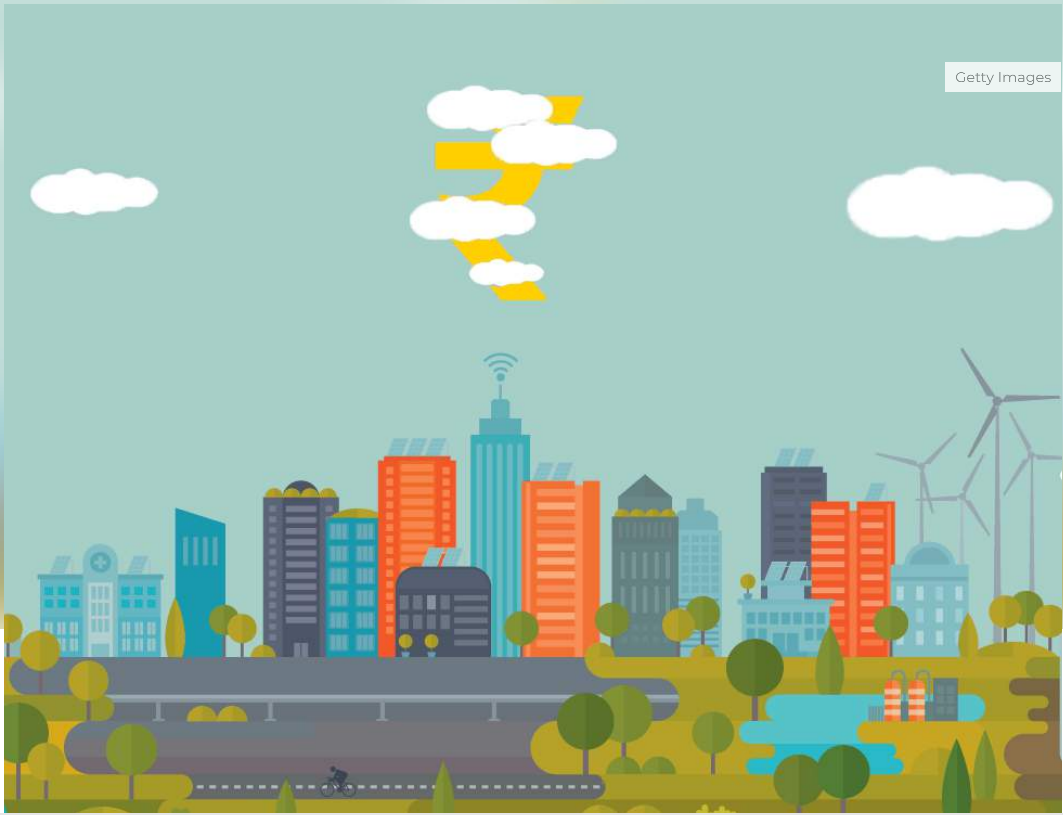
INVESTING

As fortunes of IRB, India Grid vary, InvITs need more love for Centre's asset-selling plan to click



Concept by Priyanka Salve and Muhabit ul haq

Synopsis

IRB InvIT is trading at a 50% discount to its IPO price, while India Grid Trust is trading at a premium of 35%. There are some structural issues that led to the divergence in performance, but one can't ignore the varying risks in their businesses. If the government wants to use InvITs to monetise assets, the market needs to deepen.

"I was lucky to be in the right place at the right time. But many others were also in the same place..."
-Bill Gates

The story of IRB **InvIT** and **India Grid Trust** somewhat mirrors what the Microsoft founder once said. Both were at the same place (almost) at the same time. But only one came out the winner. IRB InvIT and India Grid Trust were listed just two weeks apart in May 2017, but the narrative turned out to be strikingly different.

Infrastructure investment trusts or InvITs, the collective investment vehicles that enable direct **investments** from individual and institutional investors in infrastructure projects, were new products back then. There was a palpable air of excitement among investors. But not for long.

IRB InvIT is **trading** at a discount of 50% to its IPO price of INR102 as well as to its net asset value (NAV) per unit of INR75. On the other hand, India Grid Trust is trading at a premium of 35% to its IPO price and a 62% premium to its NAV per unit.

Poles apart

IRB InvIT

	FY18	FY19	FY20	FY21
NAV (book value) per unit	100.33	96.55	79.68	74.99
NAV (fair value) per unit	115.74	104.27	87.64	104.7
Market price at beginning of the FY	101.8*	83.29	67.3	26.3
Market price at the end of FY	82.04	66.05	25.61	53.55
Annual difference in unit price	-19.41	-20.70	-61.95	103.61
Annual distribution	10.55	12.25	10	8.5

India Grid Trust

	FY18	FY19	FY20	FY21
NAV (book value) per unit	102.73	98.17	86.52	83.13
NAV (fair value) per unit	102.73	98.59	102.26	146.25
Market price at beginning of the FY	98.64**	94.9	82.95	91.4
Market price at the end of FY	94.5	82	89.45	140.48
Annual difference in unit price	-4.20	-13.59	7.84	53.70
Annual distribution	9.56	12	12	12.2

Figure in INR

* Closing price as of May 18, 2017

**Closing price on June 6, 2017

Source: *Company disclosures, ET Prime research*

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The journey of IRB InvIT and India Grid Trust, the first two InvITs to be listed, has been fraught with many ups and downs. So much so that it took four years for the third public listing of an InvIT to happen. In the meantime, some six InvITs opted to be privately listed. In total, 15-odd InvITs are registered with the Securities and Exchange Board of India. InvITs are about to take off in a big way. This is because of their nature of giving returns that are supposed to be safe and expected to be higher than fixed deposits.

"The InvIT market has only started developing recently in India, but is expected to pick up over the years, given the government's thrust on the infrastructure sector," says Unmesh Kulkarni, managing director and senior advisor at wealth-management firm Julius Baer India.

However, most financial experts agree that InvITs are a product for savvy institutional investors and not for retail investors. We will tell you more in a bit about the risk quotient of these investment avenues and why IRB InvIT and India Grid Trust performed differently. Let's first understand how InvITs make money for their investors.

The InvIT way of making money

InvITs are a lot like mutual funds for infrastructure projects. There is a sponsor (the developer) who sets up the InvIT, which allows him to pool assets and an option to exit so that the money can be invested in other projects. The sponsor has to hold 15% of the units of the InvIT for at least three years.

Once an InvIT is formed and the developer transfers the operating assets, investors looking for passive income get their fixed return from the income generated by these assets — which could be ports, roads, or electricity-transmission networks. The developer, which usually earns its margins during the development phase of an asset, can enjoy a relatively free balance sheet, as the chunky project debt, usually repaid over 20 years or more, gets transferred along with the assets to the InvIT. The developer can then take up new projects and use the balance sheet to finance those till completion.

The InvIT can replace the project debt with new debt, which comes from the cash it collects from the pool of investors, or it can continue with the same debt if rates are good.

It's a win-win situation.

India is on track for its ambitious infrastructure-building programme. The investor gets regular consistent income from the revenue generated by the assets. The developer gets a nimble balance sheet; the investors get long-term passive income with the alpha coming from possible improvement in the performance of the assets (like roads or ports).

Everyone lives happily ever after. But that's just on paper.

The risk factors

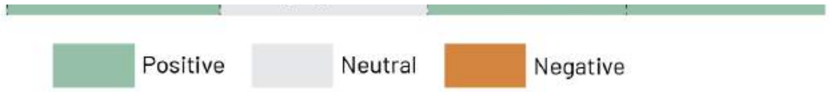
There are some structural issues that led to the divergence in the performance of IRB InvIT and India Grid Trust. But let's identify the elephant in the room first — the varying risks.

India Grid Trust is in the business of developing and operating power-transmission projects for an average of 35 years after commissioning. Once the transmission line is built, a long-term contract determines a fixed tariff rate per unit, which is paid to the transmission-line company. So, given the fixed nature of the tariff and comparatively less fluctuation in electricity demand on an annual basis, the earnings of India Grid InvIT are consistent.

Compare this with IRB InvIT, which is engaged in the road-construction business. Traffic flow on select stretches can be affected by multiple factors. A protest can impact traffic on a stretch of road. An alternative route or mode of transport can impact traffic. Changes to regulations that allow trucks to carry 25% more weight can also affect the number of vehicles plying.

Pros and cons

	Inter-state power transmission	Power generation	Roads	Ports
Certainty of cash flows	Driven by long-term agreements	Offtake an cost of fuel key risk	Traffic risk in BOT projects	End-user industry risk
Counter-party risk	Exposure limited to systemic risk	Direct exposure to debt-laden state electricity boards	Cost overuns, limited O&M impact on toll collection	Exposure to multiple end-users
Operational risk	Limited O&M requirements	Substanstial periodic manitenance needs	High O&M required	Limited O&M requirements
Future growth potential	Severe deficit in power-transmission capacity, but long-term contracts may limit future gains	India is power surplus at present	High growth potential	Good potential, limited by feassible locations
Competitive enviornment	Few credible players	High competition due to multiple players	Limited number of companies in BOT, HAM	Few private players



Source: *ET Prime research, DRHPs of InvITs*

“In the five-year period from FY15 to FY19; traffic grew at a CAGR of 5% per annum,” says Rajeshwar Burla, vice-president, corporate ratings at Icra, highlighting that traffic saw de-growth in FY20 and FY21.

In the pandemic year, the roads sector was impacted more than power transmission. Lockdowns put restrictions on movement, resulting in IRB InvIT paying investors a distribution of INR8.5 per unit in FY21, its lowest in four years.

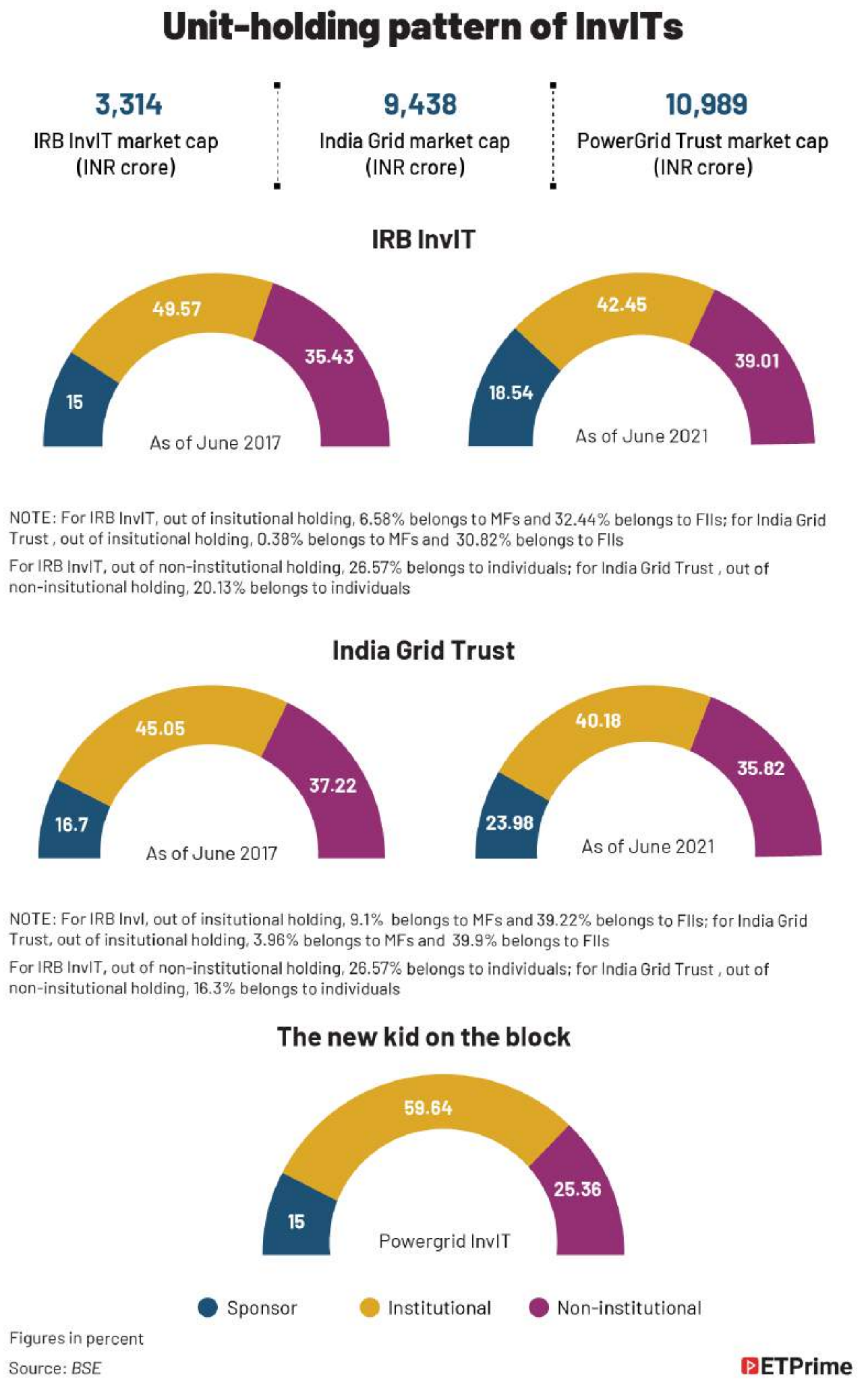
In FY20, the unit price of IRB InvIT fell from INR67 at the beginning of the year to just INR26. On the other hand, the unit price of India Grid improved from INR83 at the beginning of the year to INR89 at the end, though it did fall from its high of INR95 in February 2020.

Assets of India Grid have a residual life of around 30 years, while it is an average of 15 years for IRB InvIT. However, two highway stretches connecting Bharuch and Surat and one connecting Surat to Dahisar will come to the end of their concession period in April and May 2022. These two projects accounted for 51% of FY21 Ebitda of IRB InvIT. Another road stretch, Amritsar-Pathankot, has been affected due to the ongoing farmer protest.

However, retail shareholding in IRB InvIT has doubled since listing, with many new retail investors buying the InvIT in FY21.

The unit price of IRB InvIT doubled from INR25 by the end of FY21. An investor who bought IRB InvIT at the INR25 level would make a 34% return passively. But as attractive as these returns sound, the volatility hardly resembles that of a passive-income product.

On the other hand, while institutional holding has dropped even in India Grid, it is important to note that 8.4% of the units are now owned by insurance companies. Given the success of India Grid, it is not surprising that the government has decided to list the PowerGrid InvIT in the public market, while it seems to have chosen the private-placement route for the upcoming NHAI InvIT.



InvIT as an investment option

The regulators and exchanges are trying to improve investor sentiment in InvITs by allowing even single-unit trades and by including InvITs in indices. Both the moves are expected to improve the liquidity of the instruments.

“Currently, InvITs comprise only a small proportion of investors’ portfolios.

Moreover, unlike real estate, which is more popular and widely followed by investors, the infrastructure sector is not that well-understood or followed by general investors," says Kulkarni of Julius Baer India. He believes that investors need to become a bit more familiar with the dynamics of InvITs — in terms of the underlying investments in infrastructure assets or cash flows — before the instrument class attracts a wider investor audience.

With the Union government planning to monetise many state-owned assets, InvITs come into the limelight. According to the National Infrastructure Pipeline report, freight corridors, roads, power-transmission lines, gas-transportation pipelines, FCI warehouses, and railway signalling and track infrastructure could be monetised by issuing InvITs.

The total assets under management (AUM) across eight active InvITs, excluding PowerGrid InvIT, are around INR1.4 lakh crore. The bulk of the assets are under toll roads (INR47,500 crore) followed by telecom (INR42,000 crore), gas pipeline (INR16,500 crore), and power transmission (INR14,000 crore), says the report.

"In InvITs, distribution can be made in the form of return of capital, dividend, or interest. Return of capital happens in InvITs because unlike REITs (real estate investment trusts), the underlying assets such as roads are not perpetual. At the end of the tolling or concession period, these assets have to be transferred back to the government authority which owns them. InvITs, in which the residual maturity of the asset is not very long, will return a higher proportion of capital to unit holders," says Sachin Gupta, chief rating officer at CARE Ratings.

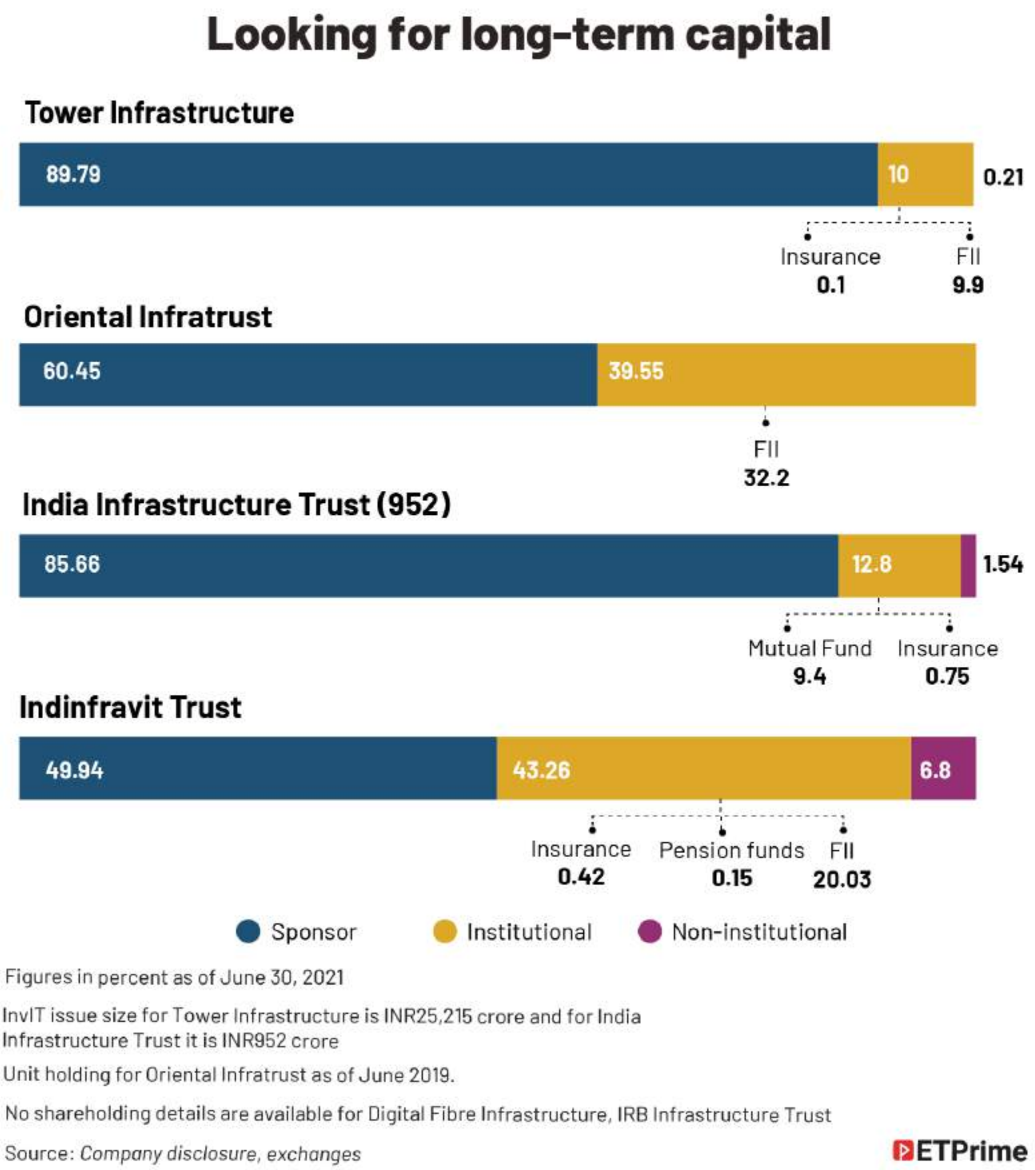
Since the assets are owned for a set duration by the InvIT, investors get distribution mainly in the form of interest rate and return of capital followed by some dividend. Interest is taxable for unit holders as per their income-tax slab, while return of capital is exempt from tax but not entirely.

"Technically, return of capital does incur taxes. If you buy an InvIT today at INR100 and then over a year you get INR20 as return of capital, your cost goes down INR80. But when you sell the instrument for, say, INR200, you will have to pay tax on INR200 minus INR80, which is INR120. So, the INR20 is tax-free only till you sell the unit. If you hold the unit till maturity, then there are no tax implications," says a tax expert working for a global consultancy firm.

While REITs are an appreciating asset, InvITs are a depreciating asset.

Private InvITs seem to have been gaining popularity among developers, as investors are open to putting money in diverse infrastructure assets and even in high-risk propositions such as under-development assets. Under the guidelines, a private InvIT can have up to 1,000 investors and not more. The investment size is also fairly large at around INR1 crore.

However, a closer look at the unit-holding pattern of some of the private InvITs shows that sponsors continue to hold more than significant units, diluting the goal of completely monetising assets. Even here, foreign portfolio investments goal of completely monetising assets. Even here, foreign-portfolio investments dominate the unit holding, while domestic mutual funds, insurance, and pension funds are yet to own meaningful shares.



What rides on InvITs

As far as fundraising is concerned, REITs have an edge over InvITs. Publicly listed REITs today have a total market cap of INR60,000 crore, while it is under INR24,000 crore for InvITs. If the government is keen on using InvITs as a way to monetise assets worth INR6 lakh crore, the market needs to deepen and the investor base needs to widen.

India has an infrastructure-funding problem. For a while, short- to medium-term capital of five to 10 years is financing infrastructure projects with a gestation period of 20-30 years. The government is attempting to correct it, and one idea that has been encouraged is the creation of InvITs.

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The idea is to raise money from a pool of medium- to long-term investors, both institutional and retail, rather than seeking funding from banks and institutions. InvITs are going to be big in the coming years, but before that the market needs to mature and investors should taper their expectations from these products.

At a time when equity markets are high, InvITs are not at the top of investors’ watchlist. But they serve a different purpose. In terms of asset allocation, these are good substitutes to fixed-income products. But like we have said, there are many teething issues that need attention.

(*Graphics by Manali Ghosh*)

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