April 3, 2020

Balance sheet to be only screener ahead…

Construction remains one of the most severely impacted sectors due to the Covid-19 lockdown. The tolling at highways was stopped given the lockdown while execution of EPC/HAM projects has come to a blanket halt amid unavailability of labour and raw materials. We expect labour unavailability to persist even once the lockdown is lifted as it could take time for remobilisation of labourers. Also, even if the work at project sites resume within one or two weeks post the lockdown, the onset of the monsoon season from Q2FY20E could slow down execution, going ahead. Amid these circumstances, the strength of balance sheet will be the only lever for survival as seen in the last down cycle.

BOT project faces near term challenges

As per media reports, NHAI has stopped collecting toll fees from users on national highways during the lockdown period. Thus faced with a sharp drop in toll collection following a nationwide lockdown, private highway developers are likely to invoke *Force Majeure* clause to seek compensation from the government. Furthermore, a 90 day loan moratorium announced by RBI, is only likely to be partial relief in cash flow in near term. We highlight that even post lockdown, given the possibility of staggered resumption, we expect low traffic movement. Consequently, BOT toll assets are bound to witness pressure in near term toll collection as well as debt servicing.

Second order impact to be on growth visibility

The second order impact of the lockdown on the sector could be: a) **Delay in project awarding:** project awarding from NHAI was expected from March, 2020 onwards. This could now deferred by at least three to six months since most government executives/offices are working at minimum workforce; and b) **delay in land acquisition:** The government is expected to roll out a fiscal stimulus for industries to mitigate the impact of the lockdown on the Indian economy leaving limited capital availability for land acquisition. Also, NHAI's monetisation plan of TOT assets could get postponed amid the impact of Coronavirus. These factors could lead to a slower pace of land acquisition, thus aggravating operational challenges for road-based players. The ordering delay, in our view, could also impact growth in FY22E.

Valuation & Outlook

All the stocks in our construction coverage universe have seen a sharp correction in prices in the past one month. Share prices of companies like NCC, Ashoka Buildcon have been hammered up to the low price range seen in 2008, 2013. While at such low price points, almost all companies are available at dirt cheap valuations, we bear in mind that challenges remain for companies, going ahead. This is also reminiscent of the 2008 and 2013 slowdown, which led to a lot infrastructure players virtually going out of business given the debt trap. **In this scenario, we assign higher weightage to the balance sheet strength** and, thus, prefer companies like **KNR Constructions** and **PNC Infratech** and assign a **BUY** rating**,** given the lower working capital and debt levels. Nonetheless, a recovery can only happen over medium to long term horizon. With vulnerability in operations, we keep the ratings and target price **Under Review** for **NCC** and **Ashoka Buildcon** but **advise investors to avoid the counters for the time being.**

Rating Matrix

	Rating	
	Old	New
KNR Construction	Buy	Buy
PNC Infratec	Buy	Buy
NCC	Buy	Under Review
Ashoka Buildcon	Hold	Under Review

Target price (₹)

	CMP	Target price		Upside
		Old	New	
KNR Construction	191	335	240	26%
PNC Infratech	93	255	125	34%
NCC	18	70	NA	NA
Ashoka Buildcon	38	120	NA	NA

Sector Update

ICICI Securities – Retail Equity Research

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Company wise impact

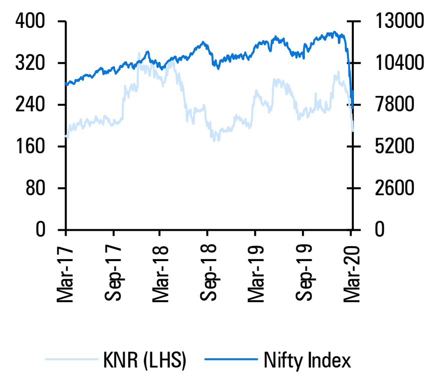
Exhibit 1: Company wise impact

Company	Impact	Valuations/ Estimates Changes
KNR Construction	Execution has come to a blanket halt amid unavailability of labour and raw materials. This coupled with monsoon in Q2, is likely to result in weaker execution till H1FY21. Project awarding activity to take a back seat amid Covid led minimum workforce at various awarding authorities level.	We build in near zero revenues for 1 month in Q1FY21 and slower execution thereon to bake in labour remobilisation issue. We cut our revenues estimates for FY21 by 16% and earnings by 25%. The order inflows estimates are cut by 20% in FY21. The working capital for FY21 is now baked in at higher levels, with subsequent normalisation in FY22. Our revised target price implies 5x FY22 EV/EBITDA vs 7.5x FY21 EV/EBITDA, ascribed earlier.
PNC Infratech	Execution has come to a blanket halt amid unavailability of labour and raw materials. This coupled with monsoon in Q2, is likely to result in weaker execution till H1FY21. Project awarding activity to take a back seat amid Covid led minimum workforce at various awarding authorities level	We build in near zero revenues for 1 month in Q1FY21 and slower execution thereon to bake in labour remobilisation issue. We cut our revenues estimates for FY21 by 17% and earnings by 25%. The order inflows estimates are cut by 20% in FY21. The working capital for FY21 is now baked in at higher levels, with subsequent normalisation in FY22. Our revised target price implies 3.5x FY22 EV/EBITDA vs 7x FY21 EV/EBITDA, ascribed earlier.
NCC	Steeper pain will be on receivables levels as dues might take longer time thereby stretching the already stretched working capital. Execution has come to a blanket halt amid unavailability of labour and raw materials. This coupled with monsoon in Q2, is likely to result in weaker execution till H1FY21. Project awarding activity to take a back seat amid Covid led minimum workforce at various awarding authorities level.	In a base case, the FY21E earnings to be impacted by 32% given the 19% cut in revenues estimates and ~50 bps cut in margins. Furthermore, weak execution will result in higher debt levels vs. earlier target of debt reduction ove rthe next 3-6 months. Cut our order inflows estimates for FY21 by 20%. **Keep our ratings UNDER REVIEW but advise avoiding till clarity emerges on balance sheet position.**
Ashoka Buildcon	With SBI Macquarie exit required by March 2020 initially, delay in the monetisation of Assets is likley to takea steep impact on balance sheet. Furthermore Execution has come to a blanket halt amid unavailability of labour and raw materials. This coupled with monsoon in Q2, is likely to result in weaker execution till H1FY21. Project awarding activity to take a back seat amid Covid led minimum workforce at various awarding authorities level.	Delay in monetisation of asset, would result in subsequent delay in SBI Macquarie exit and possibly irreparable damage on balance sheet if the exit (in owrst case) is required to be given through company resourses. In a base case, the FY21E EPC revenues estimates cut by 20% cut with 100 bps cut in margins. Cut our order inflows estimates for FY21 by 20%. Furthermore, weak execution will result in higher debt levels . **Keep our ratings UNDER REVIEW but advise avoiding till clarity emerges.**

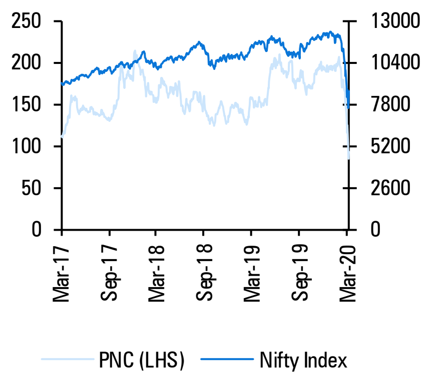
Source: Company, ICICI Direct Research

Price Charts

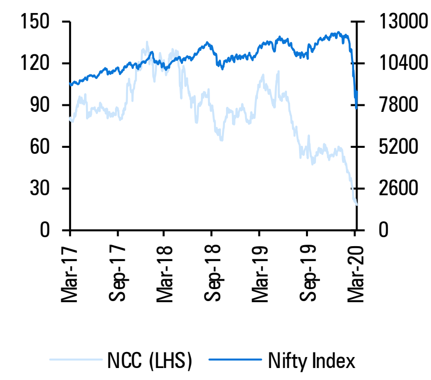
KNR Construction



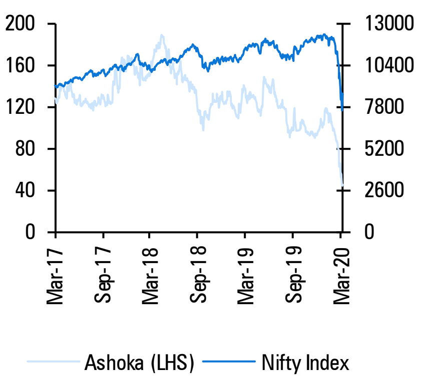
PNC Infratech



NCC



Ashoka Buildcon



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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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