# Sadbhav Infrastructure Project Limited

July 10, 2019

**Rating**

| Facilities | Amount (Rs. crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Long Term / Short – term Bank Facilities | 400.00 | **CARE A- / CARE A2+ (Single A Minus / A Two Plus) (Under Credit Watch with Developing Implications)** | Placed on credit watch with developing implications |
| **Total Facilities** | **400.00 (Rupees Four Hundred Crore Only)** | | |

*Details of facilities in Annexure - 1*

**Detailed Rationale & Key Rating Drivers**

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

Successful completion of the afore-mentioned transaction is expected to result in rationalization of SIPL's 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 from listed units of IndInfravit and project management fees linked with toll collection along with right of first offer (ROFO) option of monetizing future 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 receipts of payments and claim from authority for the transaction assets shall be 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 SIPL before arriving at a view on its credit rating. Further, the company needs to comply with conditions precedent (CP) including but not limited to obtaining no objection certificate (NOC) from authority and lenders, which would further determine the quantum and timing of cash flow from stake sale.

The ratings continue to take into account the parentage of Sadbhav Engineering Limited (SEL; rated CARE A / CARE A1 (Under Credit Watch with Developing Implications)) which is one of the leading players in the domestic road construction sector, low revenue risk associated with its under-construction hybrid annuity model (HAM) road projects once they become operational. The ratings are, however, constrained on account of continued under-performance of its two operational SPVs leading to their dependence on SIPL, susceptibility of the operational BOT projects to inherent traffic, operations & maintenance (O&M), regulatory and interest rate risks along with its moderate scale of operations on standalone basis. The ratings are further constrained by inherent funding and execution risk associated with under construction HAM projects along with delay in the execution of some of the ongoing HAM projects.

Extent of support required to be extended to its two under-performing operational BOT projects, completion of ongoing HAM projects within extended time frame approved by NHAI along with rationalization of debt levels of SIPL from stake sale proceeds shall remain key rating sensitivity. Further, pace of addition of new BOT projects and its impact on capital structure shall remain remain key credit monitorable.

**Detailed description of the key rating drivers**

**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 (IndInfravit) 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 units which are listed and marketable in nature 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

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

holding of some InvIT units by SIPL is also expected to provide annual dividend income to it along with right of first offer (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.

***Parentage of SEL and support extended by it:*** SEL held 69.05% stake in SIPL as on March 31, 2019. SEL is the flagship company of Sadbhav Group and the engineering, procurement and construction (EPC) contractor of all the BOT projects of SIPL. SEL has track record of over two decades in the Indian road construction sector and has successfully completed construction of more than 8,400 lane km of road since its establishment. SEL has extended its unconditional and irrevocable corporate guarantee for the entire outstanding long term debt of SIPL of Rs.892 crore as on March 31, 2019. Furthermore, SEL has also infused short term loan of Rs.634 crore in SIPL as on March 31, 2019 for funding SIPL's equity commitments and shortfall.

***Improved cash surplus of operational SPVs during FY18 and FY19 resulting in higher up-streaming of funds to the sponsor:*** 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.

***Liquidity Analysis:*** SIPL's on a standalone basis had low fund-based debt of Rs.10 crore without recourse to SEL as on March 31, 2019. Rated bank facilities of Rs.400 crore comprise of non-fund based bank guarantee (BG) without recourse to SEL where in there has been no invocation in the past. SIPL's liquidity position remains moderate on account of tightly matched internal accruals with repayment obligations and equity commitments along with absence of fund based committed bank lines on standalone basis. However, up-streaming of surplus cash from operational SPVs have supported SIPL's liquidity position. As on March 31, 2019, SIPL had cash and cash equivalent (including reserves created in SPVs and margin money) of Rs.0.44 crore on standalone basis and Rs.170.38 crore on consolidated basis. Average utilization of the non-fund based limits remained at around 85% for the past twelve months ended June 2019.

However, the cash flow from operations remained healthy at around Rs.180 crore during FY19 due to healthy profitability and efficient working capital management. Further, the liquidity of SIPL is underpinned by it being a subsidiary of SEL which has track record of supporting SIPL in times of exigencies. Liquidity position is expected to improve significantly with cash flows from stake sale transaction. The cash proceeds from the stake sale transaction would be largely utilized for reduction in debt levels of SIPL and balance for future equity commitments in SPVs.

***<u>Key Rating Weaknesses:</u>***

***Execution and funding risk associated with under-construction HAM projects elevated by delay in implementation of some of them:*** SIPL has 12 under-construction HAM projects in its portfolio with aggregate Bid Project Cost (BPC) of Rs.11,081 crore out of which eight HAM projects have received appointed date while it is awaited for balance four HAM projects. HAM projects derive comfort from inherent strengths such as (i) low project funding risk with inflation indexed annuity to be received for construction and favorable clauses introduced in the concession agreement (CA) to debottleneck project execution challenges (ii) lower post implementation risk on account of inflation-indexed annuity to be received for operations and maintenance (O&M) of the road and (iii) receipt of bank rate linked interest annuity. However, unlike the clauses contained in the CA, delay in de-scoping of the unavailable project land has been witnessed in many of the on-going HAM projects of SIPL. There has been delay in execution of some of ongoing HAM projects of SIPL mainly due to hindrances in land acquisition, delay in de-scoping of unavailable land, utility shifting, lack of clarity on change scope, etc. Provisional COD for one of the HAM projects has been recommended by NHAI while extension of time has been approved or in various stages of approval in other ongoing projects which once approve shall provide relief to SPVs to an extent for project execution. However, completion of ongoing HAM projects within revised timeline shall be crucial.

The under construction HAM projects of SIPL have equity commitments of around Rs.841 crore spread over FY20 – FY22. 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. Equity commitments for these HAM projects and shortfall in two operational SPVs are expected to be fulfilled largely through stake sale proceeds and internal cash accruals of

SIPL as against earlier expectation of debt and internal accruals. However, timely completion of stake sale transaction and utilization of stake sale proceeds for rationalizing debt levels will be crucial from credit perspective.

***Under-performance of its two operational BOT road projects leading to their dependence on SIPL for their uninterrupted operations and debt servicing:*** There has been significant shortfall in toll collections of two of BOT road projects primarily on account of lower than estimated toll collections. Lower toll collections in these two projects are primarily on account of toll leakages and higher than envisaged proportion of local category vehicles which are exempted from toll. Further, traffic is expected to remain subdued for one of the projects in medium term with development of alternate route. Significant extent of support required to be extended by SIPL to these two SPVs shall continue to constrain its ratings.

***Susceptibility of the operational toll based BOT projects to traffic, interest rate and regulatory risk:*** The operational toll based SPVs of SIPL are susceptible to inherent revenue risk related to traffic growth, wholesale price index (WPI) linked toll rates and timely release of compensation from state authorities for loss of revenue from exempted vehicles in its two SPVs. Furthermore, since most of the operational toll projects have a high mix of commercial traffic indicating higher linkage to the state of economy and macroeconomic condition the same can have an adverse impact during times of severe economic downturn. The SPVs are also exposed to inherent interest rate risk since the interest rate on the debt taken by majority of them is floating in nature. Further, MBCNL is exposed to inherent regulatory risk considering that this is a project of state transport department and hence susceptible to any change in law apart from risk related to delay in commencement of revenue from check posts even after achieving commercial operations date (COD) due to various factors beyond the control of the company.

***Moderate scale of operations on standalone basis due to limited revenue diversity; albeit with expected increase in financial flexibility through stake sale:*** SIPL has moderate scale of operations on standalone basis with major source of income being the O&M and major maintenance contracts that the company has entered in to with its SPVs. SIPL's TOI declined marginally to Rs.356 crore in FY19 as compared to Rs.384 crore in FY18 largely on account of delay in receipt of appointed date in four HAM projects leading to lower O&M income. SIPL shall continue its O&M and major maintenance work for nine operational SPVs even post stake sale. However, annual dividend income from proposed holding of some InvIT units by SIPL is expected to augment its current revenue streams. Further, SIPL's financial flexibility is expected to increase with proposed holding of InvIT units which can be liquidated along with ROFO option for monetization of future operational HAM projects to InvIT portfolio.

**Analytical approach:** Standalone along with factoring support expected to be received from its parent, SEL, for servicing its guaranteed contractual debt and factoring likely support to be extended by SIPL to its various SPVs as well as benefit of up-streaming of cash surplus generated at its SPV level.

**Applicable Criteria**
[Criteria on Assigning Outlook to Credit Ratings]
[CARE's Policy on Default Recognition]
[Criteria for Short Term Instruments]
[Rating Methodology - Infrastructure Sector Ratings (ISR)]
[Rating Methodology: Factoring Linkages in Ratings]
[Financial Ratios - Non-Financial Sector]

**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*

**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 Bank Facilities | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue (Rs. crore) | Rating assigned along with Rating Outlook |
|---|---|---|---|---|---|
| Fund-based/Non-fund-based-LT/ST | - | - | - | 400.00 | CARE A- / CARE A2+ (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)<br>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)<br>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 Developing Implications) | - | 1)CARE A (SO); Stable (20-Feb-19)<br>2)CARE A+ (SO); Stable (18-Sep-18) | 1)CARE A+ (SO); Stable (08-Jan-18) | 1)CARE A+ (SO) (14-Oct-16) |
| 5. | Fund-based/Non-fund-based-LT/ST | LT/ST | 400.00 | CARE A- / CARE A2+ (Under Credit watch with | 1)CARE A-; Stable / CARE A2+ (04-Apr-19) | - | 1)CARE A-; Stable / CARE A2+ (28-Nov-17) | - |

| 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) | | | | |
| 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)<br>2)CARE A+ (SO); Stable (18-Sep-18)<br>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)<br>2)CARE A+ (SO); Stable (18-Sep-18)<br>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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