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Analysis: Investors prep to buy stressed Indian road projects

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by **Rouhan Sharma**

Aggressive bids to win highway development contracts are likely to make it difficult for companies to complete construction within estimated costs, providing acquisition opportunities for India-focused investors in 2025. Rouhan Sharma reports.

When India's highways ministry relaxed bid parameters in the aftermath of the Covid-19 pandemic to help smaller enterprises with business opportunities, little did it anticipate a rush of potentially unviable proposals to win contracts.

Industry officials and observers are now doubtful whether companies that previously served as contractors to the developers, will be able to complete all of their projects, and are viewing the potential stress as an acquisition opportunity.

While Mumbai-based EAAA India Alternatives - earlier known as Edelweiss Alternatives Asset Advisors - focuses primarily on buying operational assets, it will consider evaluating projects where the "required land is acquired, substantial construction work is completed, and additional financial support can help bring the project to final completion," President and Head of Real Assets Subahoo Chordia said.

He did not comment on the relaxation of the bid norms by the National Highways Authority of India (NHAI), only saying that it is important to ensure that the contractors have the financial and technical capabilities to successfully complete their projects.

Edelweiss' highways platform Sekura Roads has about nine assets spanning around 5,000km, and is in the midst of acquiring a portfolio of 11 roads from local developer Ashoka Buildcon. The developer won the contracts in competitive bidding prior to the pandemic.

Industry experts predict that because of the way projects in the hybrid annuity model are structured - which have drawn the aggressive bids - potential stress is likely to show up in the later phases of construction.

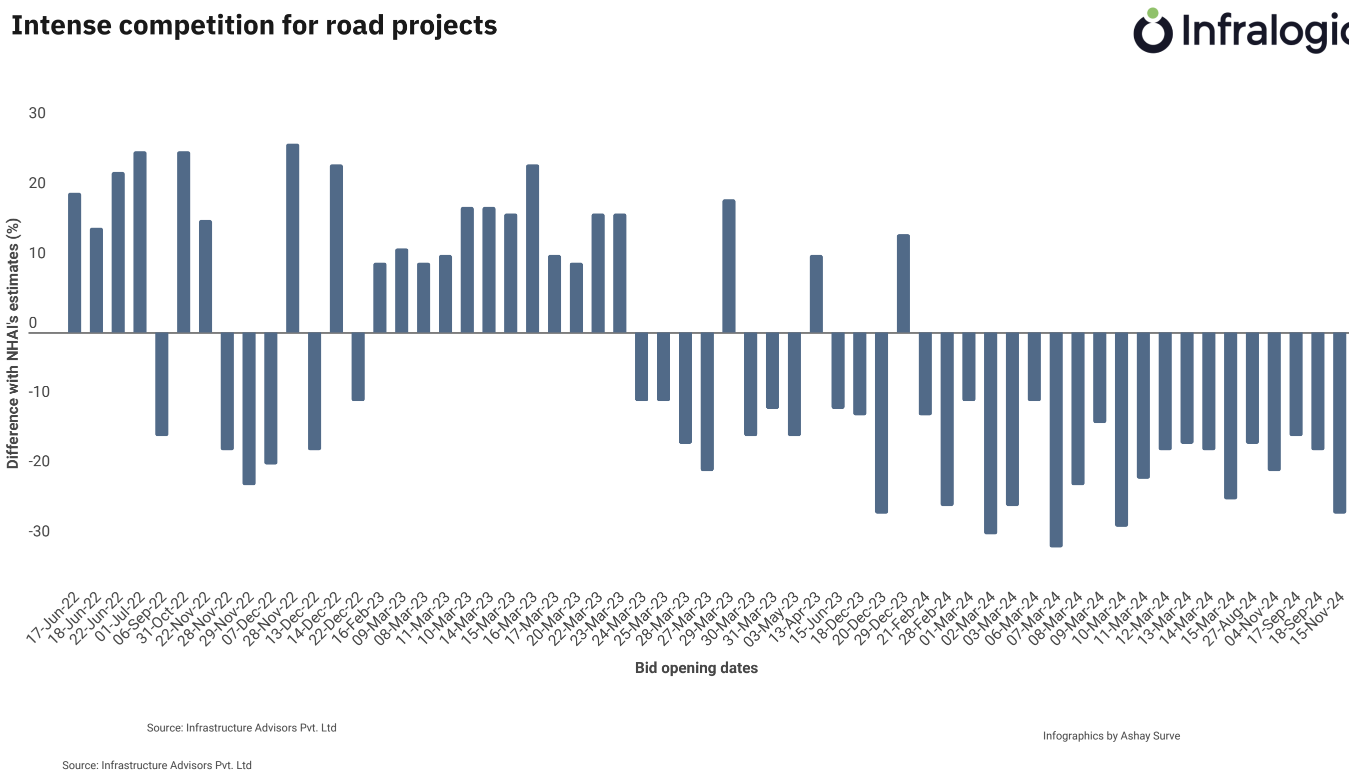
While the NHAI grants 40% of a project's cost, which it disburses during the initial stages, a developer can combine this with some debt finance and minimal equity to complete about 50-60%

of construction, the partner and head of infrastructure at a Mumbai-based alternatives asset manager told *Infralogic*.

"Once this capital is exhausted, I expect they will struggle to complete the rest of the project," he said.

The firm is in the midst of a fundraise, which aims to deploy capital in distressed, construction-stage and operating highways assets. It has achieved first close and is aiming for a second close soon, after which it will tap offshore investors to reach final close, said the partner.

Mumbai-based boutique consulting firm Infrastructure Advisors estimates that at least 85 of the 130 projects awarded between September 2022 and November 2024 drew bids below the NHAI's estimates - one was as low as 32% less than the authority's assessment.



"The downward trend in the bids indicates that stress is building up, presuming that the NHAI got its own estimates correct," said Praveen Sethia, founder director at Infrastructure Advisors.

"There is a serious flaw in the system, both at the authority level and at the lender level, that allows such proposals to be accepted," he added.

The advisory ranked fourth in *Dealogic's* 2023 annual ranking for debt arrangers in the Asia Pacific, raising about INR 100bn (USD 1.2bn), mostly for Indian highway projects.

While NHAI officials were quick to realise what had happened and started stricter monitoring to ensure adherence to quality and timeliness, Sethia expects this trend to contribute to the potential stress on the contractors, which did not factor in the stricter monitoring scenarios at the time of bidding.

"Once they realise that they need to spend more on construction than they estimated, they will run out of cash by the time they complete 60-80% of the project," said Sethia.

The new breed of bidders are not used to executing projects either in the hybrid annuity or build-operate-transfer models, he said.

"The key reason for their abnormally low bids is that their proposals were "neither well-calculated nor well-informed relating to the provision of the concession agreement as applied to both construction and operations," he said.

While 40% of a project's cost is provided as a grant, the developer arranges the remaining in a combination of debt and equity. It is repaid its investment with interest in half-yearly installments over a 15-year period, during which the NHAI assumes the traffic risk.

"Unlike in other projects where the viability is negatively impacted in case of a rising interest rate, in the hybrid model, your project looks good if the bank rate increases," said Sethia. If the rate is lowered, the project will be impacted adversely, he said, adding that bidders may have built in higher estimates, which may not be true over the next 15 years.

The Indian road ministry's intent to switch to the pureplay public-private partnership (PPP) through build, operate, transfer (BOT) contracts has also led to contractors bidding aggressively as they will not be able to participate in these auctions since the BOT projects are at least thrice the size of the hybrid projects, said Sethia.

Ashish Modani, Group Head of Corporate Ratings at Moody's local arm ICRA, said that while it isn't correct to make a general statement about all developers, there are entities facing liquidity issues because of a sizeable equity commitment to fund their projects.

Owing to the paucity of funds, a few developers are relying on two to three-year borrowings to tide over liquidity issues, expecting to sell the asset once construction is completed, he said.

"In case of material delays in project completion, the monetisation will get deferred and once the repayment of these loans are due there will be pressure on the developer's credit profile and liquidity position, exposing them to a refinancing risk," he said.

The pace of projects awarded too have declined over the past one and a half years as the NHAI neared the completion of its flagship Bharatmala programme, adding to the competitive intensity.

Project awards declined by 50% to 563km in the first four months of this financial year starting April 2024, compared to a year earlier, ICRA said in a September note. For the 12 months through March 2023, projects awarded fell 31% to 8,551km from 12,375km a year earlier, ICRA said.

It expects bidding to remain aggressive given the lower tendering activity over the last 18 months.

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