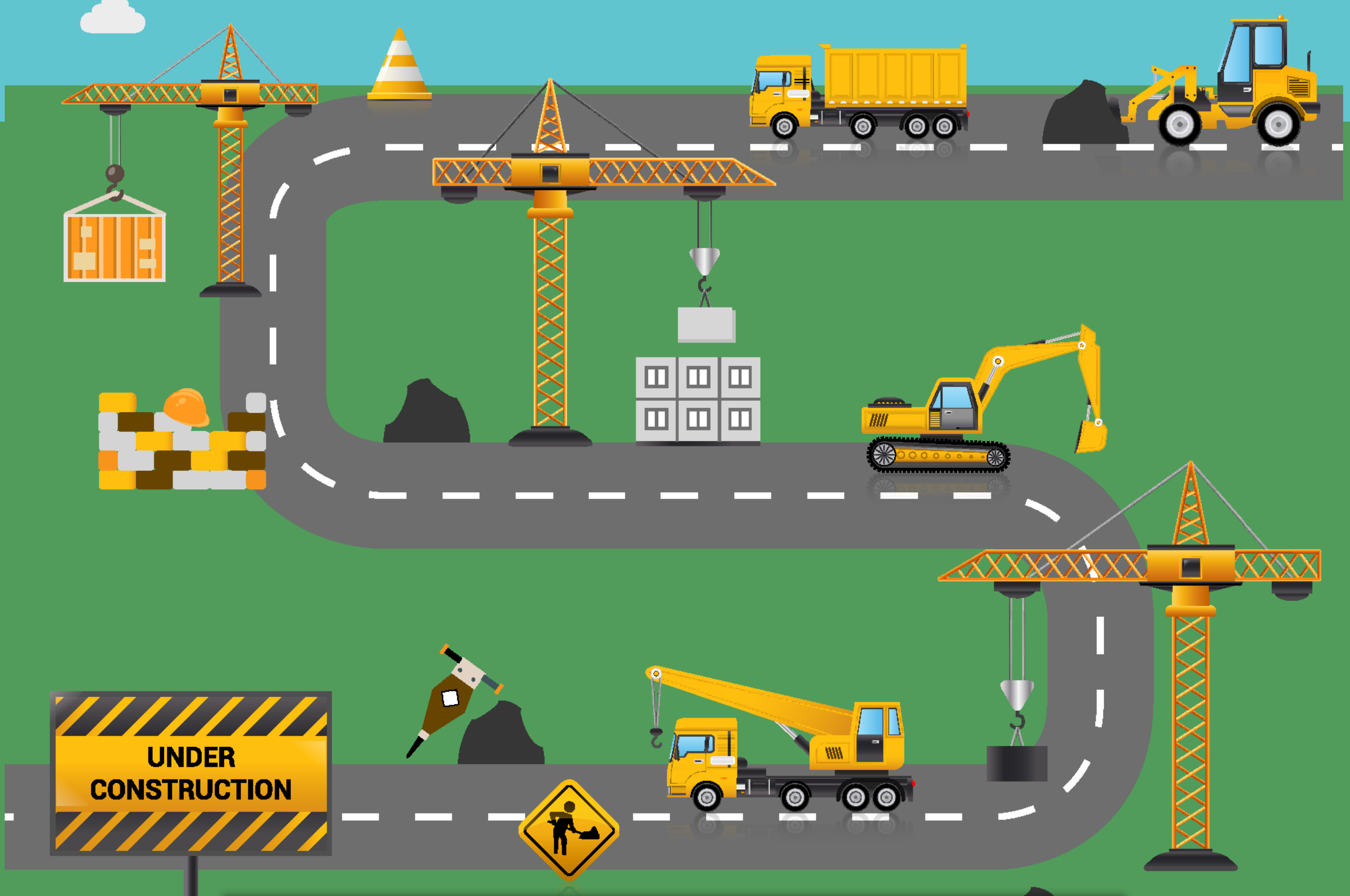
AXIS SECURITIES

February 2024



Top Sector Ideas: Infra-Road & Others

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Infra-Road : Q3FY24 Review

Q3FY24 Infra-Road – All Eyes on New Order Inflows

✓ *Financial Performance*

- During the quarter, road infrastructure companies under our coverage reported revenue growth of 7%. EBITDA was flattish, while APAT grew by 4% against our expectation of 14%/11%/13% YoY, primarily owing to underperformance of GR Infra projects and KNR Construction Ltd.

✓ *EBITDA Margins Decline*

- EBITDA margins declined by 30bps/120bps QoQ/YoY. Overall performance remained below our expectations during the quarter.

✓ *Company-wise Performance*

- PNC Infratech & H.G. Infra contributed positively on Revenue/EBITDA/APAT fronts, and their performances were largely in line with our expectations.
- GR Infraprojects & KNR Construction's performance was below our expectations on all counts, which impacted the overall performance.
- PSP Projects, KEC International & RITES' performance were below expectation on the EBITDA/PAT front, while Ahluwalia Contract outperformed on all counts.

Infra-Road : Outlook

Near-Term Outlook

- **Pace of road construction improved:** Till Nov'23, the pace of road construction improved by 10% YoY, with 5,248 km of roads constructed compared to 4,766 km in the previous period. Highway construction for Q2FY24 stood at 1,452 km. The Road Ministry has set the target of road construction at 12,000 km for FY24.
- **Low awarding activity:** Awarding activity during the period Apr-Nov'23 remained low at 2,815 km against 5,382 km of highways YoY. The delay was on account of the government's strict policy guidelines to not to award projects before land acquisition and all other clearances are in place. It is expected that awarding will gain pace in the remainder of the year before the model code of conduct for the general election is implemented.
- **Overall inflows from the Road sector remained below management expectations:** The order inflow for companies under our coverage universe remained tepid during the quarter owing to low awarding activity by the NHAI and higher competitive intensity in EPC projects. Managements have also reduced their order inflow guidance for FY24 by 30-40% from their earlier envisaged number. However, they sounded positive and believed that order intake would accelerate in FY25 as the bidding pipeline remains strong at over Rs 1.8 Lc Cr.
- **Focus on state governments' road projects:** Besides the NHAI pipeline, companies are also looking to bid for various state governments' road projects with strong pipelines and better payment terms
  - ✓ Most road companies are looking to diversify their operations to reduce dependence on road projects.
  - ✓ Asset monetization also remains a key priority for road developers and during the quarter HG Infra successfully monetized its 3 HAM assets and PNC Infra signed definitive agreement to divest its equity stake in 12 road assets.
  - ✓ At present, most of the companies under our coverage have robust order books giving healthy revenue visibility for the next 2-3 years. .

Infra-Road : Outlook

Sector Long-term Outlook

- **Pace of road construction to gain momentum:** With the NHAI looking to award many road projects under the central government's flagship program – Bharatmala Pariyojana for building highways and expressways, the pace of road construction will gain further momentum. Moreover, the 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 the majority of these projects would be awarded under the EPC and HAM model, road construction companies will be major beneficiaries of the government's infra-spending. With a robust order book, healthy bidding pipeline, and diversified order book, we remain positive on the sector's long-term outlook. However, from a short-term perspective, we remain cautiously optimistic, and all eyes are on new order inflows and receipt of AD (Appointed Date) for projects awarded.
- **Competitive intensity has reduced in HAM projects:** Managements have indicated in their earnings conference calls that competitive intensity has reduced in higher value HAM projects bidding, while they remained high on EPC projects.
- **We remain positive on the sector from the long-term perspective.**

Short and Medium-term Outlook

Short Term

Volatile Raw material prices:
Prices of cement and steel are fluctuating

Delay in Appointed Dates:
Delays in appointed date to affect revenue growth

Superior Execution:
Execution to remain healthy in Q4

Better Order Inflow:
Awarding expected to increase in Q4FY24

Medium Term

Key Monitorables – *Direction of RM; Appointed date; Order Inflow; and Execution*

Top Sector Ideas: Infra-Road

Stock	Reco.	TP	Recommendation Rationale
PNC Infratech Ltd	BUY	Rs 510*	✓ PNCIL has an order book of Rs 17,380 Cr (as of 31st Dec'23), indicating revenue visibility for the next 2-2.5 years. The order book is well diversified between Roads and Water projects. This coupled with improved execution quality, we expect PNCIL to grow its revenue by 11% CAGR over FY23-26E. ✓ In the Interim Union Budget 2024-25, Capex has been increased by 11% for the infrastructure sector, thereby providing greater opportunities for companies like PNCIL. With a strong bid pipeline of over Rs 1.90 Lc Cr, the management expects an order inflow of Rs 8,000 Cr in FY24 and Rs 12,000 Cr in FY25. ✓ The Union Budget 2023-24 increased the Capex for the Road sector by 33% and the JJM by 27%. This has created significantly greater opportunities for companies like PNCIL. ✓ The Company, along with its wholly-owned subsidiary, PNC Infra Holdings Limited, has signed a Master Securities Purchase Agreement (SPA) with Highways Infrastructure Trust (HIT), an Infrastructure Investment Trust (InvIT), to divest 12 of the Company's road assets: 11 National Highway (NH) Hybrid Annuity mode (HAM) assets and 1 State Highway BOT Toll asset. ✓ The proposed disinvestment is aligned with the Company's strategic objective of recycling the capital invested in operating road assets to leverage the ambitious growth vision.

** Note: Target Price is based on our Q3FY24 Result Update Report*

Top Sector Ideas: Infra-Road

Stock	Reco.	TP	Recommendation Rationale
HG Infra Engineering Ltd	BUY	Rs 1,080*	✓ The company's order book stands healthy at Rs 9,623 Cr (as of 31st Dec'23), comprising 51% from the EPC road projects, 37% in HAM road projects, and the balance 12% from the Railway & Metro projects. ✓ The company also secured projects worth Rs 1,100 Cr in Q4FY24 from Railways. 73% of the total projects are from the Government of India, and the balance 27% is from the private sector, implying revenue visibility for the next 2-3 years. We expect the company to post revenue growth of 17% CAGR over FY23-FY25E. ✓ The company is expecting an order inflow of Rs 5,000-6,000 Cr in FY24 and Rs 8,000-10,000 Cr in FY25. The current bid pipeline is strong both in HAM and EPC and in other sectors where the company is looking to diversify. ✓ Going forward, the company is looking to diversify more into railways, metros, and solar projects. The management expects 20-25% of its order book to come from non-road projects in the next 2-3 years. ✓ The company completed HAM asset monetization of 3 SPVs, and the balance 1 SPV is to be completed by Mar'24, with proceeds already received. The completion of HAM asset monetization is positive for the company.

** Note: Target Price is based on our Q3FY24 Result Update Report*

Top Sector Ideas: Infra-Others

Stock	Reco.	TP	Recommendation Rationale
Ahluwalia Contracts India Ltd	BUY	Rs 1110*	✓ The company has an order book of Rs 11,247 Cr (as of 31st Dec'23). The breakup of this order book is as follows: Hospital – 24.7% (Rs 2,777 Cr), Commercial – 7.6% (Rs 857 Cr), Institutional – 23.6% (Rs 2,652 Cr), Residential – 11.8% (Rs 1,327 Cr), Infrastructure – 31.9% (Rs 3,520 Cr), and Hotel – 0.4% (Rs 41 Cr). ✓ Apart from the robust order book, the company is also L1 in two projects worth over Rs 3,200 Cr. The robust order book and L1 status give us revenue visibility for the next 3 years. Therefore, we are pencilling in revenue growth of 25% CAGR over FY23-FY26E and expect the company to post improved margins. ✓ The year-to-date (YTD) order inflow stood at Rs 5,834 Cr. The company is L1 in 2 projects worth Rs 3,230 Cr, which are expected to be awarded soon. Additionally, the management expects to win additional orders of ~Rs 200-300 Cr during the remainder of FY24. ✓ The company has also diversified and bid for projects such as airport buildings, metros, and urban infra, and it foresees more traction in commercial buildings, hotels, hospitals, and education buildings. Moreover, the company will focus on the private sector owing to the increase in private Capex, as there is less competition and more opportunities. ✓ The company exhibits a strong financial position reflected in its virtually debt-free status, robust cash/bank balance (10% of market cap), and high return ratio.

** Note: Target Price is based on our Q3FY24 Result Update Report*

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