

## 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 ratings 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 BBB idf-mf/RWN	Downgraded; maintained on RWN
IL&FS Infrastructure Debt Fund - Series 1B Scheme	-	-	-	INR2,351	IND A- idf-mf/RWN	Downgraded; maintained on RWN
IL&FS Infrastructure Debt Fund - Series 1C Scheme	-	-	-	INR2,831.1	IND A+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 have been downgraded owing to the weakening of the underlying portfolio quality of the schemes on account of exposure to Infrastructure Leasing & Financial Services Limited's (IL&FS; 'IND D') group entities. The credit profiles of IL&FS group companies have significantly weakened following the downfall of the sponsor IL&FS. The RWN reflects uncertainty over the ongoing resolution process of the IL&FS group at the National Company Law Appellate Tribunal. All IL&FS IDF schemes generally have an exposure of around 23.81% to two IL&FS group companies – IL&FS Solar Power Limited and IL&FS Wind Energy Limited (IWEL) – whose credit profiles have weakened.

Scheme 1A, maturing on 29 April 2019, is at an increased risk due to the expected write-off of the scheme's exposure to IWEL, falling due for repayment on 15 April 2019. This might result in lower-than-expected returns from the scheme to investors. The likely write-off will marginally affect the assets under management (AUM) of scheme 1B. The delay in the divestment process of IWEL has added to the risk of the non-availability of enough funds for the redemption on the due date. However, the management plans to redeem the current value of investments in scheme 1A on maturity, except IWEL, which is up for sale.

According to the management, financial and technical bids for IWEL have been received from a few parties and the proceeds from the sale would be sufficient to repay its debt in full. Also, it asserted that the fund would build up sufficient cash reserves for timely scheme redemption through a combination of strategies. However, any delays in the materialisation of cash flows would result in reduced recovery; crystallisation of the plan is critical for successful redemption.

## KEY RATING DRIVERS

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**Expected Write-Off of Group Entity's Debt:** The downgrade reflects a reduction in the AUM of schemes 1A and 1B in view of the expected write-off of IWEL's debt, whose repayment is due on 15 April 2019. Delays in the resolution of the IL&FS group by the National Company Law Appellate Tribunal and the weakened credit profiles of IWEL and IL&FS Solar Power have increased the likelihood of a reduced recovery. However, given the next scheme is due for redemption in April 2021, the management expects that there would be sufficient time available for the recovery of the amounts in a timely manner.

**Competent Asset Manager:** In Ind-Ra's view, investment manager IL&FS Infra Asset Management Company Ltd (IIAML or asset management company) has a reasonable track record in managing the portfolio. Experience and structuring skills in financial services are considered critical ingredients for the commercialisation of infrastructure transactions. IIAML employs senior professionals with a decent experience in the sector and in the financial services business.

Ind-Ra believes that as part of its investment policy, IL&FS IDF has created a balanced, diversified portfolio within the overall ambit of the prescribed investment guidelines, the aberration being IL&FS group entities. However, the successful redemption of the schemes on maturity without any haircuts on units and the ability of IIAML to ensure a robust portfolio will remain key monitorables.

**Expected Sale of IIAML:** The new board of the IL&FS group has invited bids for the acquisition of IL&FS's stake in IIAML. Ind-Ra is of the view that the acquisition of the asset management company by a strong sponsor with a deep understanding of and expertise in the infrastructure sector will enable infrastructure debt funds to identify the right investment opportunities. The sale of IIAML to another sponsor will be an event for a further rating action.

## RATING SENSITIVITIES

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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 resolution process of the IL&FS group and the stake sale of IWEL.

## COMPANY PROFILE

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IL&FS Financial Services Ltd ('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 the trustee company of the fund was transferred to IL&FS Investment Managers Limited, a subsidiary of IL&FS, from IL&FS Financial Services. IIAML, a subsidiary of IL&FS Investment Managers, is the asset manager of the IL&FS IDF.

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 under scheme A, INR2.35 billion under scheme B and INR2.8 billion under scheme C, which have a 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 investors.

## FINANCIAL SUMMARY

Particulars (INR million)	Series 1A		Series 1B		Series 1C	
	FY18	FY17	FY18	FY17	FY18	FY17
Total assets	3666.62	3274.95	3648.22	3261.89	4288.54	3804.41
Total income and gains	441.83	358.74	436.32	347.63	542.31	408.41
Surplus for the year	390.91	314.00	385.59	303.03	483.03	356.38
Source: Audited Financials of IL&FS Mutual Fund (IDF) – Scheme 1A, 1B & 1C						

## RATING HISTORY

Instrument Type	Current Rating/Rating Watch			Historical Rating/Rating Watch		
	Rating Type	Rated Limits (million)	Rating	16 October 2018	29 December 2016	24 June 2015
IL&FS Infrastructure Debt Fund - Series 1A Scheme	Long-term	INR2,317.9	IND BBB idf-mf/RWN	IND A+ idf-mf/RWN	IND AAAidf-mf	IND AAAidf-mf
IL&FS Infrastructure Debt Fund - Series 1B Scheme	Long-term	INR2,351	IND A- idf-mf/RWN	IND AA- idf-mf/RWN	IND AAAidf-mf	IND AAAidf-mf
IL&FS Infrastructure Debt Fund - Series 1C Scheme	Long-term	INR2,831.1	IND A+ idf-mf/RWN	IND AA- idf-mf/RWN	IND AAAidf-mf	IND AAAidf-mf

## COMPLEXITY LEVEL OF INSTRUMENTS

For details on the complexity levels of the instruments, please visit <https://www.indiaratings.co.in/complexity-indicators>.

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## Applicable Criteria

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### Rating Mutual Fund Schemes of Infrastructure Debt Funds

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## Analyst Names

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