On the growth highway

Pub Date:	08 Feb 2016	Publication:	The Hindu Business Line	Edition:	New Delhi
Journalist:	Seetharaman R	Language:	English	Page No.:	4
CCM:	100.68	MAV:	155048.27	Circulation	13046

IRB Infrastructure Developers

On the growth highway

The company's track record of executing projects on time is an advantage

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Investors with a long-term perspective can buy the stock of leading road developer IRB Infrastructure Developers. The company's order book has been growing at a healthy pace and earnings growth has revived in recent times.

This should continue, given the strong thrust to road projects by the government and the National Highways Authority of India (NHAI) through key policy changes. IRB as a major developer should benefit.

The stock, after a solid 2014 election rally, has lost about 8 per cent over the past year. Given the company's growth prospects, the current valuation does not seem expensive. At ₹234, the stock trades at about 12 times its estimated 2016-17 earnings, much lower than 27 times its peer Ashoka Buildcon trades at.

Government thrust

The years 2012-13 and 2013-14 saw bidding for build, operate and transfer (BOT) projects fall significantly. This was due to growing debt , land acquisition problems and high premium payments starting from the first year of operations. To counter this, the government has taken two key steps. One, it has allowed premium payment by developers to commence three years after the start of operation of the BOT toll projects.

Next, it has approved the Hybrid Annuity Model (HAM), a 40:60 mix of EPC (construction contract) and BOT annuity models. This removes the traffic risk for road developers and assures annuity income during the operation phase of the concession period.

These measures have helped to revive bidding for road projects this fiscal. NHAI plans to bid out over 15,000 plus km road network over the next three to four years.

Leading player

IRB is among the big boys in the road sector in the country. Its portfolio of 21 BOT projects (14 operational, six in construction phase and one won recently) is among the largest in the country.

Given its track record of winning BOT contracts and executing them well, the company can be reasonably expected to get a fair share of the upcoming projects over the next few years. The recent big win of the ₹10,000 crore plus Zozila pass project in Jammu and Kashmir — IRB's first BOT annuity contract — lends confidence. With this, IRB's order book stands at ₹17,320 crore — at 4.5 times 2014-15 revenue — that provides good construction earnings visibility.

The Zozila pass project will earn the company semi-annuity revenue of ₹981 crore from 2022 for 15 years. Annualised, this revenue is almost half of what it was in 2014-15.

IRB has indicated it will be agnostic towards the type of contracts it will bid for, whether BOT toll, BOT annuity or HAM, as long as it gets a competitive 18 per cent plus return on its investment.

Reviving finances

For the nine months ending December 2015, IRB's consolidated revenue grew 25 per cent year-on-year while profit grew 20 per cent. This is a strong revival from the performance in the period between 2013 and 2015.

A few factors helped. One, the company's construction activity picked up and revenue grew a robust 37 per cent. Traffic growth grew at about 7 per cent. This along with easing of premium payment terms on the NH1 – Ahmedabad-Vadodara project, and the start of tolling on the NH-8 – Ahmedabad-Vadodara segment helped consolidated toll revenue grow 13 per cent.

Toll and construction revenue accounted for about 41 per cent and 56 per cent of overall revenue for the nine months ended December 2015.

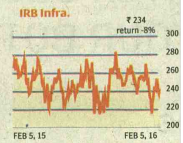
With the Agra-Etawah project's construction and partial tolling expected to begin in the first quarter of 2017, revenue and earnings growth should continue at a good pace in the near term. In the long run, the completion of the six under-construction projects and new project wins should help.

IRB's net debt-to-equity ratio is about 2.7 times as of December 2015 and interest cover was around 1.6 times. This is not too high considering the dynamics of the business and the high leverage of many peers.

As the company starts monetising some projects through investment trusts , the company's leverage levels can improve.

Why

- Favourable policy environment
- Healthy order book
- Steady traffic growth

Did you know?

The ₹10,000 crore plus Zozila pass contract won by IRB is the largest awarded by NHAI so far in terms of project cost