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Execution slackens; order flow a key monitorable

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Poor project execution due to the extended monsoons is expected to contain revenue growth at ~15% YoY for our infrastructure universe in Q2FY20. EBITDA margins should hold firm, but earnings are forecast to decline 8% YoY on higher interest, depreciation and taxes (post expiry of sec-80IA benefits). PNCL and HGIEL are likely to buck the trend with stronger earnings. DBL, KNRC and PNCL saw order inflows in Q2 vs. nil wins for other coverage stocks. We continue to prefer PNCL, HGIEL, KNRC and ASBL.

Heavy rains dampen execution: We expect moderate revenue growth of ~15% YoY for our coverage stocks in Q2 as a strong, extended monsoon season has hampered the pace of project execution. PNCL is likely to clock robust revenue growth of ~70% YoY led by a high executable order backlog and low base. EBITDA margins for our coverage look to be stable, barring a 300bps YoY drop forecast for KNRC as its share of lucrative irrigation projects ebbs.

Order flow muted: Order inflows failed to revive after elections as expected, due to land acquisition issues and delayed disbursals amid a change of guard at various state governments. We believe NHAI awarding could pick up from Nov'19 post elections in Haryana and Maharashtra, and expect ~5,000km to be awarded in FY20 vs. NHAI's target of ~6,000km. The book-to-bill ratio for road developers remains strong at 2.1-3.1x as on Sep'19 despite muted orders.

Higher effective tax rate to mar earnings: The discontinuation of section 80IA benefits will raise tax rates for most road developers. We expect PNCL and HGIEL to buck the trend with YoY earnings growth of 96% (low base) and 33% (corporate tax cut benefits) respectively, while other players under our coverage are headed for declines.

Gradual award of appointed dates a key positive: As at end-Sep'19, ADs for only 13 of the 46 HAM projects won by our coverage universe were pending from NHAI (vs. 19 as at end-Jun'19), leading to a better executable order backlog for most companies. Our management interactions suggest the balance dates could be awarded in Q3 (9 projects) / Q4 (4 projects).

Stay selective: Execution visibility on the existing order backlog remains intact, albeit with some lag due to delayed ADs, even as India's road sector holds immense opportunities. We stay selective and prefer PNCL, HGIEL, KNRC and ASBL.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
ASBL IN	98	185	BUY
DBL IN	376	610	BUY
HGINFRA IN	268	395	BUY
KNRC IN	208	360	BUY
PNCL IN	170	250	BUY
SADE IN	131	175	BUY

Price & Target in Rupees | Price as of 10 Oct 2019

ORDER BACKLOG as on Sep'19E*

Ticker	Backlog (Rs bn)	Book-to-bill (x)	Executable (%)
ASBL IN	82.3	2.1	72.8
DBL IN	209.2	2.3	69.5
HGINFRA IN	52.3	2.5	52.7
KNRC IN	65.5	3.1	63.6
PNCL IN	120.0	2.9	83.4
SADE IN	94.0	2.7	72.4

Source: Company, BOBCAPS Research | *Includes L1 projects

FIG 1 – BOBCAPS INFRASTRUCTURE (ROADS) UNIVERSE: STANDALONE Q2FY20 ESTIMATES

Company (Rs mn)	Sales			% change		EBITDA			% change		EBITDA Margin (%)			PBT			Adjusted PAT			% change		EPS (Rs)		
	Q2 FY20E	Q2 FY19	Q1 FY20	YoY	QoQ	Q2 FY20E	Q2 FY19	Q1 FY20	YoY	QoQ	Q2 FY20E	Q2 FY19	Q1 FY20	Q2 FY20E	Q2 FY19	Q1 FY20	Q2 FY20E	Q2 FY19	Q1 FY20	YoY	QoQ	Q2 FY20E	Q2 FY19	Q1 FY20
ASBL	8,060	7,644	8,768	5.4	(8.1)	1,017	1,037	1,095	(1.9)	(7.1)	12.6	13.6	12.5	694	899	957	531	621	647	(14.5)	(17.9)	1.9	2.2	2.3
DBL	18,058	16,237	22,880	11.2	(21.1)	3,259	2,815	4,121	15.8	(20.9)	18.0	17.3	18.0	800	954	1,607	600	832	1,252	(27.9)	(52.1)	4.4	6.1	9.2
HGIEL	4,763	4,291	5,261	11.0	(9.5)	707	623	795	13.5	(11.0)	14.9	14.5	15.1	420	379	527	326	246	344	32.8	(5.2)	5.0	3.8	5.3
KNRC	4,625	4,163	4,646	11.1	(0.5)	785	831	900	(5.6)	(12.8)	17.0	20.0	19.4	365	453	589	300	450	477	(33.3)	(37.1)	2.1	3.2	3.4
PNCL	9,500	5,586	13,218	70.1	(28.1)	1,311	746	1,796	75.7	(27.0)	13.8	13.4	13.6	896	448	1,447	688	351	1,001	95.9	(31.3)	2.7	1.4	3.9
SADE	6,468	6,906	8,376	(6.3)	(22.8)	784	833	1,046	(6.0)	(25.1)	12.1	12.1	12.5	281	383	534	210	383	395	(45.1)	(46.7)	1.2	2.2	2.3
Total	**51,474**	**44,828**	**63,149**	**14.8**	**(18.5)**	**7,863**	**6,886**	**9,753**	**14.2**	**(19.4)**	**15.3**	**15.4**	**15.4**	**3,456**	**3,515**	**5,660**	**2,656**	**2,883**	**4,116**	**(7.9)**	**(35.5)**	**2.5**	**2.7**	**3.9**

Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY ORDER BACKLOG

Company	Order backlog (incl. L1 projects)			Book-to-bill ratio (TTM revenues; x)		
(Rs mn)	Q2FY20E	Q2FY19	Q1FY20	Q2FY20E	Q2FY19	Q1FY20
ASBL	82,318	97,637	90,378	2.1	3.7	2.4
DBL	2,09,243	2,39,351	1,90,290	2.3	2.8	2.1
HGIEL	52,304	48,822	57,103	2.5	2.9	2.7
KNRC	65,545	58,065	65,188	3.1	2.9	3.2
PNCL	1,19,970	1,19,525	1,18,850	2.9	4.9	3.2
SADE	94,039	1,37,432	1,08,097	2.7	3.9	3.1

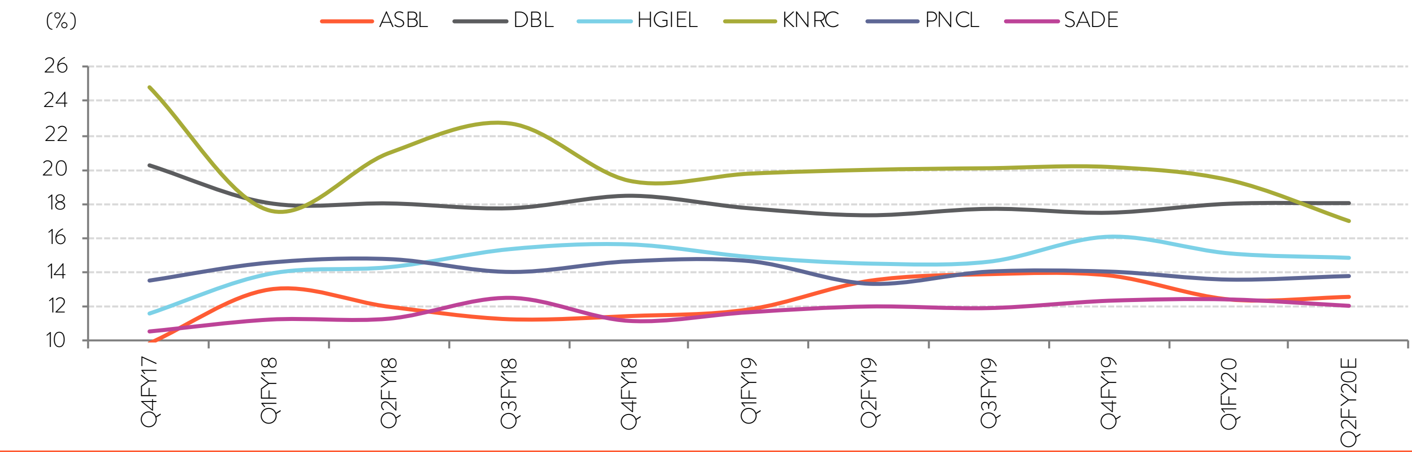
FIG 3 – KEY MONITORABLES DURING THE QUARTER

Company	Comments
Ashoka Buildcon (ASBL)	▪ Expect moderate revenue growth of 5.4% YoY due to onset of heavy monsoon. Significant contribution to the revenue is expected from TOT EPC and under-construction HAM projects. Construction revenue to grow 6.4% YoY to Rs 7.6bn with higher contribution from roads at ~85% (~53% last year, ~82% in Q1) and balance from Power T&D. Order inflows remained nil during the quarter ▪ Operating margins to decline ~100bps YoY (+10bps QoQ) to 12.6% due to favourable revenue mix last year ▪ Management expects decline in gross debt by ~Rs 1bn QoQ to ~Rs 5bn and stable interest cost QoQ ▪ Traffic across projects expected to fall due to slowdown in economy and heavy rainfall. On like-to-like basis, we expect traffic to decline ~5% YoY
Dilip Buildcon (DBL)	▪ Led by award of ADs, revenue projected to grow 11.2% YoY. ADs for remaining NHAI HAM projects of Bellary-Byrapura and Nidgatta-Mysore expected by end-Oct'19. So far, ADs received for 10 of 12 HAM projects ▪ Won a Rs 21.2bn mining contract for overburden removal in Madhya Pradesh for a period of 1,552 days ▪ Three projects completed ahead of schedule in FY20 YTD, entitling DBL to early completion bonus of Rs 913mn – of this, Rs 379mn received in Q1 and remainder expected in Q2, pushing up EBITDA margin to ~18% (+70bps YoY) ▪ Effective tax rate (ETR) expected at ~25% post discontinuance of section 80IA benefits
HG Infra Engineering (HGIEL)	▪ Expect moderate revenue growth of 11% YoY due to onset of heavy monsoon which hit Maharashtra project execution. Strong execution is expected from Gurgaon-Soha HAM project and private EPC road projects ▪ Order inflows nil during the quarter ▪ Management expects gross debt reduction of Rs 200mn-250mn QoQ to Rs 3.25bn-3.3bn. Finance cost likely to remain flattish sequentially. Capex for the quarter guided at Rs 150mn-200mn ▪ With the change in corporate tax rate, adj. PAT to increase 33% YoY
KNR Constructions (KNRC)	▪ Expect modest revenue growth of 11% YoY due to monsoon-led execution slowdown (apart from three under-construction HAM projects where execution remained strong) ▪ EBITDA margins to contract ~300bps YoY to ~17% as the share of high-margin irrigation projects dwindles ▪ Order inflows remained strong at ~Rs 17bn, largely from the irrigation segment (Rs 8.5bn contract for Palamuru Rangareddy Lift Irrigation Scheme – Pkg-10 awarded in Q2 and expected to contribute ~Rs 300mn to revenue) ▪ Recent termination of NHAI HAM project Meensurutti-Chidambaram (EPC cost of Rs 3.5bn) due to land acquisition issues will not impact our earnings estimates. Equity invested stands at Rs 83.5mn, likely to be written off ▪ Management expects decline in gross debt by ~Rs 170mn QoQ to ~Rs 3.2bn (promoter contribution at ~Rs 2.05bn), while interest cost likely to remain stable sequentially ▪ ETR to remain high at ~18% (0.6% last year) post discontinuance of section 80IA benefits, affecting earnings ▪ Claims of ~Rs 570mn associated with an old irrigation project from Orissa received in Q2; net receipt pegged at ~Rs 250mn (booked under exceptional income) and hence reported PAT to rise ~22% YoY
PNC Infratech (PNCL)	▪ Robust execution momentum to continue backed by award of ADs in six of seven HAM projects. Strong execution expected in third-party EPC projects of Mumbai-Nagpur Super Expressway and Purvanchal Expressway ▪ Margins forecast to remain unchanged sequentially ▪ Rs 1.5bn arbitration award received during Q2 for Garh Mukteshwar-Moradabad road EPC project; net proceeds of Rs 973mn booked under exceptional income to drive reported PAT up 370% YoY ▪ Won Rs 10.6bn road EPC contract for construction of Lucknow Ring Road in Uttar Pradesh, to be completed in 36 months ▪ Traffic growth forecast to remain strong, albeit on a lower base

Company	Comments
Sadbhav Engineering (SADE)	▪ Expect 6.3% YoY decline in Q2 revenue due to delayed ADs (pending for two NHAI and 1 KSHIP HAM project) and hence a low executable order backlog
	▪ No order inflows during the quarter
	▪ Discontinuance of section 80IA benefits to elevate the tax burden (new tax rate), likely leading to earnings decline of 45% YoY in Q2 (ETR nil last year)
	▪ Terminated Bhimasar-Bhuj NHAI HAM project due to right-of-way issues (EPC cost of Rs 7.6bn), which depleted the order backlog
	▪ Key highlight is the conclusion of 100% stake sale in nine operational assets of SIPL (69.6% subsidiary of SADE) to IndInfravit at EV of Rs 66.1bn. Deal likely to be concluded by mid-Nov'19

Source: Company, BOBCAPS Research

FIG 4 – QUARTERLY EBITDA MARGIN TREND



Source: Company, BOBCAPS Research

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ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

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Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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