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# Roads sector: toll collections set to surge, but risks loom for developers

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Rating agency Icra Ltd's forecast of a double-digit growth in toll collections during FY20 signals better times for road developers. It paves the way for higher revenue growth and improved cash flows, particularly for firms with operational road assets.

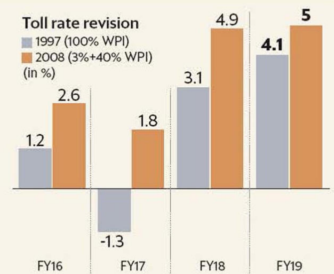
After recovering from the aftermath of demonetization and the goods and services tax (GST), toll collections have been improving steadily since March 2018. These toll collections are a function of toll rates and traffic growth. Currently, developers are in a sweet spot as both are rising, albeit on a low base. Toll rate revisions are linked partly to the Wholesale Price Index. So far this year, the index has risen 4.7%, higher than the 3% growth in FY18. Meanwhile, traffic growth is robust too. Icra's analysis of 48 road projects shows that the implied traffic growth has improved from 0.4% year-on-year in the March 2018 quarter to 1.7% and 4% in the June and September quarters, respectively.

This is mirrored well in the robust double-digit revenue growth for road developers in the recent past.

Note that the revenue of road construction firms with higher mix of operational toll assets had plummeted for many quarters after December 2016 on account of demonetization and GST implementation. That's not all—project construction too was impacted. Firms such as Dilip Buildcon Ltd, PNC Infratech Ltd and NCC Ltd too portrayed sharp revenue contraction with profitability and cash flows at risk. In the last one year, their shares have plummeted 40-50%.

**Rising fortunes**

Toll rates are expected to close on a positive note in FY19 after steadily rising over the last two years, especially for projects awarded after 2008.




WPI: Wholesale Price Index
Source: Icra

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Now, with toll collections expected to grow in double digits, revenue accretion looks promising. According to analysts, in operational road projects, higher revenue directly helps the developer to service interest costs as profitability is relatively high when compared to other infrastructure assets. This was portrayed in improved interest cover ratio (interest/operating profit) on the back of higher toll collections in the last three quarters. If this trend continues, the sector's leverage may reduce, translating into better investor appetite, which is currently dull.

The confidence in improving toll collections stems also from the hefty growth in truck and passenger vehicle sales over the last two years. "While the former accounts for nearly 70% of the total traffic movement on most of the national highways, the latter comprises the balance," explains Rajeshwar Burla, assistant vice-president and associate head (corporate ratings) at Icra.

That said, the recent slowdown in these vehicular segments is a worry. Along with it, possibility of weak order flows in the wake of the general election and the tight liquidity scenario, has put investors again on the back foot. Although the mining ban has been lifted, industrial and manufacturing activity is wobbly.

Further, there have been very few private equity deals in the sector. This could have helped developers monetize assets.

Most stocks in the roads sector have plummeted, trading way below the year-ago levels. True, higher toll collections will smoothen revenue growth and cash flows for the sector. But, uncertainty on the outcome of the elections, which is key to the government's continued focus on the country's infrastructure, could make investors shy away from parking funds in this space.