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Indian Construction Industry Report

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Table of Contents

1. Economic Outlook 5
1.1 Global Economy 5
1.2 Indian Economic Outlook 7
1.2.1 GDP Growth and Outlook 7
1.2.2 Gross Value Added (GVA) 8
1.2.3 Investment Trend in Infrastructure 10
1.2.4 Industrial Growth 11
1.2.5 Consumer Price Index 11
1.2.6 Overview on Key Demographic Parameters 13
1.2.7 Concluding Remarks 16

2. Overview of the Construction sector in India 17
2.1 PPP models for enabling infrastructure growth 17
2.2 Construction EPC in India 18
2.3 EPC Companies in India 20
2.4 Opportunities in NIP for the construction segment 20
2.5 Impact of Covid-19 pandemic 21
2.6 Challenges faced by EPC companies 22
2.7 Threats and Challenges to the company: 23
2.8 Outlook 24

3. Peer Benchmarking 25
3.1 Benchmarking Based on Operational Parameters 25
3.2 Benchmarking Based on Financial Parameters 26

List of Charts

Chart 1: Global Growth Outlook Projections (Real GDP, Y-o-Y change in %) 5

Chart 2: Gross Fixed Capital Formation (GFCF) as % of GDP (At constant prices): 10

Chart 3: Y-o-Y growth in IIP (in %) 11

Chart 4: Retail Price Inflation in terms of index and Y-o-Y Growth in % (Base: 2011-12=100) 12

Chart 5: RBI historical Repo Rate 12

Chart 6: Trend of India Population vis-à-vis dependency ratio 13

Chart 7: Age-Wise Break Up of Indian population 14

Chart 8: Yearly Trend - Young Population as % of Total Population 14

Chart 9: Urbanization Trend in India 15

Chart 10: Trend of Per Capita Gross National Disposable Income (Current Price) 15

Chart 11: Trend of Per Capita Private Final Consumption Expenditure (Current Price) 16

Chart 12: Share of key segments that contribute to construction spending 17

Chart 13: Budgetary outlay towards infrastructure sector 21

Chart 14: Trend in construction GVA at constant price 22

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Chart 15: Movement in raw material prices........23
Chart 16: Comparison of Operating Profit Margin (%)........27
Chart 17: Comparison of Net Profit Margin (%)........28
Chart 18: Comparison of Capital Employed (%)........29
Chart 19: Comparison of Current Ratio........30
Chart 20: Comparison of Interest Coverage Ratio........31
Chart 21: Comparison of Debt Equity Ratio........32

List of Tables

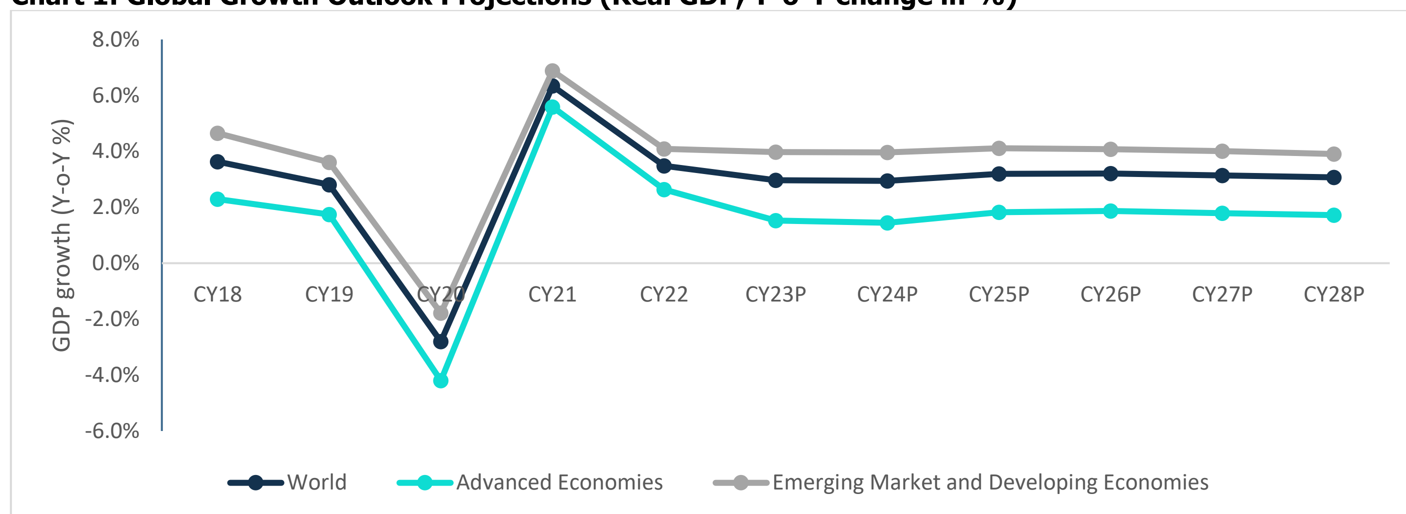
Table 1: GDP growth trend comparison - India v/s Other Economies (Real GDP, Y-o-Y change in %)........5
Table 2: RBI's GDP Growth Outlook (Y-o-Y %)........8
Table 3: Sectoral Growth (Y-o-Y % Growth) - at Constant Prices........10

1. Economic Outlook

1.1 Global Economy

As per the International Monetary Fund (IMF)'s World Economic Outlook growth projections released in October 2023, the global economic growth for CY22[1] stood at 3.5% on a year-on-year (y-o-y) basis, down from 6.3% in CY21 due to disruptions resulting from the Russia-Ukraine conflict and higher-than-expected inflation worldwide. On the other hand, the global economic growth for CY23 is projected to slow down further to 3.0% and 2.9% in CY24, attributed to compressing global financial conditions, expectant steeper interest rate hikes by major central banks to fight inflation, and spill-over effects from the Russia-Ukraine conflict, with gas supplies from Russia to Europe expected to remain tightened. For the next 4 years, the IMF projects world economic growth in the range of 3.0%-3.2% on a y-o-y basis.

Chart 1: Global Growth Outlook Projections (Real GDP, Y-o-Y change in %)



Notes: P-Projection;
Source: IMF – World Economic Outlook, October 2023

Table 1: GDP growth trend comparison - India v/s Other Economies (Real GDP, Y-o-Y change in %)

	Real GDP (Y-o-Y change in %)									
	CY19	CY20	CY21	CY22	CY23P	CY24P	CY25P	CY26P	CY27P	CY28P
India	3.9	-5.8	9.1	7.2	6.3	6.3	6.3	6.3	6.3	6.3
China	6.0	2.2	8.5	3.0	5.0	4.2	4.1	4.1	3.7	3.4
Indonesia	5.0	-2.1	3.7	5.3	5.0	5.0	5.0	5.0	5.0	5.0
Saudi Arabia	0.8	-4.3	3.9	8.7	0.8	4.0	4.2	3.3	3.3	3.1
Brazil	1.2	-3.3	5.0	2.9	3.1	1.5	1.9	1.9	2.0	2.0
Euro Area	1.6	-6.1	5.6	3.3	0.7	1.2	1.8	1.7	1.5	1.3
United States	2.3	-2.8	5.9	2.1	2.1	1.5	1.8	2.1	2.1	2.1

P- Projections; Source: IMF- World Economic Outlook Database (October 2023)

[1] CY – Calendar Year

Advanced Economies Group

The major advanced economies registered GDP growth of 2.6% in CY22, down from 5.6% in CY21, which is further projected to decline to 1.5% in CY23. This forecast of low growth reflects increased central bank interest rates to fight inflation and the impact of the Russia-Ukraine war. About 90% of advanced economies are projected to witness decline GDP growth in CY23 compared to CY22. In addition, this is further expected to decline to 1.4% in CY24.

One of the major countries from this group is the **United States**. The United States registered GDP growth of 2.1% in CY22 compared to 5.9% in CY21. Whereas, growth for CY23 and CY24 is projected at 2.1% and 1.5%, respectively. Among advanced economies group, private consumption has been stronger in the United States than in the euro area. The business investments have also been robust in the second quarter, in addition, the general government fiscal stance of United States is expected to be expansionary in CY23. However, the unemployment rate is expected to rise coupled with declining wages and savings. With this, the GDP growth is expected to soften in near term.

Further, the **Euro Area** registered GDP growth of 3.3% in CY22 compared to 5.6% in CY21. For CY23 and CY24, the growth is projected at 0.7% and 1.2%, respectively. There is divergence in GDP growth across the euro area. Wherein, Germany is expected to witnesses slight contraction in growth due to weak interest rate sensitive sector and slow trading demand. On the other hand, the GDP growth for France has been revised upwards on account of growing industrial production and external demand.

Emerging Market and Developing Economies Group

For the emerging market and developing economies group, GDP growth stood at 4.1% in CY22, compared to 6.9% in CY21. This growth is further projected at 4.0% in CY23 and CY24. About 90% of the emerging economies are projected to make positive growth. While the remaining economies, including the low-income countries, are expected to progress slower.

Further, in **China**, growth is expected to pick up to 5.0% with the full reopening in CY23 and subsequently moderate in CY24 to 4.2%. The property market crisis and lower investment are key factors leading to this moderation. Whereas, **India** is projected to remain strong at 6.3% for both CY23 and CY24 backed by resilient domestic demands despite external headwinds.

The **Indonesian** economy is expected to register growth of 5% both in CY23 and CY24 with a strong recovery in domestic demands, a healthy export performance, policy measures, and normalization in commodity prices. In CY22, **Saudi Arabia** was the fastest-growing economy in this peer set with 8.7% growth. The growth is accredited to robust oil production, non-oil private investments encompassing wholesale and retail trade, construction and transport, and surging private consumption. Saudi Arabia is expected to grow at 0.8% and 4.0% in CY23 and CY24, respectively. On the other hand, **Brazil** is expected to project growth of 3.1% in CY23 driven by buoyant agriculture and resilient services in the first half of CY23.

Despite the turmoil in the last 2-3 years, India bears good tidings to become a USD 5 trillion economy by CY27. According to the IMF dataset on Gross Domestic Product (GDP) at current prices, the nominal GDP has been estimated to be at USD 3.4 trillion for CY22 and is projected to reach USD 5.2 trillion by CY27. India's expected GDP growth rate for coming years is almost double compared to the world economy.

Besides, India stands out as the fastest-growing economy among the major economies. The country is expected to grow at more than 6% in the period of CY24-CY28, outshining China's growth rate. By CY27, the Indian economy is estimated to emerge as the third-largest economy globally, hopping over Japan and Germany. Currently, it is the third-largest economy globally in terms of Purchasing Power Parity (PPP) with a ~7% share in the global economy, with China [~18%] on the top followed by the United States [~15%]. Purchasing Power Parity is an economic performance indicator denoting the relative price of an average basket of goods and services that a household needs for livelihood in each country.

Despite Covid-19's impact, high inflationary environment and interest rates globally, and the geopolitical tensions in Europe, India has been a major contributor to world economic growth. India is increasingly becoming an open economy as well through growing foreign trade. Despite the global inflation and uncertainties, Indian economy continues to show resilience. This resilience is mainly supported stable financial sector backed by well-capitalized banks and export of services in trade balance. With this, the growth of Indian economy is expected to fare better than other economies majorly on account of strong investment activity bolstered by the government's capex push and buoyant private consumption, particularly among higher income earners.

1.2 Indian Economic Outlook

1.2.1 GDP Growth and Outlook

Resilience to External Shocks remains Critical for Near-Term Outlook

India's real GDP grew by 9.1% in FY22 and stood at ~Rs. 149 trillion despite the pandemic and geopolitical Russia-Ukraine spill overs. In Q1FY23, India recorded 13.1% y-o-y growth in real GDP, largely attributed to improved performance by the agriculture and services sectors. Following this double-digit growth, Q2FY23 witnessed 6.2% y-o-y growth, while Q3FY23 registered 4.5% y-o-y growth. The slowdown during Q2FY23 and Q3FY23 compared to Q1FY23 can be attributed to the normalization of the base and a contraction in the manufacturing sector's output.

Subsequently, Q4FY23 registered broad-based improvement across sectors compared to Q3FY23 with a growth of 6.1% y-o-y. The investments, as announced in the Union Budget 2022-23 on boosting public infrastructure through enhanced capital expenditure, have augmented growth and encouraged private investment through large multiplier effects in FY23. Supported by fixed investment and higher net exports, real GDP for full-year FY23 was valued at Rs. ~160. trillion registering an increase of 7.2% y-o-y.

Furthermore, in Q1FY24, the economic growth accelerated to 7.8%. The manufacturing sector maintained an encouraging pace of growth, given the favourable demand conditions and lower input prices. The growth was supplemented by a supportive base alongside robust services and construction activities. This momentum was maintained in the Q2FY24 with GDP growth at 7.6%, mainly supported by acceleration in investments. However, private consumption growth was muted due to weak rural demand and some moderation in urban demand amid elevated inflationary pressures in Q2FY24. On the supply side, a significant improvement in manufacturing and construction activities supported growth. Overall, the economy expanded by 7.7% in H1FY24 compared to 5.3% in H2FY23. As per recent Ministry of Statistics and Programme Implementation (MoSPI)'s advanced estimate release, the real GDP growth for FY24 is pegged at 7.3% and will attain a level of ~ Rs. 171.79 trillion.

GDP Growth Outlook

- Driven by resilience in urban demand and the front loading of the government's capital expenditure, the H1FY24 witnessed a strong growth. While festive cheer will support urban demand in Q3, the outlook for rural demand revival remains clouded amid monsoon deficiency and likely hit to the agricultural production.

- The recent announcements of various relief measures such as LPG price reduction and extension of Pradhan Mantri Garib Kalyan Anna Yojna (PMGKAY) are expected to provide some cushion and so far, investment demand has remained robust. However, there could be some moderation in H2FY24 as both the government and private sector may restrain their capital spending ahead of the general elections. Despite some expected moderation in the H2FY24, India's overall GDP growth for FY24 is expected to remain on a firm footing.

- Strong credit growth, resilient financial markets, and the government's continual push for capital spending and infrastructure are likely to create a compatible environment for investments.

- External demand is likely to remain subdued with a slowdown in global activities, thereby indicating adverse implications for exports. Additionally, heightened inflationary pressures and resultant policy tightening may pose a risk to the growth potential.

  Taking all these factors into consideration, in December 2023, the RBI in its bi-monthly monetary policy meeting estimated a real GDP growth of 7% y-o-y for FY24 comparatively lower from MoSPI's estimate.

Table 2: RBI's GDP Growth Outlook (Y-o-Y %)

FY24P (complete year)	Q3FY24P	Q4FY24P	Q1FY25P	Q2FY25P	Q3FY25P
7.0%	6.5%	6.0%	6.7%	6.5%	6.4%

Note: P-Projected; Source: Reserve Bank of India

1.2.2 Gross Value Added (GVA)

Gross Value Added (GVA) is the measure of the value of goods and services produced in an economy. GVA gives a picture of the supply side whereas GDP represents consumption.

Industry and Services sector leading the recovery charge

• The gap between GDP and GVA growth turned positive in FY22 (after a gap of two years) due to robust tax collections. Of the three major sector heads, the service sector has been the fastest-growing sector in the last 5 years.

• The **agriculture sector** was holding growth momentum till FY18. In FY19, the acreage for the rabi crop was marginally lower than the previous year which affected the agricultural performance. Whereas FY20 witnessed growth on account of improved production. During the pandemic-impacted period of FY21, the agriculture sector was largely insulated as timely and proactive exemptions from COVID-induced lockdowns to the sector facilitated uninterrupted harvesting of rabi crops and sowing of kharif crops. However, supply chain disruptions impacted the flow of agricultural goods leading to high food inflation and adverse initial impact on some major agricultural exports. However, performance remained steady in FY22.

In FY23, the agriculture sector performed well despite weather-related disruptions, such as uneven monsoon and unseasonal rainfall, impacting yields of some major crops and clocked a growth of 4% y-o-y, garnering Rs. 22.3 trillion.

In Q1FY24, this sector expanded at a slower pace of 3.5% y-o-y growth compared to y-o-y growth a quarter ago. This further stumbled to 1.2% in Q2FY24. Overall, H1FY24 registered a 2.4% growth with weakest monsoon experience caused by El Nino conditions.

Going forward, rising bank credit to the sector and increased exports will be the drivers for the agriculture sector. However, a deficient rainfall may have impact on the reservoir level, weighing on prospects of Kharif sowing. Considering these factors, the agriculture sector is estimated to attain Rs. 22.7 trillion and mark 1.8% y-o-y growth for complete FY24.

• The **industrial sector** witnessed a CAGR of 4.7% for the period FY16 to FY19. From March 2020 onwards, the nationwide lockdown due to the pandemic significantly impacted industrial activities. In FY20 and FY21, this sector felt turbulence due to the pandemic and recorded a decline of 1.4% and 0.9%, respectively, on a y-o-y basis. With the opening up of the economy and resumption of industrial activities, it registered 11.6% y-o-y growth in FY22, albeit on a lower base.

The industrial output in FY23 grew by 4.4% with estimated value Rs. 45.2 trillion owing to a rebound in manufacturing activities and healthy growth in the construction sector.

The industrial sector grew by 5.5% in Q1FY24, while Q2FY24 growth was up by 13.2% owing to positive business optimism and strong growth in new orders supported manufacturing output. The industrial growth was mainly supported by sustained momentum in the manufacturing and construction sectors. Within manufacturing, industries such as pharma, motor vehicles, metals, petroleum and pharma witnessed higher production growth during the quarter. The construction sector (13% growth in Q2FY24) benefited from poor rainfall during August and September and higher implementation of infrastructure projects. This was reflected in robust cement and steel production and power demand in Q2FY24. Overall, H1FY24 picked up by 9.3% with manufacturing and construction activities witnessing significant acceleration.

India’s industrial sector is experiencing strong growth, driven by significant expansion in manufacturing, mining, and construction. This growth is supported by positive business sentiment, declining commodity prices, beneficial government policies like production-linked incentive schemes, and efforts to boost infrastructure development. These factors collectively contribute to the sustained buoyancy in industrial growth due to which the industrial growth is estimated at 7.9% on y-o-y basis registering the value of Rs. 48.9 trillion in FY24.

The **services sector** recorded a CAGR of 7.1% for the period FY16 to FY20, which was led by trade, hotels, transport, communication, and services related to broadcasting, finance, real estate, and professional services. This sector was the hardest hit by the pandemic and registered an 8.2% y-o-y decline in FY21. The easing of restrictions aided a fast rebound in this sector, with 8.8% y-o-y growth witnessed in FY22.

Overall, in FY23, benefitting from the pent-up demand, the service sector was valued at Rs. 20.6 trillion and registered growth of 9.5% y-o-y.

In Q1FY24, the services sector growth jumped to 10.3%. Within services, there was a broad-based improvement in growth across different sub-sectors. However, the sharpest jump was seen in financial, real estate, and professional services. Trade, hotels, and transport sub-sectors expanded at a healthy pace gaining from strength in discretionary demand. The service sector growth in Q2FY24 moderated to 5.8% partly due to the normalization of base effect and some possible dilution in discretionary demand. Considering these factors, service sector marked 8% growth in H1FY24.

With this performance, steady growth in various service sector indicators like air passenger traffic, port cargo traffic, GST collections, and retail credit are expected to support the services sector. With this, the growth of service sector is estimated at Rs. 86.2 trillion registering 7.7% growth in FY24 overall.

Table 3: Sectoral Growth (Y-o-Y % Growth) - at Constant Prices

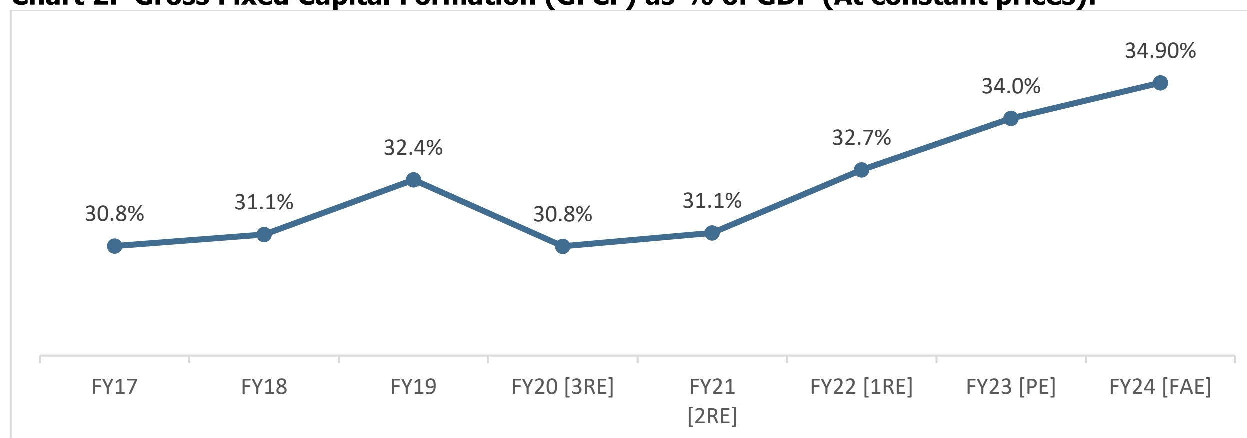
At constant Prices	FY19	FY20	FY21	FY22 (FRE)	FY23 (PE)	FY24 (FAE)
Agriculture, Forestry & Fishing	**2.1**	**6.2**	**4.1**	**3.5**	**4.0**	**1.8**
Industry	**5.3**	**-1.4**	**-0.9**	**11.6**	**4.4**	**7.9**
Mining & Quarrying	-0.9	-3.0	-8.6	7.1	4.6	8.1
Manufacturing	5.4	-3.0	2.9	11.1	1.3	6.5
Electricity, Gas, Water Supply & Other Utility Services	7.9	2.3	-4.3	9.9	9.0	8.3
Construction	6.5	1.6	-5.7	14.8	10.0	10.7
Services	**7.2**	**6.4**	**-8.2**	**8.8**	**9.5**	**7.7**
Trade, Hotels, Transport, Communication & Broadcasting	7.2	6.0	-19.7	13.8	14.0	6.3
Financial, Real Estate & Professional Services	7.0	6.8	2.1	4.7	7.2	8.9
Public Administration, Defence and Other Services	7.5	6.6	-7.6	9.7	7.2	7.7
GVA at Basic Price	**5.8**	**3.9**	**-4.2**	**8.8**	**7.0**	**6.9**

Note: FRE – First Revised Estimates, PE – Provisional Estimate, FAE – First Advance Estimate; Source: MOSPI

1.2.3 Investment Trend in Infrastructure

Gross Fixed Capital Formation (GFCF), which is a measure of the net increase in physical assets, witnessed an improvement in FY22. As a proportion of GDP, it is estimated to be at 32.7%, which is the second-highest level in 7 years (since FY15). In FY23, the ratio of investment (GFCF) to GDP climbed up to its highest in the last decade at 34%. Continuing in its growth trend, this ratio is expected to reach 34.9% in FY24.

Chart 2: Gross Fixed Capital Formation (GFCF) as % of GDP (At constant prices):



Note: 3RE – Third Revised Estimate, 2RE – Second Revised Estimates, 1RE – First Revised Estimates, PE – Provisional Estimate, FAE-First Advance Estimate; Source: MOSPI

Overall, the support of public investment in infrastructure is likely to gain traction due to initiatives such as Atmanirbhar Bharat, Make in India, and Production-linked Incentive (PLI) scheme announced across various sectors.

1.2.4 Industrial Growth

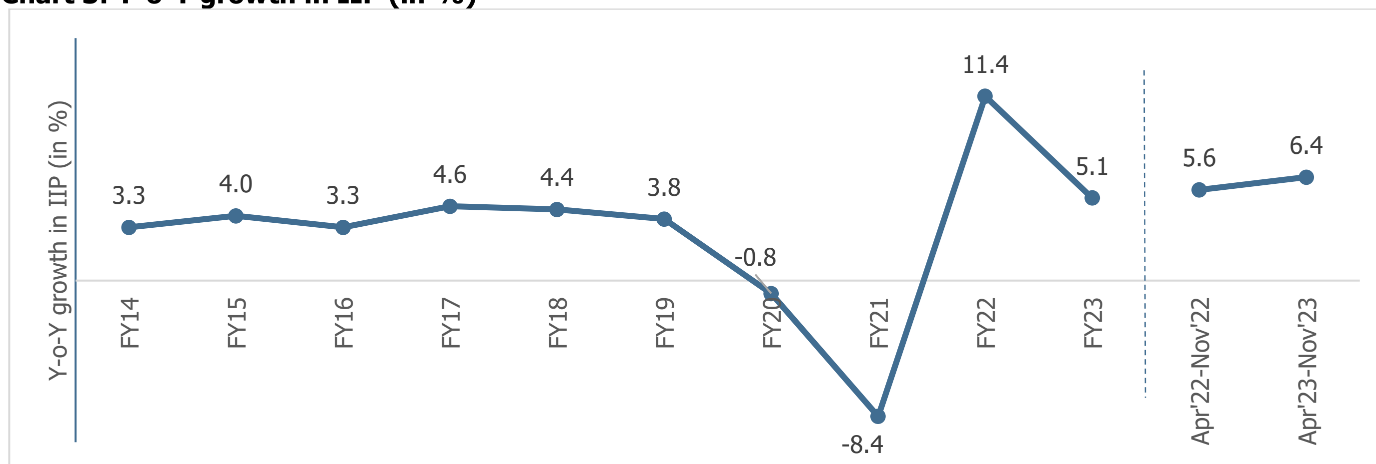
Improved Core and Capital Goods Sectors helped IIP Growth Momentum

The Index of Industrial Production (IIP) is an index to track manufacturing activity in an economy. On a cumulative basis, IIP grew by 11.4% y-o-y in FY22 post declining by 0.8% y-o-y and 8.4% y-o-y, respectively, in FY20 and FY21. This high growth was mainly backed by a low base of FY21. FY22 IIP was higher by 2.0% when compared with the pre-pandemic level of FY20, indicating that while economic recovery was underway, it was still at very nascent stages.

During FY23, the industrial output recorded a growth of 5.1% y-o-y supported by a favorable base and a rebound in economic activities. The period April 2023 – November 2023, industrial output grew by 6.4% compared to the 5.6% growth in the corresponding period last year. For the month of November 2023, the IIP growth slowed down to 2.4% compared to the last year primarily on account of a normalization of base.

So far in the current fiscal, while the infrastructure-related sectors have been doing well, slowing global growth and downside risks to rural demand have posed a challenge for industrial activity. Though the continued moderation in inflationary pressure offers some comfort, pain points in the form of elevated prices of select food items continue to persist.

Chart 3: Y-o-Y growth in IIP (in %)



Source: MOSPI

1.2.5 Consumer Price Index

India's consumer price index (CPI), which tracks retail price inflation, stood at an average of 5.5% in FY22 which was within RBI's targeted tolerance band of 6%. However, consumer inflation started to upswing from October 2021 onwards and reached a tolerance level of 6% in January 2022. Following this, CPI reached 6.9% in March 2022.

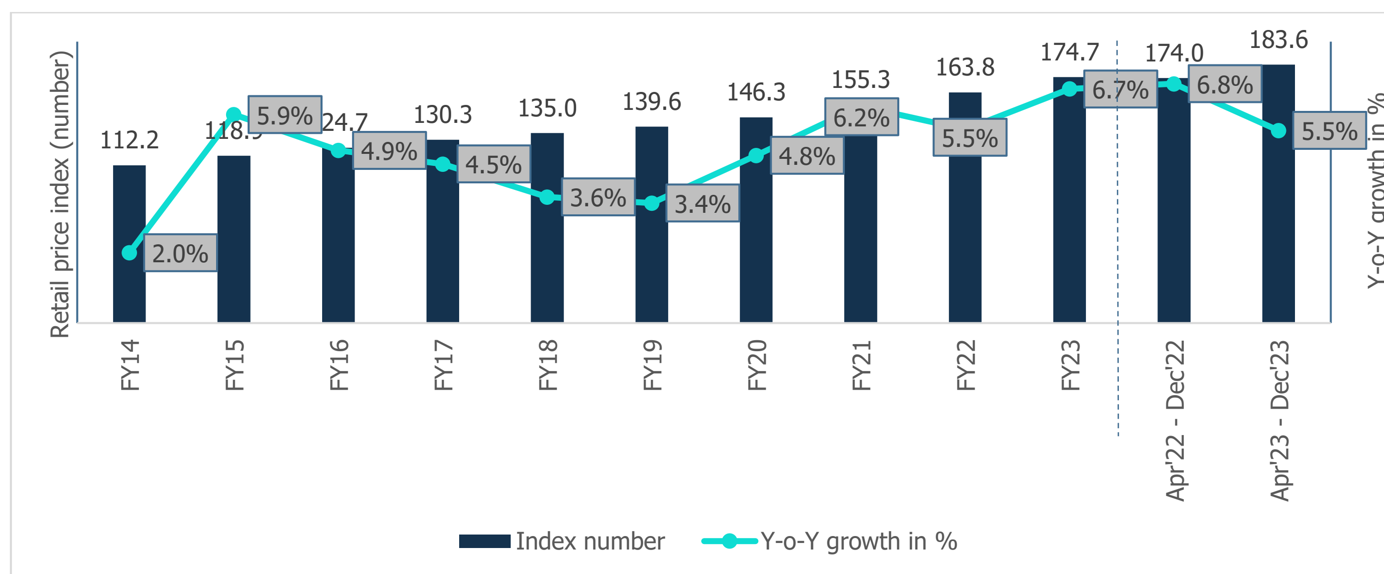
CPI remained elevated at an average of 6.7% in FY23, above the RBI's tolerance level. However, there was some respite toward the end of the fiscal wherein the retail inflation stood at 5.7% in March 2023, tracing back to the RBI's tolerance band. Apart from a favorable base effect, the relief in retail inflation came from a moderation in food inflation.

In the current fiscal FY24, the CPI moderated for two consecutive months to 4.7% in April 2023 and 4.3% in May 2023. This trend snapped in June 2023 with CPI rising to 4.9%. In July 2023, the CPI had reached the RBI's target range for the first time since February 2023 at 7.4% largely due to increased food inflation. This marked the highest reading observed since the peak in April 2022 at 7.8%. The notable surge in vegetable prices and elevated inflation in other food categories such as cereals, pulses, spices, and milk have driven this increase. Further, the contribution of food and beverage to the overall inflation had risen significantly to 65%, surpassing their weight in the CPI basket. In August 2023, the food inflation witnessed some moderation owing to government's active intervention. This was further moderated for second consecutive month in September 2023 to 5%, led by a sharp correction in vegetables prices and

lower LPG prices. Helped by deflation in the fuel and light category, the retail inflation in October 2023 softened at 4.9%. This trend revsered in November 2023 due to spike in certain vegetable prices as well as sticky inflation in non-perishable food items such as cereals, pulses and spices and the CPI rose to 5.6%. In the month of December 2023, elevated food prices and an unfavourable base drove headline inflation to a four-month peak of 5.7%.

While the consistent decrease in core inflation due to falling commodity prices and diminishing demand-side pressures is encouraging, the ongoing high food inflation, potentially exacerbated by a projected drop in Kharif production and uncertainties around Rabi sowing, remains worrisome. Despite these concerns, the favourable base effect throughout Q4FY24 and the expected easing of food price pressures with the arrival of fresh crops from January to March could help mitigate inflation risks.

Chart 4: Retail Price Inflation in terms of index and Y-o-Y Growth in % (Base: 2011-12=100)

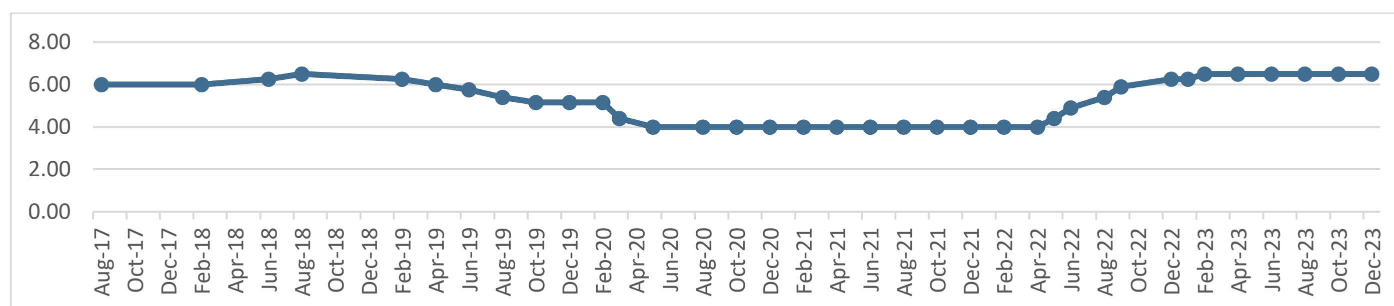


Source: MOSPI

The CPI is primarily factored in by RBI while preparing their bi-monthly monetory policy. At the bi-monthly meeting held in December 2023, RBI projected inflation at 5.4% for FY24 with inflation during Q3FY24 at 5.6%, Q4FY24 at 5.2% Q1FY25 at 5.2% , Q2FY24 at 6.5% and Q3FY24 at 6.4%.

The RBI has increased the repo rates with the rise in inflation in the past year from 4% in April 2022 to 6.5% in January 2023. Considering the current inflation situation, RBI has kept the repo rate unchanged at 6.5% in the last five meetings of the Monetary Policy Committee.

Chart 5: RBI historical Repo Rate



Source: RBI

In a meeting held in December 2023, RBI also maintained the liquidity adjustment facility (LAF) corridor by adjusting the standing deposit facility (SDF) rate of 6.25% as the floor and the marginal standing facility (MSF) at the upper end of the band at 6.75%.

Further, the central bank continued to remain focused on the withdrawal of its accommodative stance. With domestic economic activities gaining traction, RBI has shifted gears to prioritize controlling inflation. While RBI has paused on the policy rate front, it has also strongly reiterated its commitment to bringing down inflation close to its medium-term target of 4%. Given the uncertain global environment and lingering risks to inflation, the Central Bank has kept the window open for further monetary policy tightening in the future, if required.

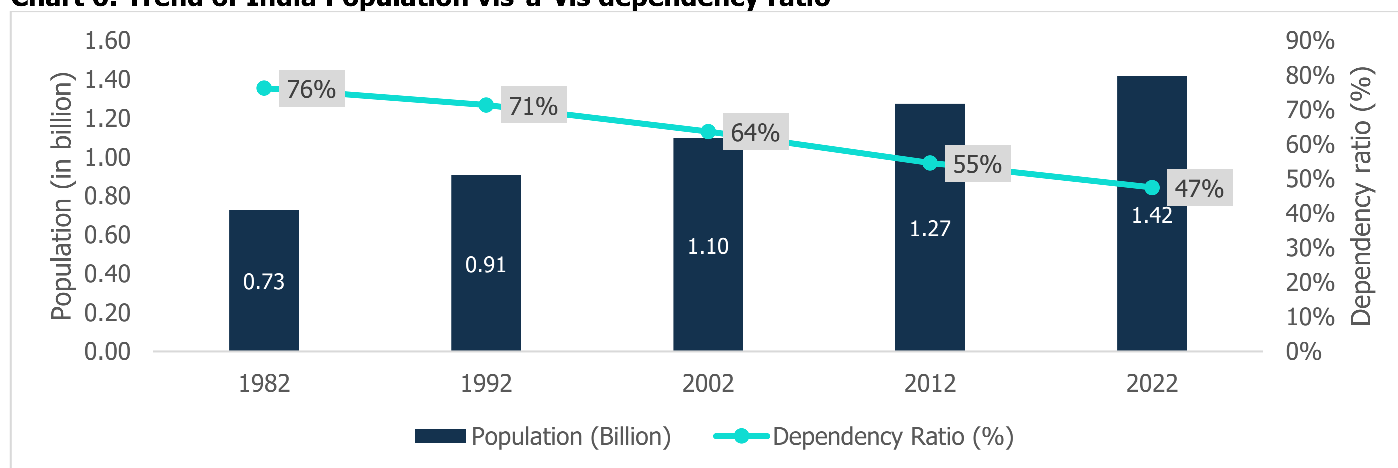
1.2.6 Overview on Key Demographic Parameters

- **Population growth and Urbanization**

The trajectory of economic growth of India and private consumption is driven by socio-economic factors such as demographics and urbanization. According to the world bank, India's population in 2022 surpassed 1.42 billion slightly higher than China's population 1.41 billion and became the most populous country in the world.

Age Dependency Ratio is the ratio of dependents to the working age population, i.e., 15 to 64 years, wherein dependents are population younger than 15 and older than 64. This ratio has been on a declining trend. It was as high as 76% in 1982, which has reduced to 47% in 2022. Declining dependency means the country has an improving share of working-age population generating income, which is a good sign for the economy.

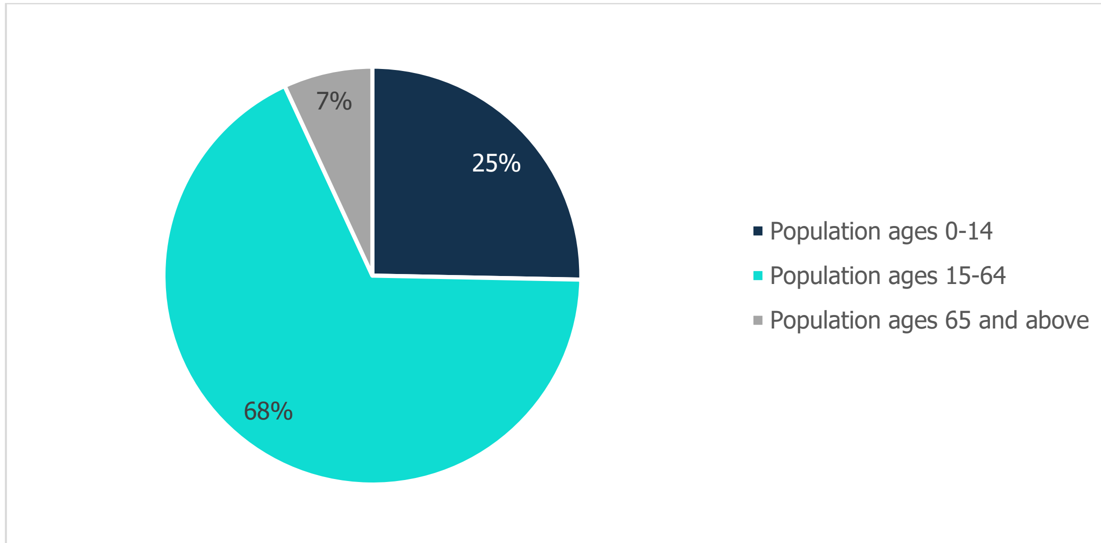
Chart 6: Trend of India Population vis-à-vis dependency ratio



Source: World Bank Database

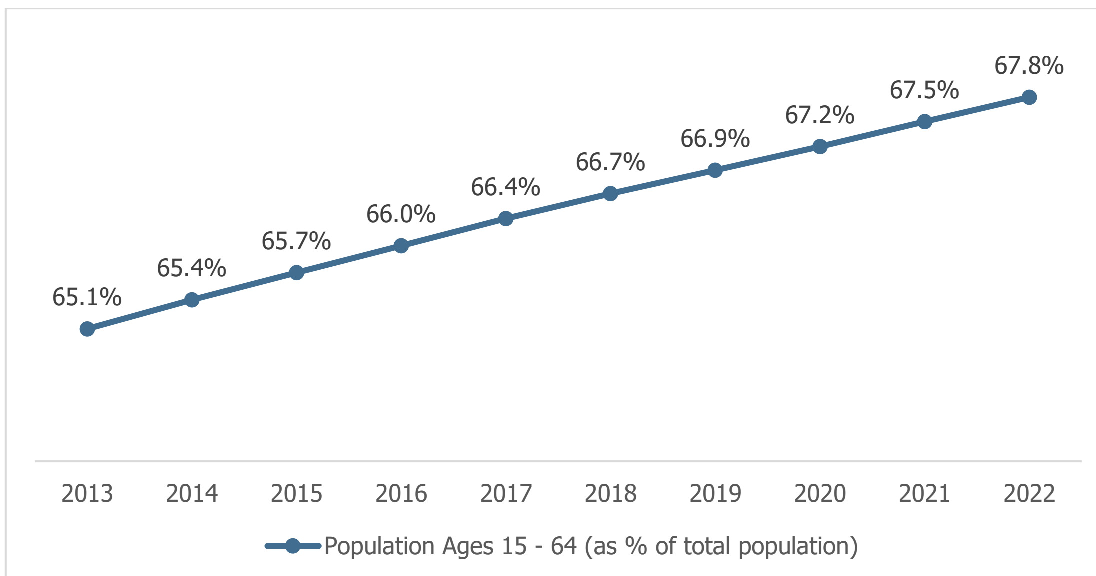
With an average age of 29, India has one of the youngest populations globally. With vast resources of young citizens entering the workforce every year, it is expected to create a 'demographic dividend'. India is home to a fifth of the world's youth demographic and this population advantage will play a critical role in economic growth.

Chart 7: Age-Wise Break Up of Indian population



Source: World Bank Database

Chart 8: Yearly Trend - Young Population as % of Total Population

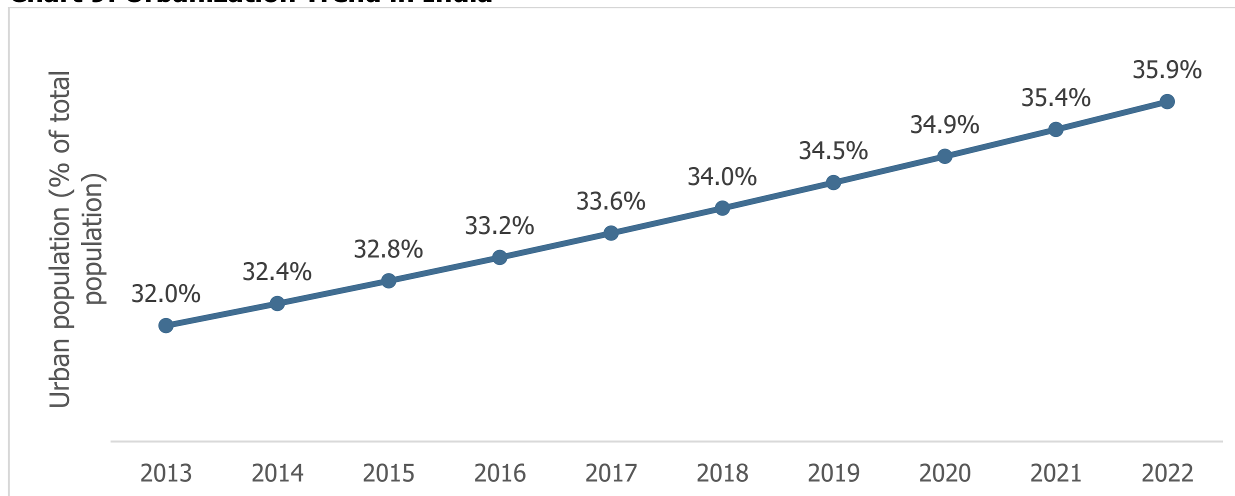


Source: World Bank database

- **Urbanization**

The urban population is significantly growing in India. The urban population in India is estimated to have increased from 403 million (31.6% of total population) in 2012 to 508 million (35.9% of total population) in the year 2022. People living in Tier-2 and Tier-3 cities have greater purchasing power.

Chart 9: Urbanization Trend in India



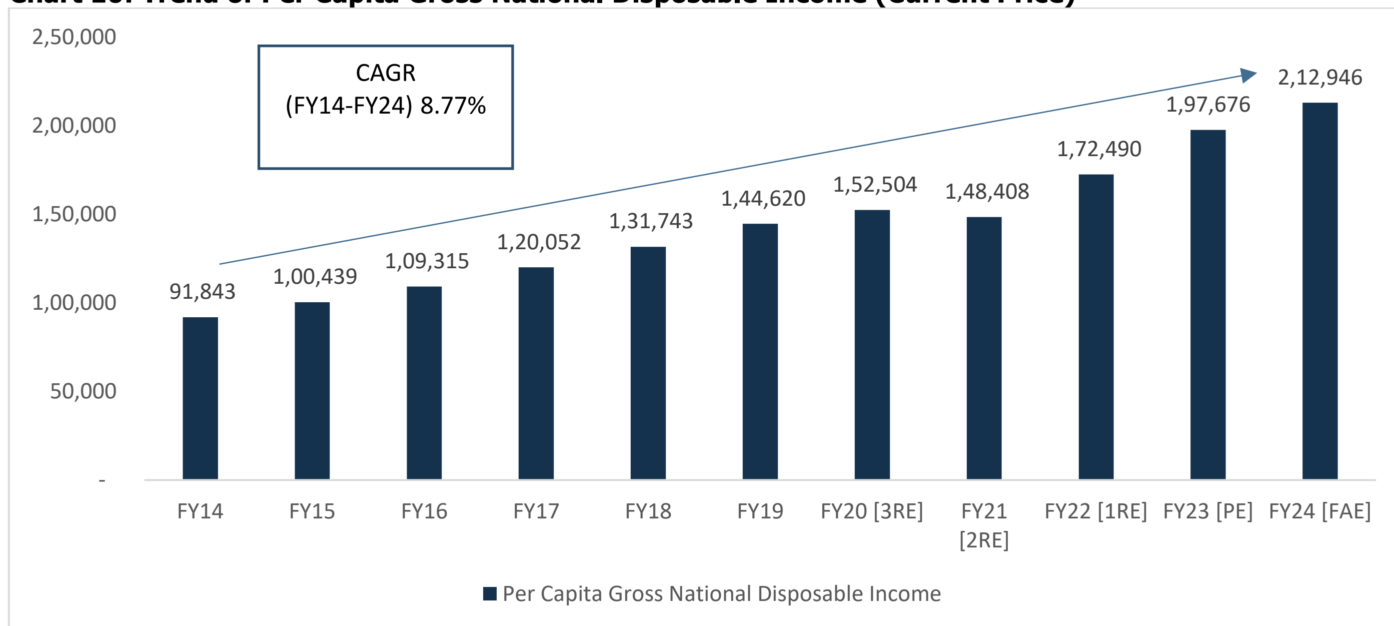
Source: World Bank Database

- **Increasing Per Capita Disposable Income**

Gross National Disposable Income (GNDI) is a measure of the income available to the nation for final consumption and gross savings. Between the period FY14 to FY24, per capita GNDI at current prices registered a CAGR of 8.77%. More disposable income drives more consumption, thereby driving economic growth.

The chart below depicts the trend of per capita GNDI in the past decade:

Chart 10: Trend of Per Capita Gross National Disposable Income (Current Price)

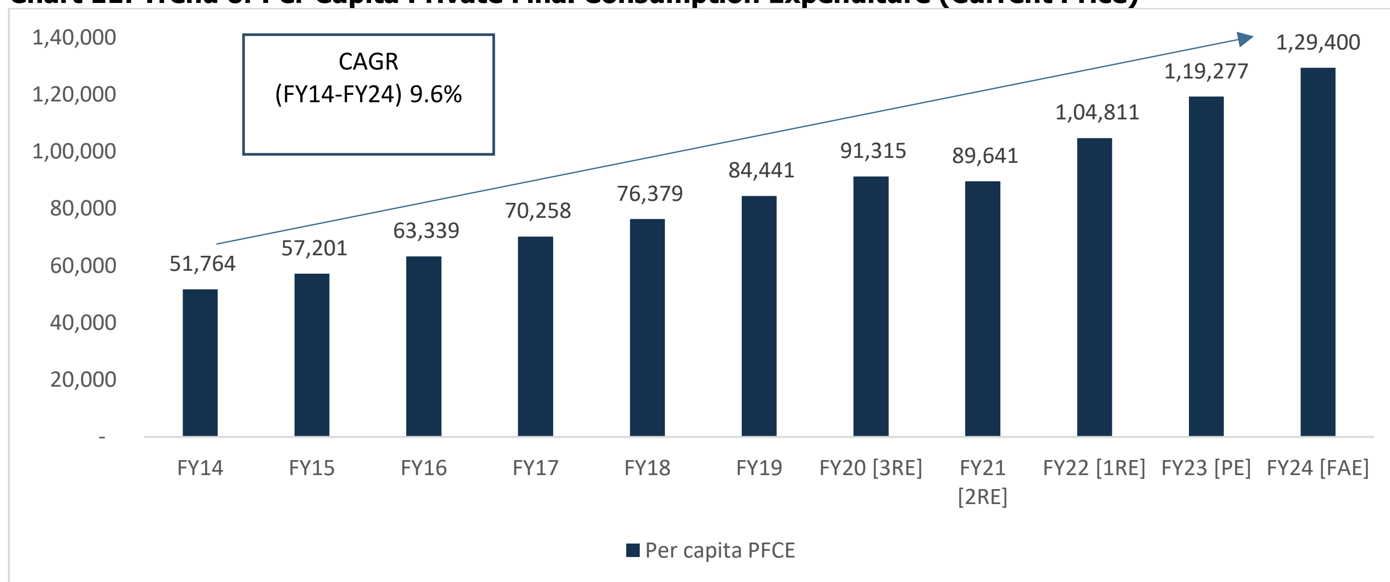


Note: 3RE – Third Revised Estimate, 2RE – Second Revised Estimates, 1RE – First Revised Estimates, PE – Provisional Estimate; Source: MOSPI

- **Increase in Consumer Spending**

With increase in disposable income, there has been a gradual change in consumer spending behaviour as well. Private Final Consumption Expenditure (PFCE) which is measure of consumer spending has also showcased significant growth in the past decade at a CAGR of 9.6%. Following chart depicts the trend of per capita PFCE at current prices:

Chart 11: Trend of Per Capita Private Final Consumption Expenditure (Current Price)



Source: MOSPI

1.2.7 Concluding Remarks

The major headwinds to global economic growth are escalating geopolitical tensions, volatile global commodity prices, and a shortage of key inputs. Despite the global economic growth uncertainties, the Indian economy is relatively better placed in terms of GDP growth compared to other emerging economies. According to IMF's forecast, it is expected to 6.3% in CY24 compared to the world GDP growth projection of 3%. The bright spots for the economy are continued healthy domestic demand, support from the government towards capital expenditure, moderating inflation, and improving business confidence.

Likewise, several high-frequency growth indicators including the purchasing managers index, auto sales, bank credit, and GST collections have shown improvement in FY23. Moreover, normalizing the employment situation after the opening up of the economy is expected to improve and provide support to consumption expenditure.

Further, as per the Indian Meteorological Department (IMD), the rainfall witnessed a deficit until September 2023. A drop-in yield due to irregular monsoons and a lower acreage can lead to a demand-supply mismatch, further increasing the inflationary pressures on the food basket. Moreover, the consumption demand is expected to pick up in Q3FY24 due to the festive season. Going forward, the rising domestic demand will be driven by the rural economy's performance and continual growth in urban consumption. However, high domestic inflation and global headwinds pose a downside risk to domestic demand.

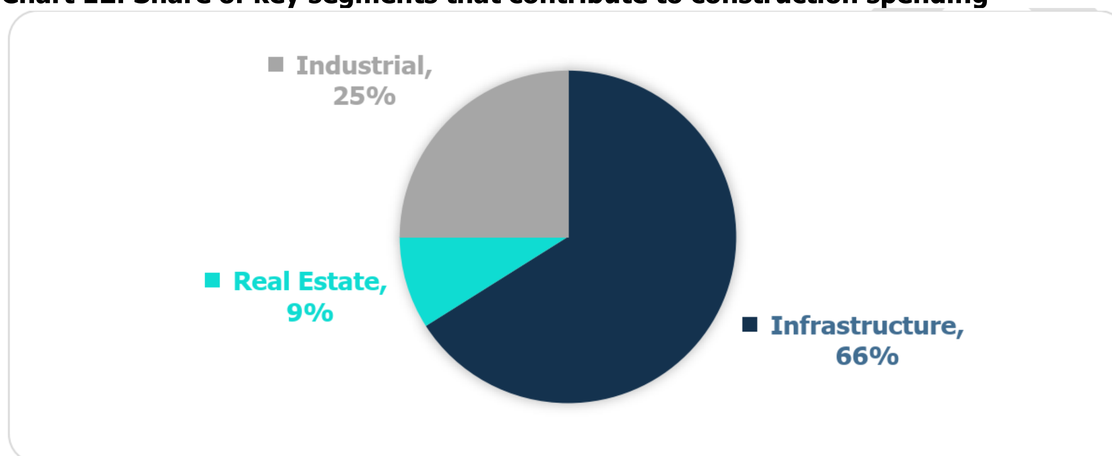
At the same time, public investment is expected to exhibit healthy growth as the government has allocated a strong capital expenditure of about Rs. 10 lakh crores for FY24. The private sector's intent to invest is also showing improvement as per the data announced on new project investments. However, volatile commodity prices and economic uncertainties emanating from global turbulence may slow down the improvement in private CapEx and investment cycle.

2. Overview of the Construction sector in India

The construction sector is the country's second-largest economic segment after Agriculture. The sector contributed 8.4% to the national GVA (at constant price) in FY23. The order book of construction companies is dependent upon the capital expenditure in the economy. Broadly, the investments can be classified into infrastructure, real estate and industrial construction. The largest segment of Indian Construction industry is Infrastructure segment which contributes 59.7% as of FY23. The major chunk of growth is attributable with increase in government spending in building infrastructure. The construction segment witnessed a drop in FY21 due to impact of COVID but has strongly recovered in FY22 and FY23.

Overall the Indian Construction sector has grown at a CAGR of 10.6% from FY18 to FY23 from Rs. 2,375 Billion to Rs. 3,922 Billion. The construction sector is further expected to grow from Rs. 3,922 Billion in FY23 to Rs. 6,494 Billion in FY30 at a CAGR of 7.5%. Historically, infrastructure creation, spread across sectors such as roads and highways, telecom, airports, ports, power, oil and gas and railways has dominated the investments. Increase in Infrastructure demand & government initiative shows the potential for catapulting India to the third largest construction market globally. The sector is expected to contribute 15% to the Indian economy by 2030.

Chart 12: Share of key segments that contribute to construction spending



Source: Department of Industrial Policy and Promotion (DIPP)

2.1 PPP models for enabling infrastructure growth

The government has taken constant steps for encouraging strong private participation in infrastructure sector, particularly from the perspective of the NIP. Hence the focus has been on building a robust enabling environment with a well-thought policy framework and a well-developed public authority for encouraging PPPs.

The different types of PPP models are as follows:

• Build – Operate – Transfer (BOT)

BOT is one of the most common privatization agreements. BOT model is generally used to develop discrete assets rather than a whole network, for example a toll road. In this agreement, the government will hand over the constructing and operating rights to a private sector which would be given out for a pre-determined period of time. Once the period is complete, the rights are transferred back to the government.

• Build – Own – Operate (BOO)

Under this, the government grants the right to finance, design, build, operate and maintain a project to a private entity, which retains the ownership of the project. The private entity is not required to transfer the facility back to the government.

• **Build – Own – Operate – Transfer (BOOT)**
The private sector builds and owns the facility for the duration of the contract, with the primary goal of recouping construction costs (and more) during the operational phase. At the end of the contract the facility is handed back to the government. This structure is suitable when the government has a large infrastructure financing gap as the equity and commercial risk stays with the private sector for the length of the contract. This model is often used for school and hospital contracts.

• **Engineering, Procurement and Construction (EPC)**
In the EPC mode, the private partner is solely responsible for construction of the project, the tolling and operations of the project are undertaken by the public partner.

• **Design – Build (DB)**
In this project agreement, a private partner is contracted by the government to design and build the facility based on the requirements performed by the government. Along with the agreement, the government will state the responsibilities in order to perform the operation and the maintenance of the facility. DB is also called as Build – Transfer (BT).

• **Design – Build – Operate (DBO)**
In the case of DBO, the designing and building of the facility is done based on a turn-key basis. After the completion of the facility, it is transferred to the public sector but the private sector will operate the facility for a specific period of time. The DBO can be also referred to as Build Transfer Operate (BTO).

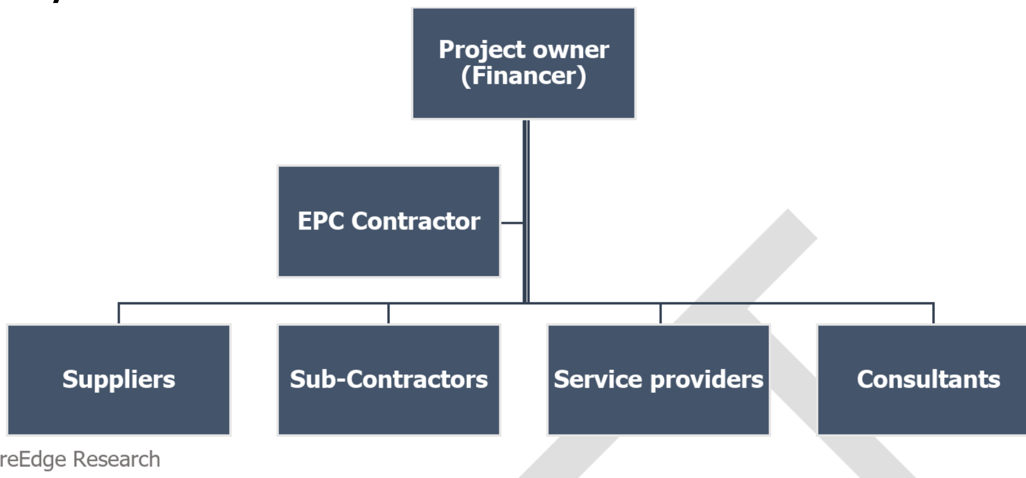
• **Design – Build – Finance (DBF)**
The private sector constructs an asset and finances the capital cost during the construction period only. The variations of DBF include Design – Build – Finance – Operate (DBFO), Design – Build – Finance – Maintain (DBFM) and Design – Build – Finance – Maintain – Operate (DBFMO). These activities are performed for a particular period of time or a long - term lease. Once the lease time is over, the property is given back to the public sector.

• **Lease – Renovate – Operate – Transfer (LROT)**
In this type, the existing infrastructure is handed over to a private facility for a particular time period. This is given to undergo renovation and its operation for a specific time period. The operation is performed on the condition that the private facility will recover the cost that is agreed in return as per the contractual agreement along with the transferring of the entity back to the government.

2.2 Construction EPC in India

EPC stands for 'Engineering, Procurement and Construction'. EPC entails the contractor build the project by designing, installing and procuring necessary labour and land to construct the infrastructure, either directly or by subcontracting. The EPC contract is a type of construction contract between parties where the contractor is responsible for all the engineering, procurement, and construction activities to deliver the completed project to the employer or owner. In addition to the delivery of the complete facility, the EPC contractor must deliver it within a guaranteed time and guaranteed price. EPC vendors are those service providers which execute projects on a turnkey basis.

Figure 1: Key Stakeholders of EPC Contract



Source: CareEdge Research

Basic Features of an EPC Contract

- Single point responsibility
- Fixed contract price
- Fixed completion date
- Performance guarantee
- Caps on liability
- Security
- Liquidated damage
- Defect liability period
- Force majeure

EPC companies are generally responsible for design, procurement, construction, commissioning, and handover of the project to the project owner. An EPC contract is a project document that binds the owner and contractor into a contractual framework by clearly transferring the risk responsibility related to designing, procuring, and constructing to the contractor. It also documents the performance standards the completed project is required to meet. EPC contractor then uses various suppliers, sub-contractors, engineers, and consultants to execute the project.

EPC contracts are of various types including turnkey contracts or contracts with fixed prices.

EPC companies can be classified based on their area of operation/specialization as below:

- General Contracting/Infrastructure
- Building construction – Residential and Commercial segments
- Oil & Gas EPC
- Power EPC: General Power EPC and Power Transmission, Solar Power
- Specialized EPC: Marine, Industrial, Railways, Tunnelling, Mining etc.

2.3 EPC Companies in India

List of few major company names from each segment:

Segment	Companies
Infrastructure /General Contracting	Larsen & Toubro Ltd. Gammon India Ltd. NCC Ltd
Building construction (Residential and Commercial Segments)	Larsen & Toubro Ltd. Shapoorji Pallonji & Co. Ltd. Ahluwalia Contracts (India) Ltd.
Oil & Gas	Larsen & Toubro Ltd. Petron Engineering Construction Limited
Power	BHEL Larsen & Toubro Ltd. Tata Projects Ltd.

Source: CareEdge Research

2.4 Opportunities in NIP for the construction segment

Before the onset of the pandemic the Government of India had unveiled the National Infrastructure Policy (NIP) covering various sectors and regions indicating that it is relying on an 'infrastructure creation' led revival of the country's economy. The NIP which covered rural and urban infrastructure entailed investments to the tune of Rs. 11,10,000 thousand lakhs to be undertaken by the central government, state governments and the private sector during FY20-25. Now with that the economy has almost opened up with most of the migrant workers too are returning, infrastructure development will be relied upon to propel the Indian economy from the current slowdown.

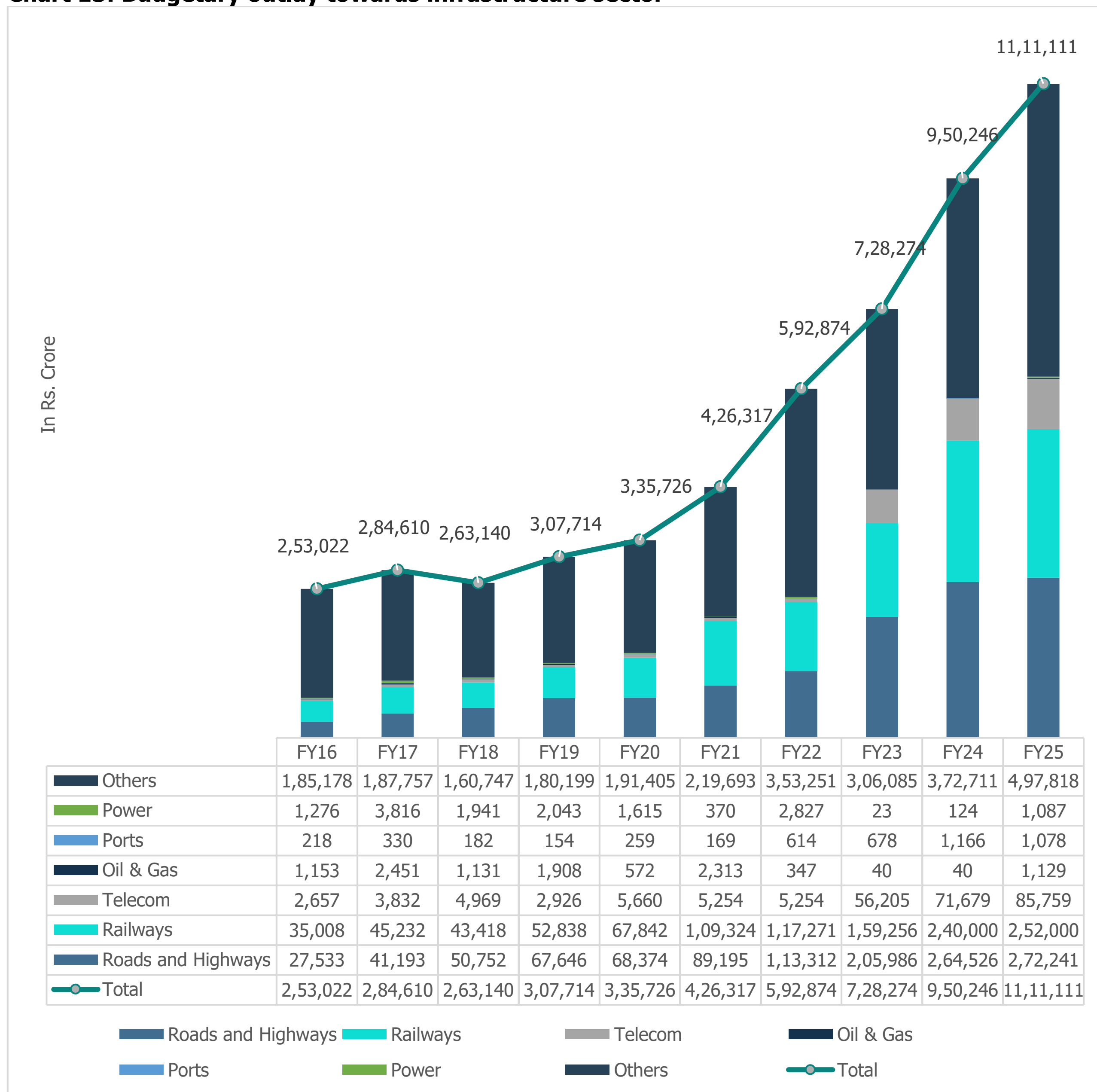
This in turn is expected to offer significant opportunities to EPC players in India. Significant investment in infrastructure development, real estate will boost construction activities and act as a catalyst for growth of EPC companies in India.

Through the National Infrastructure Pipeline, the government of India plans to complete around 7,400 projects aggregating to Rs. 11,10,000 thousand lakhs. The project pipeline is expected to be collectively funded by the Central Government, State Governments and PSUs to the extent of 79% with the remaining 21% being envisaged to come from the private sector.

Key highlights of Union Budget

One of the major drivers of the EPC market in India is the infrastructure investment by the government of India. The Union Budget 2023-24 depicted higher focus on infrastructure development. The main thrust of capital expenditure is on defence, roads and railways.

Chart 13: Budgetary outlay towards infrastructure sector



	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Others	1,85,178	1,87,757	1,60,747	1,80,199	1,91,405	2,19,693	3,53,251	3,06,085	3,72,711	4,97,818
Power	1,276	3,816	1,941	2,043	1,615	370	2,827	23	124	1,087
Ports	218	330	182	154	259	169	614	678	1,166	1,078
Oil & Gas	1,153	2,451	1,131	1,908	572	2,313	347	40	40	1,129
Telecom	2,657	3,832	4,969	2,926	5,660	5,254	5,254	56,205	71,679	85,759
Railways	35,008	45,232	43,418	52,838	67,842	1,09,324	1,17,271	1,59,256	2,40,000	2,52,000
Roads and Highways	27,533	41,193	50,752	67,646	68,374	89,195	1,13,312	2,05,986	2,64,526	2,72,241
Total	2,53,022	2,84,610	2,63,140	3,07,714	3,35,726	4,26,317	5,92,874	7,28,274	9,50,246	11,11,111

Source: Union Budget

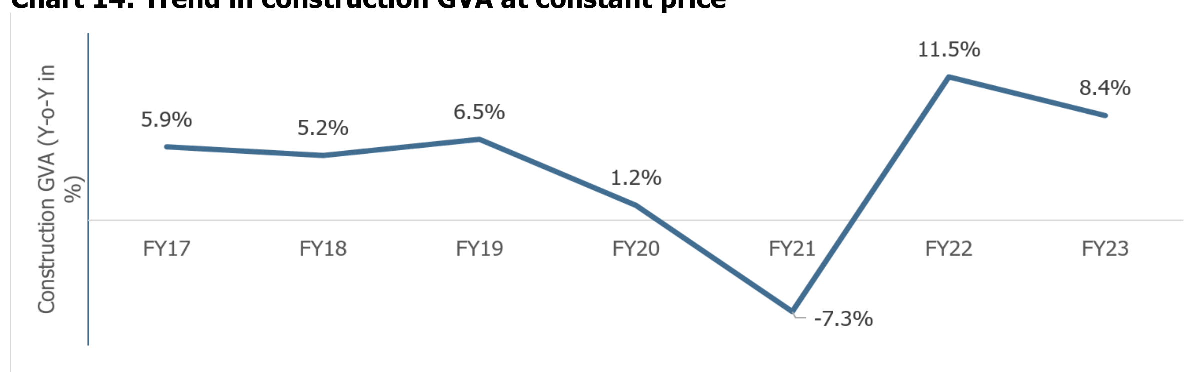
2.5 Impact of Covid-19 pandemic

The GVA of construction segment has been witnessing slowdown since the start of FY20 due to factors such as general elections, extended monsoon. Slowdown got severe in March 2020 as a result of the restrictive measures and lockdowns imposed by the Government to contain the spread of the Covid-19 pandemic that led to a halt of economic activities and business operations. The onset of the Covid-19 pandemic in FY21 presented many challenges for the Engineering, Procurement and Construction (EPC) companies. Many projects got cancelled or delayed due to the uncertainty caused by the pandemic. There was delayed RFP response, logistical challenges due to nation-wide lockdown and supply-chain bottlenecks impacting procurement of goods and assets which in turn impacted project

execution. The most severe impact felt, however, was of the exodus of labour. The order book position of several EPC companies was affected due to the Covid-19 induced challenges which in turn impacted their revenue mainly during the first and second quarter of FY21. However, by the third quarter, the nation-wide lockdown was mostly lifted, the issues of raw material and labour shortages were resolved and business operations began to normalize.

India's economic recovery strengthened in the Q4FY21 before the onset of the second wave of pandemic. Construction segments benefited from the unlock process which gathered pace during the last two quarters. In FY21 Construction sector GVA fell by a sharp 7.3%. The growth was amplified in Q1FY22 because of a favourable base effect (low growth in Q4FY21) which aided the growth in the construction segments growing by 71.3% in Q1FY22 in contrast to a growth rate of 18.3% recorded during the previous quarter. Q2FY22 also witnessed a growth of 8.1%. Moreover, Q3FY22 witnessed a slowdown of 2.8% which later rebound to 2% increase. Overall, the growth in FY22 of 31% in FY22 can be attributed to lower base. The growth was also aided by resumption of economic activity. Q1FY23 registered growth of 33% whereas Q2FY23 registered growth of 15% with normalcy in business environment post pandemic.

Chart 14: Trend in construction GVA at constant price



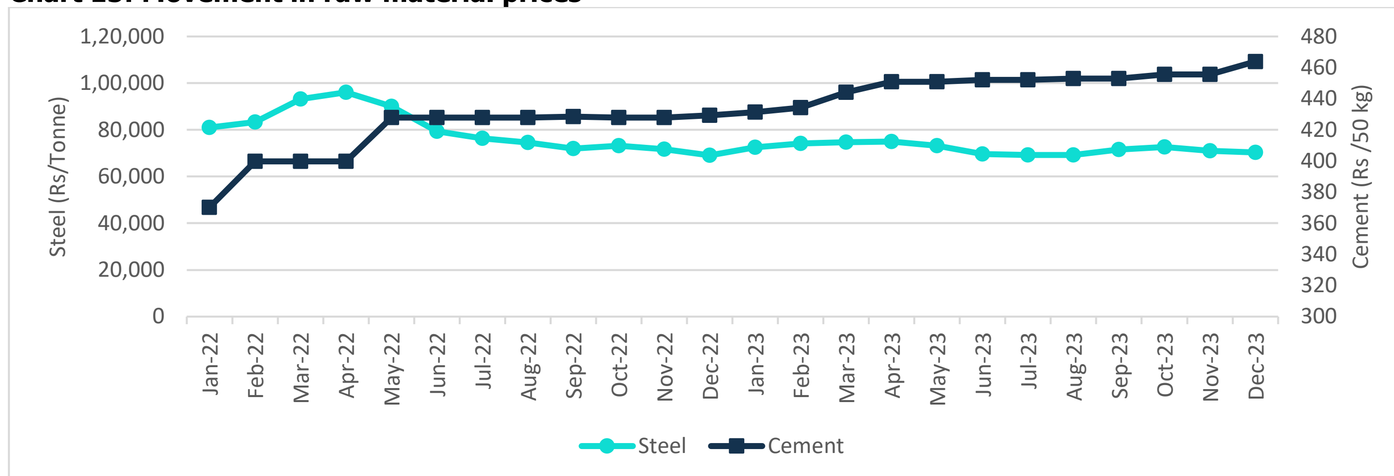
Source: MOSPI

2.6 Challenges faced by EPC companies

➢ **Players are susceptible to changes in raw material prices**

The prices of essential raw materials such as steel, cement, bitumen, and others may adversely impact the project cost and project return on investment. Bitumen prices are influenced by factors like production cuts, limited supply, inflation, crude oil import delays, geopolitical tensions, and macroeconomic headwinds. This volatility in raw material costs can disrupt project cost and impact overall project profitability. Raw material cost of different construction companies ranges in 30-50% of the total cost. Any variation in the prices of raw materials during the construction period of the project has a direct impact on total cost of the project. In FY22, the average price of domestic steel and cement increased by 45% and 8% respectively. Here, increased international steel prices led to significantly higher export volumes, which in turn led to an increase in domestic steel prices. Whereas, the rise in cement prices was primarily on account of rising input and fuel costs pressure due to geopolitical tensions. However, the price of steel has corrected in from H2FY23. The volatile commodity prices impacted margins of construction players in FY23, however, with the prices stabilising, it is expected that margins will recover over a period of time.

Chart 15: Movement in raw material prices



Source: CMIE, CareEdge Research
Note: Average Finished Steel Prices and Wholesale Cement Prices in Domestic Market

➢ **Time and cost overrun due to delay in getting clearances**

EPC sector has witnessed many consistent changes over the past few years. Delay in project completion is one of the major challenges for the EPC market in India. EPC projects are large scale, time and cost sensitive. The gestation period of project also increases because of factors such as political risks in the country, liquidity crunch, and delay in getting environmental clearance, forest clearance, defence land handovers etc. Time overrun and project inflationary cost escalations plague many large government-based projects. All projects have to be time bound to be profitable; however, the market still suffers from inherent delays owing to various reasons.

➢ **Highly competitive intensity**

The segment is highly fragmented with a large number of unorganized players. This leads to highly competitive intensity and affects the pricing power of the EPC players. Further, global players including include Samsung and Bechtel and others have entered Indian markets thus bringing with them global project management experience. This has increased business competition as the capacity and expertise required by the local players must be on par with global standards. But it has also brought about collaboration of local players with global players to manage complex projects requiring global skills and best practices.

2.7 Threats and Challenges to the company:

- **Challenges in Scaling up project execution and managing Large Size Projects:**

In FY23, the company experienced a significant revenue increase, rising from Rs. 77 crores in FY22 to Rs. 161 crores, marking over 100% year-on-year growth. This rapid expansion posed challenges in scaling up project execution and managing larger projects. This surge presents challenges in scaling operations, requiring strategic resource allocation, enhanced operational efficiency, and robust quality control measures to maintain high standards. Additionally, meeting project timelines continues to be important, necessitating effective scheduling, proactive risk management, and timely interventions to avoid delays and cost overruns.

- **Adherence to Contractual Obligations:**

Failure to adhere to contractual obligations can have severe repercussions, including financial penalties, reputational risk, and severe financial obligations. These lapses can significantly impact the overall performance and timelines of projects. It is imperative for companies to meticulously follow contract specifications to mitigate these risks and uphold

their commitments. This ensures smoother project execution and fosters trust and credibility with clients, contributing to future project awarding from the authority.

- **Challenge in Saleability of Flats**

In certain regions, excessive construction has resulted in a surplus of flats, making it challenging to sell properties and causing inventory build-up. Additionally, high home loan interest rates can discourage potential buyers from purchasing new flats, affecting overall saleability. Intense competition among developers can lead to reduced prices, impacting profitability and the ability to sell flats at desired rates.

- **Delays in Land Acquisition and Approvals:**

The process of acquiring land for infrastructure projects often faces significant delays. One of the key reasons is the demand for higher compensation from landowners, as stipulated under the 2003 Land Acquisition Act. These increased compensation results in high cash outflow from the government/ project authority. Consequently, the projects experience significant cost and time overruns, which can severely impact their project viability, funding requirement and overall project returns.

- **Impact of Regulatory Changes on the Real Estate Market:**

Frequent changes in government regulations can introduce uncertainty in the real estate market. Policies such as the Real Estate (Regulation and Development) Act (RERA) are designed to protect buyers but also require strict compliance from developers. Government incentives for affordable housing can divert demand from higher-end projects, affecting the saleability of more expensive flats. Additionally, policies promoting urbanization and smart city initiatives can present new opportunities but also challenge developers to adapt to evolving regulations and standards.

2.8 Outlook

The Construction sector was hit hard during the pandemic, because of the lockdown, labour migration leading to logistical challenges. However, the sector has witnessed a growth in FY22 and FY23, supported by unlock measures and significant infrastructure investments by the Government.

The industry has experienced a similar growth trajectory in the FY24, supported by a sustained focus on infrastructure investments in roads, railways, and airports, in addition to the expansion in real estate activity. According to CMIE, early indications from the real estate sector reveal a robust 23.5% year-on-year growth in sales revenues for the quarter ending December 2023. While operating expenses related to sales increased at a comparatively slower rate of 19.4%, the industry's most significant operating expense, categorized as other operating expenses, witnessed a notable rise of 75.3%. Consequently, the industry's operating profit saw a faster growth rate of 32.1% compared to sales. The operating profit margin expanded by 224 basis points, reaching 34.3%.

Over the long term, the outlook for construction sector is favourable supported by continued government spending on infrastructure. The Government has expanded the National Infrastructure Policy (NIP) during the Budget to 7,400 projects from 6,835 projects and announced plans for the National Monetization Pipeline and Development Finance Institution (DFI) to improve the financing of infrastructure projects. The NIP covers various sectors and regions indicating that it is relying on an 'infrastructure creation' led revival of the country's economy. The NIP covering rural and urban infrastructure entailed investments to the tune of Rs.11,10,000 thousand lakhs will be undertaken by the central government, state governments and the private sector during FY20-25.

Road construction in India is expected to grow with new funding mechanisms by NHAI, such as ToT (Toll Operate Transfer) and InvITs (Infrastructure Investment Trust) and interest from international funds (both for equity as well as debt).

This has the potential for catapulting India to the third largest construction market globally. The sector is expected to contribute 15% to the Indian economy by 2030. The recent policy reforms such as the Real Estate Act, GST and REITs are steps to reduce approval delays and are only going to strengthen the real estate and construction sector.

3. Peer Benchmarking

3.1 Benchmarking Based on Operational Parameters

Key Construction Peers

Following key construction peers have been considered for peer benchmarking of Garuda Construction and Engineering Ltd:

Name of the Company	Business Overview
Garuda Construction and Engineering Limited	Garuda Construction and Engineering Pvt Ltd. is a construction and engineering company based in Mumbai. They are involved in various aspects of construction, including infrastructure development, residential and commercial buildings, and civil engineering projects. Garuda Construction and Engineering excels in managing diverse projects, supported by experienced leadership and advanced technology. Their strong financial position, commitment to quality and safety, and focus on sustainability bolster their market standing. Client-centric approaches, a skilled workforce, and strong industry partnerships further enhance their adaptability and innovation.
PSP Projects Limited	PSP Projects Limited is a construction and contracting company that provides services in various sectors including industrial, institutional, residential, and government projects. The company is involved in civil construction, infrastructure development, and other related activities. PSP Projects excels in diverse project expertise and maintains strong financial health, backed by experienced leadership ensuring efficient management and quality outcomes. They prioritize advanced technology, quality and safety standards, sustainability, and a client-centric approach. Their skilled workforce, strong industry relationships, and adaptability drive their competitive edge and innovation in the construction industry.
Capacite Infraprojects Limited	Capacite Infraprojects Ltd. is a construction company providing project design, construction and management services to leading real-estate and government bodies. The company's area of focus is high-rise and super-high-rise construction projects, retail & commercial, gated community, healthcare & factories and others. Capacite Infraprojects excels in high-rise and complex projects, supported by advanced construction technology and a skilled workforce. Their client-centric approach and commitment to quality and safety build trust. Led by an experienced management team, the company emphasizes sustainability and maintains financial stability, ensuring innovation and adaptability in a competitive industry.

Vascon Engineers Limited	Vascon Engineers Limited is an established construction company in India. The company has a presence across multiple sectors, including residential, industrial, IT parks, malls and multiplexes, hospitality and community welfare centres, schools and hospitals. Vascon Engineers stands out with a diverse project portfolio, experienced leadership, and a strong track record of successful completions. They leverage advanced construction technology, prioritize quality and safety, and emphasize sustainability. Skilled workforce and solid industry relationships, Vascon Engineers remains innovative and adaptable in the competitive construction industry.
Ahluwalia Contracts (India) Limited	Ahluwalia Contracts (India) Limited has been present in the civil construction industry for more than 40 years. Company has experience in working on residential, commercial, institutional, corporate offices, power plants, hospitals, hotels, IT parks, Metro stations and depots, and automated car parking lots for Government as well as private clients. Ahluwalia Contracts with diverse project expertise, a strong track record of timely and budget-friendly completions, and experienced leadership. Their client-focused approach, skilled workforce, strong industry relationships, and adaptability further enhance their competitive edge in the construction industry.
B.L.Kashyap and Sons Limited	B. L. Kashyap and Sons Limited is another prominent Indian construction and infrastructure development company. They have a strong track record in building various projects, including residential, commercial, and infrastructure. B.L. Kashyap and Sons excels with its broad project expertise and strong track record of timely, budget-conscious completions. Their experienced management team and advanced technology enhance project efficiency and quality. The company's commitment to safety, solid financial position, client-focused approach, and skilled workforce further bolster their competitive edge and adaptability in the construction industry.

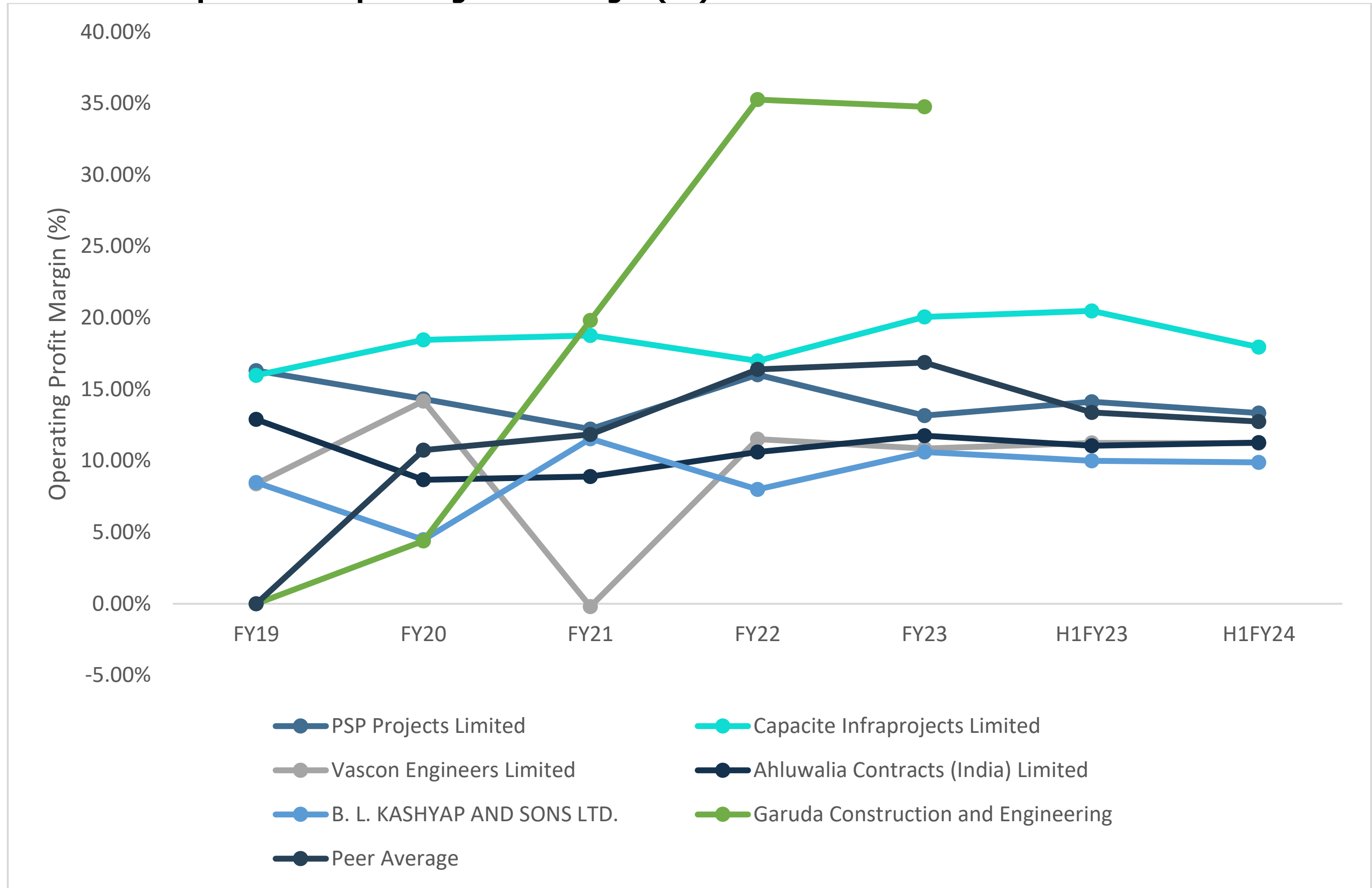
3.2 Benchmarking Based on Financial Parameters

The peer benchmarking of Garuda Construction and Engineering with its peers set has been done on profitability, liquidity and leverage parameters.

Profitability Parameters

1. Operating Profit Margin (%)

Chart 16: Comparison of Operating Profit Margin (%)



Source: Company Reports, CareEdge Research
Note:

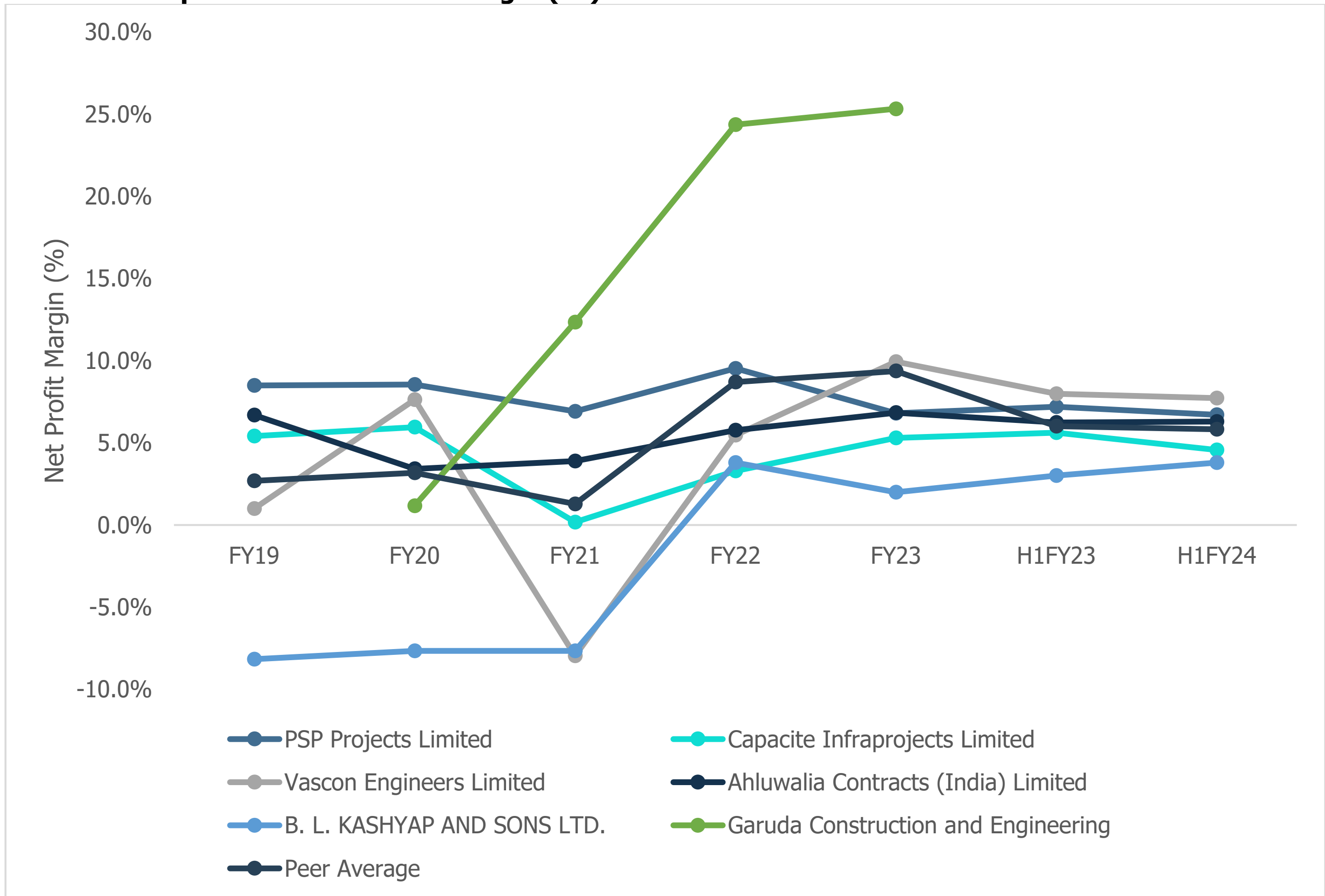
- Consolidated financials have been considered
- Half yearly financial data for Garuda is not available

For FY23, the operating profit margin of construction peers has been in the range of 10.8%-34.8%, the highest being of the Garuda Construction and Engineering at 34.8% in FY23 way above peer average of 16.9% in same period. The operating margins of PSP Projects ltd and Vascon Engineers Ltd declined in FY21 due to impact of Covid-19 on hospitality and construction businesses.

Garuda Construction and Engineering's operating margin was around 4.4% in FY20, however it improved significantly in FY21 to 19.8% which further went to 35.3% in FY22. Garuda Construction and Engineering's average operating margin for last 3 years from FY21-FY23 was around 30.0% which is double than the average margin of peers at 15.0% in similar period.

2. Net Profit Margin %

Chart 17: Comparison of Net Profit Margin (%)



Source: Company Reports, CareEdge Research

Note:

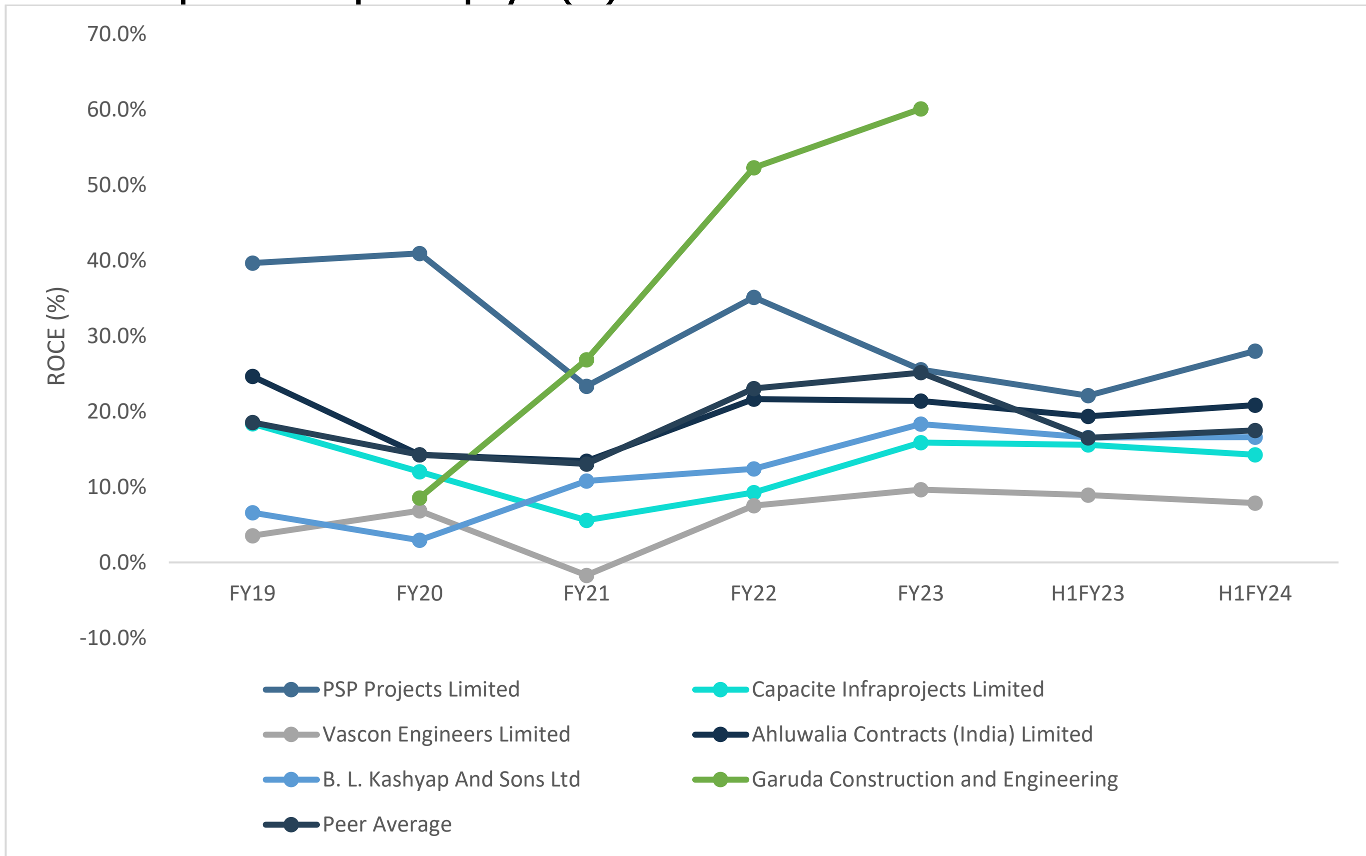
- Consolidated financials have been considered
- Half yearly financial data for Garuda is not available

The net profit margin of all peers except Garuda, was significantly impacted in FY21 on account of Covid-19. However, it has recovered from thereon as the construction businesses have recovered from the impact of the pandemic. The average net profit margin of all peer sets crossed the pre-pandemic levels in FY23.

Whereas, Garuda Construction and Engineering's net profit margin improved significantly in FY21. In FY23, the net profit margin was 25.3% vs. net profit margin of its peers which were 6.8%, 5.3%, 9.9%, 6.8%, and 2.0% for PSP Projects Limited, Capacite Infraprojects Limited, Vascon Engineers Limited, Ahluwalia Contracts (India) Limited, and B. L. Kashyap And Sons Ltd, respectively. Garuda Construction and Engineering has showcased exponential growth where margins improved from 1.2% in FY20 to 25.3% in FY23. The average margin of last 3 years from FY21-FY23 of Garuda Construction was at 20.7% and average among peers was 6.5% in same period.

3. Return on Capital Employed (%)

Chart 18: Comparison of Capital Employed (%)



Source: Company Reports, CareEdge Research
Note:

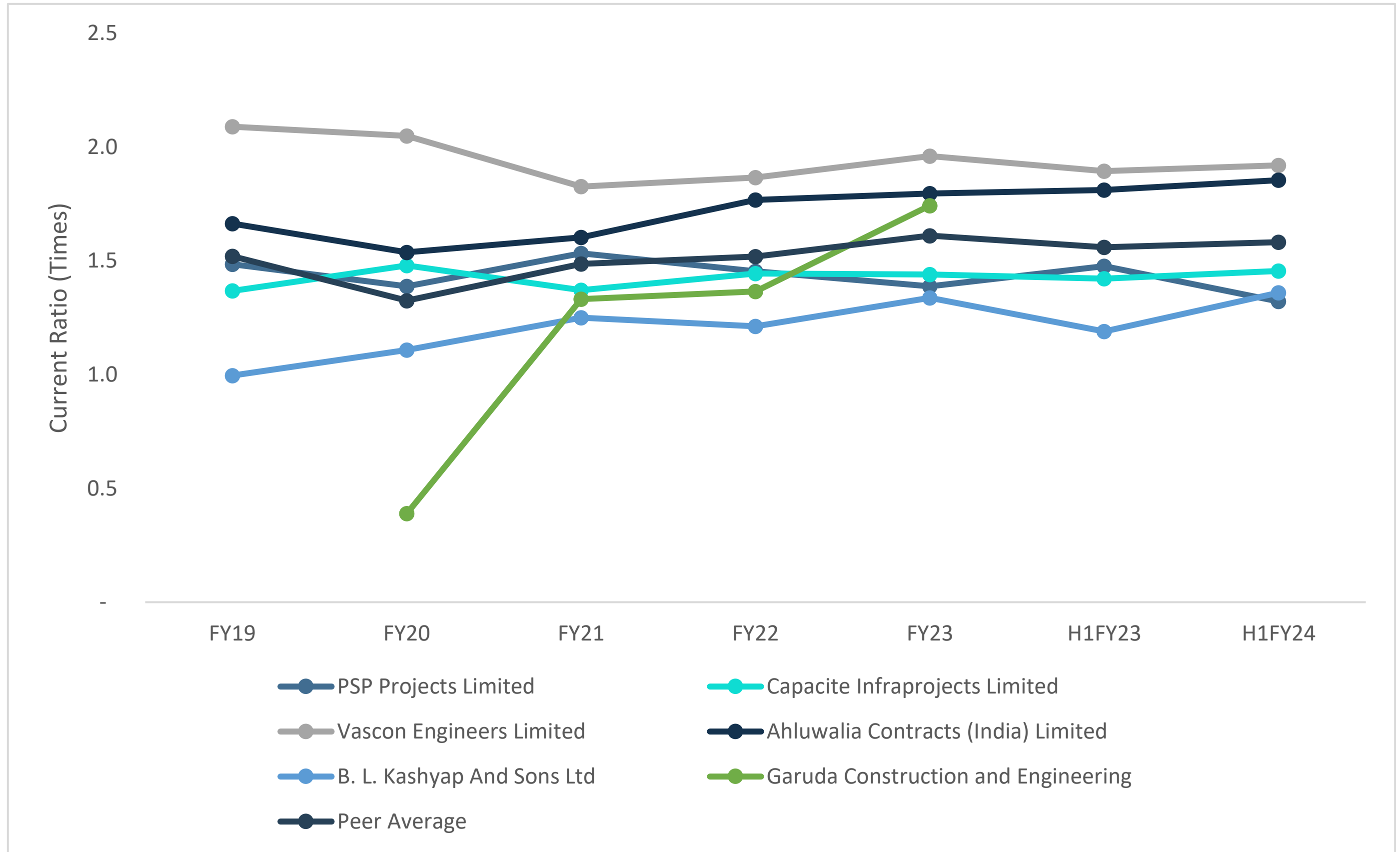
- Consolidated financials have been considered
- Half yearly financial data for Garuda is not available

ROCE of some players has also improved significantly during post covid period. During FY23, the ROCE of Garuda Construction and Engineering's was 60.1% in FY23, highest in the past four years. The industry average was just around 25.2% for the same period.

Liquidity Parameter

4. Current Ratio

Chart 19: Comparison of Current Ratio



Source: Company Reports, CareEdge Research
Note:

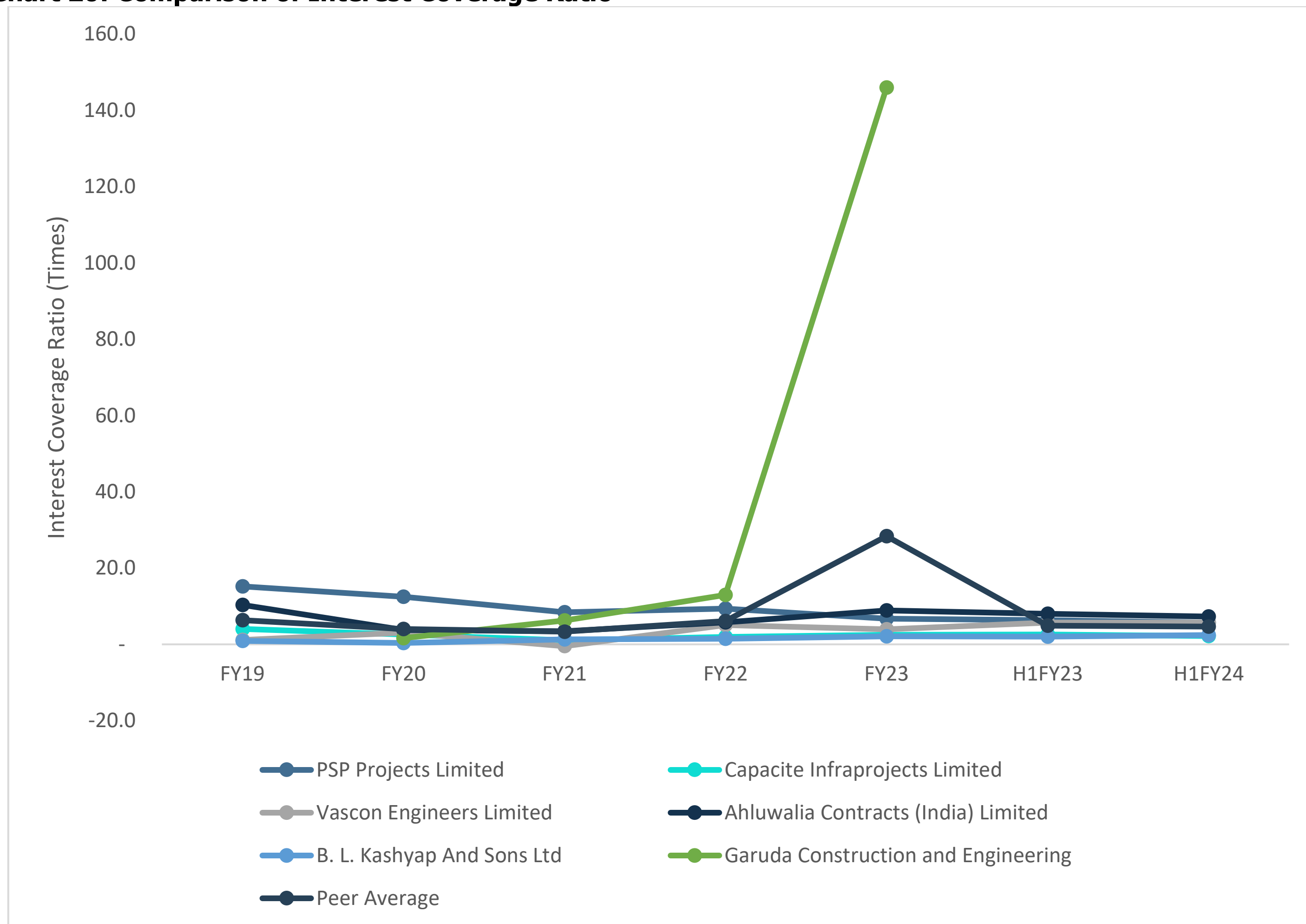
- Consolidated financials have been considered
- Half yearly financial data for Garuda is not available

The past five years' average current ratio for the peer set has been around 1.5x. Garuda Construction and Engineering's current ratio was above average in FY23 at 1.7x. Important to note that the ratio was mere 0.4x in FY20, when the industry average was 1.30x. Current ratio of Garuda Construction has been in line with the peer set where highest ratio is of Vascon Engineers Limited and lowest is of B.L. Kashyap And Sons Ltd.

Leverage Parameters

5. Interest Coverage Ratio

Chart 20: Comparison of Interest Coverage Ratio



Source: Company Reports, CareEdge Research

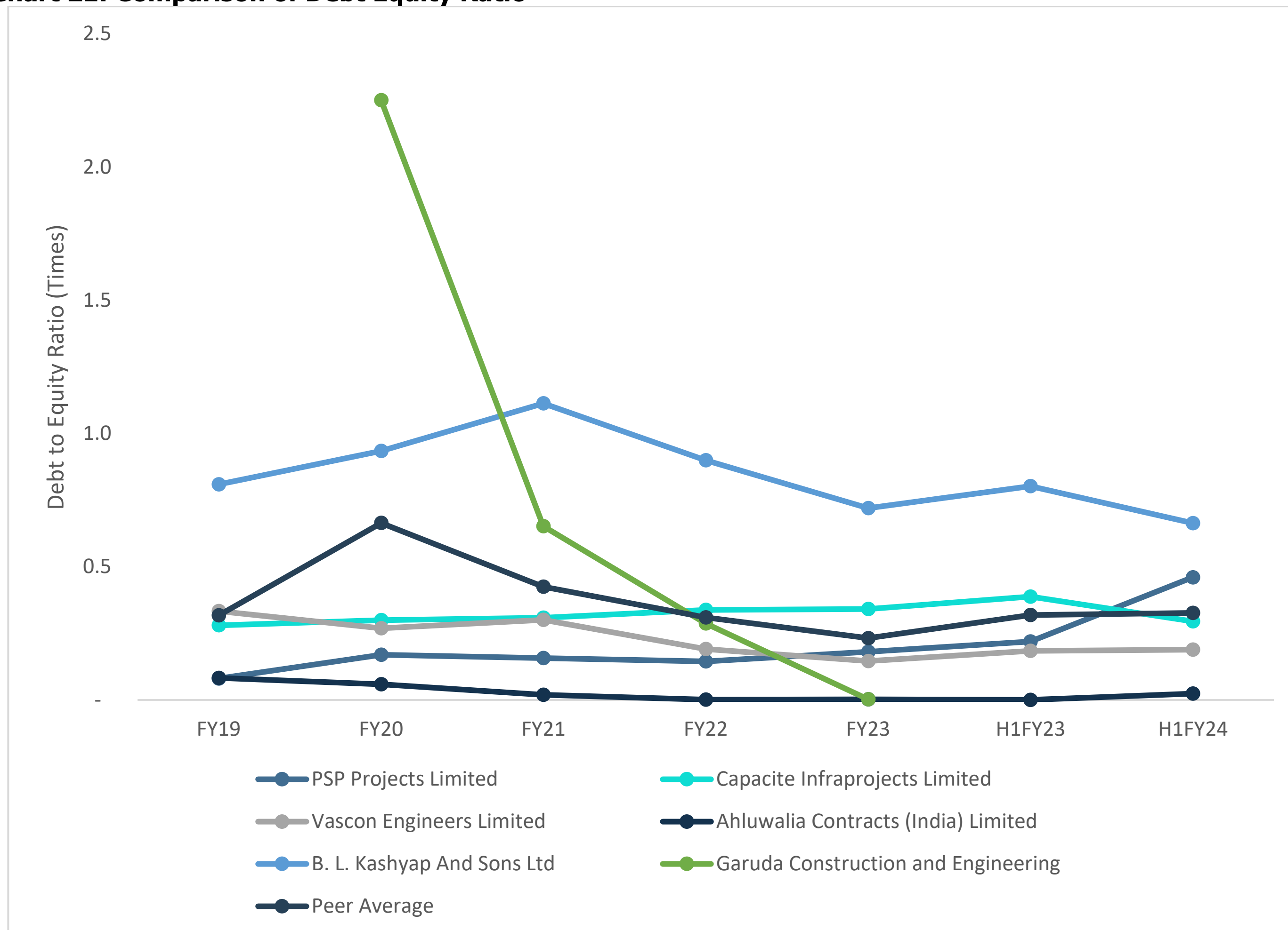
Note:

- Consolidated financials have been considered
- Half yearly financial data for Garuda is not available

The average interest coverage ratio of all peers has demonstrated similar trend as the profitability ratios. After being impacted significantly in FY21, it has witnessed recovery over FY22 and FY23. With significant increase in earnings and simultaneously repayment of debt, Garuda Construction and Engineering's interest coverage ratio has increased exponentially to 146.0x in FY23 from 13.0x in FY22. The average interest coverage ratio of the peers has been at 28.4x in FY23.

6. Debt Equity Ratio

Chart 21: Comparison of Debt Equity Ratio



Source: Company Reports, CareEdge Research
Note:
- Consolidated financials have been considered
- Half yearly financial data for Garuda is not available

The average debt to equity ratio of construction peers was 0.32x, 0.66x, 0.42x, 0.31x and 0.23x respectively during FY19-FY23. Garuda Construction and Engineering's debt equity ratio came down gradually, as it became virtually debt-free.

Garuda Construction and Engineering debt to equity ratio was at 2.3x in FY20 where industry average was just at 0.7x. However, the company has reduced debt significantly and increase in shareholder's equity has led to decline in debt to equity ration to 0.7x, 0.3x and with very less to negligible debt in FY21, FY22 and FY23 respectively.

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