

The bull, the bear & the fair value

 27th August 2008

BUY

Price	Target Price
Rs159	Rs218

Sensex – 14,482

Price Performance

(%)	1M	3M	6M	12M
Absolute	11	(15)	0	0
Rel. to Sensex	9	(4)	6	

Source: Bloomberg

Stock Details

Sector	Construction
Reuters	IRBI.BO
Bloomberg	IRB@IN
Equity Capital (Rs mn)	3324
Face Value (Rs)	10
No of shares o/s (mn)	332
52 Week H/L (Rs)	222/133
Market Cap (Rs bn/USD mn)	53/1,203
Daily Avg Vol (No of shares)	198089
Daily Avg Turnover (US\$ mn)	0.7

Shareholding Pattern (%)

	30/06/08	31/03/08	18/02/08
Promoters	74.4	74.4	74.4
FII/NRI	16.8	17.0	18.0
Institutions	3.9	3.7	2.3
Private Corp.	0.9	0.6	0.2
Public	4.1	4.3	5.1

Source: Capitaline

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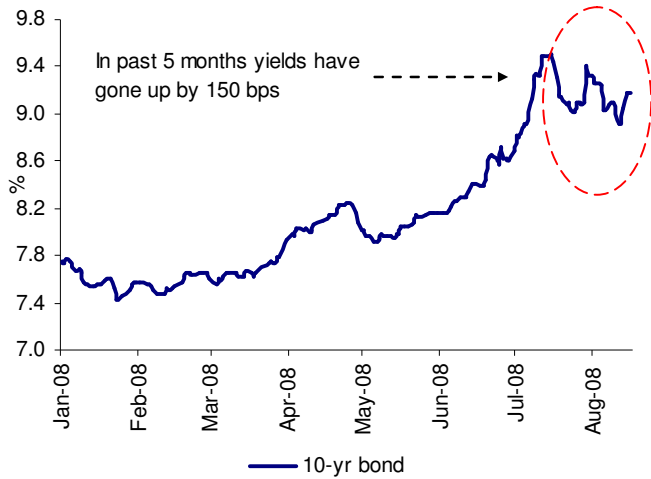
IRB stock has underperformed sensex by 10% over last three months driven by concerns over rising interest rate and visible slowdown in Indian economy. We did a stress test on our model for IRB, where in we have assumed scenarios of 9-13% interest rate, 11-15% cost of equity as the discounting rate and 6-10% traffic growth for its road BOT portfolio. The extreme bear case and extreme bull case value derived from this stress case is Rs135 (bear case) to Rs288 (Bull case) for IRB. *The stock is currently trading at Rs155, which is 12% away from our extreme bear case value of Rs135, clearly signaling the street's extreme pessimism on interest rates and traffic growth for IRB.* Also the market is not putting any value to further asset accretion that IRB can deliver by utilizing the free cash flows over next 4-5 year. Given our view of "near peak interest rate cycle" and IRB's undemanding valuations of 8.5x FY10E EPS and 6.7x FY10E EBITDA, we believe that the stock provides an attractive long term investment opportunity. We reiterate our BUY rating on the stock with a SOTP price target of Rs218.

IRB stock underperforms given sharp rise in G-sec yields and general slowdown in economy

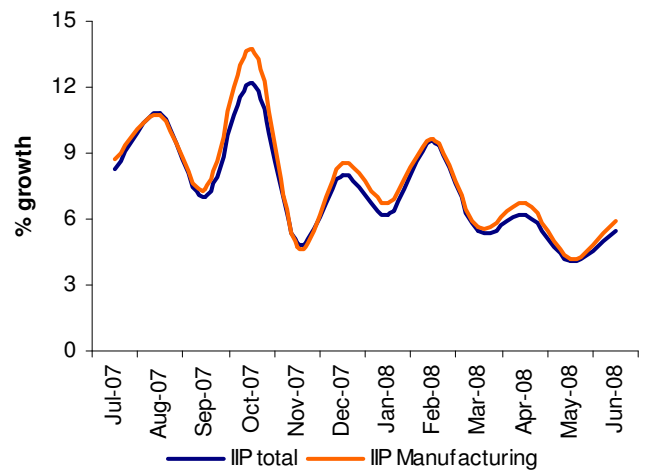
The G-Sec yields have gone up by 150 bps from 7.67% to 9.17% in last five months and have continued their uptrend, clearly painting to a scenario of higher interest rate regime. For infrastructure developers, increase in interest rates not only negatively impacts project cash flows, and consequently their IRRs, it also increases the discounting rate for project thereby lowering project NPVs. For example a 100bps increase in interest rates across system reduces value of a project like Mumbai Pune Expressway by close to 10%.

Following surge in inflation and consequent increase in BPLRs by 50-75bps by banks, there is general consensus of moderation in India's GDP growth. Also after 5 years of continued growth momentum, the Indian economy is bound to witness a bit of a slowdown. The consensus estimates of India's GDP growth is around 8%, which is a marked moderation of 100 bps from last year. Since traffic growth for road BOTs is directly related to GDP growth, the same is likely to moderate in line with GDP growth. Infrastructure developers also get impacted by this slowdown in traffic growth. For example a 100 bps reduction in traffic growth impacts value of project like Mumbai Pune Expressway by close to 10%. **Given this scenario IRB stock has given a 22% negative return on absolute basis and 10% negative returns relative to Sensex.**

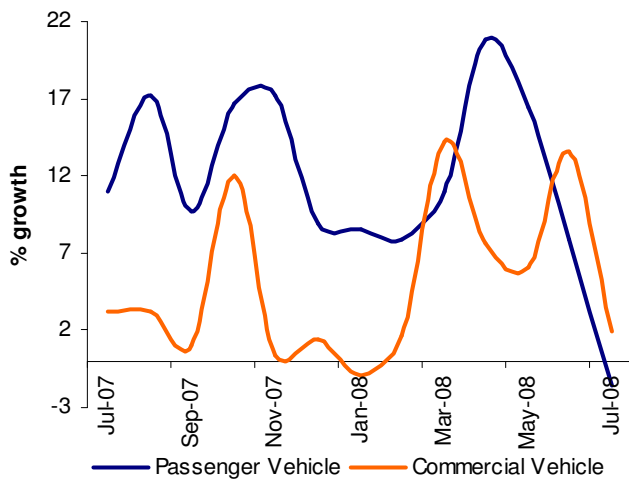
Rising G-sec bond yield



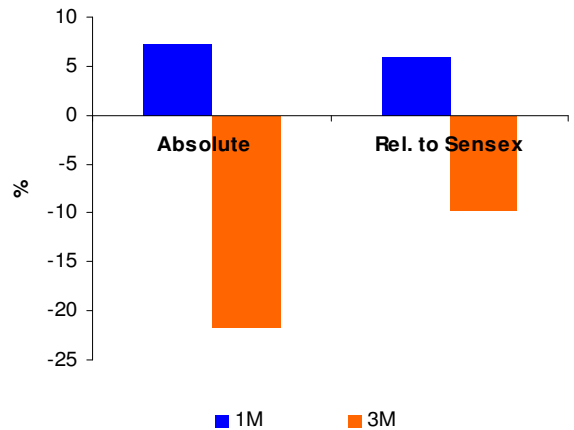
IIP growth decelerating



Sharp Slowdown in automobile sales



IRB stock performance



Bear-Bull case value range of Rs135-288 per share

In order to see the extreme impact of interest rates, discounting factor and traffic growth on value of IRB, we did a stress test on our model for IRB, where in we have assumed scenarios of 9-13% interest rate for the BOT projects, 11-15% cost of equity as the discounting rate and 6-10% traffic growth for its BOT portfolio. The extreme bear case and extreme bull case value derived from this stress test is Rs135 (bear case) to Rs288 (Bull case) for IRB.

Rs per share	BOT	E&C	Real estate	PV of loans	Total
Bear Case	67.4	49.8	12.2	5.5	134.9
Base Case	118.3	59.7	17.1	6.5	201.6
Bull Case	186.6	69.7	24.5	7.5	288.3

Note: See exhibits below for bear & bull case value for each business

Stress case assumption

Variable	Range
Cost of equity	11%-15%
Interest rate for projects	9%-13%
Traffic growth assumption	6%-10%
Value of E&C business	10-14X
Value of Real Estate	0-50% discount of land sale value

Sensitivity on IRB's BOT Portfolio

Cost of equity = 15%		Traffic Growth				
Rs per share of IRB		6%	7%	8%	9%	10%
Interest Rate	9%	88.1	100.1	112.7	126.1	140.4
	10%	83.0	95.1	107.8	121.3	135.6
	11%	77.8	90.0	102.8	116.4	130.8
	12%	72.6	84.9	97.8	111.4	125.9
	13%	67.4	79.7	92.7	106.5	121.0

Cost of equity = 14%		Traffic Growth				
Rs per share of IRB		6%	7%	8%	9%	10%
Interest Rate	9%	94.1	106.9	120.5	135.0	150.5
	10%	88.7	101.7	115.4	129.9	145.4
	11%	93.3	96.4	110.2	124.8	140.3
	12%	77.9	91.0	105.0	119.6	135.2
	13%	72.4	85.6	99.6	114.4	130.1

Cost of equity = 13%		Traffic Growth				
Rs per share of IRB		6%	7%	8%	9%	10%
Interest Rate	9%	100.6	114.4	129.1	144.8	161.4
	10%	95.0	108.9	123.7	139.4	156.1
	11%	89.3	103.4	118.3	134.0	150.8
	12%	83.6	97.8	112.8	128.6	145.5
	13%	77.8	92.1	107.2	123.2	140.1

Cost of equity = 12%		Traffic Growth				
Rs per share of IRB		6%	7%	8%	9%	10%
Interest Rate	9%	107.7	122.6	138.5	155.4	173.4
	10%	101.8	116.8	132.8	149.8	167.9
	11%	95.8	111.0	127.1	144.1	162.3
	12%	89.8	105.1	121.3	138.4	156.7
	13%	73.7	99.1	115.4	132.7	151.0

Cost of equity = 11%		Traffic Growth				
Rs per share of IRB		6%	7%	8%	9%	10%
Interest Rate	9%	115.4	131.6	148.7	167.0	186.6
	10%	109.2	125.5	142.8	161.1	180.7
	11%	102.9	119.3	136.7	155.2	174.9
	12%	96.5	113.1	130.6	149.2	169.0
	13%	90.2	106.8	124.5	143.2	163.0

Note: The sensitivity to interest rates in the above table assumes that the interest rate remains same during the entire concession period. For example MPEW concession period end in August 2019, hence say at 11% rate the model assumes that interest rates are likely to remain at 11% till August 2019. We believe that this assumption is unlikely to come true, since over such a long period of time interest rates are unlikely to remain so high.

Sensitivity on E&C business

PER(X)	10	11	12	13	14
FY2010E-Rs4.975/Share	49.8	54.7	59.7	64.7	69.7

Sensitivity on Real Estate Land Bank

Discount	50%	40%	30%	20%	At Par
NAV-Rs24.5/share	12.2	14.7	17.1	19.6	24.48

Sensitivity on PV of loans to Subs

CoE	15%	14%	13%	12%	11%
Rs /Share	5.5	6.0	6.5	7.0	7.5

IRB Stock is 12% away from our bear case value

The stock is currently trading at Rs155, which is 12% away from our extreme bear case value of Rs135, This clearly signals that the streets is extremely pessimistic on company's ability to deliver growth. Also the market is not putting any value to further asset accretion that IRB can deliver by utilizing the free cash flows over next 4-5 year. For example, with free cash flows of Rs14 bn over FY2009-12E and by leveraging it 3x , IRB can add close to 560 km (more than 70% of its current BOT size) of new BOTs to its portfolio without any equity dilution.

Maintain BUY

Our banking analyst opines that we are very close to the peak of interest rate cycle in India and given this view we believe that the IRB stock price provides a good long term investment opportunity. We believe IRB is in on the verge of a steep growth trajectory led by aggressive asset accretion of BOT concessions and buoyant order backlog for the E&C division. With hike in toll rates for its jewel, 'The Mumbai Pune expressway', kick start of revenues from new BOT concessions and faster execution of its E&C order book of Rs65 bn, we expect IRB to report 80% revenue CAGR and 125% earnings CAGR over FY2008-10E. At current levels stock is currently trading at very undemanding valuations of 8.5x FY10E EPS and 6.7x FY10E EBITDA. We maintain our BUY rating on the stock with a SOTP price target of Rs218 (see exhibit below for SOTP calculations).

IRB SOTP fair value Rs218

SPV	Asset Owned/Operated	Holding	Valuation Measure	Disc rate	Value (Rs mn)	Value/Share	
EPC	Modern Road Makers	EPC & O&M Business	100%	PER	12	19834	59.7
BOT	Mhaiskar Infrastructure	MPEW & NH4	100%	FCFE	13%	19059	57.3
	Surat Dahisar SPV	Surat Dahisar	80%	FCFE	14%	3566	10.7
	IDAA Infrastructure	Bharuch Surat	100%	FCFE	14%	11344	34.1
	MMK Toll Road	Mohol-Mandrup	100%	FCFE	14%	865	2.6
	IRB Infrastructure	Karpada-Patalganga	100%	FCFE	14%	457	1.4
	NKT Road & Toll	Ahmednagar Tembhuri	100%	FCFE	14%	634	1.9
	Thane Ghodbunder Toll Road	Thane Ghodbunder	100%	FCFE	14%	1693	5.1
	ATR Infrastructure	Pune Nashik	100%	FCFE	14%	1939	5.8
	Aryan Toll Road	Pune Sholapur	100%	FCFE	14%	1040	3.1
	Ideal Road Builders	Thane Bhiwandi Bypass Kaman Paygon Bhiwandi Wada Khambatki Ghat	100%	FCFE	14%	1713	5.2
Total BOT Portfolio						42310	127.3
Realty	Aryan Infra Investment	Real Estate JV	66%	land sale		8139	24.5
Add: PV of Loans to SPV						2,334	7.0
Total						72618	218.5

Key Financials

Income Statement

Y/E, Mar (Rs. m)	FY2007(P)	FY2008	FY2009E	FY2010E
Net Sales	5250.9	7327.1	11638.7	23935.6
Growth (%)		39.5	58.8	105.7
Total Expenditure	2449.3	3207.8	6344.0	12015.1
Growth (%)		31.0	97.8	89.4
Direct Expenses	2044.6	2532.8	5587.2	10552.2
% of sales	38.9	34.6	48.0	44.1
Periodic Maintenance	0.0	0.0	0.5	10.6
% of sales	0.0	0.0	0.0	0.0
Personnel expenses	206.1	341.0	452.7	879.8
% of sales	3.9	4.7	3.9	3.7
Office administration and other expenses	198.5	334.0	303.5	572.5
% of sales	3.8	4.6	2.6	2.4
EBIDTA	2801.6	4119.3	5294.7	11920.5
Growth (%)		47.0	28.5	125.1
EBIDTA %	53.4	56.2	45.5	49.8
Other income	228.5	520.3	171.5	334.2
Interest	1386.5	1957.6	1349.2	3067.3
Depreciation / Amortization	862.2	1016.1	928.3	1491.5
EBT	1055.4	1665.9	3188.6	7695.9
Prov for Tax	260.6	399.8	662.0	1467.7
EAT	794.8	1266.1	2526.6	6228.2
Minority Interest	183.6	126.4	0.0	447.0
Adjusted PAT	611.1	1139.7	2526.6	5781.2
Growth (%)		86.5	121.7	128.8
EAT (%)	11.6	15.6	21.7	24.2

Balance Sheet

Y/E, Mar (Rs. m)	FY2007(P)	FY2008P	FY2009E	FY2010E
Equity share capital	2472.7	3323.6	3323.6	3323.6
Share Premium	0.0	8935.1	8935.1	8935.1
Reserves & surplus	1296.9	2436.6	4963.3	10744.5
Shareholders Funds	3769.6	14695.4	17222.0	23003.2
Minority Interest	1115.3	1241.7	1241.7	1688.7
Secured Loans	22403.5	24581.8	27115.7	34665.1
Unsecured Loans	2776.0	2776.0	2776.0	2776.0
Loan Funds	25179.6	27357.8	29891.8	37441.2
Total Liabilities	30064.5	43294.9	48355.5	62133.0
Gross Block	1269.0	1842.3	1954.5	1983.1
Less: Acc Depreciation	381.4	545.9	734.5	947.4
Net block	887.6	1296.4	1220.0	1035.7
Capital WIP	5553.1	9798.9	14090.7	12500.0
Intangible Assets	17994.0	17372.1	16632.4	29444.6
Investment	413.5	8553.5	8553.5	8553.5
Current Assets	7366.1	10541.0	15729.4	23261.3
Inventories	91.7	111.9	199.8	371.1
Sundry Debtors	1436.5	1960.6	5090.8	9386.6
Cash and Bank	3703.4	4404.4	6374.7	9439.5
Loans and Advances	2134.5	4064.1	4064.1	4064.1
Current Liab & Prov	2326.0	4206.3	7809.7	12601.3
Current liabilities	1029.5	2968.5	6571.9	11343.5
Provisions	1296.4	1237.8	1237.8	1257.8
Net current assets	5040.2	6334.7	7919.7	10660.0
Net Deferred Taxes	-8.3	-8.3	-8.3	-8.3
Miscellaneous Exps	184.4	184.4	184.4	184.4
Total Assets	30064.5	43531.7	48592.4	62369.9

Cash Flow

Y/E, Mar (Rs. m)	FY2007(P)	FY2008E	FY2009E	FY2010E
Profit before Tax	n.a.	1665.9	3188.6	7695.9
Add : Depreciation	n.a.	1016.1	928.3	1491.5
Add : Non Cash	n.a.	0.0	0.0	0.0
Less: Tax Paid	n.a.	-399.8	-662.0	-1467.7
Net changes in WC	n.a.	-573.3	473.2	495.7
Operational Cash Flows	n.a.	1708.9	3928.2	8215.4
Capital expenditure	n.a.	-4491.8	-4491.8	-12700.0
Investments	n.a.	-8140.0	0.0	0.0
Investing Cash Flows	n.a.	-12631.8	-4491.8	-12700.0
Borrowings	n.a.	2178.2	2534.0	7549.4
Issue of shares	n.a.	9445.7	0.0	0.0
Add/Redn of Reserves	n.a.	0.0	0.0	0.0
Dividend paid	n.a.	0.0	0.0	0.0
Payment to / from Minority Interest	n.a.			
Financing Cash Flows	n.a.	11623.9	2534.0	7549.4
changes in cash	n.a.	701.0	1970.3	3064.8
Opening balance	n.a.	3703.4	4404.4	6374.7
Closing balance	n.a.	4404.4	6374.7	9439.5

Key ratios

	FY2007(P)	FY2008E	FY2009E	FY2010E
EPS (Rs)	1.8	3.4	7.6	17.4
CEPS (Rs)	5.0	6.9	10.4	23.2
Book Value Per Share (Rs)	11.3	44.2	51.8	69.2
Dividend Per Share (Rs)	0.0	0.0	0.0	0.0
Valuations Ratios (x)				
PER	83.8	44.9	20.3	8.9
P/CEPS	30.9	22.4	14.8	6.6
P/BV	13.6	3.5	3.0	2.2
EV/EBIDTA	25.9	18.0	14.1	6.6
EV/Sales	13.8	10.1	6.4	3.3
M-Cap/EBIDTA	18.3	12.4	9.7	4.3
M-Cap/sales	9.7	7.0	4.4	2.1
Financial ratios				
RoCE (%)	7.2%	9.9%	9.9%	19.5%
RoNW (%)	16.2%	7.8%	14.7%	25.1%
Debt/Equity	6.7	1.9	1.7	1.6
Dividend yield (%)	0.0	0.0	0.0	0.0

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