direct taxes paid	(9)	(24)	(13)	0	(9)	(25)
Cash Flow from Operations	(120)	(555)	306	431	371	9
(Inc)/ Dec in Fixed Assets	(0)	(2,285)	(48)	(43)	(73)	(5)
(Inc)/ Dec in Investments	12	(173)	130	5	123	26
Cash Flow from Investing	12	(2,457)	82	(39)	51	21
Issue/ (Buy Back) of Equity	0	5	134	0	(124)	25
Inc./ (Dec.) in Loans	119	3,147	(125)	(61)	78	189
Dividend Paid (Incl. Tax)	0	0	0	0	0	0
Interest Expenses	(4)	(113)	(383)	(332)	(350)	(238)
Cash Flow from Financing	115	3,038	(375)	(393)	(396)	(24)
Inc./ (Dec.) in Cash	7	26	14	(0)	25	6
Opening Cash balances	4	11	38	51	51	76
Closing Cash balances	11	38	51	51	76	82

Source: Company, Angel Research

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Disclosure of Interest Statement

MEP Infrastructure

1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):

Buy (> 15%)
Reduce (-5% to -15%)

Accumulate (5% to 15%)
Sell (< -15%)

Neutral (-5 to 5%)