Infrastructure Sector

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Experts Day Update

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We organised an Experts Day event recently where we interacted with Mr. Parvesh Minocha, group managing director of Feedback Infra Private Limited. Following are the key takeaways:

- Infrastructure spending has risen significantly over the past two to three years in asset creation, particularly in areas like highways, metros, railways, border roads and tunnels. However, there has been tepid progress in developing inland waterways and ports. Airport development activity has largely been dominated by Bengaluru and Delhi airport expansion, while Navi Mumbai airport construction is yet to commence.
- The road segment business witnessed some structural changes whereby existing projects have been acquired by pension funds and other international PE funds (Brookfield, Roadies etc).
- Private sector investment is still lagging in the infrastructure segment with a few exceptions like the solar power space. In both PPP and HAM (hybrid annuity model) projects, private developers seem to be unwilling to bear revenue risks and consequently, the quantum of investments remains limited. Investment is not flowing even to relatively safer projects like railways, roads, ports and metros.
- Response from developers in the construction sector is weak with most of the development witnessed in highways, metros, tunnels in border areas, and railways originating from government-funded contracts.
- A large number of highway projects were awarded in FY18 to the construction sector. The actual execution is expected in FY19. More projects are expected to be awarded in 2QFY19/3QFY19. This is also the case with solar power projects.
- Projects awarded under HAM were 20% higher than government estimate, while bids for BOT contracts displayed signs of stress and were lower than government estimate. EPC projects were bid at highly competitive rates. Response for TOT (Toll-Operate-Transfer) projects was marked by very aggressive bidding. Bids received were 40% higher than the National Highways Authority of India or NHAI's lower estimate and 30% higher than L2 level.
- Suppliers, such as those supplying construction equipment, elevators, escalators, cement, steel, lighting, switchgear, braking system, telephone system, etc. to the above mentioned sectors are expected to perform well.
- Loss-making low-IRR road BOT projects which faced statutory/financial problems earlier and hence remained half-complete have been resolved by taking special measures with only 13-14 projects (~5%) out of a total of ~240 projects remaining unresolved.
- Revenues from most projects have not kept pace with earlier projections. Revenues earned from ~ 70% of the projects are insufficient to earn a reasonable return on equity. Road BOT projects are under stress because of the high debt level of developers. The stress is high as these developers have shown the desire to sell their equity component in these projects for as low as Re.1 in order to be able to service their debt.
- Over the past two to three years, over 30 roads projects have changed hands with players like Brookfield, Roadies (International) among others showing buying interest.
- Progress of the government's Bharatmala programme remains as per capacity, with bids for 7,000-8,000km of highways being awarded annually.
- Construction of large express highways (like Delhi-Vadodara, Nagpur-Ahmedabad-Bengaluru Delhi-Katra, etc) are expected to commence from FY19/FY20, the spending on which is likely to be in the range of Rs200bn to Rs300bn per highway by central as well as state governments.
- The government's integrated conservative mission under its 'Namami Gange Programme' is expected to take off in FY20 and the design order for its plants has been placed.
- Poor coal off-take by power generators can be attributed to non-payment of dues by power distribution companies (discoms) which has disincentivised power producers from undertaking additional power generation. Thermal power projects (excluding gas-based), which were stuck because of financial constraints, are expected to come on stream again towards the end of FY19.
- Losses in the power distribution segment, which ballooned to Rs650bn in FY16, are expected to moderate following privatisation of activities like meter reading, cabling etc.
- While there is visibility on infrastructure spending by the government over the next two-three years, it must be noted that private investment has been slower than the government's spending. Private participation needs to pick up in order to boost economic growth.
- 60%-70% of land acquisition for the Mumbai-Ahmedabad bullet train project has been completed and work on the same is likely to start by FY19-end. Annual spending on the project is likely to be ~Rs200bn.
- While ports in India enjoy excess capacity, they suffer from poor connectivity via road/rail networks. Containerisation is expected to witness double-digit growth over the next 10 years. However, the supply imbalance seen in certain pockets should get rebalanced once the movement via inland waterways commences.
- Most project financing takes place through NBFCs which are in turn funded by banks in bulk.

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