Emkay Research

25 November 2009

# IRB Infrastructure Developers Ltd

Stock Update

## Assessing bull, bear and fair value

## ACCUMULATE

| Price | Target Price |
|---|---|
| **Rs251** | **Rs250** |
| **Sensex** | **17,199** |

### Price Performance

| (%) | 1M | 3M | 6M | 12M |
|---|---|---|---|---|
| Absolute | 0 | 29 | 79 | 264 |
| Rel. to Sensex | (3) | 17 | 47 | 84 |

*Source: Capitaline*

### 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) | 280/65 |
| Market Cap (Rs bn/USD mn) | 83/1,795 |
| Daily Avg Vol (No of shares) | 2209763 |
| Daily Avg Turnover (US$ mn) | 11.1 |

### Shareholding Pattern (%)

| | S'09 | J'09 | M'08 |
|---|---|---|---|
| Promoters | 73.8 | 73.9 | 74.4 |
| FII/NRI | 11.9 | 11.2 | 13.0 |
| Institutions | 7.5 | 8.2 | 4.1 |
| Private Corp | 2.6 | 2.2 | 4.0 |
| Public | 4.2 | 4.6 | 4.6 |

*Source: Capitaline*


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### Summary


- Over last 6 months IRB stock has significantly outperformed the broader market as well its peers 1) driven by renewed vigor for gaining momentum in road development in India, aptly propagated by dynamic minister's (for road & surface transport -Mr. kamalnath) ambitious target of constructing 20 km/day 2) IRB's recent big ticket order wins totaling h Rs43 bn 3) Pick up in traffic growth 4) Easing liquidity scenario and softer interest rate regime.
- IRB's management is confident that based cash flows of its current BOT portfolio of 11 operational projects, the company can execute additional projects for Rs15-20bn, over and above the Rs43 bn worth of new projects already bagged in H1FY2010. However, the management has also highlighted that, projects worth Rs120 bn from NHAI are on RFP stage, bids for which are to be called over next 3-6 months. In order to capitalize on this huge opportunity IRB is planning to raise equity resources and the board has passed enabling resolution to raise upto Rs12 bn. This also has been fuelling IRB outperformance.
- However post the recent outperformance, it becomes imperative to assess the range of Bull-Bear case value for IRB stock. We did a sensitivity test for IRB, where we assumed scenarios of 9.5-13.5% interest rates, 12-14% CoE and 5-7% traffic growth for its BOT portfolio. The exercise yielded a Bear-Bull case range of Rs161 – 364. Our bull case value of Rs364/share for IRB is based on assumption of 1) 9.5% interest rate (as compared to 11.5% in base case), 2) 7% traffic growth (as compared to 6% - in base case) 3) COE of 12% and 4) 14X PER for construction business (as compared to 12X in base case).
- Though we see little possibilities of all the favorable value drivers (factored in our bull case), materializing at same time and the stock moving to bull case, we believe the stock can still trade 20% higher than our current fair value of Rs250 for the stock. This is based on realistic assumption of PER of 14X for construction business, interest rates of 10.5%, Traffic growth estimates of 6.5% and 13% COE.
- We believe IRB is an ideal play on India's continued focus on developing road infrastructure through PPP model, is on a verge of steep earnings growth. We expect IRB to register revenue growth of 82% and earnings growth of 63% over FY2009-11E. The proposed fund raising exercise will equip IRB with a war chest of Rs65-70 bn to capitalize on huge opportunity in road BOT space in India and also significantly scale up its construction business. Though we remain directionally positive on road BOTs in general and IRB in particular, our target of Rs250, does not provide significant upsides. Maintain - ACCUMULATE.

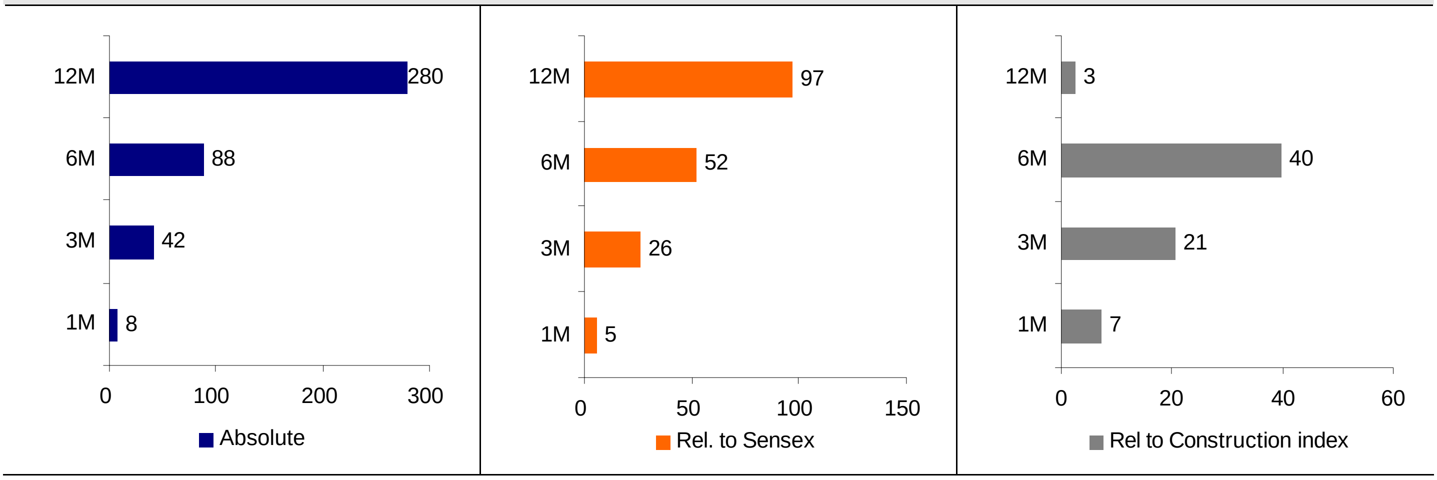

### Key Financials

| Y/E, Mar (Rs. m) | Net sales | EBIDTA | EBIDTA (%) | PAT | EPS (Rs.) | EPS growth (%) | ROE (%) | PE (x) |
|---|---|---|---|---|---|---|---|---|
| FY2008 | 7,327 | 4,119 | 56.2 | 1,139 | 3.4 | 86.4 | 7.0 | 73.2 |
| FY2009P | 9,919 | 4,374 | 44.1 | 1,759 | 5.3 | 54.3 | 10.2 | 26.8 |
| FY2010E | 18,192 | 8,474 | 46.6 | 3,299 | 9.9 | 87.6 | 16.0 | 25.3 |
| FY2011E | 32,864 | 12,138 | 36.9 | 4,673 | 14.1 | 41.6 | 18.5 | 17.9 |

## IRB Stock has significantly outperformed

Over last 6 months IRB stock has significantly outperformed the broader market as well its peers (see exhibit below). We attribute such out performance to 1) driven by renewed vigor for gaining momentum in road development in India, aptly propagated by dynamic minister's (for road & surface transport -Mr. kamalnath) ambitious target of constructing 20 km/day 2) IRB's recent big ticket order wins totaling h Rs43 bn 3) Pick up in traffic growth 4) Easing liquidity scenario and softer interest rate regime.

**IRB stock has outperformed its peers by 40% and sensex by 52% over last 6 months**




## Road BOTs gaining traction-NHAI sets target of awarding 13394 km in FY2010

To achieve the Government's ambitious target of constructing 20 kms/day NHAI has set a target of awarding 135 projects covering 13394 kms with investment of close to Rs1000bn in FY2010. Out of these 70 projects covering 7968 kms with investment of close to Rs616 bn NHAI plans to award over next two quarter.

**NHAI FY2010 targets**

| | No of projects | Length (Kms) | Investment (Rs bn) |
|---|---|---|---|
| **Phase II** | 12 | 700 | 139 |
| **Phase III** | 96 | 8825 | 602 |
| **Phase V** | 18 | 2403 | 240 |
| **OMTs** | 9 | 1466 | 11 |
| **Total** | **135** | **13394** | **992** |

*Source: NHAI*

## New projects worth Rs120 bn ready for bidding - IRB to raise funds

IRB's management is confident that based on its current BOT portfolio of 11 operational projects and construction order backlog of approximately Rs100 bn, the company can execute additional projects for Rs15-20bn, over and above the Rs43 bn worth of new projects already bagged in H1FY2010. However, the management has also highlighted that, projects worth Rs120 bn from NHAI are on RFP stage, bids for which are to be called over next 3-6 months. In order to capitalize on this huge opportunity IRB is planning to raise equity resources and the board has passed enabling resolution to raise upto Rs12 bn.

## IRB potentially can execute new projects worth Rs65-70 bn

With equity funds of Rs12bn, IRB will be able to execute projects worth another Rs50 bn. This means at a time when the road sector in India is about to see significant order traction, IRB will be ready with a war chest of Rs65-70 bn to capitalize on the same and significantly ramp up its BOT portfolio and scale of its construction business. We believe the company's aggressive management would be able to leverage its strong project management and execution skills and exploit significant growth potential in the road BOT space in India, thereby providing a positive tailwind.

## Bear-Bull case value range of Rs161-364 per share

However post the recent outperformance, it becomes imperative to assess the range of Bull-Bear case value for IRB stock. We did a sensitivity test on our model for IRB where we have assumed scenarios of 9.5-13.5% interest rate for the BOT projects, 12-14% cost of equity as the discounting rate and 5-7% traffic growth for its BOT portfolio. The exercise yielded a Bear-Bull case range of Rs161 – 364.

| Variable | Range |
|---|---|
| E&C business target PER | 10-14X |
| Cost of equity | 12%-14% |
| Interest rate for projects | 9.5%-13.5% |
| Traffic growth | 5%-7% |

| Rs per share | E&C | BOT | Real estate | PV of loans | Total |
|---|---|---|---|---|---|
| **Bear Case** | 66 | 87 | 5 | 4 | **161** |
| **Base Case** | 79 | 161 | 5 | 5 | **250** |
| **Bull Case** | 92 | 262 | 5 | 6 | **364** |

## Sensitivity of interest rate and traffic growth on project NPVs

Since infrastructure developers operate at a very high debt: equity ratio, interest rates significantly impact their project cash flows, and consequently their equity IRRs. For example a 100 bps reduction in interest rate for project like Mumbai – Pune (MPEW) enhances its NPV by 3%. Similarly a 100 bps reduction in discounting rate enhances its Net Present Value (NPV) by 5%. Traffic growth for road BOTs, which is essentially related to GDP growth of a region, also is a significant driver of value for projects. For example a 100 bps improvement in traffic growth impacts value of project like Mumbai Pune Expressway by close to 9%.We have shown the sensitivity on the NPV of IRB's BOT portfolio at various levels of interest rates and discount rates. (We have assigned the value Rs161/share to IRBs BOT portfolio in our price target of Rs250 for IRB).

## Sensitivity of interest rate and traffic growth on IRB's BOT portfolio

**Sensitivity at 12% CoE**

| | | Interest Rate | | | | |
|---|---|---|---|---|---|---|
| | 182.4 | *9.5%* | *10.5%* | *11.5%* | *12.5%* | *13.5%* |
| Traffic Growth | *7.0%* | **261.6** | 249.7 | 237.6 | 225.4 | 212.8 |
| | *6.5%* | 232.7 | 220.9 | 208.8 | 196.5 | 184.0 |
| | *6.0%* | 206.3 | 194.5 | 182.4 | 170.1 | 157.5 |
| | *5.5%* | 182.1 | 170.3 | 158.1 | 145.7 | 133.1 |
| | *5.0%* | 159.8 | 147.9 | 135.8 | 123.3 | 110.8 |

**Sensitivity at 13% CoE**

| | | Interest Rate | | | | |
|---|---|---|---|---|---|---|
| | 161.2 | *9.5%* | *10.5%* | *11.5%* | *12.5%* | *13.5%* |
| Traffic Growth | *7.0%* | 230.8 | 219.8 | 208.6 | 197.3 | 185.7 |
| | *6.5%* | 206.0 | 195.1 | 183.9 | 172.5 | 160.9 |
| | *6.0%* | 183.3 | 172.4 | **161.2** | 149.7 | 138.1 |
| | *5.5%* | 162.4 | 151.5 | 140.2 | 128.7 | 117.0 |
| | *5.0%* | 143.2 | 132.2 | 120.9 | 109.3 | 97.7 |

**Sensitivity at 14% CoE**

| | | Interest Rate | | | | |
|---|---|---|---|---|---|---|
| | 143.6 | *9.5%* | *10.5%* | *11.5%* | *12.5%* | *13.5%* |
| Traffic Growth | *7.0%* | 205.3 | 195.1 | 184.7 | 174.1 | 163.3 |
| | *6.5%* | 183.9 | 173.7 | 163.3 | 152.7 | 141.8 |
| | *6.0%* | 164.1 | 154.0 | 143.6 | 132.9 | 122.0 |
| | *5.5%* | 146.0 | 135.8 | 125.3 | 114.6 | 103.6 |
| | *5.0%* | 129.2 | 118.9 | 108.4 | 97.6 | **86.7** |

*Note- 1) Our CoE assumption is higher by 1% point for under construction project.*

*2) Traffic growth shown in the table are estimates of growth in initial phase i.e. from FY2011-17, post which we have assumed a gradual decline in growth rates.*

## Stock can trade 20% higher than our fair value estimates

Our bull case value of Rs364/share for IRB is based on assumption of 1) 9.5% interest rate (as compared to 11.5% in base case), 2) 7% traffic growth (as compared to 6% - in base case) 3) COE of 12% and 4) 14X PER for construction business (as compared to 12X factored in base case). Though we see little possibilities of all the favorable value drivers (factored in our bull case), materializing at same time and the stock moving to bull case, we believe the stock can still trade at Rs297 or 20% higher than our current fair value of Rs250 for the stock. This is based on realistic bull case assumption of PER of 14X for construction business, interest rates of 10.5%, Traffic growth estimates of 6.5% and 13% COE. In the following exhibit we have discussed probabilities of all these value drivers to see how far the stock can trade from our fair value estimates.

| Variable | Range | Comment |
|---|---|---|
| E&C business target PER | 10-14X | Best case multiple of 14X for IRB's construction business, same as the multiple we have assigned to IVRCL's construction business. (30% discount to L&T) |
| Cost of equity | 12%-14% | We see little room for reduction in CoE, as the implied 6% risk premium ideally factors traffic growth and interest rate risks. |
| Interest rate for projects | 9.5%-13.5% | The new reset of interest rates is due for IRB's key project and we see a maximum of 100 bps reduction from current rate of 11.5%. |
| Traffic growth | 5%-7% | The company saw traffic average growth of 5% in H1FY2010. We believe though our estimates of 6% growth are reasonable, the same can have marginal upsides since they are bouncing back from low base of FY2009. Hence we can expect traffic growth to inch up a bit higher to 6.5%. |

### IRB SoTP

| SPV | Asset Operated | Holding | Valuation Measure | Disc rate | Bull Case* | Base case |
|---|---|---|---|---|---|---|
| **Modern Road Makers** | **EPC & O&M Business** | **100%** | **PER** | **12** | **91.8** | **78.7** |
| **Mhaiskar Infrastructure** | Mumbai Pune Expressway & NH4 | 100% | FCFE | 12% | 49.3 | 45.7 |
| **Surat Dahisar SPV** | Surat Dahisar | 80% | FCFE | 13% | 4.8 | 1.6 |
| **IDAA Infrastructure** | Bharuch Surat | 100% | FCFE | 13% | 20.7 | 16.9 |
| **MMK Toll Road** | Mohol-Mandrup Road | 100% | FCFE | 13% | 2.9 | 2.9 |
| **IRB Infrastructure** | Karpada-Patalganga Bridge | 100% | FCFE | 13% | 1.0 | 1.0 |
| **NKT Road & Toll** | Ahmednagar Tembhurni Road | 100% | FCFE | 13% | 1.9 | 1.8 |
| **Thane Ghodbunder Toll Road** | Thane Ghodbunder | 100% | FCFE | 13% | 5.5 | 5.3 |
| **ATR Infrastructure** | Pune Nashik | 100% | FCFE | 13% | 6.9 | 6.6 |
| **Aryan Toll Road** | Pune Sholapur | 100% | FCFE | 13% | 3.5 | 3.3 |
| **Ideal Road Builders** | Thane Bhiwandi Bypass Kaman Paygon | 100% | FCFE | 13% | 6.8 | 6.7 |
| **IRB Kolhapur IRDC** | Kolhapur City Roads | 100% | FCFE | 14% | 7.4 | 6.1 |
| **Goa (Panji) -Karnataka** | Goa (Panji) -Karnataka | 100% | FCFE | 14% | 6.5 | 4.1 |
| **Amritsar Pathankot** | Amritsar Pathankot | 100% | FCFE | 14% | 13.3 | 9.8 |
| **Jaipur - Deoli** | Jaipur - Deoli | 100% | FCFE | 14% | 18.3 | 13.3 |
| **Amravati Talegaon** | Amravati Talegaon | 100% | FCFE | 14% | 7.7 | 5.7 |
| **Total Value of existing BOT Portfolio** | | | | | **156.6** | **130.7** |
| **Terminal value of firm** | | 100% | FCFE | 15.0% | **38.4** | **30.3** |
| **Aryan Infra Investment** | **Real Estate JV** | 66% | Book value | | **5.0** | **5.0** |
| **Add: PV of Loans to SPV** | | | | | **5.4** | **5.0** |
| **Total** | | | | | **297** | **250** |

***Note-Bull Case based on realistic assumption discussed in exhibit earlier.**

## Maintain ACCUMULATE

We believe IRB, an ideal play on India's continued focus on developing road infrastructure through PPP model, is on a verge of steep earnings growth trajectory with two of its biggest BOT projects Surat -Dahisar and Bharuch Surat contributing to revenues and earnings in FY2010. Also the construction business with existing E&C order backlog of Rs74 bn (and Rs8 bn order from Goa - Karnataka project to be added to backlog) will fuel IRB earnings growth. Overall we expect IRB to register revenue growth of 82% and earnings growth (after minority interest) of 63% over FY2009-11E. Also the proposed fund raising exercise will equip IRB with a war chest of Rs65-70 bn to capitalize on huge opportunity in road BOT space in India and also significantly scale up its construction business.

Though we remain directionally positive on road BOTs in general and IRB in particular, our target of Rs250, does not provide significant upsides. We maintain our ACCUMULATE rating on the stock with a target of Rs250.

### Income Statement

| Y/E, Mar (Rs. m) | FY2008 | FY2009P | FY2010E | FY2011E |
|---|---|---|---|---|
| **Net Sales** | **7327.1** | **9918.8** | **18192.1** | **32864.2** |
| Growth (%) | 39.5 | 35.4 | 83.4 | 80.7 |
| **Total Expenditure** | **3208.2** | **5544.9** | **9717.9** | **20725.9** |
| Growth (%) | 31.0 | 72.8 | 75.3 | 113.3 |
| Direct Expenses | 2532.8 | 4682.5 | 8376.3 | 18092.4 |
| % of sales | 34.6 | 47.2 | 46.0 | 55.1 |
| Periodic Maintainance | 0.0 | 0.0 | 160.6 | 160.6 |
| % of sales | 0.0 | 0.0 | 0.9 | 0.5 |
| Personnel expenses | 341.0 | 424.8 | 683.5 | 1446.1 |
| % of sales | 4.7 | 4.3 | 3.8 | 4.4 |
| Office admin & other exp | 334.4 | 437.6 | 497.4 | 1026.7 |
| % of sales | 4.6 | 4.4 | 2.7 | 3.1 |
| **EBIDTA** | **4118.9** | **4374.0** | **8474.3** | **12138.3** |
| Growth (%) | 47.0 | 6.2 | 93.7 | 43.2 |
| EBIDTA % | 56.2 | 44.1 | 46.6 | 36.9 |
| Other income | 520.3 | 296.0 | 561.9 | 547.6 |
| Interest | 1957.5 | 1376.6 | 2581.3 | 3803.9 |
| Depreciation / Amortization | 1016.1 | 1143.8 | 1889.5 | 2393.0 |
| **EBT** | **1665.5** | **2149.5** | **4565.4** | **6489.0** |
| Prov for Tax | 399.8 | 377.8 | 985.5 | 1602.9 |
| **EAT** | **1265.7** | **1771.7** | **3579.9** | **4886.0** |
| Growth (%) | 59.3 | 40.0 | 102.1 | 36.5 |
| EAT (%) | 17.3 | 17.9 | 19.7 | 14.9 |
| Minority Interest | 126.4 | 13.2 | 280.9 | 213.3 |
| **Adjusted PAT** | **1139.3** | **1758.5** | **3299.0** | **4672.7** |

### Balance Sheet

| Y/E, Mar (Rs. m) | FY2008 | FY2009P | FY2010E | FY2011E |
|---|---|---|---|---|
| Equity share capital | 3323.6 | 3323.6 | 3323.6 | 3323.6 |
| Share Premium | 10048.3 | 10035.2 | 10035.2 | 10035.2 |
| Reserves & surplus | 2835.1 | 3941.9 | 7240.9 | 11913.6 |
| **Shareholders Funds** | 16207.0 | 17300.7 | 20599.7 | **25272.4** |
| **Minority Interest** | **281.1** | **599.2** | **880.1** | **1093.4** |
| Secured Loans | 17436.4 | 22082.8 | 34652.0 | 48974.0 |
| Unsecured Loans | 2776.0 | 2776.0 | 2776.0 | 2776.0 |
| **Loan Funds** | **20212.4** | **24858.8** | **37428.0** | **51750.0** |
| **Total Liabilities** | **36700.5** | **42758.7** | **58907.8** | **78115.8** |
| | | | | |
| Gross Block | 1483.1 | 7578.1 | 4524.5 | 5524.5 |
| Less: Acc Depreciation | 533.9 | 4439.7 | 1456.4 | 2069.3 |
| **Net block** | **949.2** | **3138.4** | **3068.0** | **3455.2** |
| Capital WIP | 8888.5 | 14545.4 | 8900.0 | 32939.3 |
| Intangible Assets | 17898.8 | 17022.9 | 30505.5 | 28725.3 |
| **Investment** | **1984.9** | **1108.3** | **1108.3** | **1108.3** |
| **Current Assets** | **9589.0** | **10326.1** | **21687.2** | **22673.4** |
| Inventories | 502.1 | 2054.0 | 852.5 | 1929.5 |
| Sundry Debtors | 117.6 | 129.8 | 1461.7 | 4065.9 |
| Cash and Bank | 5221.5 | 4147.3 | 12724.5 | 10029.6 |
| Loans and Advances | 3747.8 | 3994.9 | 6648.5 | 6648.5 |
| **Current Liab & Prov** | **2599.5** | **3210.4** | **6433.0** | **10857.4** |
| Current liabilities | 1048.9 | 1302.7 | 4615.9 | 9035.3 |
| Provisions | 1550.6 | 1907.7 | 1817.1 | 1822.1 |
| **Net current assets** | **6989.5** | **7115.7** | **15254.2** | **11816.0** |
| Net Deferred Taxes | -26.3 | -181.6 | -181.6 | -181.6 |
| Miscellaneous Exps | 15.9 | 9.6 | 9.6 | 9.6 |
| **Total Assets** | **36700.5** | **42758.7** | **58664.1** | **77872.1** |

### Cash Flow

| Y/E, Mar (Rs. m) | FY2008 | FY2009P | FY2010E | FY2011E |
|---|---|---|---|---|
| Profit before Tax | 1665.5 | 2149.5 | 4565.4 | 6489.0 |
| Add : Depreciation | 1016.1 | 1143.8 | 1889.5 | 2393.0 |
| Add : Non Cash | 0.0 | 52.7 | 0.0 | 0.0 |
| Less: Tax Paid | -399.8 | -377.8 | -985.5 | -1602.9 |
| Net changes in WC | -431.2 | -1200.4 | 438.6 | 743.3 |
| **Operational Cash Flows** | **1850.6** | **1767.8** | **5908.0** | **8022.3** |
| Capital expenditure | -3605.8 | -6953.6 | -9900.0 | -25039.3 |
| Investments | -1571.4 | 876.5 | 0.0 | 0.0 |
| **Investing Cash Flows** | **-5177.2** | **-6077.1** | **-9900.0** | **-25039.3** |
| Borrowings | -4967.2 | 4646.4 | 12569.2 | 14322.0 |
| Issue of shares | 9445.7 | 0.0 | 0.0 | 0.0 |
| Add/Redn of Reserves | 0.0 | -13.1 | 0.0 | 0.0 |
| Dividend paid | 0.0 | 0.0 | 0.0 | 0.0 |
| Pymt to / from Min Int | | | | |
| **Financing Cash Flows** | **4478.5** | **4633.3** | **12569.2** | **14322.0** |
| changes in cash | 1151.9 | 324.1 | 8577.2 | -2694.9 |
| Opening balance | 3703.4 | 5221.5 | 4147.3 | 12724.5 |
| **Closing balance** | **4855.3** | **5545.5** | **12724.5** | **10029.6** |

### Key ratios

| | FY2008 | FY2009P | FY2010E | FY2011E |
|---|---|---|---|---|
| EPS (Rs) | 3.4 | 5.3 | 9.9 | 14.1 |
| CEPS (Rs) | 6.9 | 8.8 | 16.5 | 21.9 |
| BV/Share (Rs) | 48.8 | 52.1 | 62.0 | 76.0 |
| DPS (Rs) | 0.0 | 0.0 | 0.0 | 0.0 |
| | | | | |
| **Valuations Ratios (x)** | | | | |
| PER | 73.2 | 47.4 | 25.3 | 17.9 |
| P/CEPS | 36.6 | 28.6 | 15.3 | 11.5 |
| P/BV | 5.1 | 4.8 | 4.0 | 3.3 |
| EV/EBIDTA | 23.9 | 23.8 | 12.8 | 10.3 |
| EV/Sales | 13.4 | 10.5 | 5.9 | 3.8 |
| M-Cap/EBIDTA | 20.3 | 19.1 | 9.8 | 6.9 |
| M-Cap/sales | 11.4 | 8.4 | 4.6 | 2.5 |
| **Financial ratios** | | | | |
| RoCE (%) | 10.9% | 8.9% | 14.1% | 15.0% |
| RoNW (%) | 7.0% | 10.2% | 16.0% | 18.5% |
| Debt/Equity | 1.2 | 1.4 | 1.8 | 2.0 |
| Dividend yield (%) | 0.0 | 0.0 | 0.0 | 0.0 |

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