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UPDATE

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Fast tracking asset monetisation. Recent cabinet approvals for ToT projects and waiver of bank guarantee for interest component involved in arbitration claims indicate government's intent to address the fund availability issues for the sector. Post the ToT-3 round, NHAI is set to finalize bids for ToT 4 by 4QFY20. Asset monetization coupled with stricter implementation of FASTag and improving pace of construction will address funding issues of NHAI, enabling improvement in order inflows from 4QFY20 onwards.

Asset monetization paving way for debt reduction

Recent financial bids for ToT 3 at Rs50.1 bn, marginally higher than NHAI's bid price, have come at 15X FY2018 toll collection thereby meeting 50% of its full year target. These bids are similar to those for ToT 2. As per the current plan, NHAI plans to monetize around 6,165 km till FY2025 and we believe that related sale of toll rights for a 30 year period at similar valuations would take care of 25-30% proportion of NHAI's current debt. Stricter implementation of FASTag and improving pace of construction can ensure scale up in toll collection. This coupled with asset monetisation via ToT, INVIT and securitisation will ease cash flows for NHAI, thereby resulting in improvement in awarding activity from NHAI. We expect FY2020 to be a year of consolidation for NHAI with subdued project awards in comparison with past years and expect it to improve from FY2021 onwards.

Amendments in ToT model ensure wider set of projects offered to wider range of investors

Cabinet has approved amendments in ToT model proposed by NHAI. Relaxation in time frame of toll revenue history from two year to one year ensures a wider set of assets for monetization by NHAI. NHAI has also been allowed to vary the concession period of toll projects between 15-30 years ensuring a wider range of investors for ToT monetization. NHAI has also been allowed to raise long-term financing from banks against toll receipts via toll securitization. So far since last one year, NHAI had been constrained in its ability to scale up project awards meaningfully due to incremental debt burden and debt servicing. With a target to raise Rs110 bn/121 bn/133 bn via ToT asset monetization for FY2020/2021/2022 and Rs386 bn via securitization, these proposals are in the right direction to bridge the financing gap. However, the amendment of doing away with the need to furnish bank guarantees for interest amount involved in arbitration claims with government does little in terms of easing funding to the sector due to inability or unwillingness of players to furnish large bank guarantees for arbitral amount.

Players better positioned to benefit from revival in ordering as and when it happens

Select companies in our coverage universe are better positioned in terms of 1) balance sheet strength with D/E ranging from 0.3X to 0.9X for FY2020E, 2) asset monetisation easing debt burden at consolidated level, 3) better control over working capital and 4) improving asset turnover ratios. Stocks at current valuations are already factoring in the bear case scenario of muted order inflows and slow execution. A pick-up in orders is already visible from other segments and is further expected to ramp up from FY2021 onwards, albeit at a slow pace. Our top picks are DIIIP Buildcon and Ashoka Buildcon.

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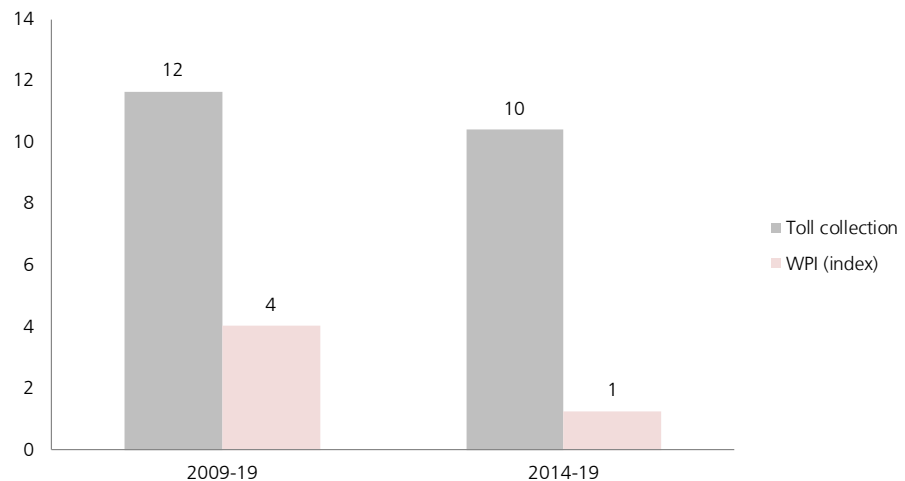
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Exhibit 1: ToT 3 bundle receives highest bid at ~15X FY2018 toll collections, similar to ToT 2
Details of the three ToT bundles of NHAI bid

	ToT-1	ToT-2	ToT-3
Number of stretches	9	8	9
Location	Andhra Pradesh - 6 Gujarat 3	West Bengal - 3 Gujarat - 2 Rajasthan - 2 Bihar - 1	Tamil Nadu - 4 Uttar Pradesh - 3 Jharkhand - 1 Bihar - 1
Median toll collection track record (y)	10.9	6.7	7.0
Toll collections in FY2018 (Rs bn)	5.1	3.0	3.4
Length (km)	681.0	587.0	566.0
NHAI's expectation (Rs bn)	62.5	53.6	50.0
NHAI'expectation/FY2018 toll (X)	12.2	17.9	14.8
Highest bid bid/FY2018 toll (X)	18.9	15.4	14.9
Difference in top two bids versus H2	29	26	15
Number of bids	4	3	3
Highest bidder	Macquarie	Cube Highways	Cube Highways

Source: News reports, CRISIL, Kotak Institutional Equities

Exhibit 2: Toll collections have grown at a CAGR of 10/12% over past decade/five years
CAGR and toll collection and WPI for NHAI's own and BOT projects, March fiscal year ends, 2009-19(%)



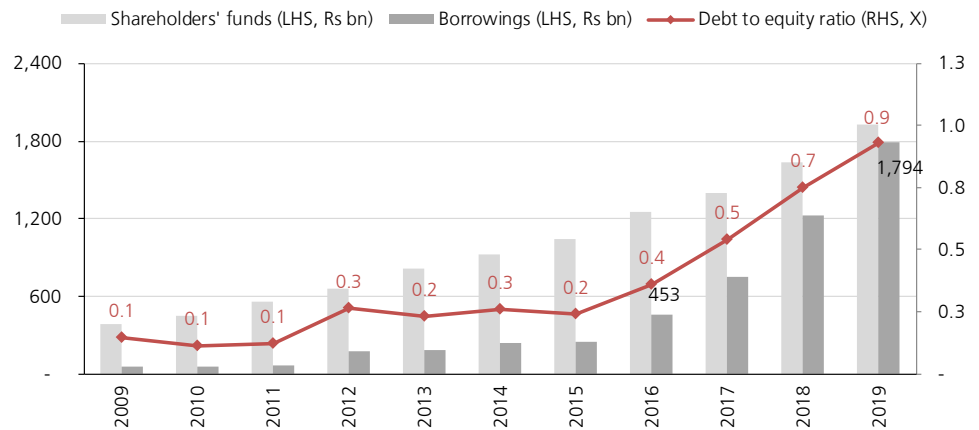
Notes:

- We limit our analysis to projects with as long operational history (5/10 years)
- Most of the projects used in 2014-19 analysis relates to BOT projects having meaningful share of projects with base on tariff hike formula (3%+40% WPI)

Source: NHAI, RBI, Kotak Institutional Equities

Exhibit 3: NHAI balance sheet has Rs1.8 tn of debt at present

Annual trend in debt, equity and debt to equity ratio of NHAI, March fiscal year ends, 2009-19



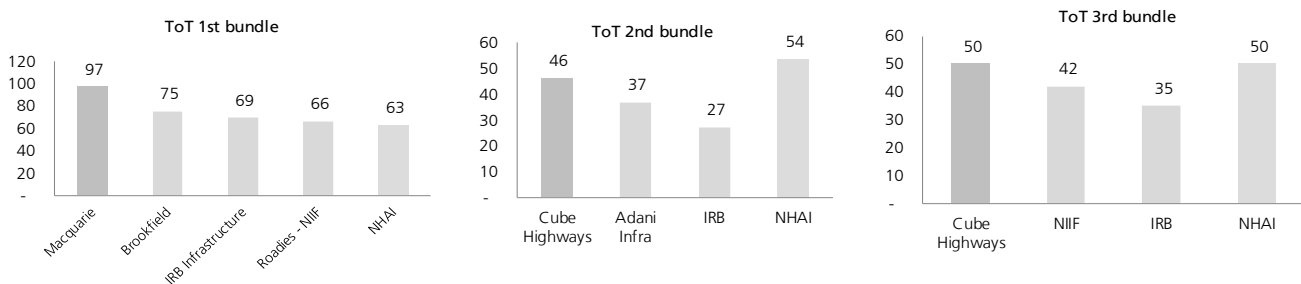
Source: NHAI, Kotak Institutional Equities

Stocks are factoring in worst case scenario - What can go wrong further?

- ▶ **Lack of interest in NHAI asset monetization.** In the recent bidding for ToT 3, only three players participated and there was a vast difference in bids submitted by them. This can pose a risk to expected ramp up in ordering. However, with wider set of investors targeted via reduced concession period of ToT, we expect NHAI to meet its asset monetization target.

Exhibit 4: Number of players submitting bids for ToT projects has reduced

Bids submitted by various players versus NHAI's expectation (Rs bn)



Source: PIB, NHAI, Kotak Institutional Equities

- ▶ **Delays in pick up from other segments.** Companies have managed to diversify beyond NHAI and bagged orders across segments such as mining, urban infra including airports and metros, irrigation, state highways, flyovers, smart city, T&D, railways. Going ahead, the pipeline looks good but it may take time to reach awarding stage given large size of projects involved such as Ganga Expressway, RRTS corridors, metro projects.
- ▶ **Aggressive competition may put pressure on margins.** Due to delayed ordering from NHAI, competition has increased immensely for new project awards with marginal difference between L1 and L2 bids along with entry of new or unlisted players. This can have an adverse impact on margins.

Exhibit 5: Recent bidding for Bundelkhand and Gorakhpur expressway shows marginal difference between bids

Difference in the bids between L1 and L2 players (%)

Bundelkhand Expressway Status	Player	Difference between L1 and L2(%)
Package 1	L1 Apco Infratech	3
Package 2	L1 Apco Infratech	4
Package 3	L1 Ashoka Buildcon	2
Package 4	L1 Gawar Constructions	2
Package 5	L1 Gawar Constructions	1
Package 6	L1 Dilip Buildcon	1

Gorakhpur Expressway Status	Player	Difference between L1 and L2(%)
Package 1	L1 Apco Infratech	4
Package 2	L1 Dilip Buildcon	1

Source: Companies, Kotak Institutional Equities

Companies are better positioned to benefit from revival in ordering**Exhibit 6: Companies have reduced leverage levels in last two years with asset monetization**

Trend in standalone leverage for players (X), March fiscal year ends, 2017-2021E

	2017	2018	2019	2020E	2021E
Dilip Buildcon	1.3	1.1	1.1	1.0	0.9
Ashoka Buildcon	0.1	0.0	0.3	0.3	0.3
Sabhav Engineering	0.9	0.8	0.8	0.3	0.3

Source: Company, Kotak Institutional Equities estimates

Exhibit 7: Debt/EBITDA is also within targeted range for the companies

Trend in standalone Debt/EBITDA for players (X), March fiscal year ends, 2017-21E

	2017	2018	2019	2020E	2021E
Dilip Buildcon	2.5	2.0	2.1	2.2	2.0
Ashoka Buildcon	0.1	0	0.2	0.8	0.8
Sabhav Engineering	4.2	3.5	3.6	4.2	4.2

Source: Company, Kotak Institutional Equities estimates

Exhibit 8: Asset monetization progressing as per schedule

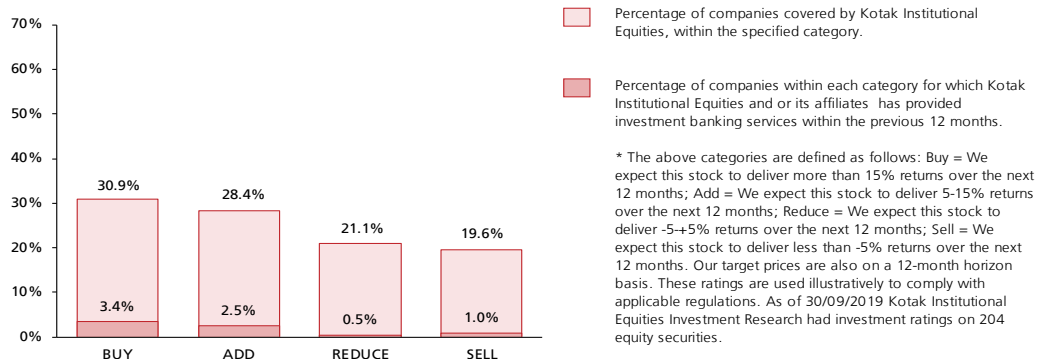
Companies	Status of asset monetisation
Dilip Buildcon	Monetized 5 HAM assets to Cube highways at 1.4X P/BV, in talks with investors for remaining 7 HAM assets
Ashoka Buildcon	In talks with investors for selling stake in operational and under construction projects
IRB Infrastructure	Deal with GIC is progressing on schedule and approvals are expected to be received during 3QFY20/4QFY20
Sabhav Engineering	Deal with IndInfraVIT is progressing on schedule and approvals are expected to be received during 3QFY20/4QFY20

Source: Company, Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of September 30, 2019

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