Welspun Enterprises Limited
Q3 FY16 Results Conference Call
February 16, 2016

Moderator: Ladies and gentlemen, good day and welcome to the Welspun Enterprises Limited conference call for business update post Q3 FY16 results. From the management we have Mr Sandeep Garg – Managing Director of Welspun Enterprises and Mr. Akhil Jindal – Group-CFO and Head-Strategy. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing * then 0 on your Touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sandeep Garg. Thank you and over to you, sir.

Sandeep Garg: Thanks everybody for coming on this call. Let me introduce the team which is on this side. I am Sandeep Garg, Managing Director, Welspun Enterprises. Along with me is Mr. Akhil Jindal, who is the Group CFO and Head Strategy. Along with me is CFO Welspun Enterprises, Mr. Shrinivas Kargutkar; assisted by Mr. Kevin Daftary from Finance. We also have on line the team of Mr. Akhil Jindal, consisting of Harish Venkateshwaran and Subir Sen from Investor Relations.

First, let me start with a good news. After a long time your company decided to re-enter into the infra space. And we bided the first hybrid annuity model project of the country, which is Delhi-Meerut Expressway. We bided only for package 1 and I am happy to announce that we were the bidder who was selected to award the construction. And now for everybody just to brief that what hybrid annuity model is about, it is a new model that the Ministry and the NHAI have come up for road projects. Conventionally the projects have been either EPC or they had been BOT, which is Build Operate Transfer in that these kinds of two models have been in vogue.

The challenge was that on the PPP model that is Build own Operate Transfer the risks and rewards were not consistent. So as a PPP model of BOT the risk of all construction risk as well as collectional risks were transferred to the concessionaires, whereas in case of EPC bids, there were only construction risk being transferred to the party and there was no quality assurance possible beyond a particular time.

So hybrid annuity model, which the government came up was something which gave a better risk reward ratio. In this model the government has a budgeted number but the bidders are free to bid for the project cost. Any bidder would bid two parameters, one is what is if the cost of the project and this is called bid project cost. And an operating and maintenance cost for the period of 15 years.

So by and large the operation and maintenance period of this model is fixed to be 15 years. However the construction period keeps on changing depending upon the complexity of the projects. So total contract period is the period during which the project is constructed plus the O&M periods.

During the construction phase, the government provides a capital subsidy or a capital support of 40% of the bid price. This balance 60% the concessionaire is supposed to arrange by way of equity and debt. The revenue streams are in three manner. One is that the government pays this 60% of the capital invested over a period of 15 years in a predefined semi-annual annuities. On top of it, they pay the interest cost on the outstanding amount at a bank plus 3% rate and the third stream is whatever is bided as an O&M cost is paid by the government. So these are the three streams that the concessionaire gets.

All toll risks etc, etc are transferred to the government or NHAI. So this is in a nutshell what the hybrid annuity model is. Now as you would have anticipated, there are certain advantages of this hybrid annuity model. One because the government is subsidizing of giving a support of 40% of the total outlay, there is a less equity requirement for the developer. Then since there is a predefined annuity stream which comes in, there is ability to map the return of the debt to synchronize with the money that is supposed to flow from the NHAI and hence servicing of debt becomes much easier.

Also since interest payment is a separate revenue stream, it is possible for the concessionaire to pay the interest much easier than it is on other toll float projects. Then there is additional comfort that the government is giving in terms of the payments which are now available during the construction phase as well as during the operation and maintenance phase and they are linked to the future annuity payments rather than being restricted to a debt payment. And there are no traffic risks that the concessionaire is supposed to bear. So with these advantages we chose this to be our niche area of our play and hence chose to bid the project.

Now to brief you about this project this project is called Delhi-Meerut Expressway and we have won the package one. It is 8.716 kilometer road, for which the NHAI estimate was Rs. 663 crores approximately. We bid a price of Rs. 841.5 crores and we were declared the successful bidder on this project.

Now we proposed to fund this project in the following manner. The NHAI capital support will be 40% which is Rs. 336 crores approximately, a term loan of about Rs. 400 crores which represents 48% of the total capital cost and about Rs. 101 crores in the form of equity. So on a base case, the other advantage of this whole model is that all these prices are subject to escalation based on the WPI and CPI and hence provide a natural hedge against price increase during the construction phase as well as during the operation and maintenance phase.

To give you an idea as to how this selection of the project and the model has benefited the company. We analyzed the projects that have been awarded on EPC basis by NHAI post September and against their estimated project cost the various bidders who have taken the bids they have bided approximately minus 10% to minus 25% on the bid price, on the estimated price by NHAI the average L1 price being somewhere around negative 18%. So as against negative 18% on EPC bid, we had been able to command a price with premium of about 26% over NHAI it is primarily because of the model that we chose and the section that we chose.

Now I am sure if this is a good news as we have re-entered the business which was a concern by couple of investors posed in last few conferences and we hope that this trend will continue. The other information that I would want to share with you is and continuing with our intent to create value for the stakeholders, we have been able to divest one of the assets, road assets that we had in about partial manner. The project was known as Dewas Bhopal Corridor Limited, which is a joint venture between Welspun Enterprises and Chetak Enterprises.

We were 50%:50% JV partners, we have sold 37% of our stake and Chetak has sold its 37% of stake. Total 74% of the stake has been sold with and we have reserved our rights to be able to sell the balance 13% plus 13% based on the approval from the MPRDC/Government of Madhya Pradesh. The enterprise value was for this transaction was Rs. 662 crores, which includes contingent deferred payment of Rs. 34 crores which is on account of some claims and our debt which was taken over by the acquirer of Rs. 317 crores.

This transaction in totality has resulted on a reduction on the following situation. There has been a cash inflow of about Rs. 126 crores into Welspun Enterprises and a debt reduction of Rs. 158 crores from the books of the company. We are still owner of 13% on this entity and 13% is held by Chetak and we are reserved our right to be able to sell this stake on same price escalated by interest rate of about 12% for the period of next 24 months. With this sale of the Dewas Bhopal Corridor in part we still are left with five road projects including partial ownership of DBCL and four other road projects and one water project in Madhya Pradesh. So total BOT assets still are six on the balance sheet of the company/subsidiaries. These all BOT assets are operational at this point in time.

From the published results, you would have seen that we have taken an accelerated depreciation for operating Dewas Water Project. The 9 months accelerated depreciation is amounting to about Rs. 33 crores. The annual impact of this will be about Rs. 44 crores. The reason of doing the accelerated depreciation is that this is a conservative accounting we already have submitted to the government an alternate proposal under Swiss Challenge which we believe is about to be approved and since there will be an alternate scheme which will come into place we chose to depreciate the asset by September of 2017, which is the period when the alternate scheme will come in force, or is likely to come in force.

These are the major events of this quarter on the infra side. On the oil and gas side as I had told, we have a 35% stake in a joint venture company called Adani Welspun Exploration Ltd in which we have three relevant blocks. One block which is known as Kutch 1 or GK-OSN-2009/1. Adani Welspun has increased its stake from 20% to 25%. This field has already been declared as a find or Discovery Block. This 5% additional stake that we have acquired is at no past cost. We will only bear the additional 5% cost as we move forward. So whatever are the future expenses, we will incur, rather than 20%, 25% thereof and accordingly whatever is produced we will have our right to 25% of the produce.

The two Kutch blocks that we are, there is one more Kutch block which we call Kutch 2 even that is right now declared as a discovery and both these two blocks are under appraisal phase. And we expect that the clarity will emerge in next three quarters about their commercial viabilities.

There is one additional block which is called Mumbai Block, of which we are currently 100% interest owner in Phase I. We have put in a request to the government for surrendering the Phase I and entering into Phase II which is likely to be met. And on the Phase II we have farmed this out to ONGC who will be taking up a position of 55% and will spend their money to develop this block in the Phase II.

In addition, we also are investors in Welspun Energy. We have approximately 15% stake under the current stake and on a fully diluted basis it will be somewhere in high single digits. Our investment is restricted to Rs. 90 crores this entity has currently a 693 megawatt operational capacity, 547 megawatt as solar and 146 megawatt as wind. The current under construction solar is about 435 megawatt which is likely to be completed by June 2016.

In terms of the business going forward, our plans on the infra side are as I said, we have entered into the road space through Hybrid Annuity Model and we wish to continue to bid in this area. We believe this is a niche area where we can operate effectively. We would continue to look at the option that NHAI/Ministry is currently developing in terms of the TOT model which is Toll Operate Transfer, which is projects for which the construction has been completed. They are operational for last at least two years and have a data on what the toll collections are for past two years at least. And since they have no construction risks, we would look at it from a perspective of investing and as a business and taking over the operations of these assets.

We will also continue to look at Expressway. We are in discussions with major companies to tie up on Expressways which are likely to be awarded in next 9 to 12 months which should come up for the bidding. Since we already have one BOOT asset, we are continuing to look at bulk transmission in the water segment and as I have been saying we will continue to look at it but in a cautious manner and we would only look at projects where we have synergies of knowing the steel market and knowing the steel pipe industry well, as well as where the client has a safety and quality culture that matches our value systems.

So this is our future plan. I am done with my initial remarks.

Akhil Jindal: I think Sandeep, just to add on to what you have said. So I think the balance sheet also is an important element of the numbers that. So basically the balance sheet as on December 31 2015 our net worth stands at Rs. 1,525 crores and you would remember that we have been able to take all the losses of **Maxsteel** and otherwise and then also the net worth has been maintained at Rs. 1,525 crores with a gross debt of Rs. 99 crores left after the DBCL deal that Sandeep just mentioned. We have a cash and a cash equivalent of Rs. 889 crores so that makes it our net debt as minus Rs. 790 or the cash being Rs. 790, with the other long term liability of Rs. 38 crores, our total balance sheet size stands at Rs. 773 crores.

On the asset side, we have net fixed assets of Rs. 363 crores and these are some of the projects that Sandeep mentioned are in oil and gas and partly in road and other assets. And the other long term investments of Rs. 348 crores. So you would appreciate that on one side, we have a net worth of Rs. 1,525 crores and on another side we have a net debt of minus Rs. 790 crores and that makes the balance sheet extremely healthy and capable enough for us to take the projects and complete the projects in time and also be shortlisted in many of the projects that Sandeep just mentioned as a higher priority area for us going forward.

So I thought I would just mention you about the balance sheet. So that is it from my side. Sandeep, you can continue.

Sandeep Garg: Okay, thank you Akhil thanks for coming in and pitching in. I think we can now start taking the question and answers from the investors.

Moderator: Thank you very much. We will now begin with the question and answer session.

The first question is from the line of Prabhat Anantharaman from HDFC Securities. Please go ahead.

Prabhat Anantharaman: Has the execution started on the Hybrid Annuity Model, the Delhi-Meerut Expressway?

Sandeep Garg: The project has been awarded to us on 6 January 2016. The concession will be signed by the end of February and there is a time difference of about 150 days for between the concession signing and the appointed date for the CPs to be completed by both parties that is NHAI and us. So we expect the ground execution to start somewhere around September of this year.

Prabhat Anantharaman: And sir, in terms of execution have we employed any in-house execution team or we will outsource the EPC work?

Sandeep Garg: The model that we are going to follow, we do have our in-house execution team which is already on ground. However as a decision we have taken at the corporate level that we would prefer to outsource the construction to the construction partners. And as I had addressed in my initial remarks, if you had noticed that most of the EPC bids are going at about minus 18% over the estimates of NHAI that is a very highly competitive environment and it does not become value accretive for us to do things at those price levels. So we are going to be outsourcing the construction.

Prabhat Anantharaman: Have you signed up with some sub-contractors or could you give us the names of few sub-contractors that you are looking at, who will perform the execution work for you?

Sandeep Garg: See we have not signed up at this point in time and it will be detrimental to the company's interests for somebody to know which are the active parties under consideration. But we are likely to finalize our sub-contracts, the offers are already in and about three weeks from now and then we can declare the successful bidders names.

Prabhat Anantharaman: And sir, in terms of order books so our order book today is basically Rs. 841 crores of this project, that is it, and no other major orders in the book?

Sandeep Garg: Yeah, another about Rs. 60 crores, Rs. 70 crores of legacy EPC work and in addition we have this BOT assets, which I talked about in my initial opening statement.

Prabhat Anantharaman: And sir, what kind of pipeline are we looking for the Hybrid Annuity Model over the course of the next one or two years and in terms of how much order inflow are we expecting and which projects are we looking at?

Sandeep Garg: See we are currently looking at orders worth about Rs. 5,000 crores which are likely to be tendered between now and May 2016. This is the pipeline that we are looking at this point in time. And since I cannot predict the success factors so I would restrain from giving an indication on an order book. But this is what my top of the canvas is. And in terms of the Hybrid Annuity Model, the intent of the government is to put about 30% of their total road projects in that Hybrid Annuity Model. So the quantum of work is substantial over the next few years.

Prabhat Anantharaman: This Rs. 5,000 crores you mentioned is only for hybrid annuity that you are looking at?

Sandeep Garg: That is correct.

Prabhat Anantharaman: And you have submitted bids in all projects for Rs. 5,000 crores or?

Sandeep Garg: These are announced bids but not bided at this point in time.

Prabhat Anantharaman: And sir, you mentioned you are going to look at toll model but sir I would ask you the question is why I mean the reason we are doing Hybrid Annuity Model is because the risk does not come and those kind of risks comes on except for the execution part which we are obviously going to tie up with some reputed sub-contractor to do it. But sir, then why would we take this traffic risk on our hands by doing this toll model?

Sandeep Garg: The Company has developed an expertise of operating and maintaining the roads. We have done successfully for six roads. Now given that these projects are completed and have a history of tolling which is more than two years the interpolation or extrapolation of that data is much easier to do rather than have a situation where you have no toll data and you are taking a risk. Now we believe that this model can give a very good return going forward and if that is the case then we are surely going to look at it but we are going to be as conservative as we should be in taking any decision on a toll based road project. So we are going to be if that gives us a reasonable surety on the tolling as well as the returns, then only we are going to enter into it.

Prabhat Anantharaman: Sir, which geographies if I may ask you are looking at for this toll based projects?

Sandeep Garg: Largely in Rajasthan, Gujarat, Madhya Pradesh these are the three states that we would look at.

Prabhat Anantharaman: And sir, my last question is so you mentioned you are apart from the 40% support you will get from NHAI for the Delhi-Meerut Expressway you plan to deploy Rs. 400 crores in term loans and Rs. 100 crores in equity?

Sandeep Garg: Yeah.

Prabhat Anantharaman: And sir, have you already tied up the term loans or this is basically the Board has approved and you are yet to?

Sandeep Garg: So Akhil, would you want to take this question?

Akhil Jindal: Yeah, see basically the way this is to be funded as and Sandeep mentioned to the investors and analysts in the beginning that 40% will come from the government, 60% is what we need to fund. And out of 60% let us say around 12% is us and 48% is the debt. So while we speak I can make an announcement that we have almost reached an in principle tie up within a period of last 20 odd days, since the time we have initiated this process.

I think two things have come into play. One is the very fact that the risk reward model is now quite balanced the developer is not being exposed to disproportionate amount of risk as it is earlier, plus of course Welspun's own credibility in the banking sector that has helped extensively. So within 20 days if we are able to have an in principle tie up of the entire Rs. 400 crores of debt. And as per the concession agreement we have six months' time. So I am sure by the time we will actually achieve the financial closure, the project would have achieved significant progress any which way.

Prabhat Anantharaman: Why I asked this question sir is because speaking to other road developers, we get the sense that the bankers are not quite confident about those models yet?

Akhil Jindal: You are right yeah, so there is lot of education which is going on, you are absolutely right the bankers are firstly they are saddled with their own issues in terms of the other road projects, number one. Secondly, they have not understood this risk mechanism adequately enough. So there is lot of education going on while we are talking. NHAI is doing their bit, Welspun is doing their bit, SBICAP is doing their bit, E&Y, Deloitte, everyone is involved, everyone is helping the lenders to understand the risk mitigation mechanism that the government has built in here.

So you are right, I mean this has not been easy for us to go through each and every lender and to explain to him the distribution of risk returned mechanism. So you are right I mean for some lenders who are badly burnt because of the infrastructure delays and NHAI of past payment issues and so many other factors. They could be nervous but believe me there are equal amount of lenders who are also very keen to kind of a deal with the good close with a good balance sheet. And as long as we can show them that it could be as long as we can tell them that our equity is almost ready and it can be formed any day that we want. The lenders stay sort of comfortable.

Moderator: Thank you. The next question is from the line of **ASN Raju** from Networth Stock Broking. Please go ahead.

ASN Raju: Congratulations for the new business model it is well understood by the management and bid it for it and awarded. The other is when we are going to get revenue from oil business?

Sandeep Garg: Mr. Raju, the oil and gas business is a long gestation business. Now we have as I said, two blocks we already have a discovery. the next steps to this is going to be that we will do an appraisal program which or the pace for an appraisal program is anything between 18 months to 24 months. So after the appraisal program is completed and we find there is a commercial viability of it, then the commercial wells are grilled and our connected infrastructure to bring the produce is built along side and then the production starts. So if assuming everything goes by the book, we can see the revenues from these two blocks in about three years from now.

ASN Raju: Sandeep, I am very much impressed with your toll projects, which were already constructed. Definitely in the long term we will get a good revenue as India is growing, everything growing on. Now everyone is ready to sell. So if we buy in this time by observing carefully, we will get a very good business from them I think so?

Sandeep Garg: Thank you, Mr. Raju. Thank you for appreciating our insights.

ASN Raju: And third one. Consolidated quarterly balance sheet and what is the necessity of getting loans as everyone says that Rs. 790 crore net cash and cash equivalent is there? What is the necessity for going to debt for the new annuity project?

Sandeep Garg: Two points. The idea is to now as you have rightly said it is time for us to grow. If I were to execute the complete project by the equity which means that I will pump in about Rs. 500 crores into this project, I would be left with about Rs. 300 crores which means I can do at best another one project. We believe that this window of making disproportionate profits is available for about 18 months when most of the players in the market are stressed and we would want to use the balance sheet strength to maximize the returns from my shareholder, given that the balance sheet is strong we can borrow at much lower cost than anybody else. And we can lever, at a SPV level in a proportionate manner. We believe that the value creation for the stakeholders is going to be much larger if we take debt rather than did everything from our expertise**.**

ASN Raju: My one more last question. When we are having cash and when we are interested to buy new toll roads why we sold the Dewas-Bhopal Road?

Sandeep Garg: Two reasons, for that decision making. As our business model says that this space itself is not a hold to maturity model for a company like ours. The company like ours is supposed to invest, supposed to manage certain risks better than others. And when it becomes totally stable, churn it to low cost debt like insurance, the pension funds and things like that, who are a low cost debt operators and like the stable revenue streams. So the rationale of churning that particular projects were one that it had become almost like a stable revenue stream. Secondly, because it had completed five-and-a-half years an overlay was due on the project, which would have needed about investment of about Rs. 60 crores to Rs. 70 crores. And we believe that we could utilize those Rs. 70 crores in an alternate project much more effective and get better returns for our stakeholders and hence we decided to divest the investment.

ASN Raju: What will be the remaining value 13% stake value, sir?

Sandeep Garg: About Rs. 29.5 crores.

Moderator: Thank you. The next question is a follow up from the line of Prabhat Anantharaman from HDFC Securities. Please go ahead.

Prabhat Anantharaman: Sir, about your toll projects that the toll models that you are going bid, can you share with us if you are looking to bid for the Shivpuri-Dewas or the Kishangarh-Udaipur projects?

Sandeep Garg: No, we are not.

Prabhat Anantharaman: But they are kind of in the same geography that you are looking at?

Sandeep Garg: Yeah, I am looking at those geographies but not on those two projects.

Prabhat Anantharaman: Okay and sir just like now that we have so much cash on the book is there any change to our dividend policy for March 2016?

Akhil Jindal: I think I have to practically repeat what we said at the last call also. The company has been able to successfully exit from some of the assets that it wanted to exit. So now it is a matter of time that our board all sit together and take a view on the sustainable dividend policy. What we do not want is to have a dividend in one year and then we might have to wait for a couple of years or something of that kind. So I think this is a very important topic for the Board and Board is already discussing a sustainable dividend guidance, which I think would be more suitable at the end of the year at the April balance sheet time.

Prabhat Anantharaman: Okay so it is like a more sustainable dividend policy is what you are guiding at?

Akhil Jindal: That is right I mean the Board certainly wants some dividend guidance to be given and to be continued forever I mean as long as it can. So to that extent the view can be taken at the year-end balance sheet.

Prabhat Anantharaman: Okay and sir, just a last question. Are the promoters buying more from the market after the last time that they purchased?

Akhil Jindal: I can only say that the creeping acquisition is a way of promoters to increase their stake. Clearly promoters are at a level where they feel they could certainly buy more and they have bought around 2%, 2.5% in this financial year. So I would not rule out any possibility of buying in the future but that certainly is their own internal decision.

Moderator: Thank you. As there are no further questions, I would now like to hand the floor over to Mr. Sandeep Garg for closing comments.

Sandeep Garg: Thank you everyone. We really appreciate your taking time to come on this call and supporting us in our attempt to create value for the stakeholders. We look forward to you supporting the company in future and assure you that we will do our best to create value for you.

Moderator: Thank you. On behalf of Welspun Enterprises Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.