

India Ratings Downgrades IL&FS IDF's Series-3 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) two Series-3 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 3A Scheme	-	-	-	INR1,400	IND A+ idf-mf/RWN	Downgraded; Maintained on RWN
IL&FS Infrastructure Debt Fund - Series 3B Scheme	-	-	-	INR1,530	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 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 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 (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.

The heightened uncertainty over timely debt servicing by IWEL and the delays in its divestment process has added to the risk of non-availability of enough funds for scheme redemption on the due date. 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

Expected Write-off of Group Entity's Debt: The downgrade reflects a reduction in the assets under management (AUM) of the two schemes in IDF Series 1 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. Given the Series 3 is due for redemption in January 2023 and beyond, the management expects that there would be sufficient time available for the recovery of the amounts in a timely manner.

Competent Asset Managers: 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 and 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 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 AMC by a strong sponsor with a deep understanding of and expertise in the infrastructure sector will enable infrastructure debt fund to identify the right investment opportunities. The sale of IIAML to another sponsor will be an event for a further rating action.

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

COMPANY PROFILE

&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 IL&FS Investment Managers Limited, a subsidiary of IL&FS, from IFIN. IIAML, a subsidiary of IL&FS Investment Managers, is the asset manager of the IL&FS IDF.

IDF (Series 3) has raised a corpus of INR2.93 billion from domestic investors on a private placement basis. The amount is spread over two schemes – INR1.40 billion under scheme A and INR1.53 billion under scheme B – which have a tenor of five and seven 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.

FINANCIAL SUMMARY

Particulars	Series 3A
	FY18
Total assets (INR million)	1,425.07

Total income and gains (INR million)	26.46
Surplus for the year (INR million)	23.01
Source: Audited Financials of IL&FS Mutual Fund (IDF) – Scheme 3A	

RATING HISTORY

Instrument Type	Current Rating/Rating Watch			Historical Rating/Rating Watch		
	Rating Type	Rated Limits (million)	Rating	16 October 2018	7 May 2018	3 January 2018
IL&FS Infrastructure Debt Fund - Series 3A Scheme	Long-term	INR1,400	IND A+ idf-mf/RWN	IND AA- idf-mf/RWN	IND AAAidf-mf	IND AAAidf-mf
IL&FS Infrastructure Debt Fund - Series 3B Scheme	Long-term	INR1,530	IND A+ idf-mf/ RWN	IND AA- idf-mf/ RWN	IND AAAidf-mf	-

COMPLEXITY LEVEL OF INSTRUMENTS

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

SOLICITATION DISCLOSURES

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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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