

## Construction

### Status quo on the ground

#### Sector Update

##### Absolute performance (%)

Stock	1m	3m	1yr
GAYP	-14.1	-21.1	-57.0
IRB	-10.9	-10.4	-22.6
ILFT	-18.2	-12.6	-41.3
IVRC	-8.3	-20.4	-70.0
NJCC	-27.2	-42.3	-68.9
RMKY	-14.6	-5.5	-37.1
SINF	-0.8	-16.2	-50.0

##### Relative to Sensex (%)

Stock	1m	3m	1yr
GAYP	-8.4	-19.4	-40.2
IRB	-4.3	-6.5	-6.9
ILFT	-11.6	-8.7	-25.6
IVRC	-1.7	-16.6	-54.3
NJCC	-20.6	-38.4	-53.1
RMKY	-8.9	-3.7	-20.2
SINF	5.8	-12.3	-34.3

Source: Bloomberg

##### Valuation summary

	CMP (INR)	P/E (x)		P/B (x)	
		FY12f	FY13f	FY12f	FY13f
IRB	148.6	12.0	9.9	1.9	1.5
ILFT	167.4	7.3	7.3	1.4	1.2
IVRC	35.3	10.8	10.1	0.5	0.4
NJCC	38.3	15.2	14.9	0.6	0.5
SINF	206.5	10.5	8.4	0.9	0.8

Source: Avendus Research

Note: IRB and ILFT are on consolidated basis

Of all the current challenges faced by the construction sector, the policy paralysis at the Centre seems to us to be the biggest concern. We met the managements of some companies to seek any signs of change, but come away largely disappointed. Implementation of the Lokpal mechanism across states could make things even worse for the sector as the fear psychosis may extend to state department officials. The role of interest rate reversal as a catalyst may be muted in the context of a sharper slowdown – any significant improvement in fortunes may be at least 2 quarters away.

#### Government approvals slow; turnaround at least 2 quarters away

Our interactions with the managements of some construction companies in Hyderabad indicate that there is no discernable pick up in the pace of government approvals. Delays in documentation have impacted last-mile approval of several projects. Collections from irrigation projects executed in the state of Andhra Pradesh have normalized, though companies continue to be cautious and are going slow on execution. Receivables from central authorities in some projects have been delayed due to setting in of extreme fear psychosis amongst government officials. We see a large risk that implementation of the Lokpal mechanism across states may extend the paralysis to state machinery as well and adversely impact the construction industry, which has large exposure to orders from state government departments.

#### Bidding for NHAI projects is less intense, but IRRs still uneconomic

Managements have echoed the common view that bidding for NHAI projects have become less intense than the situation six months ago. However, companies that have won projects recently have lowered their threshold IRR expectations to 16% and below. We believe actual IRR may end up being lower, if traffic disappoints. Companies that win projects are, thus, accruing negative NPV projects; the poor relative stock performance of such companies reflects the market's concerns. Although bids aggregating to c950km were opened in Nov11, it does not necessarily indicate a pick-up in award activity since bid awards are being bunched up by the NHAI – the next bunch of bids being invited in Jan12. Large companies have shown interest in bidding for small-ticket OMT projects to get a sense of traffic patterns. The discord between the NHAI and the Planning Commission seems to have increased, resulting in resignation of several top officials of the NHAI. This is likely to further hamper the organization's working.

#### Interest rate reversal may not be enough of a catalyst

Interest rate reversal is a much-anticipated catalyst for the sector. However, its impact may not be significant in the context of overall slowdown in the sector. The sector is not facing an acute funding crunch—as in 2008—hence, we believe the competitive intensity continues to be high at the current stage. NCC (NJCC IN, Buy) is our preferred sector pick as a potential stake sale in development assets may drive a large re-rating from current levels.

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Exhibit 1: Relative stock performance

	Rating	Price (INR)	----- Relative performance (%) -----		
			1-month	3-months	Since 17 Nov11
<b>Companies winning NHAI projects in Nov11</b>					
L&T	Hold	1227	-4	-24	1
Ramky Infrastructure	NR	208	-9	-4	-3
Ashoka Buildcon	NR	195	-13	-25	-17
<b>Other construction companies</b>					
IRB Infrastructure Developers	Add	149	-4	-7	3
IL&FS Transportation Networks	Hold	167	-12	-9	-12
Punj Lloyd	NR	48	-9	-18	0
HCC	NR	21	-18	-25	-5
Simplex Infrastructures	Buy	206	6	-12	5
NCC	Buy	38	-21	-38	-6
IVRCL	Hold	35	-2	-17	-1
Gayatri Projects	NR	118	-8	-19	-9

Source: Bloomberg, Avendus Research

Note: NHAI bids opened between 18 Nov to 24 Nov

## Analyst Certification

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Ramky Infrastructure	No	No	No
Ashoka Buildcon	No	No	No
IRB Infrastructure Developers	No	No	No
IL&FS Transportation Networks	No	No	No
Punj Lloyd	No	No	No
HCC	No	No	No
Simplex Infrastructures	No	No	No
NCC	No	No	No
IVRCL	No	No	No
Gayatri Projects	No	No	No

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