AXIS SECURITIES

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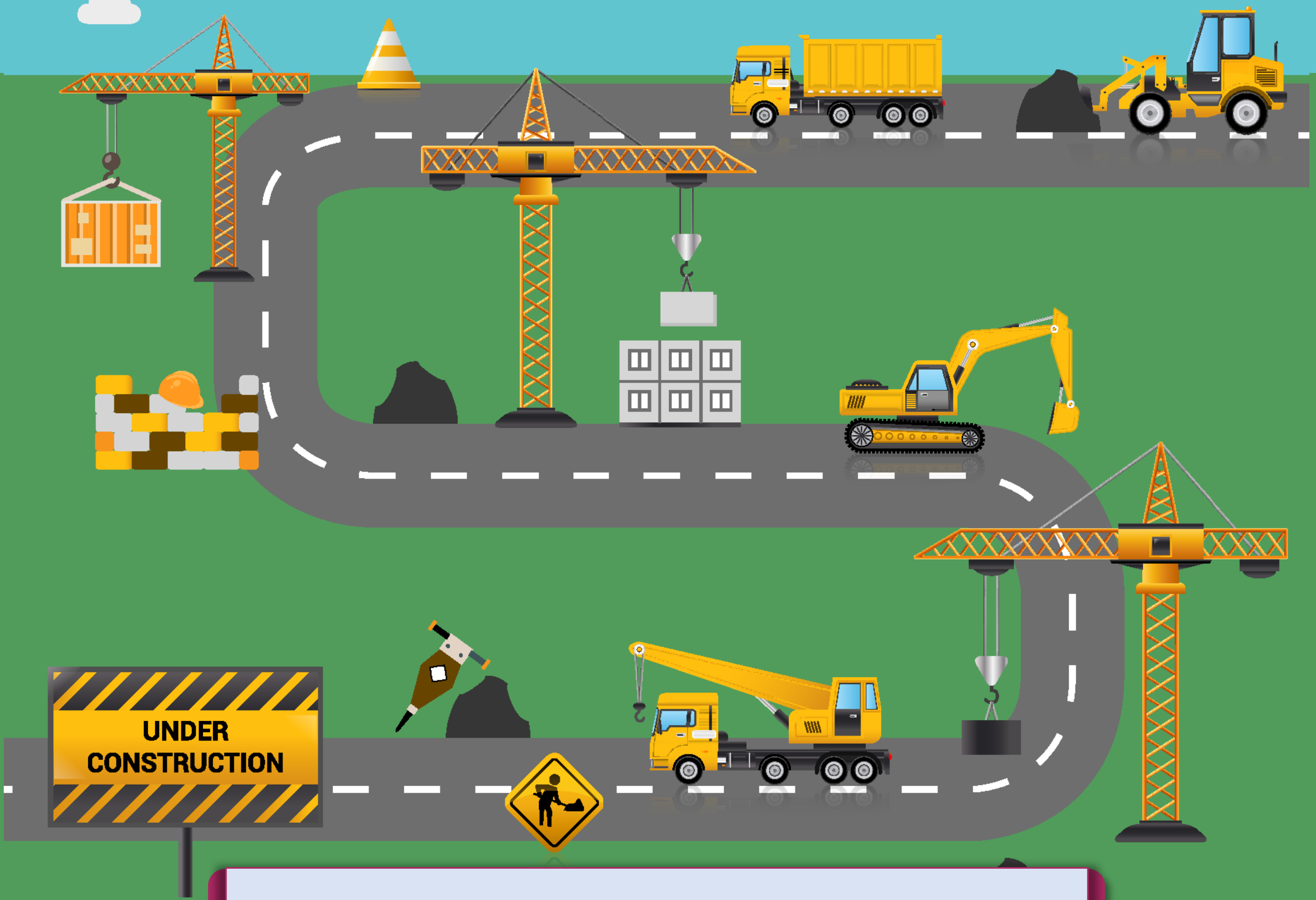

Top Sector Ideas: Infra-Road

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Infra-Road: Q1FY24 Review

Q1FY24 Infra-Road – Robust Order Book to Drive Growth; Outlook Positive

✓ ***Financial Performance***

- During the quarter, companies under our coverage reported Revenue/APAT growth of 3%/7%. EBITDA growth was flattish against our expectation of 4%/1%/5% YoY backed by better execution.

✓ ***Sequential improvement in EBITDA margin***

- On a sequential basis, EBITDA margins improved marginally by 20bps while it remained flattish on YoY basis. Overall performance remained satisfactory during the quarter.

✓ ***Company-wise performance***

- HG Infra, KNR Construction and GR Infraprojects contributed positively on Revenue/EBITDA/APAT front and performance were either higher or were in line with our expectations.
- PNC Infratech performance was marginally below our expectation owing to lower execution while we remain positive on the growth prospect of the company.

Infra-Road: Outlook

Near-Term Outlook (Key Challenges)

- **Pace of road construction improved:** During the quarter the pace of road construction improved sharply by 9% YoY and 2,150 KM of roads were constructed. Highway construction for Q1FY24 was higher than the average of the last four years and stood at 2,057 KM. Road ministry has increased the target of road construction to 14,000 KM from 12,000 KM decided earlier in FY24.
- **Low awarding activity:** Awarding activity during the quarter remained low at 600 KM against 969 KM of highways against corresponding period last year.
- **Overall inflows from road sector remained below management expectation**, except for GR Infra. The management in earnings concalls appeared positive about order inflows in FY24 and expected to meet their order inflow guidance in light of the NHAI's strong bidding pipeline of over Rs 1 Lc Cr. The management guided for better order inflows and expect most of the awarding activity to conclude by Q3FY24 before on set of general election.
- **Focus on state governments road projects:** Beside NHAI pipeline, companies are also looking to bid for various state governments road projects with strong pipeline and better payment terms
  - ✓ Most road companies are looking to diversify their operations to reduce dependence on road projects.
  - ✓ Asset monetization also remains key priority for road developers.
  - ✓ At present, most of the companies under our coverage have robust order book giving healthy revenue visibility for the next 2-3 years.
  - ✓ Softening in commodity prices is expected to aid in margin improvement moving ahead.

Infra-Road: Outlook

Sector Long-term Outlook

- **Pace of road construction too gain momentum:** With the NHAI looking to award many road projects under central government's flagship program – Bharatmala Pariyojana for building highways and expressways, pace of road construction will gain further momentum. Also, National Infrastructure Pipeline which aims to develop overall infrastructure would support road construction moving ahead.
- **Road construction companies to be major beneficiaries of infra spending:** Since majority of these projects would be awarded under EPC and HAM model, road construction companies will be major beneficiaries of government's infra spending. With robust order book, healthy bidding pipeline, and diversified order book, we remain positive on the sector's long-term outlook. Competitive intensity has reduced for larger size projects while it remains high for smaller projects.
- **Competitive intensity has reduced in HAM projects:** Company management also indicated in their earning con-call that competitive intensity has reduced in HAM projects bidding while it remained high on EPC projects. Higher value EPC projects above Rs 1,000 Cr have witnessed slowdown in competitive intensity.
- **We remain positive on the sector**

Short and Medium-term Outlook

Short term

Volatile Raw material prices

Prices of cement, steel are fluctuating

Delay in Appointed Date

Delays in appointed date to affect revenue growth

Medium Term

Superior Execution

Expect execution to be better than the last year in H1.

Better Order Inflow

Awarding expected to increase since it's a pre-election year

Key monitorables – *Direction of RM, Appointed date, Order Inflow, and Execution*

Top sector Ideas: Infra-Road

Stock	Reco.	TP/CMP	Recommendation Rationale
HG Infra Engineering Ltd	BUY	Rs 1140*	✓ The company expects to receive orders of Rs 7,000-8,000 Cr in FY24. ✓ The current bid pipeline is Rs 1,10,000 Cr from NHAI and Rs 50,000 Cr from Railways. ✓ The current bid pipeline is strong in HAM as well as EPC and other sectors where the company is looking to diversify. This will keep the order intake healthy during the year. ✓ We expect the company to grow its Revenue/EBITDA/APAT at a CAGR of 19%/18%/20% during FY23-FY25E, with healthy EBITDA margins of 16%. ✓ The company's order book is healthy at Rs 11,674 Cr (as of 30th June'23), of which 53% is from EPC road projects and rest 47% from HAM road projects. ✓ 70% of the total projects are from the Government of India and the remaining 30% from the private sector, which means revenue visibility for the next 2-3 years. ✓ The HAM monetization of assets at 1.55 times invested equity in four special purpose vehicles is a good sign for the company. This will ensure capital infusion into promising HAM projects in the future.

** Note: Target Price is based on our Q1FY24 Result Update Report*

Top sector Ideas: Infra-Road

Stock	Reco.	TP/CMP	Recommendation Rationale
PNC Infratech Ltd	BUY	Rs 435*	✓ PNCIL has an order book of Rs 14,916 Cr (as of Jun'23), with 90% of the order book executable and including L1 of Rs 4,100 Cr, a healthy order book of over 19,000 Cr (3.4x FY23 revenue). This provides healthy revenue visibility for the next 2-3 years. ✓ Given the company's robust and diversified order book and better execution capability, we expect PNCIL to post revenue growth of 12% CAGR over FY23-25E. The company expects EBITDA margins in the range of 13-13.5%. ✓ In the Union Budget 2023-24, Capex increased by 33% in the Road sector and by 27% in the JJM. This has created significantly greater opportunities for companies like PNCIL. ✓ The bid pipeline is well filled in both the road and JJM (Jal Jeevan Mission) segments. Management expects an order intake of Rs 10,000 Cr in FY24 including HAM /EPC/JJM. ✓ The company is giving top priority to asset monetization and has selected 12 projects including 11 HAM assets and 1 BOT project. Asset monetization is expected in Q4FY24, freeing up capital for future growth.

** Note: Target Price is based on our Q1FY24 Result Update Report*

Top sector Ideas: Infra-Road

Stock	Reco.	TP/CMP	Recommendation Rationale
KNR Constructions Ltd	BUY	Rs 305*	✓ The company’s order book remains robust at Rs 6,265 Cr (as of Jun 23). Including the recently won 3 projects, the order book is even better at Rs 8,045 Cr and provides revenue visibility for the next 2 years ✓ Apart from the NHAI pipeline, the company is also bidding for various state government road projects where the payment cycle is better. ✓ We expect the company to get a better order intake which will further drive its revenue growth. The company also plans to bid for new irrigation projects worth Rs 8,000 Cr in the states of Telengana, MP and Rajasthan. We expect the company to grow its revenue at a CAGR of 13% during FY22-FY25E. ✓ The company expects order inflow of Rs 4,000-5,000 Cr from road projects in FY24, which will keep the order book healthy going forward. ✓ Although the company’s order intake in FY23 was lower than expected, the company’s policy of not chasing orders at a lower margin should be appreciated. ✓ Although the company’s focus is on HAM projects, it aims to diversify into other segments such as railroads, metros and urban infra so as not to impact the revenue stream apart from the road segment.

** Note: Target Price is based on our Q1FY24 Result Update Report*

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