India

Overweight *(no change)*

Highlighted Companies

Dilip Buildcon Ltd

ADD, TP Rs400, Rs221 close

DBL has a strong order book or OB (2.7x TTM sales) and 80% of OB is expected to be under the construction phase in FY24F. DBL trades at an attractive valuation of 4.1x FY23F EV/EBITDA, at a 38% discount to its five-year average.

IRB Infrastructure Developers Ltd

ADD, TP Rs293, Rs251 close

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

Summary Valuation Metrics

P/E (x)	Mar23-F	Mar24-F
Dilip Buildcon Ltd	7.4	6.34
IRB Infrastructure Developers Ltd	12.53	7.78

P/BV (x)	Mar23-F	Mar24-F
Dilip Buildcon Ltd	0.97	0.85
IRB Infrastructure Developers Ltd	1.09	0.96

Dividend Yield	Mar23-F	Mar24-F
Dilip Buildcon Ltd	0.54%	0.54%
IRB Infrastructure Developers Ltd	0%	0%

Construction

Construction - 2QFY23 results review

- With 2.8x order book/sales, companies must fund 23% of their order book, like in Mar 2019. Execution can rerate Dilip Buildcon and PNC Infra.
- Our preferred stock picks are PNC Infra (TP: Rs316), IRB Infrastructure Developers (TP: Rs293), and Dilip Buildcon (TP: Rs400).

Strong execution can rerate Dilip Buildcon & PNC Infra

EPC companies' 2QFY23 sales grew on an average by 14% yoy. EBITDA of EPC companies grew 7% yoy, lower than sales growth, due to weak margins of NCC and KNR Constructions. Since Mar 2020, order flow has picked up (Rs1,224bn in FY21-YTDFY23), resulting in an average order book or OB-to-sales of 2.8x (latest). This augurs well for sales growth in FY24F. The companies in our coverage must fund 23% of their latest OB (like in Mar 2019). Dilip Buildcon (DBL), PNC Infra (PNC) and NCC trade at an average 21% discount to their five-year average EV/EBITDA. We believe strong EPC sales growth in FY23F-24F can rerate the valuation multiples of DBL and PNC. KNR Constructions (KNR) trades at a 23% premium to its five-year average EV/EBITDA. DBL has 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. Consolidated net debt/market capitalization is high for DBL. Thus, an expansion in the EV of DBL can have a substantial impact on its share price.

Our preferred picks are PNC Infra, IRB Infra & Dilip Buildcon

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

Analyst(s)

Rajarshi MAITRA
T (91) 22 4161 1546
E rajarshi.maitra@incredcapital.com

Dipen VAKIL
T (91) 22 4161 1551
E dipen.vakil@incredcapital.com

: 2QFY23 results summary

(Rs m)	Revenue	yoy %	qoq %	EBITDA	yoy %	qoq %	Adj. PAT	yoy %	qoq %
IRB Infra	12,840	(12)	(15)	6,061	(16)	(12)	500	(8)	(48)
IRB InvIT	1,994	(36)	(31)	1,591	(37)	(34)	735	1	(28)
Dilip Buildcon	22,619	5	(14)	2,613	15	27	642	(432)	224.0
PNC Infra	15,611	(3)	(9)	2,070	(7)	(6)	1,311	(3)	1
NCC	30,037	37	2	2,886	22	3	1,216	66	1
KNR Constructions	8,155	8	(8)	1,569	(6)	(5)	757	(21)	(25)

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Construction - 2QFY23 results review

Strong order flow of FY21-22 continues in YTDFY23

EPC companies' 2QFY23 sales grew on an average by 14% yoy. EBITDA of EPC companies grew by 7% yoy, lower than sales growth, due to weak margins of NCC and KNR.

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 (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 a 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 (Rs1,224bn in FY21-YTDFY23). Thus, average OB-to-sales ratio for companies under our coverage was 2.8x (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	56
NCC	207	(64)	186	99	71
PNC Infra	80	12	79	92	78
IRB Infra	6	(12)	68	73	60
KNR Constructions	38	35	48	52	15
Total	**396**	**39**	**557**	**388**	**280**

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	1HFY23
Dilip Buildcon	3.1	2.3	2.1	3.0	2.8	2.7	18	(2)	3	(2)	14
NCC	4.3	3.4	3.2	5.2	4.0	3.4	60	(32)	(12)	39	47
PNC Infra	4.1	4.0	1.8	2.4	2.4	2.9	71	55	3	26	18
IRB Infra	3.9	2.4	0.9	2.0	2.7	2.5	19	11	(25)	13	(14)
KNR Constructions	1.2	1.9	2.4	2.6	2.8	2.5	11	5	20	22	14
Total	**3.5**	**2.9**	**2.2**	**3.3**	**2.9**	**2.8**	**36**	**(5)**	**(5)**	**18**	**17**

SOURCE: INCRED RESEARCH, COMPANY REPORTS

23% of 1HFY23 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 23% 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	263	24
NCC	412	-	400	-
PNC Infra	122	34	193	33
IRB Infra	111	85	88	97
KNR Constructions	40	40	88	29
Total	**897**	**24**	**1,032**	**23**

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 21%/32% discount to their five-year/ Mar 2017-19 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 23%/16% premium to its five-year/ Mar 2017-19 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	4.1	(38)	(46)
NCC	6.5	6.7	5.9	(9)	(12)
PNC Infra	6.1	8.2	5.2	(15)	(37)
KNR Constructions	6.4	6.8	7.9	23	16
Average	**6.4**	**7.3**	**5.8**	**(10)**	**(21)**

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Salient features of 2QFY23 results ›

Dilip Buildcon - pieces falling in place for a strong FY24F: Sales rose 5% yoy while EBITDA grew 15% yoy. EBITDA margin (11.6%) improved by 370b qoq. DBL maintained its FY23F sales guidance of Rs100bn (vs. Rs49bn in 1HFY23) – which is achievable as OB is at 2.7x TTM sales. DBL gave guidance of ~13% EBITDA margin (vs. 9.6% in 1HFY23) – this requires a 15-16% EBITDA margin in 2HFY23F. DBL is optimistic of high margins in 2HFY23F as (a) low-margin old projects are complete, and (b) it expects to receive early completion bonus in 3QFY23F.

IRB Infra - start of Ganga Expressway and divestment of VK1 are positives: EPC sales / PBITDA declined by ~10% yoy each. IRB Infra gave FY23F EPC sales guidance (net of Goods and Services Tax or GST) of Rs45bn vs. 1HFY23 sales of Rs20bn. IRB Infra clarified that this is not a reduction in EPC sales guidance of Rs50bn, as that was gross of GST. EPC OB is at 2.5x TTM sales. IRB Infra received the appointed date (AD) for Ganga Expressway – Pkg. 1 (Oct 2022) and expects the AD for Chittoor-Thachur in 3QFY23F. Vadodara Kim (VK1) is being transferred to IRB InvIT for an enterprise value or EV of Rs13bn.

PNC Infra - 2.9x order book cover provides revenue visibility: Sales/ EBITDA declined 3%/ 7% yoy, respectively, while EBITDA margin dipped by 40 bp yoy. PNC Infra maintained its 15% yoy EPC sales growth guidance and 13-13.5% EBITDA margin for FY23F – in line with our estimates. PNC Infra signed concession agreements for seven HAM projects worth Rs74.4bn EPC value (not part of OB). Including these, OB is at 2.9x TTM sales. Out of 11 HAM projects (excluding seven recent ones), five are operational and six are under construction (balance construction value of Rs33bn). The balance construction value of HAM projects is Rs107bn (55% of OB) and PNC Infra has to finance 33% of its OB.

NCC - strong results and guidance: While sales/EBITDA grew 37%/ 22% yoy, respectively, EBITDA margin was at 9.6% (vs. 10.8% yoy). NCC is confident of ~10% EBITDA margin and gave guidance of ~30% yoy sales growth for FY23F. This implies sales guidance of Rs129bn for FY23F vs. Rs60bn in 1HFY23. Post Rs180bn orders in FY22-2QFY23, OB/sales ratio is at 3.4x (Rs400bn consolidated OB). NCC expects ~Rs40bn revenue from the Rs79bn Jal Jeevan Mission project of Uttar Pradesh government in FY23F.

KNR Constructions - steady results, trading at fair valuation: EPC sales/ EBITDA rose 8%/ dipped 6% yoy, respectively. EBITDA margin was at 19.2%, similar to three-year average of 20%. OB in 2QFY23 stood at Rs80bn (2.3x TTM sales). KNR Constructions has won a Rs7.7bn HAM project (Chittoor-Thatchur) which is not part of Sep 2022 OB. Including this, OB rises to Rs88bn (2.5x TTM sales).

IRB InvIT - Decent results driven by tariff hikes: Gross toll income of four assets grew 20% yoy due to a tariff hike of 10% in these projects since Apr 2022 and 15% in Omalur Salem Namakkal project (OSN) from Sep 2022. Payout was at Rs2.05/unit, in line with the guidance of Rs8 for FY23F. Based on CMP (Rs63), this implies a yield of 13% in FY23F. IRB InvIT fund has acquired 100% stake in VK 1 from IRB Infra (sponsor) in Oct 2022 for Rs3.4bn (EV of Rs13bn). Based on CMP and InvIT regulations, IRB InvIT can have debt of up to Rs75bn vs. net debt of Rs12bn/ Rs25bn in Mar 2022/ post acquisition of VK1, respectively. Thus, we estimate that further acquisitions of up to ~Rs50bn can be funded via debt, beyond which equity raising would be required. We believe IRB InvIT is trading at a fair valuation with an internal rate of return or IRR of 8% with a 4% p.a. long-term traffic growth, in line with a 3.8% traffic CAGR over FY18-20.

DISCLAIMER

This report (including the views and opinions expressed therein, and the information comprised therein) has been prepared by Incred Research Services Private Ltd.(formerly known as Earnest Innovation Partners Private Limited) (hereinafter referred to as “IRSPL”). IRSPL is registered with SEBI as a Research Analyst vide Registration No. INH000007793. Pursuant to a trademark agreement, IRSPL has adopted “Incred Equities” as its trademark for use in this report.

The term “IRSPL” shall, unless the context otherwise requires, mean IRSPL and its affiliates, subsidiaries and related companies. This report is not directed or intended for distribution to or use by any person or entity resident in a state, country or any jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IRSPL and its affiliates/group companies to registration or licensing requirements within such jurisdictions.

This report is being supplied to you strictly on the basis that it will remain confidential. No part of this report may be (i) copied, photocopied, duplicated, stored or reproduced in any form by any means; or (ii) redistributed or passed on, directly or indirectly, to any other person in whole or in part, for any purpose without the prior written consent of IRSPL.

The information contained in this report is prepared from data believed to be correct and reliable at the time of issue of this report.

IRSPL is not required to issue regular reports on the subject matter of this report at any frequency and it may cease to do so or change the periodicity of reports at any time. IRSPL is not under any obligation to update this report in the event of a material change to the information contained in this report. IRSPL has not any and will not accept any, obligation to (i) check or ensure that the contents of this report remain current, reliable or relevant; (ii) ensure that the content of this report constitutes all the information a prospective investor may require; (iii) ensure the adequacy, accuracy, completeness, reliability or fairness of any views, opinions and information, and accordingly, IRSPL and its affiliates/group companies (and their respective directors, associates, connected persons and/or employees) shall not be liable in any manner whatsoever for any consequences (including but not limited to any direct, indirect or consequential losses, loss of profits and damages) of any reliance thereon or usage thereof.

Unless otherwise specified, this report is based upon reasonable sources. Such sources will, unless otherwise specified, for market data, be market data and prices available from the main stock exchange or market where the relevant security is listed, or, where appropriate, any other market. Information on the accounts and business of company(ies) will generally be based on published statements of the company(ies), information disseminated by regulatory information services, other publicly available information and information resulting from our research. Whilst every effort is made to ensure that statements of facts made in this report are accurate, all estimates, projections, forecasts, expressions of opinion and other subjective judgments contained in this report are based on assumptions considered to be reasonable as of the date of the document in which they are contained and must not be construed as a representation that the matters referred to therein will occur. Past performance is not a reliable indicator of future performance. The value of investments may go down as well as up and those investing may, depending on the investments in question, lose more than the initial investment. No report shall constitute an offer or an invitation by or on behalf of IRSPL and its affiliates/group companies to any person to buy or sell any investments.

The opinions expressed are based on information which are believed to be accurate and complete and obtained through reliable public or other non-confidential sources at the time made. (Information barriers and other arrangements may be established where necessary to prevent conflicts of interests arising. However, the analyst(s) may receive compensation that is based on his/their coverage of company(ies) in the performance of his/their duties or the performance of his/their recommendations. In reviewing this report, an investor should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additional information is, subject to the duties of confidentiality, available on request.

The report is not a “prospectus” as defined under Indian Law, including the Companies Act, 2013, and is not, and shall not be, approved by, or filed or registered with, any Indian regulator, including any Registrar of Companies in India, SEBI, any Indian stock exchange, or the Reserve Bank of India. No offer, or invitation to offer, or solicitation of subscription with respect to any such securities listed or proposed to be listed in India is being made, or intended to be made, to the public, or to any member or section of the public in India, through or pursuant to this report.

The research analysts, strategists or economists principally responsible for the preparation of this research report are segregated from the other activities of IRSPL. Information barriers and other arrangements have been established, as required, to prevent any conflicts of interests.

The research analysts, strategists or economists principally responsible for the preparation of this research report are segregated from the other activities of IRSPL. Information barriers and other arrangements have been established, as required, to prevent any conflicts of interests.

IRSPL may have issued other reports (based on technical analysis, event specific, short term views etc.) that are inconsistent with and reach different conclusion from the information presented in this report.

Holding of Analysts/Relatives of Analysts, IRSPL and Associates of IRSPL in the covered securities, as on the date of publishing of this report

	Analyst/ Relative	Entity/ Associates
any financial interests in the company covered in this report (subject company) and nature of such financial interest	NO	NO
actual/beneficial ownership of 1% or more in securities of the subject company at the end of the month immediately preceding the date of publication of the research report or date of the public appearance;	NO	NO
any other material conflict of interest at the time of publication of the research report or at the time of public appearance	NO	NO
received any compensation from the subject company in the past twelve months for investment banking or merchant banking or brokerage services or investment advisory or depository or distribution from the subject company in the last twelve months for products/services other than investment banking or merchant banking or broker- age services or investment advisory or depository or distribution from the subject company in the last twelve months	NO	NO
managed or co-managed public offering of securities for the subject company in the last twelve months	NO	NO
received any compensation or other benefits from the subject company or third party in connection with the research report	NO	NO
served as an officer, director or employee of the subject company	NO	NO
been engaged in market making activity for the subject company	NO	NO

Analyst declaration

- The analyst responsible for the production of this report hereby certifies that the views expressed herein accurately and exclusively reflect his or her personal views and opinions about any and all of the issuers or securities analysed in this report and were prepared independently and autonomously in an unbiased manner.
- No part of the compensation of the analyst(s) was, is, or will be directly or indirectly related to the inclusion of specific recommendations(s) or view(s) in this report or based any specific investment banking transaction.
- The analyst(s) has(have) not had any serious disciplinary action taken against him/her(them).
- The analyst, strategist, or economist does not have any material conflict of interest at the time of publication of this report.
- The analyst(s) has(have) received compensation based upon various factors, including quality, accuracy and value of research, overall firm performance, client feedback and competitive factors.

IRSPL and/or its affiliates and/or its Directors/employees may own or have positions in securities of the company(ies) covered in this report or any securities related thereto and may from time to time add to or dispose of, or may be materially interested in, any such securities.

IRSPL and/or its affiliates and/or its Directors/employees may do and seek to do business with the company(ies) covered in this research report and may from time to time (a) buy/sell the securities covered in this report, from time to time and/or (b) act as market maker or have assumed an underwriting commitment in securities of such company(ies), and/or (c) may sell them to or buy them from customers on a principal basis and/or (d) may also perform or seek to perform significant investment banking, advisory, underwriting or placement services for or relating to such company(ies) and/or (e) solicit such investment, advisory or other services from any entity mentioned in thisreport and/or (f) act as a lender/borrower to such company and may earn brokerage or other compensation. However, Analysts are forbidden to acquire, on their own account or hold securities (physical or uncertificated, including derivatives) of companies in respect of which they are compiling and producing financial recommendations or in the result of which they play a key part.