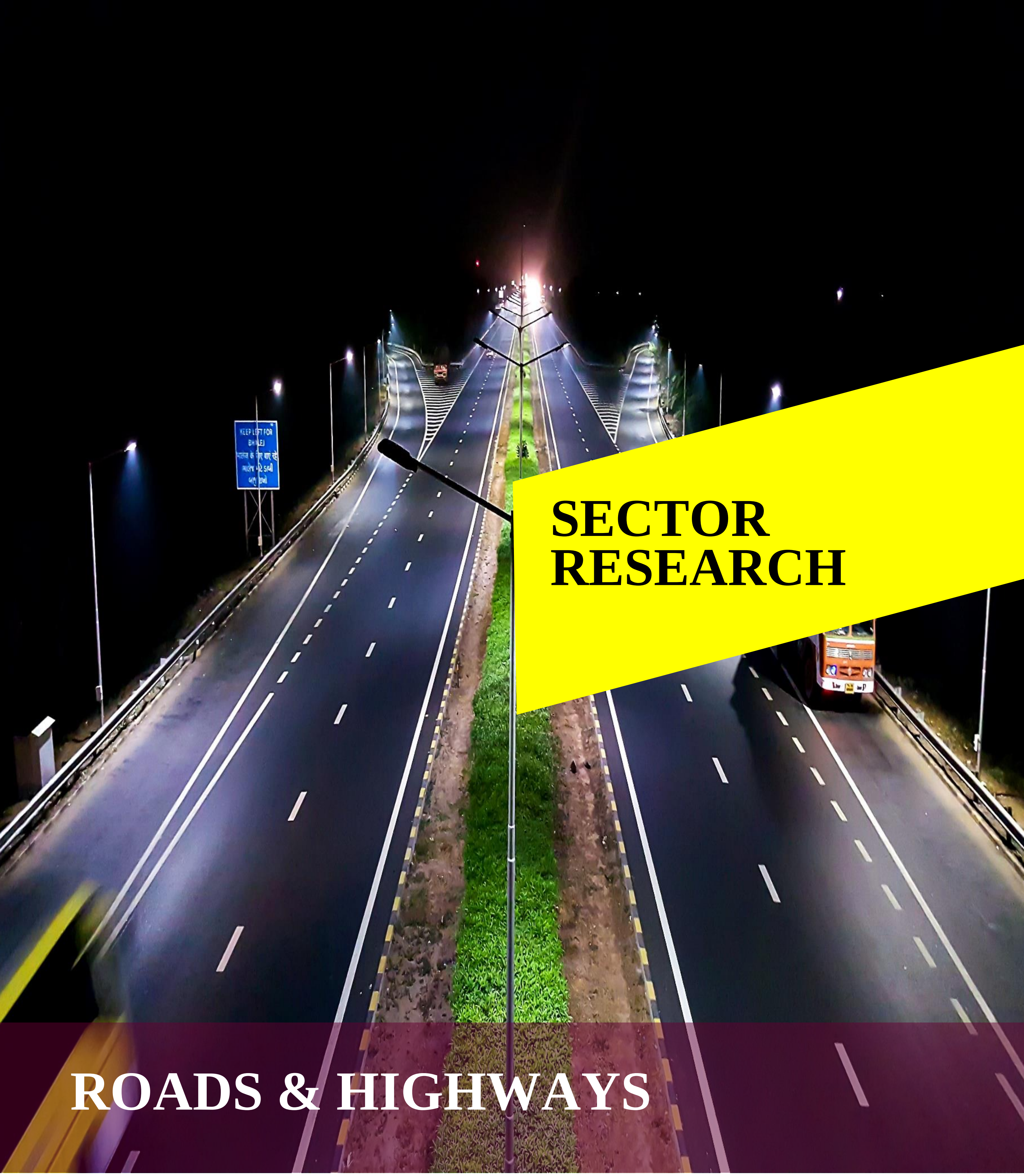

SECTOR RESEARCH

ROADS & HIGHWAYS

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Pandemic shocks notwithstanding, government's thrust on infrastructure to ensure execution momentum continues in FY22

Infrastructure Sector Analysis

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Executive Summary

The Indian road network is the second largest globally, with a length of around 63.86 lakh km. The outbreak of the virus towards end-FY20 had created panic globally, leading to the temporary suspension of economic activity. The road sector in Q1FY21 suffered a major setback during the initial lockdown, resulting in a delay of commercial operation dates by three to six months for most projects. However, once the lockdown was gradually lifted, it gained pace in terms of construction, project allocation and toll collections. The execution was robust and the pace of 37 kms per day recorded in FY21 was the highest ever recorded by National Highways Authority of India (NHAI) in a financial year.

Going forward, in FY22, Brickwork Ratings (BWR) expects road construction to pick up pace on account of various government initiatives in this sector such as the National Infrastructure Pipeline (NIP), National Monetisation Pipeline (NMP), Bharatmala Pariyojana, changes in the Hybrid Annuity Model (HAM) and fast pace of asset monetisation.

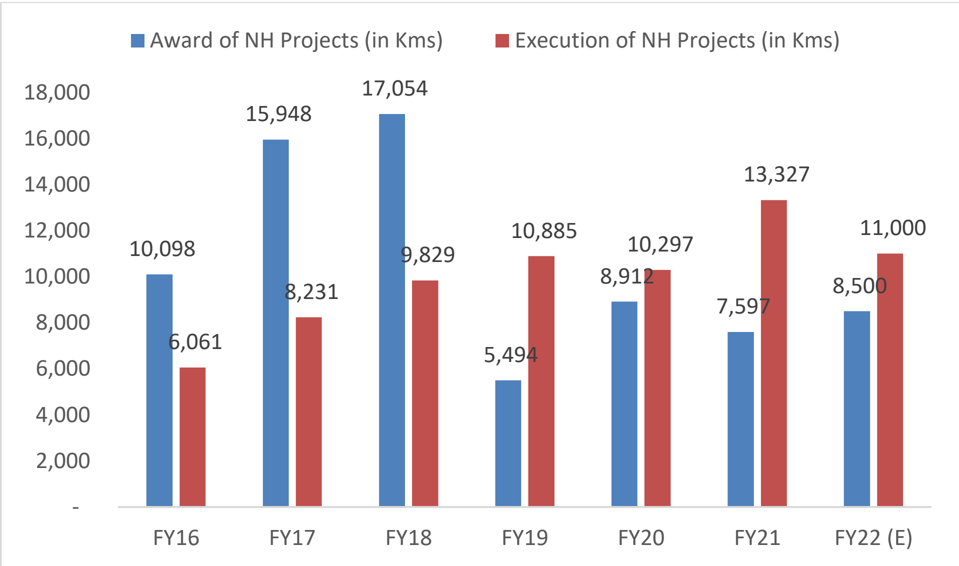
With the government modifying the HAM to make it investor friendly, we expect these changes to garner more private sector interest and the share of the HAM to increase, going forward. Additionally, to address the funding gap in the sector, more innovative ways of funding are the need of the hour. The Infrastructure Investment Trust (InvIT) and Toll Operate Transfer (TOT) model have the potential to raise funds through asset monetisation. However, due to pandemic-related challenges, it has not picked up, and progress on this front will be critical to bridge the funding gap in the sector.

Road construction to continue at record pace in FY22, led by several government initiatives

The Indian road sector witnessed a dramatic rise in FY21 in terms of a higher pace of road construction, project allocations and toll collections, despite the economic distress caused by the pandemic. The imposition of the lockdown resulted in labour shortage, with migrant labour returning to their native villages, thereby slowing the pace of road construction activity in H1FY21. However, once the lockdown was lifted, construction gained pace, and the NHAI was able to construct a total length of 13,327 km of National Highways (NH) at an average pace of 37 km per day in FY21. This road construction pace of 37 km per day was much higher than 26 km per day in FY20 and is also the highest ever achieved by the NHAI in a financial year.

Roads are the primary mode of transportation for the country and are responsible for carrying 70% freight and 90% passenger traffic. Therefore, the increased pace of construction of 37 km per day would help better to emerge from the pandemic situation and help in economic recovery.

Trend in NH Projects awarded vs executed

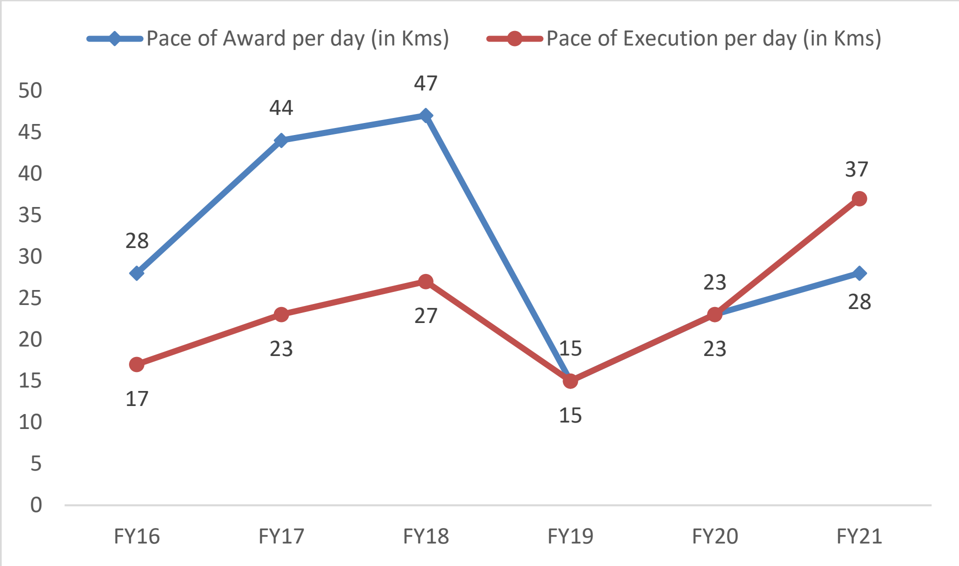


E: Ministry of Road Transport & Highways (MoRTH) Estimate

Source: NHAI, MoRTH, BWR Research

In Q1FY22, the NHAI recorded a pace of execution of 28 km per day, which was better than Q1FY21, when road construction had come to a standstill. As of Q1FY22, NHAI has already awarded 141 projects, having a length of 4,600 km, worth Rs 2.25 lakh crore.

Trend in pace of award vs pace of execution per day



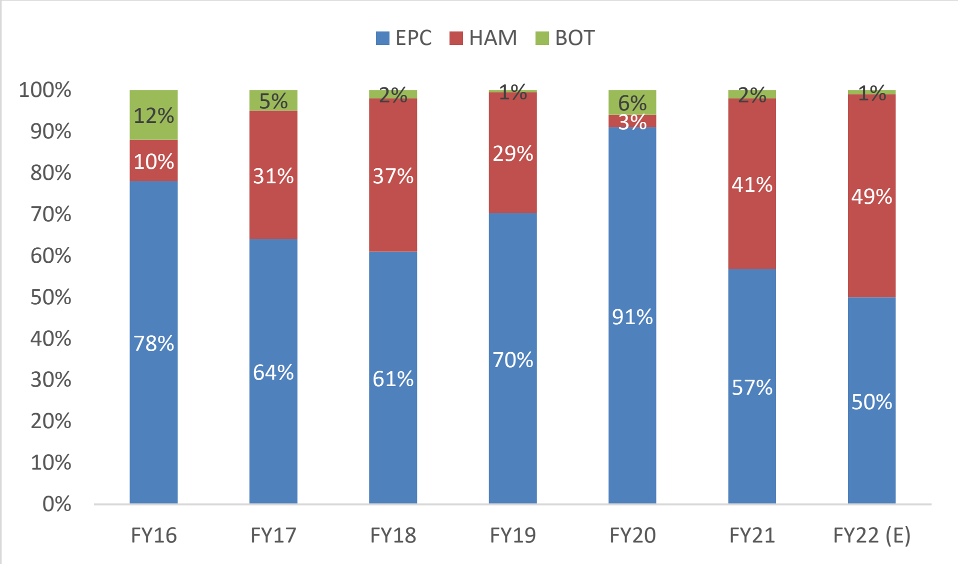
Source: NHAI, MoRTH, BWR Research

In FY22, BWR expects road construction momentum to continue at similar pace, mainly due to government's renewed focus on infrastructure, with initiatives such as the NIP, higher budgetary allocation, thrust on the development of greenfield expressways under Bharatmala Pariyojana and pro-investor changes in the Model Concession Agreement (MCA) under the HAM and Built Operate Transfer (BOT) model to encourage private participation. Moreover, initiatives such as the implementation of FASTag, focus on resolving land acquisition issues and easing liquidity for Engineering, procurement and construction (EPC) players has yielded good results and will further boost private sector interest in the sector.

Tweaking HAM, step towards garnering private interest

The success story of the roads and highways projects is largely a function of the model being used. HAM was introduced in FY16 under the Public Private Partnership (PPP) mode.

Trends in distribution of road projects by different models



E: MoRTH Estimate

Source: NHAI, MoRTH, BWR Research

Attracting private funds in the road sector has always been challenging. The recent amendment made to HAM could improve the position of private players in the contract, thus becoming the key to success.

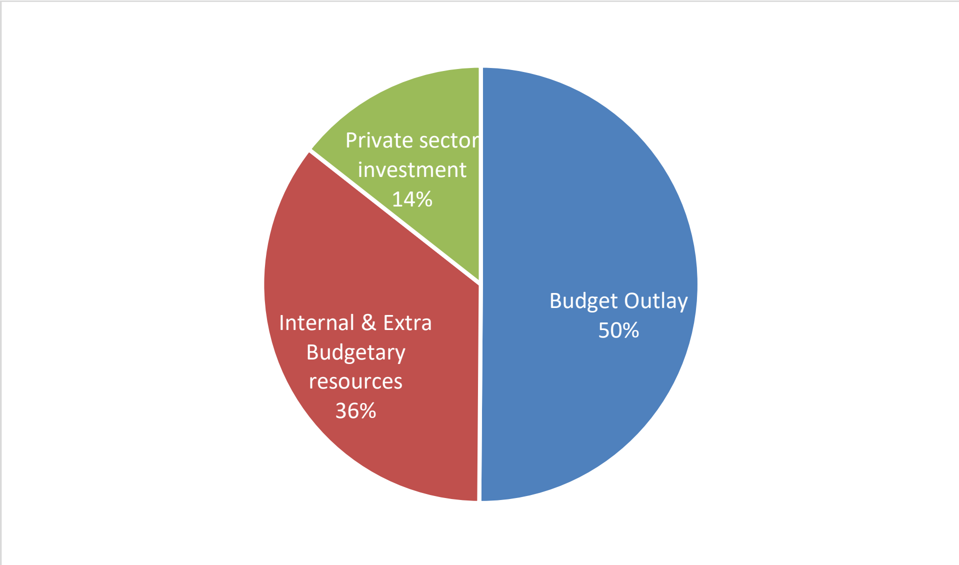
HAM faced implementation challenges such as Right of Way issues and a delay in financial closures. Under the HAM, developers had reduced equity commitments of ~10%-12% of the total project cost as 40% of the project cost is funded by the authority in the form of grants, and the remaining portion is to be funded by debt. Developers had been facing difficulties in achieving financial closure due to aggressive bidding, stressed balance sheets with their portfolios already burdened with existing/delayed HAM projects leading to increased equity commitment on their part, and selective lending by banks in infrastructure projects, among other reasons. Developers also faced interest risk associated with HAM as the interest income on annuity, which forms a sizable portion of the cash flows during the concession period, was linked with bank rate. The reduction in the bank rate led to a lower-than-envisaged interest income on annuity, which impacted entities' debt coverage metrics.

Therefore, the awarding of the projects under the HAM, which peaked at around ~40% in FY18, had drastically dropped to less than 10% in FY20, and EPC remained the preferred mode of awarding projects. Hence, the government made certain modifications in the HAM in November 2020, including the linking of interest rates to the Marginal Cost of Funds based Lending Rate (MCLR), revision of the lock-in period and an increase in the number of payment milestones to prepone cash flows to developers. These modifications in the HAM resulted in it significantly gaining momentum in FY21 reaching 41%, and the trend is expected to improve further in FY22.

....however, funding challenges remain for the sector

The road sector has always relied on public funding for executing its projects. Due to the low level of private interest, there is a considerable funding gap. Moreover, private investments coming in are also facing troubles in terms of financial closure issues. Bank lending has also been impacted due to the high level of Non-performing assets (NPAs) in the sector.

Sources of funding



Source: MoRTH, BWR Research

The government has been revolutionizing the modes of private funding with the introduction of InvITs and the asset monetisation plan. Private players are being involved not only in the construction period, but also during the maintenance and operation period.

To provide funding to the sector, the government has increased its budgetary allocation to the sector. Given that the funding gap is likely to remain, an NHAI InvIT worth Rs 5,100 crore is expected to be released soon after having been delayed in the past due to weak investor sentiments.

Additionally, the government recently announced the Asset Monetisation Plan, under which it intends to monetise road assets worth Rs 1.6 lakh crore over four years via the Toll-Operate-Transfer (TOT) model. The model entails the securitisation of toll receivables by taking an upfront concession fee from the selected bidder which is determined through a transparent competitive bidding process.

Smaller contracts of the TOT model could ease the road sector's asset monetisation process

The first wave of the pandemic in FY21 had impacted the market as investors were seeking extra time to bid on bundles. Although the second bundle had not received fruitful results, the auction of the first and third bundles were reasonably successful to continue this mode of asset monetisation. The fourth round of the TOT auction was initially announced for a total of seven stretches, for 400 kms, with the reserve price of

Rs 4,170 crore. Later, it was downsized to six stretches with a concession period of 20 years, a total length of 341 km, for a reserve price of Rs 2,165 crore, in a bid to attract higher participation. However, due to the pandemic outbreak, the fourth bundle was again deferred in September 2020. This was mainly on account of a lack of visibility on toll collections due to extended lockdowns across the country.

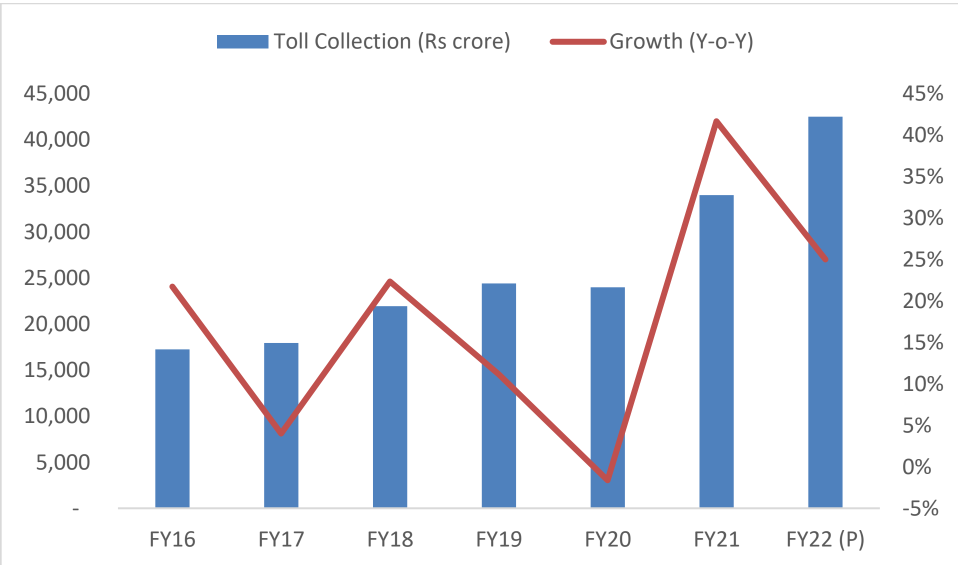
With the condition ameliorating for road construction developers in Q4FY21, NHAI launched the fifth bundle of the TOT model in two tranches. Both these tranches were well-received with a 38% premium over the reserve price of Rs 1,621 crore. Seeing the success of the fifth bundle, the NHAI/MoRTH plans to offer 1,500 km under 32 projects under the sixth tranche of the TOT model. However, the offers will be released only after the stabilisation of the pandemic situation to safeguard against covid-19-induced risks.

NHAI toll collection to continue to increase in FY22

Toll collections are a major revenue source for the MoRTH. The implementation of electronic toll collection in FY21 has increased tolls by 42%. However, new road construction would lead to new plazas, thereby increasing toll collection.

The covid-induced lockdown has led to a revenue loss in FY20 and FY21 for the NHAI. However, with the unlocking of economic activities, toll collection saw triple-digit growth in November 2020, which was comparatively more than the pre-covid period. Subsequently, the sector witnessed the highest daily toll collection, of Rs 104 crore on 25th Feb 2021, which could be attributed to the mandatory implementation of FASTag. This National Electronic Toll Collection programme not only helped the NHAI continue to adhere to covid-19 protocols for contactless toll collection, but also allowed it to keep a more systematic track record of the transactions made in toll plazas. These toll plazas still have one lane in which all the other modes of toll payment are allowed.

Trends in toll collection



P: Projections

Source: MoRTH, BWR Research

While the electronic mode has significantly increased toll revenue, we could expect to see an increase in toll revenue, driven by an increase in the number of toll plazas. The number of toll plazas would increase due to the number of projects being awarded under the TOT models, with a decrease in the stretch of the road being awarded under each contract. Additionally, the increased pace of road construction would increase the number of toll plazas and hence (expectedly) increase toll collections.

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