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Investor's delight: Gayatri Projects Ltd. – "Robust play in Road EPC sector"... "BUY"

Report date	19th April, 2018
CMP	Rs. 200
Target price	Rs. 279
Upside (%)	40
Basis of valuation	FY20E financials
Face Value	Rs. 2
Market Cap (Rs. Mn)	35, 450
Equity Capital (Rs. Mn.)	354.5 mn
Bloomberg code	GAYP:IN
Reuters code	GAPR.NS
Promoters holding	44.95%

Hyderabad based GPL with over 50 years presence in infrastructure and Construction primarily undertakes Road, Power and Irrigation projects across the Country and owns almost all its equipments, enabling optimal cost control. It also has Joint Ventures (JVs) in Build-Operate-Transfer (BOT) projects and executes construction contracts in partnership with Indian and overseas Companies. Over the last couple of years, the Company has relooked at its business strategy and has made significant changes in its business model. The Company has evolved from an asset heavy business model to an asset light business model (pure play EPC business). Gayatri Projects is one of the fewer pure play EPC companies in the sector with zero exposure to HAM and small residual exposure in BOT projects.

The Company has derisked and diversified its portfolio both geographically and business wise. As a pure play EPC company, the Company's order book largely comprises of road EPC projects, irrigation projects, land development and railways. It has a pan India presence and have projects ongoing in UP, Andhra Pradesh, Bihar, Orissa, Haryana, Northeast, Karnataka and Mumbai.

During November 2017, the Company achieved a major milestone in its value creation journey restructuring and demerger of its road BOT business. This is the final approval from NCLT. Consequently the road business will be demerged and listed as a separate entity Gayatri Highways Limited. GPL shareholders will directly own 74% of this entity. GPL consolidated balance sheet would be recast as of March 31, 2018 to exclude the assets and liabilities of the BOT businesses. Key impact of this is that the GPL consolidated debt would reduce by more than Rs.25 billion. All of its assets on BOT portfolio are successfully commissioned and toll and annuity collections have started. In addition to distributing the assets to shareholders and separately listing as announced earlier, the Company continues to look for ways to monetize this portfolio.

GPL is financially strong EPC player with high revenue visibility. There is a strong momentum of order inflow. The order book of the company is robust and stands at Rs. 120bn, which is 5.6x of its FY2017 revenues which provides strong revenue visibility.

The Company has recently won orders worth Rs. 28 bn from NHAI which is a testament of the Company's project execution capabilities and prudent bidding strategy. The Company has one of the largest market share of NHAI awarded projects. The Compnay has bid pipeline of Rs. 75.49 bn for next 2 months.

The Management efforts are now very much directed towards efficiently executing these projects and the Company is confident of delivering 30% revenue growth in its construction business over next 3-4 years.

Y/e 31 Mar (Rs. mn)	FY17	FY18 est.	FY19est.
Revenues	21,154	26,388	34,304
EBITDA	3,375	3,959	5,146
OPM (%)	15.95	15	15
PAT	745	1537	2,058
PAT (%)	3.52	5.8	6
Share Capital	354.5	354.5	354.5
Networth	9,120	10,657	12,715
ROE (%)	8.17	14.42	16.19
EPS (Rs.)	4.20	8.67	11.6
Book Value (Rs.)	51.45	60	71.73
P/E (x)	48	23	17
P/BV (x)	3.9	3.3	2.79

Source: Company, Ajcon Research

Investment recommendation and rationale

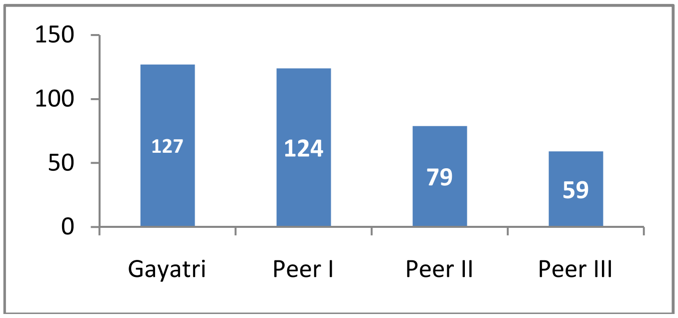
At CMP of Rs. 200, the stock is valued at a P/BV (x) of 3.9x on FY17Book Value. On anualized FY18 numbers, the stock trades at a P/BV of 3.3x. With due consideration to factors like a) strong presence in high growth construction sector, b) healthy and diversified order inflows with good revenue growth visibility, c) pan India operations spread across 15 states, d) strong in-house designing and engineering capabilities complemented by state of art fleet of construction equipment, e) highly efficient operations with strong execution capabilities - completed more than 6,500 lane km of road construction over the last 25 years, f) one of the largest market share of NHAI awarded projects, g) track-record of completing ~40 projects aggregating to Rs 90 billion+ value in last 5 years, h) strong financial position with significantly improving balance sheet, j) transformed its business from asset heavy to asset light business model – pure play EPC company with strong return profile, k) significant value unlocking through business restructuring, we recommend investors to "BUY" with a target of Rs. 279 (3.9x at estimated FY19 Book Value) for investors with a horizon of 9-12 months.

Author of the research report – Mr. Akash Jain, MBA (Financial Markets)

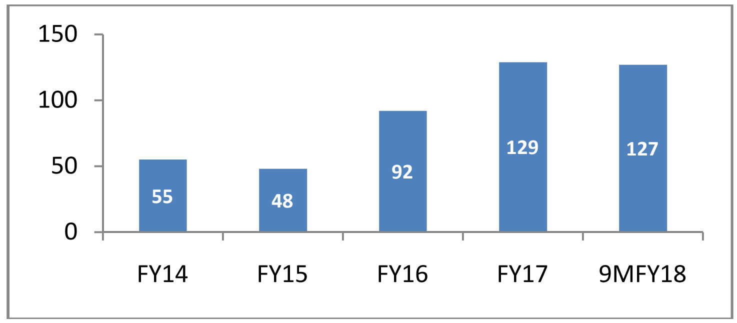
Investment Rationale

1) Industry Leading Order Book; Diversified and growing

Industry leading order book as on 31st December, 2017 (Rs.bn)

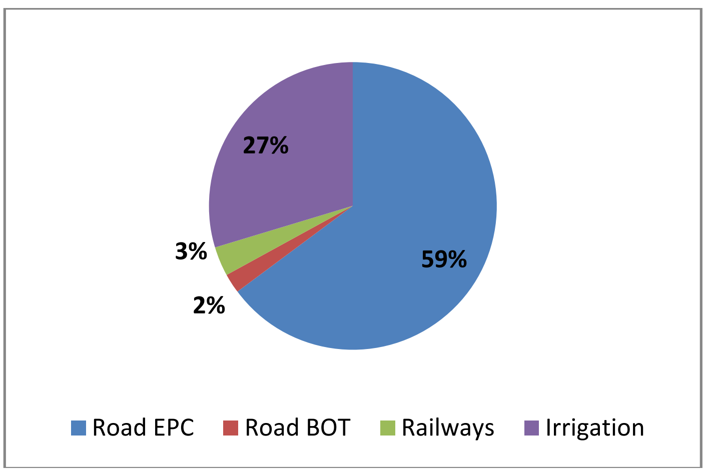


Growth in EPC order book over last 5 years (Rs. bn)

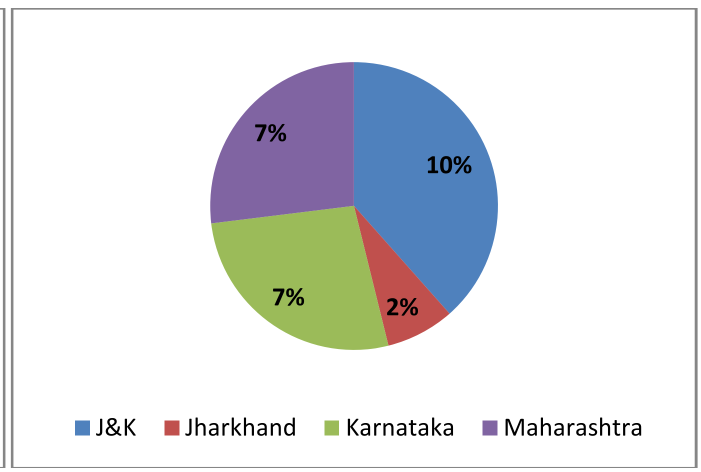


Source: Company

Diversified across segments



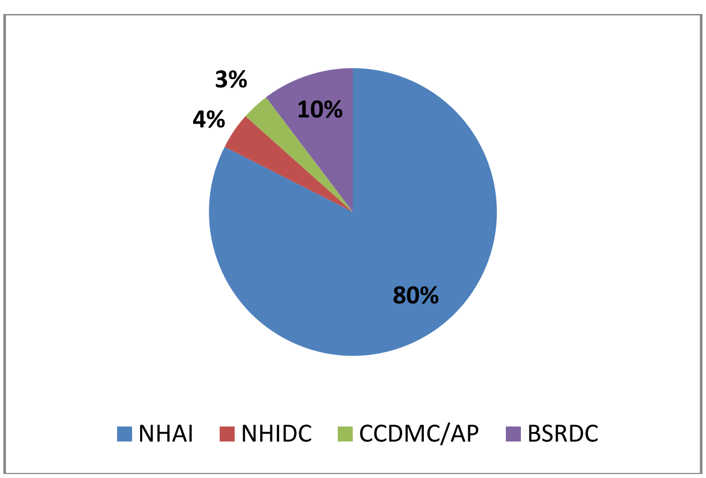
Diversified across geographies



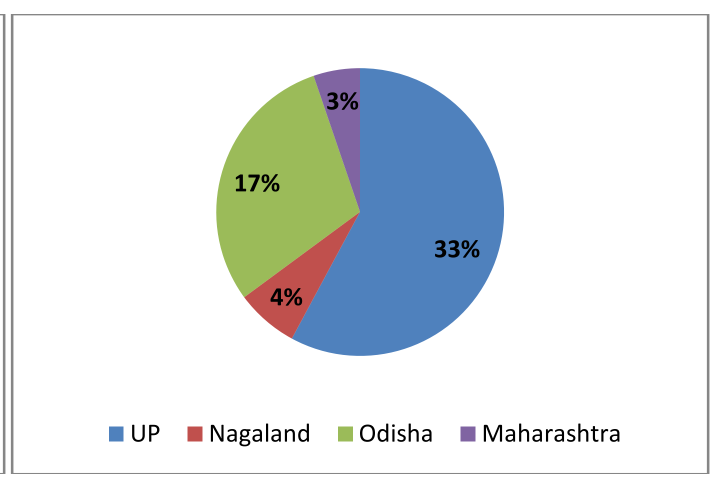
Source: Company

2) Robust road EPC order book

Client wise order book



State wise order book



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Source: Company

Recent order inflows

The Company has recently won new orders of Rs. 28 billion from NHAI in last 2-3 months which are as follows:

Project name	**Rehabilitation and upgradation of Cuttack Angul Section of NH 42**
Type	Road EPC (NHAI)
Contract value	Rs. 5,830 mn
Project name	**Jammu City Ring Road/Bypass**
Type	Road EPC (NHAI)
Contract value	Rs. 13,390 mn
Project name	**Rehabilitation and upgradation of Cuttack Angul Section of NH 42**
Type	Road EPC (NHAI)
Contract value	Rs. 5,290 mn
Project name	4-laning of Rajamunda – Barkote section of NH -23 (New NH No. 143)
Type	Road EPC (NHAI)
Contract value	Rs. 3,940 mn

Source: Company

3) Highly efficient operations with superior execution capabilities

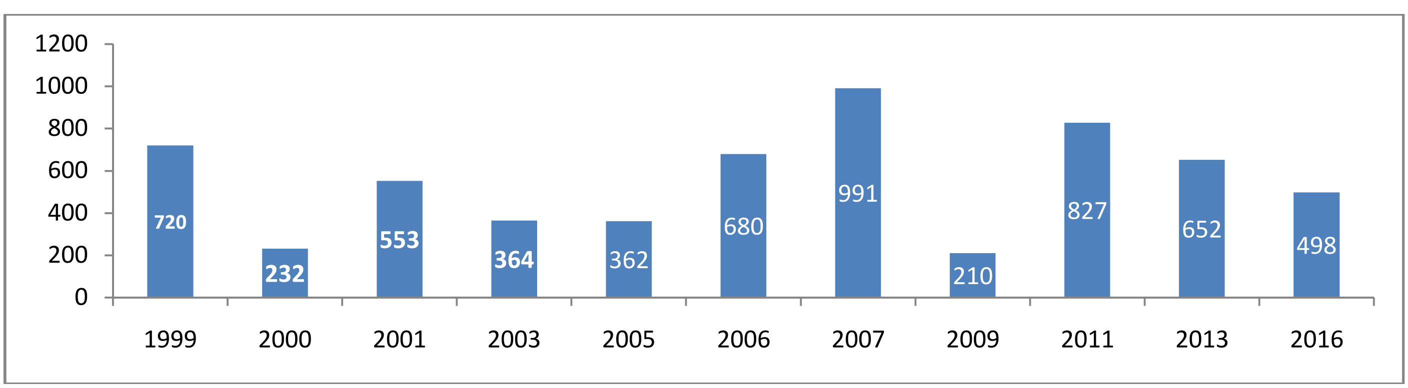
Projects executed in last 5 years

Segment	**No. of projects executed**	**Value of contract (Rs. Mn)**
Roads	12	57,262
Industrial	17	23,535
Irrigation	5	3,730
Site leveling	2	2,382
Dams & reservoirs	2	448
Railways	1	3,845
Total	39	91,202

Source: Company

Strong BG limits key competitive advantage
The Company has existing BG limit of Rs. 37,000 million. Existing BG limit provides ability to maintain order book of over Rs. 2,00,000 mn. The Company has the ability to further increase the BG limits

Roads: Peak executed capacity at ~1,000 kms for the year 2007



Required lane kilometers to be executed (as order): ~700 Lane Kms.

Capacity to execute: 1,100 – 1,200 Lane kms/year

4) Strong Q3FY18 performance witnessed

Topline witnessed yoy growth of 73.7 percent in Q3FY18 to touch Rs. 9038.6 mn led by strong execution of the order book. EBITDA witnessed growth of 70.3% to Rs. 1405 mn in Q3FY18 owing to increase in revenues. EBITDA margin declined by 31 bps to 15.4 percent on yoy basis. The fall in EBITDA margin was led by a 77.2% yoy rise in cost of goods sold to Rs.7,253.4 mn. The depreciation cost was flat yoy at Rs128.5mn, finance cost increased by 41.5% yoy to Rs691.5 mn. The Company's adjusted PAT clocked a yoy growth of 229 percent to Rs. 452 mn in Q3FY18.

The sales for 9MFY18 increased by 51.9% yoy to Rs.19,791 mn. EBITDA margin for 9MFY18 increased by 58bps yoy to 15.8% led by a 7.8% rise in other expense. The adj. PAT for 9MFY18 grew by 173.8% yoy to Rs1153.4 mn led by 29.9% yoy growth in finance cost to Rs. 1,756 mn and 17.7% yoy growth in depreciation to Rs390.8 mn.

Order book as of Q3FY18 stood at Rs140 bn. The order inflow in Q3FY18 was Rs13 bn and for 9MFY18 is around Rs124 bn. The company has a bid pipeline of over Rs. 75.49bn over the next two months. The bid pipeline consists majorly of road EPC orders of NHAI and other central govt. agencies.

The company expects FY18 revenue growth to be more than 50% yoy. The company expects to clock revenues of Rs45 bn in FY19. EBITDA margins will be in the range of 15-16% for FY18. The company aims to maintain EBITDA margin at 15% going forward. The capex for FY18 will be around Rs500-750 mn. The company expects to spend a total of Rs1 bn. in FY18-19. Gross debt of the company as of December 31, 2017 is Rs40 bn. All the BOT projects are successfully commissioned and toll & annuity concessions have started.

5) Strong financial position with significantly improving Balance Sheet

a) Significant Debt Reduction despite more than 50% YoY growth in revenue
   i. Gross debt outstanding as of 28th Feb, 2018 stood at Rs.2,028crores versus Rs.2,069cr outstanding as of 31st March 2017.

b) Company now regular in all debt servicing
   i. The Company is working with credit rating agency for rating reversion

c) All the money raised through the QIP (net of costs) used for bank repayments
   i. Gross Debt outstanding reduced to INR 18,432* million from INR 20,736 million
   ii. Gross Debt to Pro-forma equity ratio lower at 1.7x* from 2.8x earlier

d) Significant free cash flow generation from FY19 onwards
   i. First time in 10 years

6) High growth revenue visibility

a) **Historically, the Company has maintained order book to bill ratio of 4x**
b) **The Company has maintained a strong execution rate of well over 20 percent historically**
c) **Lower incremental capex needed going ahead:** Significant capex incurred in last 2 years: Gross Fixed Assets have increased from Rs. 4,620mn in FY15 to Rs. 6,035mn in FY17. The Company has ownership of more than 2,250 construction equipments.

7) Value unlocking through business restructuring

Power Assets (GEVL)

- Current Portfolio: 660MWx4 in partnership with Sembcorp Utilities, Singapore
- Super-critical technology units: More efficient plants with lower emissions
- Strategically located near sea-ports enabling logistics efficiency
- Stable and competitive coal supply

Road Assets (GIVL)

- Current Portfolio: 7 road projects
- Balanced portfolio comprising of four annuity and three toll based projects
- Road BOT assets demerged into separate company

De-merger of BOT assets creates a superior asset light EPC company with healthy returns and comfortable leverage

Sembcorp Energy India, an independent power producer, has filed draft papers with capital markets regulator Sebi to float an initial public offering (IPO). The company, which has thermal and renewable power assets in India, is promoted by the Singapore Exchange-listed Sembcorp Industries. The IPO comprises fresh issue of shares worth up to Rs 4,095 crore and an offer for sale (OFS) of up to 146,774,194 equity scrips by the existing shareholders. This includes sale of 128,941,129 shares by Sembcorp Utilities and **upto 17,833,065 equity shares by Gayatri Energy Ventures (Wholly owned subsidiary of Gayatri Projects Ltd.) which would be used to repay debt.**

About Sembcop group: Sembcorp develops, owns and operates assets in both renewable energy and thermal power in India and its portfolio in the country has over 4,000 MW of assets. Sembcorp Group has total assets of over S$23 billion and is listed on the main board of the Singapore Exchange. Singapore's state-owned investment firm Temasek Holdings Ltd is the largest shareholder in Sembcorp Industries. Sembcorp will reposition its portfolio across certain developing and developed markets and will deepen its presence in four key markets — Singapore and Southeast Asia, China, India and the UK. It also said that it has set a target of doubling of its overall renewable energy portfolio to about 4,000 MW by 2022. The parent company also reported a 85% fall in its fourth quarter net profit at $22.8 million.

Indian businesses: Sembcorp had entered the Indian energy market in 2010. The company develops, operates and manages the $3 **billion Sembcorp Gayatri Power Complex in Andhra Pradesh, which has a total capacity of 2,640 MW across two power plants.**

8) Focusing on "Asset Light" EPC segment

a) Actively bid for quality projects in core areas of expertise- roads, irrigation, industrials

b) Maintain a healthy book to bill ratio

c) Adhere to geographical cluster approach while bidding for projects to optimize management & equipment utilization and maximize profitability

d) Further enhance engineering capabilities in order to pursue new EPC contracts

e) Enter specialized sectors with low competition and high margins

f) Opportunity includes underground mining, water supply, lift-irrigation, high speed railways, urban infrastructure, pre-fab buildings etc.

Risk factors

a) Higher receivable days puts pressure on cashflows

Historically, the Company's receivable days have been around 133 days. The Company's target is to come out to lower levels at least a year wise because higher receivable days is because of EPC tenders, the payment schedule because these are now stage wise payment schedules even though you get paid for work done, but a lot of money gets blocked under receivables.

Company's response to key market concerns

Working Capital Cycle would stretch

1) Working capital cycle in-line with major industry peers and under 70 days

2) Despite doubling of revenue; gross debt increased only by INR 2.8 bn; paid INR 7 bn of gross
3) interest and have made investments worth INR 2.5bn – in last 3 years

4) During current year- gross debt reduced by INR 400 mn; despite a 52% revenue increase

Meeting debt obligations

1) Since 2015, GPL has moved to core EPC construction services business
2) No investments in unrelated assets: No BOT, HAM
3) Gross Debt to Pro-forma equity ratio lower at 1.7x from 2.8x earlier
4) Significant investment coming up for listing – potential value of GPL stake could significantly cover the debt burden (DRHP filed by SEIL for IPO)

"No HAM" strategy to impact growth

1) Moved to an asset light business model
2) Despite talking only EPC orders, the Company has been able to triple the order book in last 3 years
3) Consistently high market-share in NHAI order over last 3 years
4) HAM would lead to stretched balance sheet across sector and lower Return Ratios

Related party transactions (Gayatri Hi – Tech Hotels: GHHL)

1) Resulted in an EPC receivable of Rs. 2 bn from GHHL; receivable converted into GHHL's preference shares due to its continued inability to pay
2) GPL Management committed to selling the investment over next 2 years

3) INR 392 million worth sold to an institutional investors (Q3FY18)

Recommendation parameters for fundamental reports:

Buy – Absolute return of 20% and above
Accumulate – Absolute return between 15% and above
Book profits: On achieving the price target given in the research report for a particular Company or on a occurrence of a specific event leading to change in fundamentals of the Company recommended

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For research related queries contact:

Mr. Akash Jain – Vice President (Research) at research@ajcon.net, 022-67160431 (D)

CIN: L74140MH1986PLC041941

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Website: www.ajcononline.com

Corporate and Broking Division
408 - (4th Floor), Express Zone, "A" Wing, Cello – Sonal Realty, Near Oberoi Mall and Patel's, Western Express Highway, Goregaon (East), Mumbai – 400063. Tel: 91-22-67160400, Fax: 022-28722062

Registered Office:
101, Samarth, Off. Hinduja Hospital, 151 Lt. P.N. Kotnis Road, Mahim (West), Mumbai – 400016. Tel: 022-24460335/36/40