17 FEBRUARY 2010

India Infrastructure – Highways: Expert view

Vishal Sharma, CFA
+91 22 6628 2441
vishal.sharma@asia.bnpparibas.com

Shashank Abhisheik
+91 22 6628 2446
shashank.abhisheik@asia.bnpparibas.com

- **Opportunities aplenty; delays likely, low visibility for mega projects.**
- **Unstable policy: land, labour are key hurdles.**
- **Cost of funds and construction capability are key differentiators.**
- **Top pick: IRB Infrastructure.**

Hurdles ahead of flyovers

We hosted a meeting with an expert on India's transport infrastructure. Key takeaways are:

Near-term opportunity of USD10b

The National Highways Authority of India's (NHAI) Work Plan I envisages the award of nearly 12,000km (worth USD20b), of which nearly 3,000km have already been bid out. We estimate that approximately 5,000km of the remainder will be awarded by June 2010, translating into a near-term opportunity of approximately USD10b (expenditure of INR100m per km). We expect 15,000km to be awarded by end-2011.

Unstable policy biggest concern for foreign investors

Frequent policy changes have been the single biggest reason for low foreign investment in highways. For example, the permissible level of cross holdings and the number of bidders were changed several times last year. Just three days before the bidding date, NHAI restricted financial bids by developers with projects pending financial closure.

Land acquisition concerns are being addressed

The setting up of 150 land acquisition units to acquire land for national highways will help speed up acquisitions. Also, measures such as curbing funding to a state that does not co-operate in acquiring land for development are likely to have a significant impact.

Construction capacity a significant limiting factor

Lack of skilled labour will pose a major problem. Approximately 450,000 trained operators are required to achieve the 20km a day target set by the Minister of Road Transport. Projects bid out towards the end of the 2010 will be significantly affected by labour capacity constraints.

Financing not a big concern

Financing should not be a big issue as there is ample liquidity available in the market. At the moment, lenders are chasing borrowers. However, cost of financing can be a key differentiator among developers.

Differentiators: cost of funds + construction capabilities

All else equal, developers with access to low cost funds (large players such as Larsen & Toubro (L&T), IRB, Reliance Infra) and with construction capabilities (L&T, IRB, and Punj Lloyd) will enjoy relatively high profitability. Having construction capabilities ensures timely execution of the project and within the anticipated cost.

Stock picks

Recent bid activity reveals that IRB Infrastructure (our top pick) has been bidding prudently. Companies most affected by the recent restriction on bidders (details on p2) are L&T, IRB, Reliance Infrastructure, Hindustan Construction, Sadbhav, IVRCL and GMR Infrastructure (each with at least one project pending financial tie-up). Punj Lloyd, Simplex Infra, and GVK Power have no national highway projects pending financial tie-up.

Status of mega projects

There are approximately 10 mega projects (400-500km each) that are being planned. However, feasibility studies have been conducted for only two of them. Also, there are also issues pertaining to pre-qualification. We do not expect these projects to be awarded in the near-to-mid term. Similarly, expressways will face delays in award. Prior to the award of these projects, finalization of pre-qualification criteria is a key milestone to look out for.

Recent restriction on bidders by NHAI

NHAI has recently restricted financial bids from players who have three or more national highway projects pending financial tie-up. Consequently, these developers will not be permitted to bid for new projects. Developers who have one project pending could bid for two more, and those with two projects, could bid for one more new project. We believe this restriction is arbitrary and will not hold grounds for three reasons. First, the developers were already qualified to bid for such projects and there was no such restriction at the qualification stage. Second, the restriction was imposed just three days before the next bid submission date. Third, the number of projects (three) that have been chosen as a limit is arbitrary.

Assuming this restriction prevails, we believe two outcomes are possible. First, players waiting to tie-up funds will expedite the process. For instance, IRB is likely to announce financial closure for two projects very soon. Secondly, competition will be restricted to serious players who are realistically confident about financing the projects. This move, however, should be viewed as a serious action by NHAI against non-serious players attempting to inflate their order books.

DISCLAIMERS & DISCLOSURES

ANALYST(S)
Vishal Sharma, CFA, BNP Paribas Securities India Pvt Ltd, +91 22 6628 2441, vishal.sharma@asia.bnpparibas.com.
Shashank Abhisheik, BNP Paribas Securities India Pvt Ltd, +91 22 6628 2446,
shashank.abhisheik@asia.bnpparibas.com.

This report was produced by a member company of the BNP Paribas Group ("Group"). This report is for the use of intended recipients only and may not be reproduced (in whole or in part) or delivered or transmitted to any other person without our prior written consent. By accepting this report, the recipient agrees to be bound by the terms and limitations set out herein.

The information contained in this report has been obtained from public sources believed to be reliable and the opinions contained herein are expressions of belief based on such information. No representation or warranty, express or implied, is made that such information or opinions is accurate, complete or verified and it should not be relied upon as such. This report does not constitute a prospectus or other offering document or an offer or solicitation to buy or sell any securities or other investments. Information and opinions contained in this report are published for reference of the recipients and are not to be relied upon as authoritative or without the recipient's own independent verification or taken in substitution for the exercise of judgement by the recipient. All opinions contained herein constitute the views of the analyst(s) named in this report, they are subject to change without notice and are not intended to provide the sole basis of any evaluation of the subject securities and companies mentioned in this report. Any reference to past performance should not be taken as an indication of future performance. No member company of the Group accepts any liability whatsoever for any direct or consequential loss arising from any use of the materials contained in this report.

The analyst(s) named in this report certifies that (i) all views expressed in this report accurately reflect the personal views of the analyst(s) with regard to any and all of the subject securities and companies mentioned in this report and (ii) no part of the compensation of the analyst(s) was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed herein.

This report is prepared for professional investors and is being distributed in Hong Kong by BNP Paribas Securities (Asia) Limited to persons whose business involves the acquisition, disposal or holding of securities, whether as principal or agent. BNP Paribas Securities (Asia) Limited, a subsidiary of BNP Paribas, is regulated by the Securities and Futures Commission for the conduct of dealing in securities, advising on securities, and providing automated trading services. This report is being distributed in the United Kingdom by BNP Paribas London Branch to persons who are not private customers as defined under U.K. securities regulations. BNP Paribas London Branch, a branch of BNP Paribas, is regulated by the Financial Services Authority for the conduct of its designated investment business in the U.K. This report is being distributed in the United States by BNP Paribas Securities (Asia) Limited and is intended for distribution in the United States only to "major institutional investors' (as such term is defined in Rule 15a-6 under the Securities Exchange Act of 1934, as amended) and is not intended for the use of any person or entity that is not a major institutional investor. Major institutional investors receiving this report should effect transactions in securities discussed in the report through BNP Paribas Securities Corp. BNP Paribas Securities Corp. is a member of the New York Stock Exchange, the National Association of Securities Dealers and the Securities Investor Protection Corporation. Reproduction, distribution or publication of this report in any other places or to persons to whom such distribution or publication is not permitted under the applicable laws or regulations of such places is strictly prohibited.

Information on Taiwan listed stocks is distributed in Taiwan by BNP Paribas Securities (Taiwan) Co., Ltd.

Distribution or publication of this report in any other places to persons which are not permitted under the applicable laws or regulations of such places is strictly prohibited.

BNP Paribas and/or its affiliate(s) owned 1% or more of the market capitalisation of Hindustan Construction.

Recommendation structure

Stock recommendations are based on absolute upside (downside), which we define as (target price* - current price) / current price. If the upside is 10% or more, the recommendation is BUY. If the downside is 10% or more, the recommendation is REDUCE. For stocks where the upside or downside is less than 10%, the recommendation is HOLD. In addition, we have key buy and key sell lists in each market, which are our most commercial and/or actionable BUY and REDUCE calls and are limited to at most five key buys and five key sells in each market at any point in time.

Unless otherwise specified, these recommendations are set with a 12-month horizon. Thus, it is possible that future price volatility may cause a temporary mismatch between upside/downside for a stock based on market price and the formal recommendation.

*In most cases, the target price will equal the analyst's assessment of the current fair value of the stock. However, if the analyst doesn't think the market will reassess the stock over the specified time horizon due to a lack of events or catalysts, then the target price may differ from fair value. In most cases, therefore, our recommendation is an assessment of the mismatch between current market price and our assessment of current fair value.

Should you require additional information please contact the relevant BNP Paribas research team or the author(s) of this report.