IRB Infrastructure Developers

Execution surprises positively

Sector: Infrastructure
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 72**	
Price Target: **Rs. 105**	↓

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 2,513 cr
52-week high/low:	Rs. 169/56
NSE volume: (No of shares)	22.9 lakh
BSE code:	532947
NSE code:	IRB
Sharekhan code:	IRB
Free float: (No of shares)	14.9 cr

Shareholding (%)

Promoters	57.5
FII	21.5
DII	11.1
Others	9.8

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	5.1	-21.9	-40.6	-47.4
Relative to Sensex	2.5	-27.7	-44.6	-54.2

Sharekhan Research, Bloomberg

IRB Infrastructure's (IRB) consolidated net profit grew by 15.7% y-o-y for Q2FY2020, led by strong execution along with lower ETR. Construction revenue reported 43% y-o-y rise, led by strong execution in Agra Etawah and Hapur Moradabad projects. However, BOT revenue declined by 16% y-o-y on account of handover of key project and muted traffic growth across projects barring couple of projects. OPM contracted by 413 BPS y-o-y on account of higher construction revenue booking (although construction segment's OPM improved by 351 BPS y-o-y). Hence, operating profit grew at a lower rate of 11.5% y-o-y, which was negated by increased interest expense (up 40% y-o-y). IRB's strong order backlog at Rs. 11,381 crore (2.5x its TTM construction revenue) and order inflow expectations by March 2020 end give management confidence of maintaining EPC revenue growth momentum during FY2020-FY2021. We have cut our earnings estimates for FY2020-FY2021, factoring lower construction revenue especially in FY2021. Additionally, we have built in lower BOT valuation as against assigned through GIC deal leading to cut in our SOTP-based price target (PT) to Rs. 105. We maintain Buy rating on account of comfort on valuation.

Key positives

- Strong execution with construction revenue rising by 43% y-o-y.
- Construction segment's OPM rises by 351 BPS y-o-y (up 42 BPS q-o-q) to 29.3%.

Key negatives

- Muted traffic growth across project portfolio barring couple of projects.
- Industry tendering yet to see pick up especially on the BOT front.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 105: We have trimmed down our earnings estimates for FY2020-FY2021, factoring lower construction revenue especially in FY2021, factoring cancellation of Tamil Nadu projects along with delay in execution of few projects. We believe the induction of GIC as a financial partner for IRB resolves key issues of high leverage and easing of funding requirement of under-construction projects. Moreover, it provides another vehicle for IRB to transfer future projects, especially in privately held InvIT (which has much lesser restrictions than its listed IRB InvIT). However, we have not accounted the deal in our financials. We have cut our SOTP-based PT to Rs. 105 (factoring lower BOT valuation compared to GIC deal), while we maintain our Buy rating due to comfort on valuation.

Key Risks

Weak macro environment leading to lower traffic growth and project tendering is a key risk.

Valuation (Consolidated) Rs cr

Particulars	FY18	FY19	FY20E	FY21E
Revenue	5,694.1	6,707.0	7,001.9	6,363.8
OPM (%)	47.1	43.8	42.4	42.7
Adjusted PAT	919.7	850.0	724.6	468.4
% YoY growth	28.5	(7.6)	(14.7)	(35.4)
Adjusted EPS (Rs.)	26.2	24.2	20.6	13.3
P/E (x)	2.7	3.0	3.5	5.4
P/B (x)	0.4	0.4	0.4	0.4
EV/EBITDA (x)	5.4	5.9	6.3	6.7
RoNW (%)	16.8	14.2	11.0	6.7
RoCE (%)	13.4	12.9	12.1	9.9

Source: Company; Sharekhan Research

Strong execution in EPC vertical along with lower ETR lifts net earnings

IRB reported 22.3% y-o-y growth in consolidated revenue to Rs. 1,752 crore for Q2FY2020, backed by healthy revenue growth in construction (up 42.8% y-o-y) while BOT (down 15.8% y-o-y) was affected by handover of key Mumbai-Pune project and subdued traffic growth across most projects. Construction revenue grew strongly with higher execution in Agra Etawah (Rs. 350 crore revenue) and Hapur Moradabad (Rs. 310 crore) projects. Further, OPM contracted by 413 BPS y-o-y to 42.7%, led by higher contribution of EPC revenue during the quarter (although EPC vertical witnessed 351 BPS y-o-y rise in OPM to 29.3%). Hence, operating profit grew at a lower rate of 11.5% y-o-y to Rs. 747 crore. Further, higher interest expense (up 40% y-o-y) led to PBT declining by 4.1% y-o-y to Rs. 301 crore. Lower effective tax rate (33.5% Q2FY2020 vs. 44.9% in Q2FY2019) due to adoption of lower tax rate in SPVs led to consolidated net profit growth of 15.7% y-o-y to Rs. 200 crore.

Expect EPC revenue growth momentum to continue over FY2020-FY2021

IRB's management expects EPC revenue growth momentum to continue for FY2020-FY2021 even if couple of Tamil Nadu projects get cancelled due to land acquisition issues (however, it has not received any formal communication from the same). As per management, NHAI has lined up 19 six-laning BOT projects of 1,000kms worth Rs. 30,000 crore to be awarded before March 2020 end. The company would be eyeing for projects worth Rs. 45,000 crore over the next 4-5 months along with its partner GIC (GIC to participate on case-to-case basis with IRB through private InvIT). The company's strong order backlog of Rs. 11,381 crore (2.5x its TTM construction revenue) and expected order inflows over the next four to five months give the management confidence of maintaining strong EPC revenue growth over FY2020-FY2021.

Q2FY2020 Conference Call Highlights

- **GIC Deal:** Management expects the transfer of nine BOT assets to a private InvIT to complete by December 2019.
- **EPC revenue growth:** EPC revenue grew by 43% y-o-y to Rs. 1,330 crore. EPC revenue was driven by Agra Etawah (Rs. 350 crore), Hapur Moradabad (Rs. 310 crore), Chittorgarh Gulabpura (Rs. 150 crore), Kishangarh Gulabpura (Rs. 140 crore) and USBOT (Rs. 140 crore). Management does not see any challenge in EPC revenue growth for FY2021.
- **BOT traffic growth:** BOT revenue declined by 16% y-o-y to Rs. 416 crore. IRB's BOT portfolio witnessed subdued traffic across projects, leading to a decline in toll revenue y-o-y, barring Ahmedabad-Vadodara and Kaithal Rajasthan projects, which saw y-o-y rise in toll revenue. The company did not take any toll hike in the projects during the quarter. Management saw green shoots in traffic in most projects during October 2019.
- **New tax regime:** The company's subsidiary, MRM will continue with the old tax rate structure, while 12 out of 19 SPVs will follow new low tax rate structure. Going forward, the consolidate tax rate is expected to be close to 26% as against 34% in Q2FY2020.
- **Industry project tendering activity:** Management expects 19 six-laning projects of 1,000km worth Rs. 30,000 crore to be awarded on BOT basis before the end of this financial year. The company would be eyeing Rs. 45,000 crore projects over the next four to five months with its partner GIC. GIC would be participating on case-to-case basis with the company through private InvIT.
- **Tamil Nadu projects update:** Management has not received any formal communication from NHAI regarding cancellation of its couple of Tamil Nadu projects. The company is aware of land-acquisition issues and is confident of achieving EPC revenue growth of FY2021 even if the said projects are cancelled.
- **Goa Kundapur project update:** The project witnessed delay in execution due to the monsoon season. There is only one month work left to get PCoD. Full CoD will be received post four to five months of getting PCoD.
- **Ahmedabad-Vadodara project update:** Ahmedabad-Vadodara project received award from the High Court for continuation of relief from payment of premium to NHAI till the outcome of Section 17 proceedings under arbitration.
- **Leverage:** The debt of MRM and standalone stood at Rs. 3,200 crore with cash of Rs. 1,000 crore.

Results (Consolidated) Rs cr

Particulars	Q2FY2020	Q2FY2019	y-o-y%	Q1FY2020	q-o-q%
Net sales	**1752.1**	**1432.3**	**22.3%**	**1773.0**	**-1.2%**
other income	49.0	53.2	-7.9%	48.1	1.9%
Total income	1801.1	1485.4	21.2%	1821.1	-1.1%
Total expenses	1004.7	762.1	31.8%	917.6	9.5%
Operating profit	**747.4**	**670.1**	**11.5%**	**855.4**	**-12.6%**
Depreciation	113.9	137.2	-17.0%	153.5	-25.8%
Interest	381.3	271.9	40.2%	362.8	5.1%
Profit Before Tax	301.2	314.1	-4.1%	387.2	-22.2%
Taxes	101.0	141.2	-28.4%	180.5	-44.0%
PAT	200.2	172.9	15.7%	206.6	-3.1%
Consolidated PAT	**200.2**	**172.9**	**15.7%**	**206.6**	**-3.1%**
No of equity shares	35.1	35.1	0.0%	35.1	0.0%
EPS (Rs.)	5.7	4.9	15.7%	5.9	-3.1%
OPM (%)	42.7%	46.8%	-413 bps	48.2%	-559 bps
NPM (%)	11.4%	12.1%	-65 bps	11.7%	-23 bps
Tax rate (%)	33.5%	44.9%	-	46.6%	-

Source: Company; Sharekhan Research

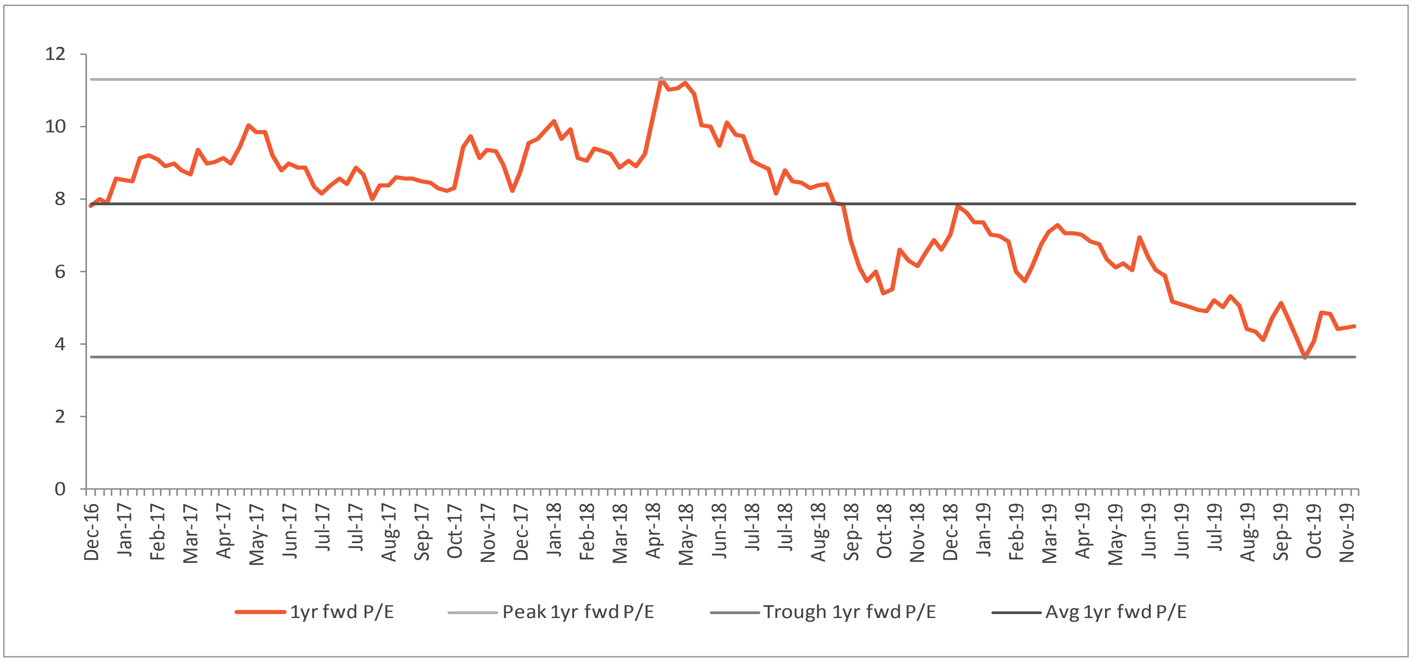
Outlook

Project tendering expected to pick up by the end of FY2020: The road sector's outlook has been hampered over the trailing one year with muted project-tendering activities due to elections. Additionally, land-acquisition issues and liquidity crunch in banking channels have continued to affect financial closures and receipt of appointed dates to commence construction. However, as per IRB's management, NHAI has lined up 19 six-laning BOT projects of 1,000kms worth Rs. 30,000 crore to be awarded before March 2020 end. The company would be eyeing for projects worth Rs. 45,000 crore over the next 4-5 months along with its partner GIC (GIC to participate on case-to-case basis with IRB through private InvIT).

Valuation

Maintain Buy with a revised PT of Rs. 105: We have trimmed down our earnings estimates for FY2020-FY2021, factoring lower construction revenue especially in FY2021, factoring cancellation of Tamil Nadu projects along with delay in execution of few projects. We believe the induction of GIC as a financial partner for IRB resolves key issues of high leverage and easing of funding requirement of under-construction projects. Moreover, it provides another vehicle for IRB to transfer future projects, especially in privately held InvIT (which has much lesser restrictions than its listed IRB InvIT). However, we have not accounted the deal in our financials. We have cut our SOTP-based PT to Rs. 105 (factoring lower BOT valuation compared to GIC deal) while we maintain our Buy rating due to comfort on valuation.

One year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
IRB Infrastructure	3.5	5.4	6.3	6.7	0.4	0.4	11.0	6.7
Sadbhav Engineering#	12.8	9.5	6.9	5.9	1.0	0.9	7.8	9.6
Ashoka Buildcon	30.2	22.5	2.6	1.7	8.1	6.7	28.7	32.8
Dillip Buildcon*#	9.1	7.8	4.6	4.2	1.5	1.2	18.1	17.3
PNC Infratech*#	12.2	11.5	6.7	6.0	1.9	1.7	16.8	15.3
KNR Constructions#	13.4	10.7	6.2	5.1	2.0	1.7	16.1	17.2

*Source: Sharekhan Research * Bloomberg Estimates # Standalone financials*

About company

IRB, incorporated in 1998, is one of the largest private roads and highways infrastructure developers in India. The company's portfolio of 23 projects comprises 20 BOT and three HAM projects. BOT segment includes seven operational projects; four projects under tolling and construction, seven projects under O&M contracts as a Project Manager for IRB InvIT and another two projects under construction. In HAM space, one project is under construction and the appointed date is awaited from NHAI for the other two.

Investment theme

IRB is the largest toll road BOT player in India and the second largest BOT operator in the country with all its projects being toll-based. The company has an integrated business model with an in-house construction arm, which provides competitive advantage in bidding for larger projects and captures the entire value from BOT assets. Further, the company has a 15% stake in its InvIT Fund, which allows it to periodically transfer road assets, freeing up its equity to invest in future projects. IRB's recent deal with GIC provides another vehicle to deleverage its balance sheet, transfer of future assets and a strong financial partner for future project bidding.

Key Risks

- Weak economic environment leading to lower growth in toll revenue.
- Lower order inflow in BOT and HAM projects can lead to muted growth in construction revenue.
- High interest rate scenario can lead to lower valuation of its stake in its listed InvIT.

Additional Data

Key management personnel

Mr. Virendra D. Mhaiskar	Chairman and Managing Director
Mr. Ajay P. Deshmukh	Chief Executive Officer – Infrastructure
Mr. Dhananjay K. Joshi	Chief Executive Officer - Corporate Affairs, Realty & Airport
Mr. Anil D. Yadav	Group Chief Finance Officer
Mr. Madhav H. Kale	Head - Corporate Strategy & Planning

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Mhaiskar Ventures Pvt Ltd	56.74
2	Life Insurance Corp of India	3.81
3	SBI Funds Management Pvt Ltd	3.46
4	Aditya Birla Sun Life Trustee Co P	3.35
5	Republic of Singapore	3.35
6	Aditya Birla Sun Life Asset Manage	3.02
7	Platinum Asset Management Ltd	2.74
8	Dimensional Fund Advisors LP	1.35
9	HDFC Asset Management Co Ltd	1.29
10	Vanguard Group Inc/The	1.28

Source: Bloomberg

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