

Contracts also locked, higher costs to hurt construction companies

BY RAJESH NAIDU, ET BUREAU | MAY 04, 2020, 08.39 AM IST

ET Intelligence Group: At top road construction companies, the most important resources now are the lawyers. Inflated project costs due to the lockdown will likely devolve on the contractors: So, they are now busy combing the contracts to ascertain how bad the damage will be.

According to various analysts' estimates, operating profit margins of roads companies could fall in the range of 3-8% for FY21. As of FY19, road companies generated operating profit margins in the range of 12-25%.

Legal experts believe that contractors may get the extension of time but no support on the costs associated with the delays. And that has got largely to do with the wording of the contract clauses. "In reference to Covid-19, there are two reference points on delays," said Vyapak Desai, leader, international dispute resolution and investigations practice, Nishith Desai Associates. "One is the delay during the lockdown period which starts from March 24. Another is postlockdown, when certain restrictions apply on construction activities. If a project is prevented from execution, which was the case during the lockdown period, then a contractor can claim extension of time from the employer during that period."

Still, costs will devolve on the contractor. "A contractor may not be entitled to claim additional costs incurred except that the contract allows such cost claim under change of law clauses," Desai said.

Domestic brokerage Spark Capital estimates that working capital days may rise by at least 30 days for FY21. It estimates that earnings of well-placed roads and construction companies may fall close to 60% for FY21.

"Despite the removal of restrictions on construction activities, there are many allied industries that are not functioning properly. Today, due to supply chain problems, availability of cement is an issue," said an official at a top construction company. "The government says not to cut salaries or sack employees, and then there is no business for us. I think the government should announce a financial package for the sector."

Costs are expected to climb further even at sites where labour resources are available, as companies must maintain social distancing norms while deploying resources at work sites.