Construction

Construction - 1QFY23 results review

- With 3x order book/sales, companies must fund 24% of their order book, like in FY19. Execution can rerate DBL, PNC, and NCC.
- Prolonged cut in excise duty on diesel can dent order execution in the infrastructure sector - a key risk.
- Our preferred stock picks are PNC Infra (TP Rs316), IRB Infra (TP Rs293), NCC (TP Rs 80) and Dilip Buildcon (TP Rs400).

Strong execution can rerate DBL, PNC, NCC

EPC companies' 1QFY23 sales grew on an average by 22% yoy. The exaggerated yoy growth was due to weak execution in 1QFY22 as it was hit by the second wave of the Covid-19 pandemic. EBITDA of EPC companies grew 9% yoy, lower than sales growth due to a 27% yoy fall in DBL's EBITDA despite its 22% yoy sales growth. Since Mar 2020, order flow has picked up (Rs1,117bn in FY21-YTDFY23), resulting in average OB-to-sales of 3x (latest). This augurs well for sales growth in FY24F. The companies in our coverage must fund 24% of their latest OB (like in FY19). Dilip Buildcon (DBL), PNC Infra (PNC) and NCC trade at an average 23% discount to their 5-year average EV/EBITDA. We believe strong EPC sales growth in FY23F-24F can rerate the valuation multiples. KNR Constructions (KNR) trades at a 38% premium to its 5-year average EV/EBITDA. DBL and NCC have the highest target EPC segment enterprise value as a proportion of target equity valuation. Rerating of EV/EBITDA multiple and/or a strong financial performance can have the highest impact on DBL and NCC. Consolidated net debt/market capitalization is high for DBL. Thus, an expansion in EV of DBL can have a substantial impact on its share price.

Prolonged cut in diesel excise duty can dent infra order execution

The government's recent reduction (May 2022) in excise duty on petrol and diesel by cutting road and infrastructure cess will increase the shortfall for these schemes. Consolidated Fund of India (CFI) will bear the shortfall. For FY23F, the finance ministry has budgeted Rs1.38tr to come from cess. The expected utilization from this fund was budgeted at Rs2.95tr, with the shortfall (Rs1.56tr) to be borne by CFI. Reduction of the cess will add an extra Rs1tr to the shortfall. During FY22, out of Rs2.48tr cess, Rs0.9tr/ Rs0.6tr/ Rs0.5tr was used by road/ railway/ drinking water sectors, respectively. Out of government funding for road/ rail sectors, 45%/ 40%, respectively, was from cess. A temporary shortfall can be met by higher utilization of CFI funds. However, persistent high crude oil prices and low excise duty on petrol/diesel can dent infrastructure order execution. During elevated oil prices (FY11-14), government spending on infrastructure was muted (1% CAGR over FY09-13) while over FY15-17 (benign oil prices), its spending on infrastructure rose by a 18% CAGR (FY14-17).

Our preferred picks are PNC Infra, IRB Infra, NCC, and Dilip Buildcon

We use discounted cash flow or DCF for valuing operational road assets and 1x capex for under-construction road assets. We use EV/EBITDA FY24F to value the EPC verticals of DBL (5x; 25% discount to 5-year median), KNR (7.5x; 17% premium to 5-year median), PNC (6x; close to 5-year median), NCC (5.5x; 15% discount to 5-year median) and IRB Infra (4x). We value the assets of IRB InvIT using a discount rate of 10.7%. Difficulty in financial closure of new Hybrid Annuity Model (HAM) projects is a downside risk for the sector.

Figure 1: 1QFY23 result summary

(Rs m)	Revenue	yoy %	qoq %	EBITDA	yoy %	qoq %	Adj. PAT	yoy %	qoq %
IRB Infra	15,066	(7)	5	6,926	(1)	(14)	954	12	(46)
IRB InvIT	2,911	15	(24)	2,425	22	(26)	1,028	(5)	(2)
Dilip Buildcon	26,215	22	5	2,054	(27)	(13)	198	(27)	563.2
PNC Infra	17,211	38	(6)	2,208	26	(5)	1,295	39	(11)
NCC	29,586	56	(6)	2,812	41	5	1,200	132	10
KNR Constructions	8,906	20	(12)	1,650	15	(19)	1,008	38	(1)

SOURCE: INCRED RESEARCH, COMPANY REPORTS

India

Overweight *(no change)*

Highlighted Companies

Dilip Buildcon Ltd

ADD, TP Rs400, Rs250 close

DBL has a strong order book or OB (2.9x TTM sales) and 85% of OB is expected to be under the construction phase in FY24F. DBL trades at an attractive valuation of 3.9x FY23F EV/EBITDA, at a 35% discount to its five-year average.

IRB Infrastructure Developers Ltd

ADD, TP Rs293, Rs261 close

Fund-raising has provided growth capital, but at a 72% equity dilution. Recent project win, in our view, provides EPC revenue growth visibility.

NCC Ltd

ADD, TP Rs80, Rs65 close

After securing orders worth Rs143bn in FY22-YTDFY23, OB/sales stood at 3.7x. This, in tandem with the beginning of execution of Rs99bn 'Jal Jeevan project', in our view, augurs well. NCC trades at an attractive valuation (5.3x FY23F EV/ EBITDA vs. five-year median of 6.5x).

Summary Valuation Metrics

P/E (x)	Mar23-F	Mar24-F
Dilip Buildcon Ltd	8.39	7.18
IRB Infrastructure Developers Ltd	13.06	8.11
NCC Ltd	7.92	6.79

P/BV (x)	Mar23-F	Mar24-F
Dilip Buildcon Ltd	1.1	0.96
IRB Infrastructure Developers Ltd	1.13	1
NCC Ltd	0.66	0.6

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Strong order flow momentum of FY21-22 continues in YTDFY23

EPC companies' sales grew on an average by 22% yoy. The exaggerated yoy growth was due to weak execution in 1QFY22 as it was impacted by the second wave of the Covid-19 pandemic. EBITDA of EPC companies grew 9% yoy, lower than the sales growth (22% yoy) due to a 27% yoy decline in DBL's EBITDA despite a 22% yoy growth in the company's sales.

After a strong order flow in FY18-19, net order flow plummeted in FY20 to Rs39bn (90% yoy decline) for EPC companies in our coverage universe, partly due to order cancellations in FY20 in case of NCC (Rs132bn) and IRB Infra (Rs35bn). Adjusted for cancellations, FY20 order flow stood at Rs211bn (a 50% yoy decline).

For EPC companies in our coverage, sales grew 36% yoy in FY19 due to strong order book (OB)-to-sales ratio in FY18 (average 3.6x) and healthy order flow in FY19. In FY20, sales declined 5% yoy as order flow dried up. OB-to-sales ratio declined to just 2.2x in FY20. Since Mar 2020, order flow has picked up (Rs1,117bn in FY21-YTDFY23). Thus, average OB-to-sales ratio for companies under our coverage was 3x (latest). This augurs well for sales growth in FY24F.

Figure 2: Order flow over FY19 to YTDFY23 for EPC companies in our coverage

	Order inflow				
(Rs bn)	**FY19**	**FY20**	**FY21**	**FY22**	**YTD FY23**
Dilip Buildcon	64	69	175	72	43
NCC	207	(64)	186	99	44
PNC Infra	80	12	79	92	74
IRB Infra	6	(12)	68	73	-
KNR Constructions	38	35	48	52	12
Total	**396**	**39**	**557**	**388**	**173**

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 3: OB-to-sales and sales growth of EPC companies in our coverage universe

	Order book/ Sales (x)						yoy Sales growth (%)				
	FY18	**FY19**	**FY20**	**FY21**	**FY22**	**Latest**	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Dilip Buildcon	3.1	2.3	2.1	3.0	2.8	2.9	18	(2)	3	(2)	22
NCC	4.3	3.4	3.2	5.2	4.0	3.7	60	(32)	(12)	39	56
PNC Infra	4.1	4.0	1.8	2.4	2.4	3.1	71	55	3	26	38
IRB Infra	3.9	2.4	0.9	2.0	2.7	2.6	19	11	(25)	13	(17)
KNR Constructions	1.2	1.9	2.4	2.6	2.8	3.0	11	5	20	22	9
Total	**3.5**	**2.9**	**2.2**	**3.3**	**2.9**	**3.0**	**36**	**(5)**	**(5)**	**18**	**22**

SOURCE: INCRED RESEARCH, COMPANY REPORTS

24% of FY22 OB has to be funded by private road developers, similar to FY19 (24%)

Around 20% of latest OB of companies in our coverage comprise hybrid annuity model (HAM) projects. The concessionaire bears 60% of the project cost of HAM projects and the project-awarding authority bears the remaining 40%.

12% of FY22 OB comprises build-operate-transfer (BOT) projects, which the concessionaire has to fund entirely. As a result, the companies in our coverage have to fund 24% of FY22 OB.

Figure 4: Percentage of OBs to be funded by companies in our coverage universe

	Order book FY19		Order book Latest	
(Rs bn)	**Total**	**% to be funded by company**	**Total**	**% to be funded by company**
Dilip Buildcon	212	30	273	25
NCC	412	-	406	-
PNC Infra	122	34	204	34
IRB Infra	111	85	95	97
KNR Constructions	40	40	94	29
Total	**897**	**24**	**1,072**	**24**

SOURCE: INCRED RESEARCH, COMPANY REPORTS

FY23F EV/EBITDA of the EPC segment is at a discount to historical levels, except for KNR Constructions

DBL, PNC and NCC trade at an average 23%/34% discount to their 5-year/ Mar 17-19 average EV/EBITDA, respectively. We believe strong EPC sales growth in FY23F-24F can rerate the valuation multiples close to historical levels. KNR Constructions trades at a sharp 38%/29% premium to its 5-year/ Mar 17-19 average EV/EBITDA, respectively.

Figure 5: Valuations of main third-party construction companies

	EV/ EBITDA (x) for EPC segment			Premium (%) of current FY23F multiple vs.	
	5-year average	**Mar 17-19**	**Current FY23F**	**5-year average**	**Mar 17-19**
Dilip Buildcon	6.6	7.6	3.9	(41)	(49)
NCC	6.5	6.7	5.3	(18)	(21)
PNC Infra	6.1	8.2	5.6	(8)	(32)
KNR Constructions	6.4	6.8	8.8	38	29
Average	**6.4**	**7.3**	**5.9**	**(8)**	**(19)**

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Salient features of 1QFY23 results

Dilip Buildcon - pieces falling in place for a strong FY24F: Sales rose 5% qoq while opex rose 6% qoq, leading to EBITDA declining 13% qoq. EBITDA margin declined 530bp yoy on account of cost overrun due to delay in legacy HAM projects won in FY18. DBL mentioned that the remaining value of low-margin projects is just Rs4-5bn (2% of OB) – which augurs well for margin in the rest of FY23F. DBL gave sales guidance of Rs100bn for FY23F with ~13% EBITDA margin – we believe this is achievable as OB stands at Rs273bn (2.9x TTM sales). Around 85% of OB is likely to be live by 4QFY23F, which augurs well for execution in FY24F.

IRB Infra - operating results in line but PAT elevated due to one-off: PAT was boosted by Rs4.2bn sales/ Rs3.7bn EBITDA arbitration award from the National Highways Authority of India or NHAI. Excluding the one-off, EPC sales / EBITDA declined 17%/ 27% yoy, respectively. EPC OB was at Rs95bn in Jun 2022 (2.6x TTM sales) – no new orders in 1QFY23. Tolling at IRB Infra's assets/ private InvIT/ public InvIT grew 8%/ 12%/ -28% qoq, respectively. After the recent equity raising, net debt/EBITDA ratio is likely to reduce from 4.6x (FY21) to 1.3x (FY23F). We believe this can rerate IRB's EPC vertical, but at 72% equity dilution.

PNC Infra - 3.1x order book cover provides revenue visibility: Sales/EBITDA declined 6%/ 5% qoq, respectively, while EBITDA margin was flat qoq but down 120bp yoy due to high raw material prices. PNC Infra gave guidance of 15% yoy EPC sales growth and 13-13.5% EBITDA margin for FY23F – in line with our estimates. PNC Infra has L1 status in seven HAM projects of Rs74bn EPC value (not part of OB). Including these, OB stands at Rs204bn (3.1x TTM sales).

NCC - strong execution and order flow: Despite a 6% qoq dip in sales, EBITDA rose 5% qoq. EBITDA margin was at 9.5% (vs. 8.5% in 4QFY22), and NCC expects it to rise to 11.5% in subsequent quarters with the easing of prices of key raw materials. Post Rs144bn orders in FY22-1QFY23, OB/sales ratio is at 3.7x. NCC expects ~Rs40bn revenue from the Rs99bn Jal Jeevan Mission project of Uttar Pradesh government in FY23F.

KNR Constructions - slow execution mars results: EPC sales/EBITDA declined 12%/19% qoq, respectively, and EBITDA margin was at 18.5% vs. 20.3% qoq and the 3-year average at 20% due to muted execution in irrigation projects. OB in 1QFY23 stood at Rs86bn (2.5x TTM sales). KNR has won a Rs7.7bn HAM project (Chittoor-Thatchur) which is not a part of Jun 2022 OB. Including this, OB rises to Rs94bn (2.7x TTM sales). The entire OB is expected to be the under construction phase in the rest of FY23F.

IRB InvIT - strong results driven by tariff hike: Gross toll for four assets (excluding Pathankot-Amritsar, Bharuch-Surat, and Surat-Dahisar) grew 70% yoy as traffic yoy in 1QFY22 was impacted due to the second Covid-19 wave and tariff hike of 8-10% in all projects since 1QFY22. Payout was Rs2/unit, in line with the guided run-rate of Rs8/unit for FY23F – a 14% yield based on CMP. Based on CMP and InvIT regulations, IRB InvIT can have debt of up to Rs75bn vs. net debt of Rs12bn as at end-Mar 2022. Thus, we estimate that further acquisitions of up to Rs63bn can be funded via debt, beyond which equity raising would be required. We believe IRB InvIT trades at a fair valuation with an internal rate of return or IRR of 9.5% with 4% p.a. long-term traffic growth, in line with a 3.8% traffic CAGR over FY18-20.

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