31 August 2020

PNC Infratech

Rating: **Buy**
Target Price: ₹205
Share Price: ₹169

Execution efficiency returning; retaining a Buy

Recent-wins-driven augmented revenue assurance and gradually returning execution efficiency are some levers making a case for PNC to set sailing again on the growth trajectory, sooner than later. Even with the stretched working capital (due to the pandemic disruption and seasonality), the balance sheet is still in shape to help execution efficiency return at the earliest, and take care of a large part of equity required for the hybrid annuity portfolio. Standalone operations hold potential to generate positive CF, and look good to suffice for the balance needed. With no change in long-term fundamentals, and supported by ample revenue assurance and a well-set balance sheet, we retain our Buy call, with a higher TP of ₹205 (from ₹202 earlier).

Recent orders boost assurance. Including the five not-yet-appointed hybrid annuities (EPC potential of ~₹62bn) and the two post-Q1 EPC wins (~₹15bn), the ~₹78bn end-Jun'20 OB shoots up to ~₹155bn. Management sees additions of another ~₹40bn possible in FY21. Besides roads, rural water-supply projects are on its radar (three bids placed, ~₹5.8bn potential).

Working capital-cycle stretched. Besides the Covid-19 disruption, speedier settling of the high-cost Mumbai-Nagpur mobilisation advances (~₹0.9bn adjusted in Q1 against work of ~₹1.3bn carried out) holds the key to a 27-day q/q protracted net-working-capital cycle (at 84). Management expects this to return to ~70 days over H2 FY21.

Y/y lower revenues in FY21. Though labour is now ~80-90% pre-Covid and full restoration is expected by Oct'20, management, on the yet-fluid situation, spoke of ~10% y/y lower FY21 EPC revenues, but with potential.

Valuation. On the Q1 performance, we raise our FY21e EBITDA margin; FY21e earnings thus are ~7% higher. FY22e earnings are ~11% lower on returning to the old tax regime, per management guidance. The sum-of-parts-based TP (₹205), though, considers the benefit of the lower-tax regime. At the CMP, the stock trades at 1.4x FY22e BV. **Risk.** Prolonged Covid.

Key financials (YE Mar)	FY18	FY19	FY20P	FY21e	FY22e
Sales (₹ m)	18,566	30,969	48,779	45,072	57,415
Net profit (₹ m)	2,510	3,249	4,603	2,951	3,698
EPS (₹)	9.8	12.7	17.9	11.5	14.4
Growth (%)	19.7	29.4	41.7	-35.9	25.3
PE (x)	17.9	12.0	5.2	14.7	11.7
EV / EBITDA (x)	14.2	8.7	2.5	6.9	5.8
PBV (x)	2.5	1.8	0.9	1.5	1.4
RoE (%)	14.9	16.6	19.7	11.0	12.4
RoCE (%)	14.9	19.7	28.6	18.7	21.0
Net debt / equity (x)	0.0	0.0	-0.2	-0.0	0.1

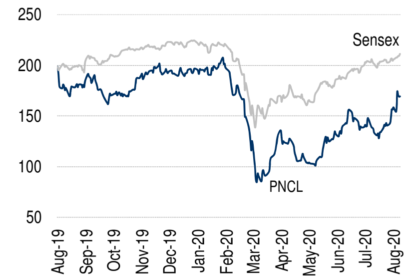
Source: Company, Anand Rathi Research *P- Provisional*

Key data	PNCL IN / PNCI.BO
52-week high / low	₹215 / 80
Sensex / Nifty	39467 / 11648
3-m average volume	$0.6m
Market cap	₹43.4bn / $593m
Shares outstanding	257m

Shareholding pattern (%)	Jun-20	Mar-20	Dec-19
Promoters	56.1	56.1	56.1
- of which, Pledged	-	-	-
Free float	43.9	43.9	43.9
- Foreign institutions	6.4	6.4	6.5
- Domestic institutions	24.2	23.8	23.1
- Public	13.3	13.8	14.4

Estimates revision (%)	FY21e	FY22e
Sales	-	-
EBITDA	3.8	-
EPS (₹)	6.8	-11.0

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations (standalone)

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
Order backlog	73,180	122,100	86,290	111,003	128,227
Order inflow	37,374	79,889	11,874	69,645	74,640
Net revenues	**18,566**	**30,969**	**48,779**	**45,072**	**57,415**
Growth (%)	*9.9*	*66.8*	*57.5*	*-7.6*	*27.4*
Direct costs	14,129	23,873	36,301	34,441	43,825
SG&A	1,248	2,522	4,835	4,544	5,724
EBITDA	**3,188**	**4,573**	**7,643**	**6,087**	**7,866**
EBITDA margins (%)	*17.2*	*14.8*	*15.7*	*13.5*	*13.7*
Depreciation	772	922	1,264	1,280	1,401
Other income	230	430	885	583	276
Interest expenses	307	641	1,144	1,114	1,139
PBT	2,339	3,440	6,120	4,277	5,603
Effective tax rate (%)	*-7.3*	*5.6*	*24.8*	*31.0*	*34.0*
+ Associates / (Minorities)	-	-	-	-	-
Net income	2,510	3,249	4,603	2,951	3,698
Adjusted income	2,510	3,249	4,603	2,951	3,698
WANS	257	257	257	257	257
FDEPS (₹ / sh)	9.8	12.7	17.9	11.5	14.4

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
Share capital	513	513	513	513	513
Net worth	18,067	21,152	25,466	28,128	31,537
Debt	1,697	3,747	3,266	3,091	3,787
Minority interest	-	-	-	-	-
DTL / (Assets)	-1,637	-1,673	-1,215	-1,215	-1,215
Capital employed	**18,128**	**23,226**	**27,517**	**30,004**	**34,109**
Net tangible assets	4,048	6,135	5,865	5,804	5,986
Net intangible assets	16	20	16	9	2
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	111	62	-	-	-
Investments (strategic)	4,948	5,730	6,732	9,552	13,852
Investments (financial)	-	-	623	-	-
Current assets (ex cash)	15,632	20,441	22,252	25,490	31,360
Cash	1,473	3,094	7,401	4,267	1,254
Current liabilities	8,100	12,256	15,371	15,117	18,344
Working capital	7,531	8,185	6,881	10,373	13,016
Capital deployed	**18,128**	**23,226**	**27,517**	**30,004**	**34,109**
Contingent liabilities	23,362	26,620	-	-	-

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
PBT + Net interest expense	2,416	3,651	6,379	4,807	6,466
+ Non-cash items	772	922	1,264	1,280	1,401
Oper. prof. before WC	3,188	4,573	7,643	6,087	7,866
- Incr. / (decr.) in WC	-1,272	653	-1,303	3,492	2,642
Others incl. taxes	-175	171	1,517	1,326	1,905
Operating cash-flow	4,635	3,749	7,429	1,269	3,319
- Capex (tang. + intang.)	1,391	2,964	927	1,212	1,576
Free cash-flow	3,245	785	6,502	57	1,743
Acquisitions	-	-	-	-	-
- Div.(incl. buyback & taxes)	161	155	309	309	309
+ Equity raised	-	-	-	-	-
+ Debt raised	-1,608	2,013	-23	-175	696
- Fin investments	272	782	1,625	2,197	4,300
- Net interest expense + misc.	85	240	239	510	843
Net cash-flow	1,118	1,621	4,306	-3,134	-3,013

Source: Company, Anand Rathi Research *P- Provisional*

Fig 4 – Ratio analysis

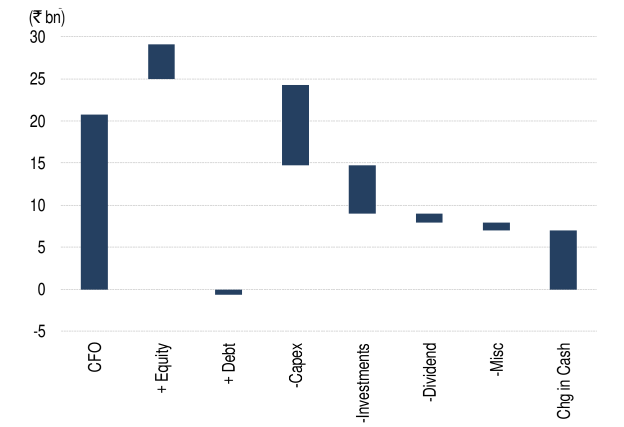
Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
P/E (x)	17.9	12.0	5.2	14.7	11.7
EV / EBITDA (x)	14.2	8.7	2.5	6.9	5.8
EV / Sales (x)	2.4	1.3	0.4	0.9	0.8
P/B (x)	2.5	1.8	0.9	1.5	1.4
RoE (%)	14.9	16.6	19.7	11.0	12.4
RoCE (%)	14.9	19.7	28.6	18.7	21.0
RoIC (%)	16.9	21.0	27.1	16.2	15.2
DPS (₹ / sh)	0.5	0.5	1.0	1.0	1.0
Dividend yield (%)	0.3	0.3	0.6	0.6	0.6
Dividend payout (%) - incl. DDT	6.4	4.8	6.7	10.5	8.4
Net debt / equity (x)	0.0	0.0	-0.2	-0.0	0.1
Receivables (days)	136	73	60	75	75
Inventory (days)	35	48	20	30	30
Payables (days)	91	56	35	44	44
CFO : PAT%	184.6	115.4	161.4	43.0	89.8

Source: Company, Anand Rathi Research *P- Provisional*

Fig 5 – Price movement

Source: Bloomberg

Fig 6 – Cumulative capital allocation, FY13-20P



Source: Company

Result / Concall highlights

- **Covid-impacted Q1 revenues, but still comforting.** The pandemic-curtailed pace of execution meant Q1 FY21 revenue from operations were lower, ~32% y/y to ~₹9.1bn. Though down because of the lockdown for much of Apr'20 (hence, fewer man-days), a gradual return of the workforce (post-resumption, efficiency gradually recovered to ~70-75% only by Jun'20) and the early onset of the monsoon, the performance is still soothing.
  - Labour availability has already improved to ~80-90% of pre-Covid levels, and management hopes for 100% by Oct'20. The yet-continuing covid-impact led to management talking of 10% y/y lower EPC revenues in FY21.
  - For Q2 FY21, management said that the early onset of the monsoon and still returning labour are likely to keep it from operating at its true potential; thus, full recovery is expected only in H2.
- **Margins held.** Cost controls were clearly at play, and helped contain the impact of negative operating leverage to a great extent. Consequently, margins, at ~13.2% were only slightly short of the lower end of the guided-to / secular range of 13.5-14%.
  - The job-mix-led gross margin compression of ~104bps y/y was mostly offset by the lower other operating expenses (~9.6% of revenues from operations, versus ~10.6% a year ago).
  - No corresponding reduction in employee benefits impacted the EBITDA margin by ~35bps y/y. As percent of revenues, employee benefits were ~4.8%, against ~4.5% in the year-ago quarter.

Fig 7 – Financial highlights

(₹ m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	% Y/Y	% Q/Q
Revenue from operations	7,355	5,586	7,270	10,757	13,218	11,802	12,180	11,579	9,053	*-31.5*	*-21.8*
EBITDA	1,294	746	1,021	1,512	1,796	2,572	1,712	1,563	1,198	*-33.3*	*-23.4*
EBITDA margins (%)	*17.6*	*13.4*	*14.0*	*14.1*	*13.6*	*21.8*	*14.1*	*13.5*	*13.2*	*-35bps*	*-27bps*
Interest	107	153	187	194	179	247	401	316	253	*41.1*	*-20.1*
Depreciation	193	206	241	282	305	309	326	324	270	*-11.4*	*-16.5*
Other income	179	61	68	123	135	447	144	159	191	*41.5*	*19.9*
PBT	1,174	448	661	1,158	1,447	2,463	1,128	1,083	866	*-40.1*	*-20.0*
Tax	149	96	187	-241	445	394	356	322	265	*-40.5*	*-17.7*
PAT	1,025	351	474	1,399	1,001	2,069	771	761	601	*-40.0*	*-21.0*
EPS (₹)	4.0	1.4	1.8	5.5	3.9	8.1	3.0	3.0	2.3	*-40.0*	*-21.0*

Source: Company

- **Earnings weighed down.** Lower operating profits (down ~33% y/y) combined with higher finance costs (up ~41% y/y) pulled earnings down ~40% y/y to ~₹0.6bn.
  - The y/y higher finance cost is largely because of the decision to avail of mobilisation advances at the Mumbai-Nagpur project in earlier quarters. However, a part of these have been adjusted against works carried out in Q1, and is the key reason behind sequentially lower finance costs. Management had earlier said these would be adjusted faster against bills raised, as these carry higher interest cost.

- The earnings decline could have been steeper if not for higher other income (up ~42% y/y). This appears to be on account of access to higher cash and equivalents.
- On the contained capex last year and no new capex in Q1, depreciation was lower y/y. But the extent of reduction was not commensurate with the reduction in revenues / absolute EBITDA.

BOT operations

- **Gross toll collection down y/y.** The pandemic-caused lockdown and only a gradual easing of traffic movement (post-resumption) led to the ~34% y/y decline in gross toll collection to ~₹1.4bn.
  - Ghaziabad-Aligarh was the worst performing asset (~50% y/y less collection; ~20% of the total), followed by Gwalior-Bhind (down ~37% y/y; ~6% of the total), and Kanpur-Ayodhya OMT project (~29% y/y lower; ~53% of the total).
  - Assuming linear daily collection during the quarter, the adjusted (for the toll-suspended days) comparable gross toll collection could have been ~₹1.7bn; still ~16% y/y lower on sluggish economic activity and Covid-induced restrictions on traffic movement.
  - Management said traffic continued to recover in Q1, and was already ~90% of pre-Covid levels in the last fortnight of Jun'20.

Fig 8 – BOT toll income*

(₹ m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	% Y/Y	% Q/Q
Gwalior-Bhind	115	95	128	143	131	105	121	108	83	-36.6	-23.1
Kanpur-Ayodhya	860	780	963	998	1,024	827	980	900	723	-29.4	-19.7
Kanpur-Kabrai	289	170	250	239	243	105	178	234	196	-19.4	-16.2
Bareily-Almora	105	90	99	95	99	90	98	99	78	-21.2	-21.2
Ghaziabad-Aligarh	524	510	540	530	550	505	543	490	276	-49.8	-43.7
Total	**1,894**	**1,645**	**1,980**	**2,005**	**2,047**	**1,632**	**1,920**	**1,831**	**1,356**	**-33.8**	**-25.9**

Source: Company * *Excluding two operational BOT-Annuity assets and one hybrid annuity asset*

  - Partly supported by the recent COD for its first hybrid annuity project (Dausa-Lalsot) and the recognition of the interest component for the hybrid annuities being constructed (higher on risen debt), the reported BOT-toll /annuity segment revenues (of ~₹1.9bn) were flat q/q, and the y/y decline contained at ~10%.

Fig 9 – Consolidated financials – Segment highlights

(₹ m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	% Y/Y	% Q/Q
Segment revenues											
Contract	7,459	5,809	6,922	10,387	13,161	11,706	11,997	11,593	9,053	-31.2	-21.9
Toll/Annuity	1,705	1,442	1,702	2,317	2,085	1,704	1,907	1,874	1,875	-10.0	0.1
Total	**9,164**	**7,251**	**8,625**	**12,704**	**15,245**	**13,409**	**13,904**	**13,467**	**10,928**	**-28.3**	**-18.9**
Segment margins (%)											
Contract	10.8	19.0	5.5	12.0	11.3	17.7	9.5	10.4	10.2	-	-
Toll/Annuity	54.1	24.1	41.8	47.0	50.1	55.5	46.3	52.9	63.7	-	-
Blended	**12.3**	**9.1**	**2.4**	**12.5**	**15.4**	**18.5**	**7.1**	**9.7**	**11.5**	**-**	**-**

Source: Company

  - The segment margin of ~63.7% was ~14 percentage points better y/y, ~11 percentage points q/q. The augmented margin despite lower gross toll collection seems attributable to revenues booked under the service concession agreement (interest component, with no corresponding operating costs).
  - The reported BOT-toll/annuity segment includes financials for the two annuity assets, three BOT toll, one toll-collection contract and one hybrid annuity asset, but excludes the minority-owned Ghaziabad-Aligarh. The financials also include revenues booked under service concession agreements for the hybrid annuities being constructed.
  - Notwithstanding the lower gross toll collection, the parent did not extend any fresh support to any of its SPVs in Q1 FY21. Since the collections are yet recovering, FY21 support is pegged at ~₹0.25bn (for Ghaziabad-Aligarh). This is against ~₹0.3bn extended to Bareily-Almora and ~₹0.5bn to Ghaziabad-Aligarh last year.
  - The no funding required for Bareily-Almora takes into account refinancing efforts. During Q1, the company utilised the excess cash at a project-SPV to extend support to the Bareily-Almora project SPV to repay external debts.

Guidance

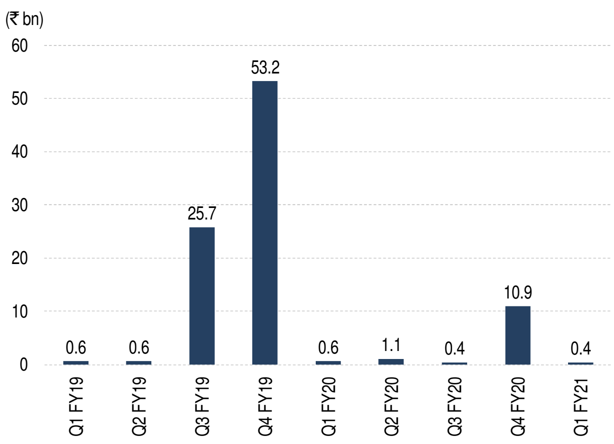
- With ~₹27bn of sturdy inflows ytd (a hybrid annuity project and two road EPC orders), management looks at inflows of another ~₹40bn, thereby largely retaining its FY21 guided-to inflows of ~₹70bn. With the four hybrid annuities added recently, management would prefer to have more EPC orders but is not averse to hybrid annuities.
- Accounting for the yet-evolving Covid-19 pandemic, the current labour availability and execution efficiency, management envisages FY21 revenues could decline ~10% y/y.
  - FY21 revenues would see material contribution from four under-construction hybrid annuity projects, for which management targets COD by end-FY21 (pending OB value: ~₹16bn).
  - Besides these, management expects sturdy contribution from its three state expressway orders (from UPEIDA and MSRDC), saying the authorities have not extended execution timelines. It continues to strive to get these completed at the earliest. These projects provide an aggregate pending executable potential of ~₹26bn (at end-Q1).
  - Management indicated that for its Purvanchal Expressway projects, the authority is pushing for an earlier-than-scheduled completion.
  - The FY21 revenue guidance has potential as it does not consider any contribution from the recent four hybrid annuities. Management hopes for these being appointed in Q4 FY21.
- Management did not offer any fresh comments on core construction EBITDA margins; however, it had earlier talked of ~13.5–14% as its secular range. FY21 margins could slightly lag the secular guidance owing to covid-compelled pressures, but any adverse impact has yet to be felt (no material pressures seen in Q1). Any impact is likely to be offset by the ~₹140m early-completion bonus (pending) for Aligarh-Moradabad (expected in the coming 2-3 months).

- For FY21, the company envisages a ~31-34% tax rate. It has pending MAT credit available of ~₹0.9bn. Of this, it expects to utilise only ₹0.6bn-0.7bn in FY21, the balance in FY22. As management now expects to be able to exhaust available MAT credit only by FY22, it now expects to continue under the old tax regime in FY22 (against earlier expectation of shifting to the new tax regime).
- While the company incurred no capex in Q1, it has plans for ~₹1.2bn-1.25bn for the rest of FY21. The guidance was raised from the earlier ~₹0.7bn-0.8bn owing to the recent two EPC orders in Gujarat, and as it expects to add more to take full-year order additions to ~₹70bn.
- The net working-capital cycle was 84 days on 30th Jun'20, up 27 days q/q, 14 days y/y. Management sees this rise as temporary and expects NWC days to return to normal (~70) over H2 FY21.

Inflows / order backlog

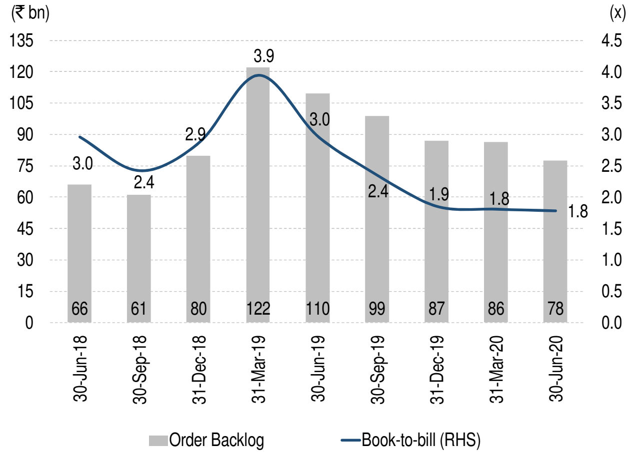
- Despite the Covid-impacted pace of tendering and awarding, the company was successful in adding a hybrid annuity project during Q1 and two EPC orders till now in Q2.
- PNC bagged its eleventh hybrid annuity project (bid project cost: ~₹14bn) in Q1 FY21. Including the three hybrid annuity projects won the previous quarter, these four cumulatively entail an EPC potential of ~₹53bn. Post-Q1, it was awarded two road EPC projects from the NHAI in Gujarat (a new region), aggregating ~₹15.5bn of potential.
  - Pending appointed dates, these projects have yet to be included in the firm order backlog. Besides these, one of the older hybrid annuity projects, the Challakere-Hariyur, awaits an appointed date and, thus, is not yet a part of the order book.
- With the hybrid annuities yet awaiting appointed dates, and the two EPC orders secured subsequent to Q1 (thus, not yet a part of the OB), its OB was down ~₹9bn sequentially, largely to the extent of works executed, to ~₹77.6bn at end-Q1 FY21. This implied a book-to-bill of ~1.8x TTM construction revenues.
  - Of its firm OB, management commented that ~66% of the backlog was from its own captive hybrid annuity projects; the balance comprises third-party EPC works. Ahead, its hopes to have a 50:50 mix between EPC and captive hybrid annuity projects.

Fig 10 – Target FY21 inflows: ~₹70bn, ~₹27bn already won; EPC the preferred model for further orders



Source: Company Note: Including change in scope of works

Fig 11 – End-Jun'20 OB: ~₹78bn; incl. orders pending appointed dates, OB at ~₹155bn



Source: Company

  - Incl. the yet-to-be-appointed ~₹9.4bn Challakere-Hariyur hybrid annuity order, the recently bagged four hybrid annuities (EPC value: ~₹53bn) and the post-Q1 road EPC orders (of ~₹15.5bn), the OB jumps to ~₹155bn and the book-to-bill, as a result, jumps to ~3.6x TTM construction revenues.

- Considering the employment generation potential, and the widespread socio-economic benefits, management is of view that the roads sector would be a key focus area for the government in the foreseeable future.

- For FY21, management aims to add orders of ~₹70bn. Having already added ~₹27bn year-to-date in FY21, it looks to add orders of ~₹40bn during the rest of the year. For this, it has its eyes on a bid-pipeline of 43 NHAI projects (comprising 25 EPC and 18 hybrid annuity projects).
  - Management said bids for these projects, of ~₹420bn, are due by Sep'20.
  - Ahead, management intends to focus more on EPC opportunities and be selective while considering hybrid annuity projects owing to the recent success with four hybrid annuities.

- On diversification, management looks to selectively diversify into rural drinking water-supply projects and has bid for three such projects in Uttar Pradesh, aggregating ~₹5.8bn. Bids for these projects were submitted in Jul'20 and are likely to be opened by Sep'20.
  - It had previously looked to or had considered diversifying into other segments, such as metro-rail (elevated packages) and railways.

- On the Ganga Expressway project by the UPEIDA, management had earlier said the project could provide multiple EPC opportunities, and that DPR preparation was underway. Given the current circumstance, it now expects the project to see some meaningful traction next year.

- On the coming modified BOT-toll opportunities, management said that it is not averse to bidding for such projects, and may selectively bid for such opportunities provided these meet risk / return thresholds.

- Management commented that while keener competition is seen for both EPC and hybrid annuity projects, it is more intense for EPC projects. EPC remains its preferred segment and it said that the bids in which the company generally participates tend to see more rational bidding.
  - Citing an adequate OB, management indicated it was under no pressure to add orders and hence would price its bids keeping its secular margin guidance / risk-return threshold in mind.

Update on hybrid annuity projects

- **Hybrid annuity portfolio, at eleven now.** With four recent wins, PNC's hybrid annuity portfolio now consists of eleven projects. Of these, it has received PCOD for one, construction is ongoing on five, one awaits an appointed date (financial closure attained); four were recently bagged (concessions signed for three in Aug'20, FC awaited for all four).

- **Appointed dates, RoW status.** Of the five hybrid annuity projects where construction has yet to commence, discussion can be under two heads:
  - **The Challakere-Hariyur project.** Management has yet to take an appointed date at the project despite having indicated earlier on the adequate ~80% RoW available with the authority. It does not mind

starting with the RoW available for the main carriage-way, and subsequently take up the service roads. Consequently, it expects to commence execution by mid-Oct'20. The site is already mobilised, and it does not expect this long-delayed project to be cancelled.

- **The four recently-bagged projects.** For these hybrid annuity projects, management indicated the right of way was adequate. Having signed concession agreements on 5th Aug'20 for the three projects bagged in Q4 FY20, management expects to take appointed dates within the stipulated timelines (by Jan'21). For the project won in Q1, the concession signing is yet awaited. Efforts to attain financial closures for these four have already begun, and management does not see any issues in attaining these within the stipulated time (five months after signing concessions).

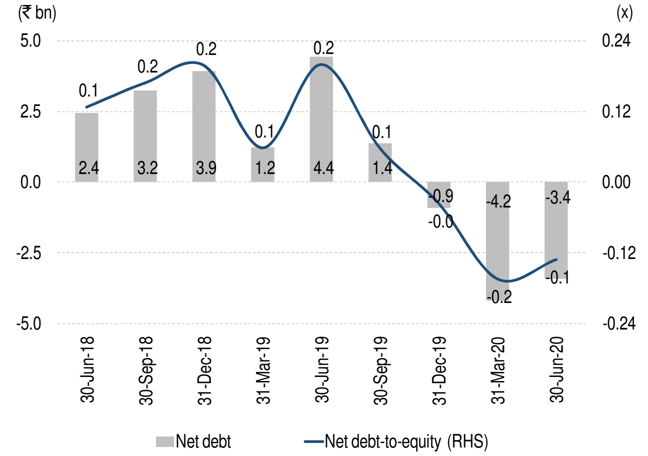
- **Equity infusion.** The equity required, including for the four new hybrid annuity projects, has risen, now pegged at ~₹15bn.
  - **Seven older assets.** Of its older hybrid annuities, management requires cumulative equity of ~₹8.5bn. Of this, it has infused ~₹4.7bn, including ~₹250m in Q1 FY21.
  - **Four newer assets.** Management estimates these recently-bagged projects to entail equity infusion of ~₹6.2bn.
  - **Infusion schedule.** Of the balance estimated ~₹10bn, it looks to infuse ~₹2.6bn in the rest of the financial year, ~₹4.3bn in FY22, ~₹1.6bn in FY23, and the balance subsequently (in FY24).

- **Targets PCOD for four more hybrid annuities.** For its earliest hybrid annuity project, the Dausa-Lalsot, the SPV attained 14th Feb'20 as its Provisional Commercial Operations Date. By end-FY21, the company targets PCOD for four more hybrid annuity projects.

Balance sheet

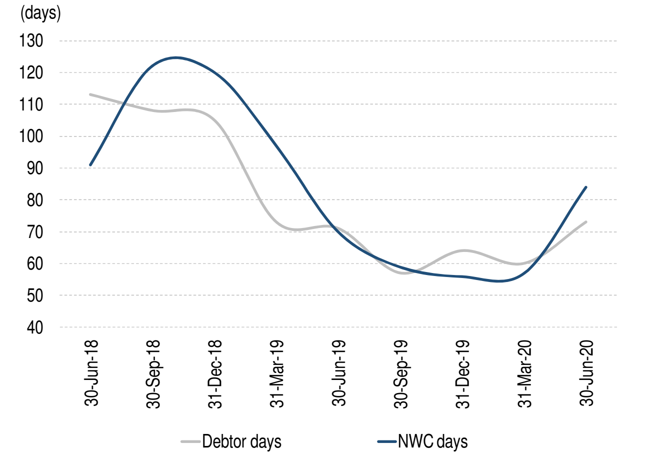
- **Net cash status stays, but cash excesses decline**. The ~₹2.6bn q/q higher net working capital holds the key to ~₹0.8bn q/q lower net cash balance (at ~₹3.4bn on 30th Jun'20).

Fig 12– Jun'20-end net cash at ~₹3.4bn; weakened q/q



Source: Company

Fig 13– NWC at 84 days; target to return to 70 days over H2



Source: Company

- The reason for the higher working capital cycle was speedier adjustment of mobilisation advances from the Mumbai-Nagpur projects against bills raised. During Q1 FY21, the company settled

~₹0.94bn of mobilisation advances against ~₹1.3bn of works carried out. This was done as these mobilisation advances carry a higher interest rate, and were earlier taken to safeguard its interest.

- The other factor responsible for the higher net working capital was the pandemic-disrupted release of payments (government departments not fully functional).
- Fresh equity infusion of ~₹0.25bn in the under-construction hybrid annuity SPVs too, though small, had a role to play in the q/q lower net cash balance.
- The Jun'20-end gross debt of ~₹3.3bn (almost the same as last quarter) entirely comprises equipment finance, and there were no working capital loans.

- **Working-capital cycle at 84 days; up 27 days q/q, 14 y/y**. Besides the extended receivables cycle (13 q/q, two y/y), we see utilisation of mobilisation advances to fund the execution (especially at the Mumbai-Nagpur project) as the reason for this protracted working-capital cycle. Besides seasonality involved in the business, we believe a part of the protraction is attributable to the disruptions (government departments not fully functional).
  - In absolute terms, we estimate higher receivables to have contributed ~₹0.9bn q/q (~₹1.8bn y/y) to ~₹2.6bn q/q (~₹3.2bn y/y) higher net working capital (at ~₹10.3bn at end-Jun'20). Mobilisation advances were ~₹3.5bn, against ~₹6.9bn at end-Q4 FY20.
  - Management sees the Q1 rise in the net working capital cycle as temporary, and expects it to return to ~70 days over H2 FY21.
- **SPV debt up.** On 30th Jun'20, debt at SPVs (incl. Ghaziabad-Aligarh, ineligible for consolidation) was ~₹41.5bn, a ~₹1.3bn net increase q/q on fresh drawdowns by the hybrid annuity projects, but partly offset by repayments by the operational BOT-toll / annuity SPVs.
  - For its operational BOT-toll / annuity assets, outstanding debt contracted ~₹1bn (net) but ~₹2.3bn drawdowns by the hybrid annuity projects (incl. at the recently completed Dausa-Lalsot) exceeded repayments.
  - Of the total SPV debt, ~₹17bn arises from the under-construction hybrid annuity assets, against ~₹14.8bn a quarter ago. The only operational hybrid annuity asset (Dausa-Lalsot) had debt of ~₹3.6bn on 30th Jun'20, up ~₹0.1bn q/q. The balance is explained by the operational BOT-toll / annuity assets.
- **Consolidated net debt rises on drawdowns.** It was up ~₹2.3bn q/q to ~₹24.7bn, largely due to fresh drawdowns by the hybrid annuity SPVs and a lower net cash balance for the standalone entity. But the rise was partly contained by repayments by the BOT-toll / annuity SPVs eligible for consolidation. Higher net debt made net D/E rise, but it still is below 1x (end-Jun'20 at ~0.93x, up from ~0.88x q/q).
- **More mobilisation advances expected.** These were ~₹3.5bn on 30th Jun'20. Though no more mobilisation advances are expected from the under-construction portfolio, management says it could draw mobilisation advances from its recent two EPC wins in Q3 FY21 (in Oct-Nov'20). Mobilisation advances for the new hybrid annuities are also expected after the appointed dates.

Other highlights

- **Execution in the Covid-19 context.** The Q1 pace of execution was disrupted by the lockdown and, subsequently, by a disrupted supply-chain and labour unavailability. On the government permitting work to resume, all appointed sites have come live. While execution was gaining momentum with a normalised supply-chain and labour returning, execution efficiencies were impacted by the early monsoon in Jun'20.
  - Management said labour at its sites was ~80-90%, is up from ~70-75% in late-Jun'20. Despite the improved labour situation, execution efficiency was ~50-60% due to the monsoon.
  - Management expects labour to return to normal post-monsoons.
  - At its operational BOT-toll assets, tolling was resumed from 20th Apr'20 but traffic volumes ramped up only toward mid-May'20 and rebounded to ~90% levels only in late Jun'20. Collections continue at ~90% pre-Covid levels, largely due to return of commercial traffic. Return to pre-covid levels is expected only post-monsoon.
  - Management commented that ~90% collections for two months imply that traffic is returning and that current collections are not a result of any pent-up demand.
- **Ghaziabad-Aligarh monetisation.** With the lapsing of the share purchase agreement signed with Cube Highways, the company along with other co-promoters of the asset have already begun discussions with another prospective buyer. Due diligence by the new suitor is in process (having reached advanced stages like technical, legal, financial, traffic study, and so on).
  - Management said it would consider a deal closure in the next couple of months, provided the valuation arrived at is reasonable and acceptable.
- **Monetisation of hybrid-annuity assets.** Management intends to exit the hybrid annuity portfolio and is looking for a prospective buyer but refrained from providing any timelines. It did indicate that it would look to monetise these assets at the "right price and right time".
- **Gwalior-Bypass BOT-annuity, an NCLT opportunity on the radar.** Citing confidentiality norms, management did not say much on this development besides that it submitted its resolution plan under the CRP process initiated pursuant to the NCLT order, and the committee of creditors has issued a LoI to the company (thereby making it eligible to bid for the project). The project, a traditional BOT-annuity asset, has seven years of balance concession.
  - We learn that the project SPV has ~₹5bn of claims approved under the arbitration process, and the NHAI has challenged the arbitration ruling in court.
  - Consequently, the bids, besides assigning value for the balance annuity receipts, would have to take a view on these claims as well.

Earnings revision and Valuation

Though the Q1 pace of execution was slightly ahead of expectations, we retain our revenue estimates owing to yet-evolving pandemic situation and the long-delayed appointed date for the Challakere hybrid annuity project.

Though we keep our revenue estimates intact, the FY21e EBITDA margin has been raised on the Q1 performance. And for FY22, we return to the old tax regime as management now expects to be able to exhaust available MAT credit only by FY22. Consequently, the FY22e effective tax rate has been raised to ~34%, against the earlier estimated ~26%. Consequent to the changes, FY21e earnings are ~7% higher, and ~11% lower for FY22.

Though we bake a higher effective tax rate into our FY22e, our sum-of-parts-based target still considers the benefit of the lower tax regime (as the FY22 actual outlay even under the old tax regime would not be 34%; adjusting for MAT credit, and migration is all but certain in FY23).

Derived using a 9x PE multiple for FY22e construction earnings adjusted for the tax implication (₹146 a share; unchanged), the exposure to the asset-ownership has been valued at ₹59 using a mix of DCF (₹22 for operational BOT-toll / annuity assets) and an equity-invested approach for hybrid annuities (₹37, raised from ₹34 earlier on change in the equity-infusion schedule). The value of the BOT and hybrid annuity assets has been arrived at after a 20% holding-company discount. The per-share target price works out to ₹205 (from ₹202 earlier).

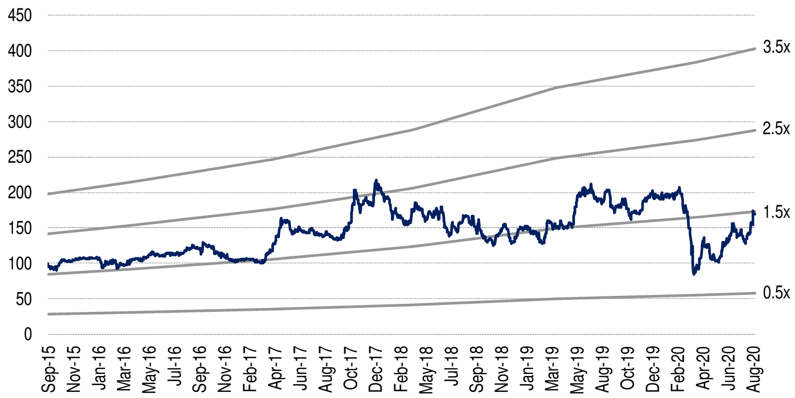
Fig 14 – Estimates revision

(₹ m)	Old Estimates		Revised Estimates		Change (%)	
	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Revenue	45,072	57,415	45,072	57,415	-	-
EBITDA	5,863	7,866	6,087	7,866	3.8	-
EPS (₹)	10.8	16.2	11.5	14.4	6.8	-11.0

Source: Anand Rathi Research

At the CMP, excl. investments, the stock quotes at PER of 8.4x FY22e un-adjusted EPS and 7.4x FY22e EPS adjusted for the tax implications. This is against the assigned 9x PE multiple. On PBV, it quotes at 1.5x FY21e and 1.4x FY22e, against our target price (₹205)-implied exit PBV of 1.7x.

Fig 15 – PBV band



Source: Bloomberg, Anand Rathi Research

Risk

- A prolonged impact of Covid-19.

Appendix

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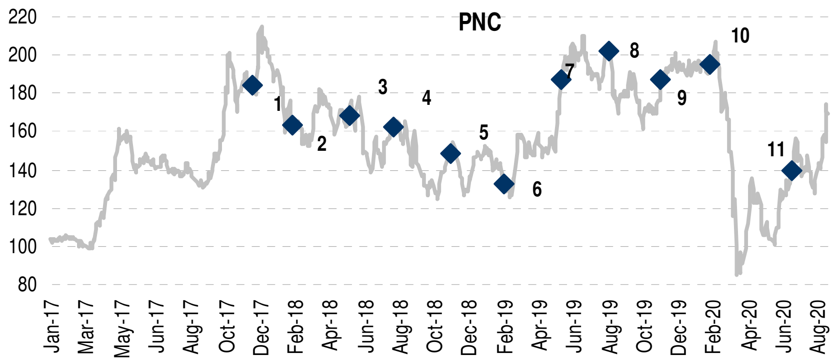

	Date	Rating	TP (₹)	Share Price (₹)
1	11-Dec-17	Buy	237	188
2	19-Feb-18	Buy	211	168
3	28-May-18	Buy	219	169
4	10-Aug-18	Buy	213	164
5	17-Nov-18	Buy	194	150
6	18-Feb-19	Buy	199	137
7	28-May-19	Buy	250	187
8	16-Aug-19	Buy	252	204
9	15-Nov-19	Buy	256	188
10	06-Feb-20	Buy	277	196
11	27-Jun-20	Buy	202	139

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