Sadbhav Infrastructure Project Limited

July 10, 2019

Rating

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long-term Non-Convertible Debentures*	794.00 (reduced from 892.00)	**CARE A (CE) [Single A (Credit Enhancement); (Under Credit Watch with Developing Implications)]**	Placed on credit watch with developing implications
Total Facilities	**794.00 (Rupees Seven Hundred Ninety Four Crore Only)**		

Details of instruments in Annexure - 1

**backed by unconditional and irrevocable corporate guarantee of Sadbhav Engineering Limited [SEL; rated CARE A / CARE A1 (Credit watch with Developing Implications)]*

Detailed Rationale & Key Rating Drivers

The rating assigned to the non-convertible debentures (NCD) issue of Sadbhav Infrastructure Project Limited (SIPL) takes into account the unconditional and irrevocable corporate guarantee extended by Sadbhav Engineering Limited [SEL; rated CARE A / CARE A1 (Credit watch with Developing Implications)].

The ratings assigned to the bank facilities of SEL have been placed on 'Credit Watch with developing implications' in view of impending impact of proposed divestment of SIPL's entire stake in its nine operational road special purpose vehicles (SPVs) to InvIT portfolio of IndInfravit Trust (IndInfravit). Post the transaction, SIPL shall continue to be the O&M contractor for these assets, along with having 10% stake in IndInfravit and right of first offer (ROFO) option for its future operational assets.

Successful completion of the afore-mentioned transaction is expected to result in rationalization of both SEL's and SIPL's (henceforth referred to as Sadbhav group[2]) debt levels along with significant reduction in reliance on internal accruals and debt for funding equity commitment in its under-construction road SPVs, which is likely to improve its debt coverage indicators and financial flexibility. Transfer of these assets to IndInfravit and proposed holding of listed InvIT units by SIPL is also expected to provide annual dividend income and project management fees (which are linked with toll collection of SPVs) along with ROFO option of monetizing future operational projects through transfer of these assets to InvIT portfolio on the back of reputed and resourceful investors of IndInfravit. Further additional cash flows, such as upside from car revenues in one of the SPVs, extension of concession period, if any, for another SPV and receipt of payments and claims from authority for the transaction assets, are expected to be received in addition to purchase consideration amounting of Rs.2,546 crore.

As such, CARE Ratings would await further developments to unfold so as to enable it to assess the exact impact of the above stake sale transaction on the future funding requirement and debt levels of Sadbhav group in light of high working capital intensity of SEL before arriving at a view on its credit rating. Further, the company needs to comply with the conditions precedent (CP) including but not limited to obtaining no objection certificate (NOC) from authorities and lenders, which would further determine the quantum and timing of the cash flows from the stake sale.

The ratings continue to derive strength from established track record of SEL in road construction segment along with its healthy and diversified order book. The ratings also take cognizance of receipt of large arbitration award in three special purpose vehicles (SPVs) of Sadbhav group, which once realized is expected to provide further cash flow cushion to the Sadbhav group.

The ratings however, continue to be constrained by various issues related to land acquisition (although extension of time (EoT) have been granted by NHAI), clearances and delay in de-scoping of un-available land leading to delay in execution of some of the projects (though approvals have been received in some of the projects subsequently) and higher working capital intensity of SEL on a sustained basis despite recovery of old debtors. Further, the ratings are, also constrained on account of stretched current asset days of SEL leading to high working capital borrowing, higher debt repayment obligations in the medium term, Sadbhav group's exposure to inherent risks associated with BOT projects and inherent challenges faced by the construction sector, including the current challenging fund raising scenario for the sector.

SEL's ability to rationalize its working capital borrowings through realization of its stretched current assets and completion of ongoing HAM projects apart from rationalization of Sadbhav group's debt level from stake sale proceeds shall be key rating sensitivities.

[1] *Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

[2] *Combining SEL (standalone) and Sadbhav Infrastructure Project Limited (SIPL; standalone) financials*

Detailed description of the key rating drivers of guarantor - SEL

Key Rating Strengths:

Proposed stake sale in its SPVs with an aim to rationalise its debt levels and reduce reliance on debt for equity commitments towards under-construction road SPVs

As per announcement on stock exchange dated July 1, 2019, SEL along with SIPL have executed Share Purchase Agreements with IndInfravit Trust for selling their entire equity stake in their nine operational BOT SPVs (seven toll and two annuity based projects) for a consideration of around Rs.2,546 crore, out of which partial consideration would be received by SIPL in the form of listed and marketable units equivalent to 10% stake in IndInfravit having estimated value of Rs.646 crore and the balance amount of Rs.1,900 crore in cash. As articulated by the management, the funds raised through stake sale are primarily expected to be utilised towards rationalisation of current debt levels, both for SEL and SIPL, along with significant reduction in reliance on debt for meeting future equity commitments in their under-construction road SPVs. Transfer of these assets to IndInfravit and proposed holding of some InvIT units by SIPL is also expected to provide annual dividend income to it along with ROFO option of monetizing future operational projects. SIPL shall continue to carry out routine and major maintenance for these projects post stake sale which is likely to maintain its revenue visibility. Approximate value of these contracts is Rs.4,000 crore over the balance concession period. Successful completion of stake sale along with rationalization of Sadbhav group's debt level from stake sale proceeds, resulting in improvement in debt coverage indicators and leverage shall be key rating sensitivities.

Established track record in the Indian road construction sector: SEL has a sound track record of over two decades in the Indian road construction sector. SEL has successfully completed construction of more than 8,400 lane km of road projects since its establishment with majority of the BOT projects completed in a timely manner.

Healthy and diversified order book: SEL had a healthy and diversified order book of Rs.11,981 crore (3.29 times of its contract receipts for FY19 [refers to the period April 1 to March 31]) as on March 31, 2019. The order book is diversified across four broad segments: EPC of third party road projects, EPC of own BOT/HAM road projects, mining and irrigation. The order book of the company is also geographically diversified with presence across various states of the country. Further, relatively less risky HAM projects constitute around 49% of its order book. The contribution of road & highway segment in the total order book of the company which is its core strength has gradually increased to 78% as on March 31, 2019 as compared to 45% as on March 31, 2015.

***Improved cash surplus of operational SPVs of SIPL during FY18 and FY19 resulting in higher up-streaming of funds*:** During the past two years, SIPL has successfully refinanced debt in nine of its operational SPVs. The same has led to substantial reduction in interest rate and staggered installment repayments utilizing its tail period thereby resulting in self-sustainable operations of these SPVs. Post refinancing, the average cost of debt in nine of its operational SPVs has reduced to around 9.27% per annum from 11.18% earlier. Furthermore, there has been notable growth in toll collection of SPVs portfolio during FY18 and FY19 due to growth in traffic in some of the stretches nearer to Golden Quadrilateral (GQ) and Haryana apart from hike in service fees by 18% with effect from April 2018 in Maharashtra Border Check Post Network Ltd. (MBCNL; rated CARE A; Stable). The same has been reflected from steady increase in cash surplus (post debt servicing and stipulated reserve requirement) from operational SPVs during FY18 and FY19. Surplus cash generated in operational SPVs has been partly up streamed to meet funding requirement of Sadbhav group.

Sadbhav group's overall gearing has continued to remain stable at 0.82 times as on March 31, 2019. Sadbhav group's overall interest coverage ratio has improved from 2.20 times for the year ended March 31, 2018 to 2.55 times for the year ended March 31, 2019.

Various initiatives undertaken by the Government of India (GOI) to improve the prospects of the road construction sector: GOI through National Highways Authority of India (NHAI; rated 'CARE AAA; Stable') has taken various steps to improve the prospects of the road sector. These include premium rescheduling for stressed projects, bidding of tenders only after 80% land has been acquired for the project, release of 75% of arbitration award against submission of bank guarantee and 100% exit for developers after two years of project completion and NHAI funding for projects that are stuck at advanced stages of completion. Furthermore, NHAI has made some favourable changes in the clauses of model concession agreement and introduced HAM based BOT projects to reduce the equity commitment of the developers. After witnessing steady increase in pace of award during last three years, pace of award has declined in FY19 due to moderation in the bidding appetite due to challenging fund raising scenario. EPC is, thus, envisaged to be the preferred mode of award till improvement in fund raising environment and bidding appetite of the developers.

Key Rating Weaknesses:

Delay in rationalization of debt levels primarily due to various execution hurdles and higher working capital intensity on a sustained basis despite realization of significant portion of old debtors: Eight ongoing HAM projects of Sadbhav Group

constituted Rs.2,327 crore in SEL's total order book as on March 31, 2019. Out of these eight, six projects with EPC value of ~Rs.981 crore were earlier scheduled to be completed by September 2019. However, as articulated by the management, four of these projects are expected to be commissioned in FY20. Certain delays in execution of some of the ongoing HAM projects is due to hindrances in land acquisition, utility shifting, delay in other clearances, etc. Consequently, these SPVs have received Extension of Time (EOT)/ de-scoping/de-linking of these projects. NHAI has approved de-scoping in one of its projects and the independent engineer has recommended for provisional commercial operations date (COD) while de-linking for unavailable land in one of the projects is expected to resolve the execution hurdles to an extent.
SEL could realize old debtors of around Rs.550 crore during FY19 from completed projects in the EPC road, BOT and irrigation segment. Nevertheless, working capital intensity continued to remain high marked by collection period of 166 days during FY19. This was mainly on account of debtors pertaining to escalation portion and change of scope in some of its ongoing HAM projects apart from GST receivables as well as due to relatively higher time required for term debt disbursement in its HAM SPVs owing to challenging fund raising environment prevailing in the construction sector. Its working capital utilization was at ~89% for the trailing twelve months ended May, 2019. However, SEL has reduced its reliance on outside consortium borrowing during FY19 through raising long-term funds and have plans for enhancing working capital limits.

Exposure of the group to inherent risks associated with BOT projects along with subdued performance of two of its SPVs, however, expected to reduce subsequent to sale of stake in operational SPVs: As on March 31, 2019, Sadbhav group had total investment (including loans and advances) of Rs.3,341 crore. Subsequent to stake sale, exposure in BOT projects is expected to be reduced significantly to around 60% based on the combined net-worth as of March 31, 2019 as against 112% as on March 31, 2019. The under construction HAM projects of the group have equity commitments of around Rs.841 crore spread over FY20 – FY22. The equity commitments for these HAM projects and shortfall in two operational SPVs (not getting transferred) are expected to be fulfilled through the funds raised from the proposed stake sale transaction and up-streaming of cash flows from MBCNL as against earlier expectation of debt sources and internal accruals. SIPL has already infused Rs.533 crore as on June 30, 2019 in eight ongoing projects. With the ROFO agreement, there is an enhanced financial flexibility for meeting the future equity requirement.

Challenging environment for the construction industry: The construction sector is facing hurdles in fund raising due to delay in enhancement of working capital limits (including non-fund based limits), delay in financial closure and equity raising plans on account of challenging business environment for the sector and weakened financial health of the banking sector. Appointed date of some of the HAM projects of SIPL has also been delayed due to challenging scenario. The inherent risk involved in the construction industry including aggressive bidding, traffic risk, interest rate risk, volatile commodity prices and delay in project progress due to resistance towards land acquisition and regulatory clearances have collectively affected the credit profile of the developers in the past.

Liquidity Analysis:
Higher repayment obligations and working capital utilization; albeit expected to improve post stake sale in road SPVs: Stretched current assets (primarily due to higher collection period) and repayment obligations have resulted in moderation in liquidity indicators of Sadbhav group marked by higher reliance on working capital borrowing and moderate debt coverage indicators during FY19. In light of higher redemption obligations of the group as compared to envisaged future cash accruals, the combined debt coverage indicators are expected to remain low.
However, financial flexibility of the group is derived from the fact that both SEL and SIPL are listed on the stock exchanges. SEL on consolidated basis had cash and cash equivalents (including reserves created in SPVs and margin money) of Rs.256 crore as on March 31, 2019. Further, SIPL is expected to receive cash of around Rs.1,900 crore from the proposed stake sale transaction which, as articulated by the management, would primarily be used to rationalise the debt at Sadbhav group level along with for meeting future equity commitments in its under-construction HAM SPVs. SIPL would receive the balance portion of sale consideration in the form of units of IndInfravit equivalent to 10% stake (having estimated value of around Rs.650 crore) which shall also provide financial flexibility to SIPL since the same are listed on stock exchange.

Analytical approach: Combined
CARE has taken a combined view of SEL (standalone) and SIPL (standalone) for analytical purpose. This is because majority of the long-term debt raised in SIPL is backed by unconditional and irrevocable corporate guarantee of SEL. Further, SEL and SIPL have operational and financial linkages for funding investment in new projects, bridging of shortfall in select SPVs as well as up-streaming of cash flow of SPVs.

Applicable Criteria
Criteria on Assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology - Infrastructure Sector Ratings (ISR)

[Rating Methodology: Factoring Linkages in Ratings]
[Financial Ratios - Non-Financial Sector]
[Criteria of Rating Credit Enhanced Debt]

About the Company - SIPL

SEL had floated a 100% subsidiary, SIPL, in January 2007, as a holding company for its BOT projects. During FY11, SEL diluted 22.22% of its stake through issue of fresh equity of Rs.300 crore and compulsory convertible cumulative preference shares (CCCPS) of Rs.100 crore to private equity (PE) investors. Proceeds of PE were utilized by SIPL for fulfilling its equity commitment in BOT projects. During September 2015, SIPL raised Rs.425 crore through Initial Public Offer (IPO) of its equity shares.

On July 1, 2019, SIPL has announced that they have executed Share Purchase Agreements with IndInfravit Trust (IndInfravit) for selling their entire equity stake in their nine operational BOT SPVs (seven toll and two annuity based projects). The transaction has been executed considering enterprise value of Rs.6,610 crore. Total sale consideration for the transaction is Rs.2,550 crore, out of which partial consideration would be received by SIPL in the form of units equivalent to 10% stake in IndInfravit having estimated value of Rs.650 crore and the balance amount of Rs.1,900 crore in cash.

(Rs. Crore)

Brief Financials – SIPL (Standalone)	FY18 (A)	FY19 (*)
Total Operating Income	384	356
PBILDT	268	271
PAT	68	57
Overall Gearing	0.95	1.08
Interest Coverage (times)	1.64	1.55

A: Audited - as per results published on stock exchange*

About the Guarantor - SEL

Incorporated in 1988, SEL has evolved as one of the prominent developers and EPC contractors in India. SEL had floated a wholly-owned subsidiary – SIPL as a holding company of BOT projects in 2007. Sadbhav Group has a portfolio of 25 BOT projects (eleven operational, one partly operational and thirteen under construction HAM projects). SEL operates majorly across four distinct business areas in the infrastructure sector viz. EPC of its own BOT road projects, cash contract-based road and metro rail EPC projects, irrigation and mining. During FY19, these segments contributed 23%, 69%, 4% and 4%, respectively, in SEL's contract receipts booked on a standalone basis.

Brief Financials – SEL (Standalone) - (Rs. crore)	FY18 (A)	FY19 (*)
Total operating income (TOI)	3,534	3,650
PBILDT	445	528
PAT	221	187
Overall gearing (times)	0.80	0.73
Interest coverage (times)	2.33	3.02

*A: Audited; * - As per results published on stock exchange*

Brief Financials – Sadbhav Group# - (Rs. crore)	FY18	FY19
TOI	3,862	3,945
PBILDT	657	739
PAT	288	243
Overall gearing (times)	0.83	0.83
Interest coverage (times)	2.20	2.55

 # combining SEL (standalone) and Sadbhav Infrastructure Project Limited (SIPL; standalone) financials

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure – 2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debentures-Non Convertible Debentures	INE764L07173	April 23, 2018	10.20%	April 23, 2023	170.00	CARE A (CE) (Under Credit watch with Developing Implications)
Debentures-Non Convertible Debentures	INE764L07181	June 06, 2018	10.20%	June 06, 2023	190.00	CARE A (CE) (Under Credit watch with Developing Implications)
Debentures-Non Convertible Debentures	INE764L07058	December 16, 2014	12.14%	Nov 18, 2019	64.00	CARE A (CE) (Under Credit watch with Developing Implications)
Debentures-Non Convertible Debentures	INE764L07074, INE764L07082	January 09, 2015	11.75%	April 13, 2020	120.00	CARE A (CE) (Under Credit watch with Developing Implications)
Debentures-Non Convertible Debentures	INE764L07108, INE764L07116, INE764L07124, INE764L07132, INE764L07140, INE764L07157, INE764L07165	September 21, 2016	10.30%	April 26, 2022	250.00	CARE A (CE) (Under Credit watch with Developing Implications)

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Bonds	LT	-	-	-	1)Withdrawn (18-Sep-18)	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)
2.	Debentures-Non Convertible Debentures	LT	64.00	CARE A (CE) (Under Credit watch with Developing Implications)	-	1)CARE A (SO); Stable (20-Feb-19) 2)CARE A+ (SO); Stable (18-Sep-18)	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)
3.	Debentures-Non Convertible Debentures	LT	120.00	CARE A (CE) (Under Credit watch with Developing Implications)	-	1)CARE A (SO); Stable (20-Feb-19) 2)CARE A+ (SO); Stable (18-Sep-18)	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)
4.	Debentures-Non Convertible Debentures	LT	250.00	CARE A (CE) (Under Credit watch with	-	1)CARE A (SO); Stable (20-Feb-19)	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
				Developing Implications)		2)CARE A+ (SO); Stable (18-Sep-18)		
5.	Fund-based/Non-fund-based-LT/ST	LT/ST	400.00	CARE A- / CARE A2+ (Under Credit watch with Developing Implications)	1)CARE A-; Stable / CARE A2+ (04-Apr-19)	-	1)CARE A-; Stable / CARE A2+ (28-Nov-17)	-
6.	Debentures-Non Convertible Debentures	LT	170.00	CARE A (CE) (Under Credit watch with Developing Implications)	-	1)CARE A (SO); Stable (20-Mar-19) 2)CARE A+ (SO); Stable (18-Sep-18) 3)Provisional CARE A+ (SO); Stable (16-Apr-18)	-	-
7.	Debentures-Non Convertible Debentures	LT	190.00	CARE A (CE) (Under Credit watch with Developing Implications)	-	1)CARE A (SO); Stable (20-Mar-19) 2)CARE A+ (SO); Stable (18-Sep-18) 3)Provisional CARE A+ (SO); Stable (16-Apr-18)	-	-

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:

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