

# Management Discussion and Analysis

## 1. INFRASTRUCTURE INDUSTRY OVERVIEW & OUTLOOK

In FY 2016-17, India's infrastructure industry, including the road sector, continued on its path of recovery. The Government has been undertaking initiatives to revive entrepreneurs' interests in the road sector through innovative models like Hybrid Annuity. As a result, around 4,337 kms ([approx. 422 km of Build-Operate-Transfer(BOT) projects, 2,434 km of Hybrid Annuity projects, 1,481 km of Engineering-Procurement-Construction (EPC) projects]) of National Highways improvement work were awarded by the National Highways Authority of India (NHAI) in FY 2016-17. Most of the bids for the road projects saw good participation than the earlier years. NHAI has been focusing on addressing land acquisition and environmental clearances for its upcoming projects. The Cabinet Committee on Infrastructure has stipulated that financial bids shall be invited only after 80% of land has been acquired and environmental clearance has been obtained. This helps to reduce any delays in project implementation after award of work. The fiscal year also witnessed focussed approach of the Government towards policy improvement for bringing back equity into the system for investment into new Projects by the Developers. 75% of Arbitral Awards in disputes were decided to be paid to the Highway Developers against Bank Guarantee under the measures approved by the Cabinet Committee on Economic Affairs (CCEA) for revival of construction sector. Roadblocks for launch of InvITs were eased out resulting in successful completion of India's first InvIT by your Company enabling it to recycle capital into future projects. As a result of these decisions, there has been a renewed interest among the Developers towards investment into the Road Sector.

## 2. SECTOR OVERVIEW: ROADS AND HIGHWAYS

The Government launched major initiatives to upgrade and strengthen National Highways through various phases of the National Highways Development Programme (NHDP). NHDP stands apart as one of the world's largest road development programmes undertaken by a single authority. The programme focuses on the widening, upgradation and rehabilitation of about 48,789 kms of roads.

Though number of road projects awarded on BOT (Toll) mode remained lower during FY 2016-17, the Government's efforts to evolve new, flexible policies to

create investor-friendly highway development initiatives have already started the process of recouping the deficit of last few years. The next fiscal year is likely to show an increase in BOT (Toll) bids with the Government aiming to build 41 kms per day of roads.

## 3. COMPANY AND BUSINESS OVERVIEW

### A. Company Overview

IRB Infrastructure Developers Ltd. (IRB), incorporated in 1998, has strong in-house integrated project execution capabilities in both its business verticals viz. Construction and Operation & Maintenance of Highways. It is the first mover and pioneer in the road BOT business and is one of India's largest road BOT operators with a rich portfolio of 22 Road BOT projects. It also has approximately 18.79% share of the Golden Quadrilateral Highway Network under various stages of development or under operations.

IRB's construction business complements its BOT vertical by executing the Engineering, Procurement and Construction (EPC) and Operation and Maintenance (O&M) aspects of BOT concessions. Over the years, IRB has developed rich in-house expertise in both EPC and O&M verticals.

Out of IRB's 22 current road projects, 14\* are operational, while 8 are under various phases of implementation. The Company's major clients are government agencies, such as NHAI and State Road Development Authorities, which engage in the development of the country's highways. In the last few years, IRB has been strategically expanding its footprint in states other than Maharashtra and Gujarat. Its road assets portfolio is across eight states. On a per lane kilometers basis, its geographic spread is 31% in Maharashtra, 22% in Rajasthan, 18% in Gujarat, 12% in Karnataka, 6% in Haryana, 6% in Uttar Pradesh, 3% in Punjab and 2% in Tamil Nadu.

\* Includes 6 projects transferred to IRB InvIT Fund in May, 2017.

### B. BUSINESS OVERVIEW

#### (I) Construction and development (EPC)

IRB has successfully constructed more than 6,525 lane kms of highways on BOT basis, while 3,321 lane kms is under construction and 1,972 lane kms where construction is yet to commence. This includes improvement of National Highway and sections of the Golden Quadrilateral Highway Network.

IRB's integrated approach towards project execution involves in-house constructing as well as operating and maintaining activities with least outsourcing. Its large pool of equipment and skilled and experienced manpower help IRB to complete projects within budget and in time. This experienced manpower also helps the Company to manage the entire tolling and maintenance functions in-house during operations phase. An evolving IT infrastructure set up provides finesse to these integrated methods of conducting business.

The Company's construction order book as on March 31, 2017 stands at approx. ₹ 9,257 Crores to be executed over the next two to three years.

Agra-Etawah Project has commenced commercial operations on the NH-2 in August, 2016. For projects under implementation, work is progressing largely as per schedule and the same are expected to be completed within their stipulated timelines.

## (II) Operations and Maintenance (O&M)

IRB has 14\* projects under operations and maintenance. IRB has in-house expertise in handling the operation and maintenance of BOT road Projects. The Company routinely carries out maintenance of toll roads, including periodic and major maintenance. Its O&M work has won many accolades in the past. IRB has been awarded CNBCTV18 Essar Steel Infrastructure Excellence Award in the Highways and Flyovers category for its Mumbai - Pune section of National Highways (NH-4) in FY 2009-10 and Bharuch Surat Section of NH-8 in FY 2010-11.

\* Includes 6 projects transferred to IRB InvIT Fund in May, 2017, in respect of which IRB is responsible for Operations and Maintenance.

## 4. FINANCIAL ANALYSIS

### BOT Assets

Net block in BOT Assets, both operational as well as under construction, have grown significantly from ₹ 2,674 Crores in FY 2007-08 to ₹ 21,955 Crores in FY 2016-17, registering a Compound Annual Growth Rate (CAGR) of 26%.

As is the norm for financing Highway BOT projects, debt funds from project lenders have been the major source of funding these projects. The project lenders have reposed trust in the Company's financial strength, demonstrated by healthy growth in internal accruals and net worth. Besides, they have also shown faith in the Company's project

execution capabilities. This trust of the project lenders has played a primary role in helping IRB to achieve required financial closures.

Since the initial public offering (IPO) in 2008, net worth grew at 14% CAGR from ₹ 1,621 Crores in FY 2007-08 to ₹ 5,272 Crores in FY 2016-17. This growth was driven by healthy earnings during this period.

Consequently, net Debt Equity Ratio (DER) touched 2.87 in March 2017. IRB invested in projects that were under construction and are now in operation. With this, it has augmented capacity to invest in new projects that may be secured on a diligent evaluation of their risks and commercial viability.

During the year, IRB has made project investments of ₹ 3,701 Crores in BOT Assets under Construction. This was funded by project debt of ₹ 1,625 Crores, Grant of ₹ 744 Crores and the balance out of Internal Accruals and Equity.

These projects require a further investment of approx. ₹ 9,356 Crores across the next two and half years, before they can commence commercial operations. The investments will be funded largely through Project Debt of ₹ 6,793 Crores, Grant of ₹ 773 Crores and the balance out of Internal Accruals and Equity.

Internal accruals are generated even after providing for debt repayments as well as dividend payouts in line with its dividend policy.

Total consolidated income increased by 14% from ₹ 5,255 Crores in FY 2015-16 to ₹ 5,969 Crores in FY 2016-17.

Revenue from operations increased by 14% from ₹ 5,128 Crores in FY 2015-16 to ₹ 5,846 Crores in FY 2016-17.

Consolidated construction revenue registered an increase of 15% from ₹ 3,029 Crores in FY 2015-16 to ₹ 3,495 Crores in FY 2016-17.

In line with economic growth in the country, the Company has seen healthy growth in toll revenues. The consolidated toll revenues (net of revenue share) increased by 12% from ₹ 2,099 Crores in FY 2015-16 to ₹ 2,351 Crores in FY 2016-17.

Other Income registered a decrease of 3% from ₹ 127 Crores in FY 2015-16 to ₹ 123 Crores in FY 2016-17.

Earnings Before Interest, Tax, Depreciation & Amortisation (EBITDA) increased from ₹ 2,787 Crores in FY 2015-16 to ₹ 3,171 Crores in FY 2016-17, up by 14%.

Interest costs increased by 25% from ₹ 1,064 Crores in FY 2015-16 to ₹ 1,333 Crores in FY 2016-17 mainly because of NH-8 section of Ahmedabad-Vadodara becoming operational during last quarter of FY 2015-16. This year interest for this project is charged to Profit and loss account for full year as against only part of interest charged last year.

Depreciation of ₹ 853 Crores in FY 2015-16 remains similar at ₹ 855 Crores in FY 2016-17.

As a result, Profit Before Tax (PBT) registered an increase of 13% from ₹ 870 Crores in FY 2015-16 to ₹ 984 Crores in FY 2016-17.

Post minority interest, Profit After Tax (PAT) also rose by 12%, from ₹ 640 Crores in FY 2015-16 to ₹ 714 Crores in FY 2016-17.

Earnings per share on basic and diluted basis, which stood at ₹ 20.36 in FY 2016-17 from ₹ 18.20 in FY 2015-16, registered a growth of 12% YoY.

The Company declared interim dividends aggregating to ₹ 5/- per equity share of ₹ 10 each for financial year 2016-17.

The Company's various Special Purpose Vehicles (SPVs) have raised project-term loans to meet ongoing construction cost of BOT projects. IRB's consolidated debt on net basis, as on March 31, 2017, is ₹15,148 Crores, compared to ₹ 13,418 Crores a year ago. This increase was primarily on account of drawing of loans for various under construction projects, such as Goa-Kundapur, Solapur-Yedeshi, Yedeshi-Aurangabad, Kaithal-Rajasthan and Agra-Etawah Projects.

## 5. INORGANIC GROWTH

In line with its strategy to grow inorganically, IRB has been evaluating various BOT projects in the secondary markets. However, since there is a substantial gap between the expectation of the seller and the potential buyer of the projects there were no acquisitions last year. Going forward, the Company would like to focus on new projects to be awarded by NHAI rather than the acquisition of road assets.

## 6. KEY COMPETITIVE ADVANTAGE

The following key advantages enabled IRB to emerge as one of the market leaders:

- Proven track record of successfully accomplishing all phases of BOT Projects in the highway sector

- Robust construction order book of approximately ₹ 9,257 Crores (as on March 31, 2017)
- One of the largest domestic BOT project portfolios in the Roads and Highway sector
- 22 BOT projects, out of which 14\* are operational
- Strong financial track record and healthy banking relationship with leading banks/financial institutions
- Integrated and efficient project execution capabilities, supported by comprehensive equipment bank
- Professionally-managed Company with qualified and skilled employee base.

\* Includes 6 projects transferred to IRB InvIT Fund in May, 2017.

## 7. RISKS AND CHALLENGES

The Company's ability to foresee and manage business risks is crucial in its efforts to achieve favourable results. While management is positive about the Company's long term outlook, it is subject to a few risks and uncertainties, as discussed below.

### Competition Risk

Attractive growth opportunities exist in the construction sector, especially with the Government going full throttle on infrastructure creation. This may increase the number of players operating in the industry. Notwithstanding these challenges, backed by its industry leading experience in the road and highway sector, the Company is confident of meeting present and future competition. Further, the Company has carved a niche position for itself in the BOT vertical. Higher competencies including financial strength required for this segment create entry barriers for new entrants, thereby reducing competition in the Company's area of operation. In addition, as a prudent and strategic measure, the Company will continue to bid for projects based on their financial, operational and execution viability.

### Availability of capital and interest rate risk

Infrastructure projects are typically capital intensive and require high levels of long-term debt financing. IRB intends to pursue a strategy of continued investment in infrastructure development projects. In the past, the Company was able to infuse equity and arrange for debt financing to develop infrastructure projects on acceptable terms for the projects. However, IRB believes that its ability to continue to arrange for capital requirements is dependent on various factors. These factors include: timing and internal accruals generation; timing and size of the projects awarded; credit availability from banks and financial institutions; the success of its current infrastructure development projects. Besides, there are also several other factors outside its control.

However, your Company's track record has enabled it to raise funds at competitive rates. Your Company had also availed External Commercial Borrowing (ECB) facility for some of its Projects which helped it to reduce the interest rate burden. Consequently, your Company's average cost of debt remains at 10.25% p.a.

Further, the Company sponsored IRB InvIT Fund became the first Listed Business Trust of India in May, 2017 with 6 operational assets (6 SPVs) valued at ₹ 5,920 Crores. Out of the IPO proceeds, external Debt of 6 SPVs of approx. ₹ 3,300 crores have been fully repaid. Your Company has received approx. ₹ 1,700 Crores as consideration from IPO of the InvIT and it continues to hold 15% of the Unit Capital of the InvIT. Consequently, your Company's net Debt: Equity Ratio has reduced substantially from 3:1 to approx. 1.8:1, which would lead to credit rating upgrade for your Company. This would help the Company to reduce the cost of debt in future.

Also, your Company has executed the ROFO/ROFR Deed and the Future Assets Agreement with IRB InvIT Fund by which your Company has provided the InvIT rights of first offer and first refusal with respect to its existing eligible toll-road assets which are owned or which may be acquired or developed by your Company. In case the InvIT would agree to acquire assets from your Company from time to time, your Company would be able to realise value of its investments which it would re-invest in upcoming opportunities in the Highway development and/or part will be utilised for payment of dividend. Hence, your Company believes that this will be an important source of capital to fund the growth opportunities for your Company in future.

## TRAFFIC GROWTH RISK

Toll revenue is a function of the toll rates and traffic growth.

**Toll rates:** The Government has been implementing a policy of linking toll rates increase to change in Wholesale Price Index (WPI). The toll rates of the Company's Bharuch-Surat, Surat-Dahisar and Omallur Projects are linked to average WPI. However, the toll rates for the projects awarded after 2008 are decided according to a formula, which is 3% plus 40% of average WPI. The Company's all other projects have fixed annual or periodical increase in their toll rates, according to their Concession Agreement.

### Traffic

Rapid economic development increases traffic growth while low economic activity has a negative impact on traffic volume. Most of the Company's projects are part of India's Golden Quadrilateral corridor or are key connectors between India's busiest highways or economic/social hubs.

This includes road projects such as Ahmedabad – Vadodara, Bharuch – Surat, Surat – Dahisar, Mumbai – Pune and many others. For their strategic connectivity, these projects are expected to record continued momentum in traffic growth in the coming years, which negates the risk of slowdown in traffic growth to a considerable extent. Moreover, the pickup in economic activity has led to higher traffic growth in the roads sector. With passage of time, even road projects which have been witnessing muted traffic growth can be expected to benefit from the uptick in economic growth.

## Input cost risk

Raw materials, such as bitumen, stone aggregates, cement and steel, need to be supplied continuously to complete projects. There is also a risk of cost escalation or raw material shortage.

The Company's extensive experience, its industry standing and bulk purchases have helped it to plan and procure raw materials at competitive rates. Moreover, the Company procures stone aggregates from its self-operated leased mines which ensures quality and lowers the cost, as compared to bought out aggregates. Besides, it also reduces supply disruption or price escalation.

## Labour risk

The timely availability of skilled and technical personnel is one of the key industry challenges. The Company maintains healthy and motivating work environment through various measures. This has helped it recruit and retain skilled workforce and, in turn, complete the projects in time.

## 8. HUMAN RESOURCE MANAGEMENT

IRB has a large pool of experienced and skilled technical manpower, with which IRB executes world-class projects and delivers excellent quality which has become synonymous with IRB. IRB aims to keep its employees continuously updated with the technical knowledge and emerging technologies relating to construction of roads and structures and toll collection systems. Hence, IRB nominates its executives to attend seminars and symposiums conducted by professional bodies of global repute. Employees are also nominated to attend other professional skill-building programmes.

IRB's reputation of providing a congenial work environment that respects individuals and encourages professional growth, innovation and superior performance, acts as a strong pull to attract new industry talent. Human resources continue to be one of the core focus areas of the Company. Respect for individual, open work culture,

effective communication, fair and equitable treatment and welfare of employees are significant value propositions, which help IRB to retain a highly engaged talent pool and generate high level of trust among its employees. IRB remains the 'employer of choice' with one of the lowest attrition rates in the infrastructure sector.

## 9. INTERNAL CONTROL SYSTEMS

IRB maintains adequate internal control systems including internal financial control systems, which provide, among other things, reasonable assurance of recording the transactions of its operations in all material respects. This system also protects against significant misuse or loss of Company assets. IRB has a strong and independent internal audit function. The Internal Auditor reports directly to the Chairman of the Audit Committee. Periodic audits by the professionally qualified, technical and financial personnel of the internal audit function ensure that the Company's

internal control systems are adequate and are complied with.

### CAUTIONARY STATEMENT

"IRB", "the Company" are interchangeably used and mean IRB Group or IRB Infrastructure Developers Ltd. as may be applicable. Statements in the Management Discussion and Analysis describing the Company's objectives, projections, estimates, expectations may be "forward looking statements" within the meaning of applicable securities, laws and regulations. Actual results could differ materially from those expressed or implied. Important factors that could influence the Company's operations include economic developments within the country, demand and supply conditions in the industry, input prices, interest rates, currency rates, changes in Government regulations, tax laws and other factors such as litigation and industrial relations.