

India Ratings Downgrades IL&FS IDF's Series-1 Schemes; Maintains RWN

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By Vineeta Jha

India Ratings and Research (Ind-Ra) has downgraded IL&FS Infrastructure Debt Fund's (IL&FS IDF) three Series-1 mutual fund schemes and maintained the ratings on rating watch negative (RWN) as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Rating Watch	Rating Action
IL&FS Infrastructure Debt Fund - Series 1A Scheme	-	-	-	INR2,317.9	IND A+idf-mf/RWN	Downgraded; maintained on RWN
IL&FS Infrastructure Debt Fund - Series 1B Scheme	-	-	-	INR2,351	IND AA-idf-mf/RWN	Downgraded; maintained on RWN
IL&FS Infrastructure Debt Fund - Series 1C Scheme	-	-	-	INR2,831.1	IND AA-idf-mf/RWN	Downgraded; maintained on RWN

The ratings do not factor in the expectation of the default risk for the scheme itself, as a fund/scheme generally cannot default. The ratings should be interpreted as an opinion about the strength of the fund's investment policies, the expertise and experience of the sponsors and investment managers, and the scheme's vulnerability to severe losses.

The ratings also do not address the risk of a loss from changes in the prevailing interest rates, credit spreads and other market conditions, and comment on the adequacy of market value to address the extent to which the fund expenses and costs may reduce distributions to unit holders. The ratings do not predict a specific level or a range of performance of a scheme/fund over any given time period and opine on the suitability or otherwise of a fund for investment or any other purposes.

Potential users of this rating should note that these ratings are on a rating scale different from the one prescribed by the Securities and Exchange Board of India for the purpose of providing credit ratings to various categories of debt securities.

The ratings are downgraded due to the deterioration in the underlying portfolio quality of the schemes due to its exposure to IL&FS group entities. The RWN reflects absence of clarity on the resolution of the above referred assets in the portfolio due to the poor financial profile of the sponsor group (IL&FS). All IL&FS IDF schemes generally have an exposure of around 23.55% in group companies - IL&FS Solar Power Limited (ISPL) and IL&FS Wind Energy Limited (IWEL), whose credit profile has weakened.

Scheme 1A, maturing in April 2019, is at an increased risk due to a possible reduction in return from IWEL. The management expects IWEL to complete divestment of its 51% holding in its seven investee wind special purpose vehicles on or before 31 March 2019. According to management, discussions are ongoing with few parties; however no player had been identified for the sale until mid-October. Management asserts that proceeds from the sale would be used to repay IL&FS IDF's debt in full. According to IL&FS IDF's management, the company aims to build-up cash reserve for timely scheme redemption through a combination of strategies. However, any delays in materialisation of cash flows would result in reduced recovery; and crystallisation of the plan is critical for successful redemption.

KEY RATING DRIVERS

Deteriorating Underlying Credit Profile of Schemes: The downgrade reflects the declining credit profile of the underlying schemes due to a substantial exposure to group companies - IWEL and ISPL (subsidiaries of IL&FS Energy Development Company Limited), whose credit profiles have weakened. IL&FS Energy Development Company's financial profile has also declined, which further increases the credit risk on IWEL and ISPL. The fund's exposure to these group companies is around 23.55% of the total assets under management (AUM) as on 30 September 2018.

Change in Management: The central government has replaced the IL&FS group board with new members. Ind-Ra is of the view that the timeliness of redemption and stake sale in IWEL without compromising the portfolio's asset quality and investors' interest is a key for the fund at this juncture.

Despite the group's expertise in India's infrastructure space with competencies encompassing project advisory, sponsoring and development of projects, their ability to execute projects in the pipeline and take up new assignments is impacted significantly in the near term, given the recent events.

At end-September 2018, the fund invested in the non-convertible debentures of 13 projects/companies, which have presence across diverse sectors. Around 0.15% of the corpus is invested in liquid instruments. Ind-Ra believes the sponsor's INR1.25 billion investment in the corpus demonstrates its confidence in IL&FS IDF's prospects. IL&FS Investment Managers (IIML) has been the first-mover in the Indian infrastructure private equity space since late 1990s and has managed several pioneering infrastructure investments in sectors such as telecom, waste management and city gas distribution. IIML also has extensive fund raising and management experience with Indian as well as international institutions, which can be leveraged by IL&FS IDF for further fund raising.

According to management, there have been no haircuts on any units managed by IL&FS IDFs.

RATING SENSITIVITIES

Portfolio composition and characteristics not conforming to Ind-Ra's expectations could trigger a negative rating action. Any sharp deterioration in the credit quality of investments that could permanently impair recovery prospects within the tenor of the schemes could also result in a downgrade. Ind-Ra will monitor the developments after the new management's intervention and the stake sale of IWEL in a timely manner.

COMPANY PROFILE

IL&FS Financial Services Ltd (IFIN; 'IND D') had set up an infrastructure debt fund under the mutual fund route, which will be governed by the mutual fund regulations of the Securities and Exchange Board of India. Effective 1 January 2017, the ownership of the asset manager and trustee company of the fund was transferred to IIML, a subsidiary of IL&FS, from IFIN. The ownership and management control of IL&FS IDF would remain within the IL&FS group as the ultimate controlling shareholder in both entities IFIN and IIML.

IL&FS IDF (Series 1) has raised a corpus of INR7.5 billion from domestic investors on a private placement basis. The amount is spread over three schemes – INR2.32 billion for scheme A, INR2.35 billion for scheme B and INR2.8 billion for scheme C with tenor of five, seven and 10 years, respectively. The units were fully paid and subsequently listed on the National Stock Exchange. The schemes offer both dividend and growth options to its investors.

RATING HISTORY

Instrument Type	Current Rating/Rating Watch			Historical Rating/Rating Watch		
	Rating Type	Rated Limits (million)	Rating	11 September 2018	29 December 2016	24 June 2015
IL&FS Infrastructure Debt Fund - Series 1A Scheme	Long-term	INR2,317.9	IND A+idf-mf/RWN	IND AAAidf-mf/RWN	IND AAAidf-mf	IND AAAidf-mf
IL&FS Infrastructure Debt Fund - Series 1B Scheme	Long-term	INR2,351	IND AA-idf-mf/RWN	IND AAAidf-mf/RWN	IND AAAidf-mf	IND AAAidf-mf

IL&FS Infrastructure Debt Fund - Series 1C Scheme	Long-term	INR2,831.1	IND AA-idf-mf/RWN	IND AAAidf-mf/RWN	IND AAAidf-mf	IND AAAidf- mf
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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

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Applicable Criteria

[Rating Mutual Fund Schemes of Infrastructure Debt Funds](#)

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