

## India Ratings Downgrades IL&FS IDF's Series-2 Schemes; Maintains RWN

# 16

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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-2 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 2 Schemes (2A, 2B & 2C)	-	-	-	INR5,750	IND AA-idf-mf/RWN	Downgraded; Maintained on RWN

The rating does not factor in the expectation of the default risk for the scheme itself, as a fund/scheme generally cannot default. The rating 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 rating also does not address the risk of a loss due to 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 fund expenses and costs may reduce distributions to unit holders. The rating does 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 downgrade reflects deterioration in the underlying portfolio quality of the schemes due to 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.

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 debt in full. Ind-Ra will monitor the developments in the portfolio and their effects on the schemes.

### 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 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 0.10% of the corpus is invested in liquid instruments. Ind-Ra believes that the sponsor's INR1.3 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 an 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.

**Strategy of Co-investing Favourable:** The fund's strategy of co-investing with few other investors should help it secure favourable transaction structures. It will also play an active role, where necessary, to ensure investee entities perform according to expectations. If one or more of the portfolio investments are stressed, IL&FS IDF will quickly step into exercise creditor rights to harness IL&FS IDF's long-term economic value. This is characteristic of several infrastructure projects despite the short-term volatility in performance or cash flows.

## 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 debt fund was transferred to IIML, a subsidiary of IL&FS, from IFIN. The ownership and management control of the fund would remain within the IL&FS group as the ultimate controlling shareholder in both entities IFIN and IIML.

IL&FS IDF (Series 2) has raised a corpus of INR5.75 billion from domestic investors on a private placement basis. The amount is spread over three schemes – INR1.69 billion for scheme A, INR2.25 billion for scheme B and INR1.81 billion for scheme C with tenor of five, seven and 12 years, respectively. The units will be paid up after the final draw down and subsequently listed on the National Stock Exchange. All investors invested in the growth option.

## RATING HISTORY

Instrument Type	Current Rating			Historical Rating/Rating Watch		
	Rating Type	Rated Limits (million)	Rating	11 September 2018	8 June 2017	17 June 2016
IL&FS Infrastructure Debt Fund - Series 2 Schemes (2A, 2B & 2C)	Long-term	INR5,750	IND AA-idf-mf/ RWN	IND AAAidf-mf/RWN	IND AAAidf-mf	IND AAAidf-mf

## SOLICITATION DISCLOSURES

Additional information is available at [www.indiaratings.co.in](http://www.indiaratings.co.in). The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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## ABOUT INDIA RATINGS AND RESEARCH

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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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