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Construction cos now find it difficult to raise funds

Plummeting Stock Prices, Bearish Market May Hurt Growth Prospects

WHILE shareholders in Indian construction majors are mourning the depressed prices of their stocks, the companies are grappling with more serious issues. The steep fall in stock prices could hamper the ability of these companies to raise cash, which is vital for any capital intensive business.

Engineering and construction companies such as Gammon, Hindustan Construction, IVRCL, Nagarjuna and Punj Lloyd have grown at a compounded annual rate of 30% over the past few years. Apart from execution skills, this growth could be sustained as the companies have been able to raise cash at will. Construction majors have raised funds over the past three years via all possible routes: initial public offerings, follow on offering, global depository receipts, FCCBs or qualified institutional placements.

However, with their stock prices languishing, companies may have to put fundraising plans on hold for the time being. The other option, to raise funds, would be to increase the level of dilution, which may not be very palatable if the stock is down 40-50% from the peaks.

If the bearish trend at the bourses persists, it is likely to hurt the growth prospects of these companies, industry watchers feel. Construction companies were amongst the biggest losers during the May, 2006 correction, with key companies falling nearly 45-50% during that period. Most stocks are yet to regain the highs seen prior to the crash.

Construction companies require a regular cash inflow for equity investments in build-operate-transfer (BOT) projects and for working capital requirements. "Working capital can be raised from a number of sources, so most of the fundraising is for capex, investment in BOT projects and for building up the balance sheet," says Praveen Sood, CFO, Hindustan Construction.

Under the BOT model, the project developer arranges for the funding, which includes an equity component of about 30%. While this generates a higher return over the long term, it also results in a big cash outflow during the execution period. Also, few can stay from BOT projects, as many of the new infrastructure projects will be funded this way. The new phase of the national highway development programme, for instance, is going to be entirely under the BOT model. More importantly, these projects will also be larger in size, typically Rs 800-1,000 crore on an average. This will straightaway mean an equity commitment of Rs 250-300 crore.

For every Rs 100 of topline growth, a contractor needs extra working capital of Rs 30, says an analyst working with a leading domestic research house. There could be some variations here, depending upon the working capital management of the company and the kind of project being executed. This would mean that for a growth of 30%, a company will need 9-10% as fresh working capital. "Working capital requirements are also lower in government contracts, as advances of 15% are available from the client," says Parvez Umrigar of Gammon India. One way out of the jam could be to go in for debt funding. "If you look at the balance sheets of construction companies, the extent of gearing is much lower than it used to be four or five years back. The net worth is also far higher," says Mr Sood. However, with the rising cost of debt, that too is not an easy way out.