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Roads and Highways

Increase in competition in road sector; lack of bidding discipline to result in profit margin erosion for contractors

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Shubham Jain
0124 4545 306
shubhamj@icraindia.com

Rajeshwar Burla
040 4067 6527
rajeshwar.burla@icraindia.com

Shiffali Garg
0124 4545 868
shiffali.garg@icraindia.com

SUMMARY

MoRTH has relaxed bidding criteria, which has increased competitive intensity in road sector

Bidding discipline remains key for road contractors to maintain adequate profitability and avoid build-up of stress on working capital cycle.

Increased competitive intensity in the Central Government-funded road projects with relaxation in bidding eligibility criteria

The Ministry of Road Transport and Highways (MoRTH) has provided relaxations in the eligibility criteria[1] of bidders for HAM/EPC projects which has in-turn resulted in increased competitive intensity over the past few months with entry of new players in the road sector from other sectors (stadium, hospitals, hotel, smart city, warehouses/silos, oil and gas) as well as increase in bidding eligibility for existing players. Lower state capex, muted private sector opportunities and higher opportunities in road sector has pushed more entities towards road sector.

ICRA Ratings expects the Central Government spend on infrastructure to be maintained, given the positive multiplier effect which infrastructure building would have on the overall economy, notwithstanding the adverse impact of Covid-19 induced slowdown on economic activities.

Therefore, competition in the road sector is expected to remain at an elevated level with more contractors fulfilling the relaxed eligibility criteria. The EPC mode continues to remain extremely competitive with many bidders quoting at a discount of as high as 30-35% to the NHAI's base price. The BOT (HAM) has also witnessed heightened competition, resulting in an average premium to the NHAI cost reducing to around 15% from 25-30% earlier and even negative O&M bid in some cases. The number of bidders has surpassed 40 (of which 30 were qualified) for some of the EPC projects and 10-15 participants (around 5-10 earlier) for HAM projects.

[1] *MoRTH circular dated Oct 15, 2020 for HAM and Nov 2, 2020 for EPC projects*

Increased competition in the EPC and the HAM projects would adversely impact the profitability of the contracting companies. This apart, the increase in prices of key raw materials would further impact the profitability of both the EPC and the HAM projects. While the impact of price increase on profitability of the EPC projects is expected to be limited as price escalation is covered in EPC agreement to a large extent, but the impact would be much higher on the HAM project returns, notwithstanding the inflation-linked adjustment to bid project cost.

The aggressive bidding for the projects may also lead to projects getting delayed or stuck or under dispute as lower profitability in the projects would constrain the contactor's ability to absorb time and cost overruns in the project. The time and cost overruns could be due to various reasons, including steep increase in commodity prices, change in scope, delays in land acquisition and approvals, force majeure events among others.

Bidding discipline remains key for road contractors to maintain adequate profitability and avoid build-up of stress on working capital cycle.

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- Road construction activity least affected due to Covid
- Increased participation in HAM projects
- Adverse impact on profitability due to rising input prices

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Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
+91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: Jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: Communications@icraindia.com
Tel: +91 124 4545 860

Registered Office

B-710, Statesman House 148,
Barakhamba Road
New Delhi-110001
Tel: +91 11 23357940-45

Corporate Office

Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon - 122 002
Tel: +91-124-4545300

Ahmedabad

1809-1811, Shapath V,
Opp: Karnavati Club,
S.G.Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/501

Bengaluru 1

'The Millenia', Tower B Unit No. 1004,
10th Floor, 1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

4th Floor, 'Shoban'
6-3-927/A&B. Somajiguda
Raj Bhavan Road,
Hyderabad - 500 082
Tel: +91 40 4067 6500

Hyderabad 2

No. 7-1-58, 301, 3rd Floor, 'Concourse',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony, S. No. 210
CTS 3202 Range Hills Road,
Shivajinagar, Pune - 411 020
Tel: +91 20 2556 1194

Email: Info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.Icraresearch.in