

Roads Projects Buckle Under Corona Pressure

The National Highways Authority of India (NHAI) had expected to construct about 500km of roads in March, but that could not happen after the COVID-19 pandemic forced a nationwide lockdown. For the fiscal year, NHAI may end up constructing only about 3,500km as other players stare at a deepening crisis.



Road developers, already under stress from a funding shortfall, are staring at a deepening crisis after the nationwide lockdown following the spread of coronavirus pandemic. Both project awarding and construction activity were expected to pick up during the dry winter period after a lingering rainy season in 2019 that stayed till November. But the lockdown has halted project execution and impacted revenue of most construction companies in the infrastructure sector.

"We were already operating at less than full capacity, but we took the decision on March 24 to completely halt operations across all locations and also informed the stock exchange about it," said **KV Rao**, the Hyderabad-based

general manager of finance at **KNR Constructions**. "Definitely, revenue is expected to be affected for the roads sector due to the pre-emptive measures that have been necessitated during this difficult time."

The disruption in work and to daily life is due to the nationwide lockdown that Prime Minister Narendra Modi-led government initiated on March 24, in a move to curb the spread of COVID-19.

On March 26, road developers and operators stopped collecting toll after a directive by the Ministry of Road Transport and Highways to heed the lockdown measures taken by the Ministry of Home Affairs. The directive clarified that developers would be able to invoke a force majeure clause. Welspun Enterprises,

▲ India's road-building programme may fall way short of the targeted 4,500km for FY2019-20

Feature

Roads & Highways



▲ In FY2020-19, road developers face the prospect of at least two successive bleak quarters due to the COVID-19 impact

DilipBuildcon, MEP Infrastructure Developers, IRB Infrastructure Developers and PNC Infratech, among others, announced suspension of all operations.

BLOW TO CONSTRUCTION ACTIVITY

NHAI expects construction in March will halve from its earlier estimates.

"We had expected to construct about 500km of roads in March, but this is not possible now and we may construct 100-200km instead, because all work has stopped," a senior official at NHAI said. "For the fiscal year, we may end up constructing about 3,500km."

Companies were affected even before the lockdown after many of the state governments closed their borders some days prior, allowing only essential items to go through. The movement of bitumen and cement that are required for constructing roads, are not considered essential during this time and their movement has been curtailed.

NHAI has awarded a little less than 3,000km this fiscal year, the official added, noting that even these projects would be affected. "Companies who successfully bid for and won these projects will get delayed because banking activities and the construction starting dates

are all going to slip behind schedule," he said.

Banks will slow down their payments as they, too, are operating with skeletal staff, which will impact project financing, the official added.

According to equity analysts at multiple brokerages, there will be up to 45 days of zero revenue from April to mid-May, for all companies. Since most migrant workers have travelled back to their hometowns, it will take them a while to return to the construction sites, and work to begin in full swing.

Analysts at Mumbai-based brokerage PhillipCapital has cut fiscal year estimates and expects a 10 per cent YoY revenue decline for all companies and a 100-150 basis points fall in margins, resulting in an average 48 per cent decline in earnings per share.

For toll projects, the brokerage expects a 15 per cent year-on-year drop in traffic. "There will be a significant hit on margins, as fixed costs continue to be incurred, even for days and weeks without any revenue," analysts said in a report dated March 31.

LIMITED ALTERNATIVES

Maintenance activity for projects that are already operational are likely to be impacted as well, said **Anil Rao, Director** at infrastructure developer **PNC Infratech**. "The supply chain has been cut off and we expect disruptions to critical components for road maintenance equipment," he remarked.

Road builder Sadbhav Engineering expected that it would take a while for things to return to normal even after the lockdown got over.

"The only alternative is to make an effort to make up for lost revenue when we return to execution mode after this situation is over," says **Nitin Patel, Executive Director, Sadbhav Engineering**, adding that the sector needs to prepare itself for a testing period.

Industry officials are evaluating legal remedies. Other than for tolling, India's finance ministry clarified on February 19 that supply chain disruptions due to the coronavirus will be covered under the force majeure clause. This would cover supply chain disruptions, particularly the solar industry that is dependent on equipment parts from various suppliers within and outside India.

Lawyers said there have already been situations where the coronavirus has influenced deal negotiations and contract drafting. With the spread of the virus and a widescale shutdown of workforce by the government, the supply chain is affected, and force majeure will have to be considered in all such contracts, pointed out **Krishan Singhania, Partner,**

Singhania & Co.

"Companies have already decided to invoke force majeure but it will have to be linked to the impossibility to perform contractual obligations and will also depend on the terms of each contract," he said.

Epidemics are recognised as force majeure in certain contracts, but the real challenge will be on how to address the issue of cost escalation, Singhania added.

TOLL IMPACT

According to research and ratings firm ICRA, 87 per cent of the companies rated by them are resilient enough to absorb the suspension of toll collections. However, the impact to companies would depend on the intensity, duration and spread of COVID-19 outbreak.

While the Road Transport Ministry has clarified that the suspension of toll collections qualifies as a force majeure event, ICRA says the invocation of the clause would help companies recover about half of what they would stand to lose. "Under the clause, 100 per cent of operations and maintenance expenditure as well as interest costs are reimbursed for the affected period. This would cover around 50-55 per cent of loss of revenue incurred by these projects," said **Rajeshwar Burla, Vice President, Corporate Ratings, ICRA.**

Freight movement has a strong correlation with the health of the economy and the toll collections exhibit good correlation with the movement in gross domestic product (GDP). Therefore, the detrimental impact of COVID-19 on the overall economy, will, in turn, affect the movement of commercial freight. The slowdown in the economy could also result in a benign inflation rate which is a key input for arriving at the toll rates. Therefore, a combination of compression in GDP growth along with benign inflation would adversely impact toll collections in FY2021, according to ICRA.

"It took more than two quarters after the 2016 demonetisation decision for the traffic to revert to its earlier levels. Similarly, after the containment of COVID-19, toll road projects may take at least one quarter to revert to their earlier levels," surmised Burla.

ICRA expects toll revenue to decline 2-3 per cent YoY in FY2020 followed by a 6-8 per cent decline in FY2021.

QUARTERLY REVIEW

Road developers reported declining topline in 3Q2019 due to an extended monsoon season. Construction activity resumed from December onwards, the companies said, while stating

their third quarter financial performance in February this year. Since then, the coronavirus shock slowed down activity before bringing it to a halt in recent weeks.

The third quarter was also notable because of the cancellations of projects already awarded as NHA could not acquire the land meant for the projects. Of late, it has begun to strictly implement a policy to cancel projects if it cannot acquire 90 per cent of the land required for the project. As a result, projects awarded to KNR Constructions, IRB Infrastructure Developers and Sadbhav Engineering were cancelled.


In many of the other projects, there were delays in acquiring land which resulted in subsequent delays in notifying the construction start dates, again affecting construction revenue during the quarter.

DilipBuildcon reported a decline of 4.16 per cent in revenue through December 2019 to Rs 23.89 billion, with revenue from its roads and bridges segment decreasing 6 per cent YoY to Rs 20 billion. The company's urban development segment chipped in with a 43 per cent YoY growth in revenue to Rs 337 million. The company's net profit dropped 39 per cent to Rs 1.27 billion, impacted by an increase in depreciation and higher tax in the same period.

Major road builders such as IRB Infrastructure Developers, Ashoka Buildcon and Sadbhav Engineering also reported revenue declines of 2, 7.7 and 52 per cent, respectively.

Road developers are now facing the prospect of at least two subsequent bleak quarters due to the impact of the coronavirus. Cognisant of the sector's challenges, **Nitin Gadkari, Minister for Road Transport and Highways** has reiterated several times that construction needed to restart on a war footing and that the problems must be converted into an opportunity.

In a video conference on April 12, Gadkari said, "I had a meeting with road sector officials. Work can be re-started at projects with condition that adequate measures are taken for safeguard against coronavirus. We have to follow guidelines. At some places, collectors have given permission, some not. We are doing a follow up along with the chief secretaries of the states."

With deal negotiations stalling, in-person meetings off the agenda and cashflows looking challenging, companies have no option but to restart construction as soon as possible so as to be able to earn as much revenue as they can before the onset of the monsoon. 

- NEYOOR B. SHARMA