Sadbhav Infrastructure Projects Limited

September 18, 2018

Ratings

Instruments	Amount (Rs. crore)	Ratings[1]	Rating Action
Long-term Non-Convertible Debenture - I	-	-	Withdrawn
Long-term Non-Convertible Debenture – II	532.00	CARE A+ (SO); Stable [Single A Plus (Structured Obligations); Outlook: Stable]	Reaffirmed
Long-term Non-Convertible Debenture – III	360.00		Final Rating
Total Instruments@	**892.00 [Rupees Eight Hundred and Ninety Two Crore only]**		

Details of instruments in Annexure-1

@backed by unconditional and irrevocable corporate guarantee extended by Sadbhav Engineering Limited (rated 'CARE A+; Stable/CARE A1')

Detailed Rationale & Key Rating Drivers

The rating assigned to the non-convertible debentures (NCD) issue of Sadbhav Infrastructure Project Limited (SIPL) takes into account the unconditional and irrevocable corporate guarantee extended by Sadbhav Engineering Limited (SEL).

The revision in short term rating of Sadbhav Engineering Ltd (SEL) takes into account CARE's expectation of lower than previously envisaged recovery of some of its long-pending debtors by September 2018 leading to higher than envisaged working capital intensity of its operations; along with challenges in fund raising faced by the construction sector which is expected to moderate the cash flows of SEL.

The ratings of SEL continue to take into account established track record of in the road construction, demonstrated capability in timely execution of large sized build-operate-transfer (BOT) projects along with its healthy and diversified order book. The ratings also factor good financial flexibility of Sadbhav group[2], completion of debt refinancing activity in many of the operational BOT projects of Sadbhav group leading to their self-sustainable operations as well as proposed up-streaming of surplus cash flows from some of these projects; along with benefits expected from various initiatives undertaken by the Government of India to mitigate the challenges and bottlenecks being faced by the road construction sector.

The ratings are, however, constrained on account of stretched receivables of SEL leading to high working capital borrowing and in turn moderate debt coverage indicators, Sadbhav group's exposure to inherent risks associated with BOT projects, and inherent challenges faced by the construction sector.

The ratings continue to take cognizance of deleveraging plans articulated by the management of Sadbhav group through realization of stretched receivables of SEL and materialization of various fund raising plans at Sadbhav Infrastructure Project Limited (SIPL) level including asset monetization and up-streaming of significant cash flows from one of its special purpose vehicles (SPVs); Maharashtra Border Check Post Network Limited (MBCNL) among various sources of long-term funding.

CARE shall closely monitor SEL's ability to recover reasonable amount of debtors from its completed BOT, Engineering Procurement and Construction (EPC) road and irrigation projects by September 2018 and achieve meaningful progress in fund raising plans at SIPL level by December 2018 leading to deleveraging of its balance sheet. Deviations from envisaged timeline leading to further moderation in cash flow cushion of Sadbhav Group shall be closely reviewed. Extent of change in scope as well as significant delay in project progress in its various on-going projects adversely impacting the working capital intensity of the Group shall also be a key rating sensitivity.

Detailed description of the key rating drivers of SEL

Key Rating Strengths

Established track record in the Indian road construction sector and demonstrated capability in timely execution of large size BOT road projects: SEL has a sound track record of over two decades in the Indian road construction sector. SEL has successfully completed construction of more than 7,551 lane km of road projects since its establishment with majority of the BOT projects completed in a timely manner. However, the progress in some of its ongoing HAM projects is behind schedule.

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[1] *Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

[2] *Combining SEL (standalone) and Sadbhav Infrastructure Project Limited (SIPL; standalone) financials*

Healthy and diversified order book: SEL had a healthy and diversified order book of Rs.13,249 crore (3.75 times of its contract receipts for FY18 [refers to the period April 1 to March 31]) as on March 31, 2018. Furthermore, the company also received new orders of Rs.2,977 crore during Q1FY19. The order book is diversified across four segments: EPC of road projects, EPC of BOT projects, mining and irrigation. The order book of the company is also geographically diversified with presence across various states of the country. Further, relatively less risky HAM projects constitute around 61% of its order book. The contribution of roads & highways segment in the total order book of the company which is its core strength has increased to 81% as on March 31, 2018 as compared to 45% as on March 31, 2015.

Improved profitability at Sadbhav group level: Based on combined financial results for FY18, Sadbhav Group's total operating income (TOI) increased from Rs.3,661 crore during FY17 to Rs.3,862 crore during FY18 primarily on account of growth in revenue from roads and highways segment and from under construction maintenance contract of HAM projects in SIPL on standalone basis. PBILDT margin of Sadbhav group improved from 15.45% during FY17 to 17.02% during FY18 on account of higher profitability at SIPL standalone level and increase in proportion of HAM projects in overall execution in SEL.

***Successful refinancing of debt in nine operational SPVs and proposed plan for up-streaming of cash flows from some of them*:** During the past two years, SIPL has successfully refinanced debt in nine of its operational SPVs. The same has led to substantial reduction in interest rate, staggered installment repayments utilizing its tail period and tie up of funds for the first major maintenance thereby resulting in self-sustainable operations of these SPVs. Post refinancing, the average cost of debt in nine of its operational SPVs has reduced to around 9.27% per annum. Furthermore, sanctioned loan facilities of MBCNL has an option of top-up loan up to Rs.220 crore upon tie-up of consortium lenders and additional loan up to Rs.300 crore in three equal tranches upon achievement of targeted revenue for consecutive three months. This is expected to result in up-streaming of cash flow for SIPL which has been suitably factored in its credit risk assessment. Top up loan of Rs. 150 crore has already been released by MBCNL till August 31, 2018. However, successful tie-up and disbursement of balance top-up debt in MBCNL and its up-streaming to SEL/SIPL within envisaged timelines will be crucial from the credit perspective in light of current challenging business environment.

Various initiatives undertaken by the Government of India (GOI) to improve the prospects of the road construction sector: GOI through National Highways Authority of India (NHAI; rated 'CARE AAA; Stable') has taken various steps to improve the prospects of the road sector. These include premium rescheduling for stressed projects, bidding of tenders only after 80% land has been acquired for the project, fast track clearances of the projects, release of 75% of arbitration award against submission of bank guarantee, 100% exit for developers after two years of project completion and NHAI funding for projects that are stuck at advanced stages of completion. Furthermore, NHAI has made some favourable changes in the clauses of model concession agreement and introduced HAM based BOT projects to reduce the equity commitment of the developers. Announcement of road development plan through Bharatmala project and fund raising plans of NHAI through Toll-Operate-Transfer (TOT) model is also expected to offer sizeable opportunity to the sector not withstanding aggressive bidding.

Key Rating Weaknesses

Increased working capital intensity of its operations and expected delay in the realization of stretched debtors: Working capital intensity of SEL increased significantly during FY17 primarily on account of increase in debtors from Rs.999 crore as on March 31, 2016 to Rs.1,665 crore as on March 31, 2017 which reduced marginally to Rs.1592 crore as on March 31, 2018. Elongation in receivables is primarily on account of change in scope in its operational BOT and some of the EPC projects and pending release of debtors in its largely completed EPC road, irrigation and mining projects. The same led to significant increase in short term working capital borrowing of SEL on standalone basis from Rs.568 crore as on March 31, 2016 to Rs.1,209 crore as on March 31, 2017 while it reduced marginally to Rs.1,045 crore as on March 31, 2018. SEL's management had articulated about its plans to significantly improve its collection efficiency through realization of dues pertaining to change in scope from authority, up-streaming of surplus funds from its two operational SPVs and release of payment from its largely completed EPC road and irrigation projects. The management has articulated about reduction in debtors from above projects by ~Rs.400 crore by September 2018 and by Rs. 200 crore by December 2018. Nevertheless, actual realization of these debtors are expected to be significantly lower than earlier estimates for September 2018 on account of delay in the release of change in scope payment due to various reasons, delay in receipt of final completion certificate in two of the EPC road projects and increased challenges in up-streaming of cash flow from one of its operational SPVs in current macro-economic environment. Going forward, Sadbhav group's ability to realize these debtors without further delay shall be extremely crucial from the credit perspective. The utilization of SEL's fund-based working capital borrowings during trailing 12 months-ended July 2018 remained high. However, reliance on outside consortium borrowings reduced considerably during 5MFY19 due to its replacement by NCD issuance of Rs. 170 crore. Moreover, proposed NCD proceeds of Rs. 190 crore are expected to be utilized for further reduction of its outside consortium borrowings.

Increase in debt levels leading to moderation in debt coverage indicators; albeit with good financial flexibility**:** The total debt of Sadbhav Group increased from Rs.1,742 crore as on March 31, 2016 to Rs.2,589 crore as on March 31, 2017 and reduced marginally to Rs.2,310 crore as on March 31, 2018. The increase in debt levels led to moderation in debt coverage indicators during FY17 and FY18. Nevertheless, SIPL has largely refinanced its earlier maturing debt repayments during FY19 and FY20 with longer tenor debt which provides some comfort from credit perspective. Further, Sadbhav group has good financial flexibility marked by overall gearing of 0.82 times as on March 31, 2018. Financial flexibility is also derived from listing of equity shares of both SEL and SIPL on stock exchanges and large operational portfolio of BOT road projects.

Exposure of the group to inherent risks associated with BOT projects along with subdued performance of two of its SPVs: Sadbhav group's exposure in the form of investment and loans & advances to its various SPVs further increased during FY18. However, comfort is derived from its portfolio of 11 operational BOT road projects with aggregate length of 3,000 lane km and under-construction road portfolio consisting of HAM projects. The under construction HAM projects have equity commitments of around Rs.1,000 crore spread over FY19 – FY21. The equity commitments for these HAM projects and shortfall in two operational SPVs are expected to be fulfilled through up-streaming of cash flows from MBCNL and other operational SPVs and cash accrual of SIPL. Going forward, SIPL's ability to materialize various fund raising plans in a time bound manner as articulated by its management will be crucial.

Challenging environment for the construction industry: The construction sector is facing hurdles in fund raising due to delay in enhancement of working capital limits, delay in financial closure and equity raising plans on account of challenging business environment for the sector and weakened financial health of the banking sector. The inherent risk involved in the construction industry including aggressive bidding, traffic risk, interest rate risk, volatile commodity prices and delay in project progress due to resistance towards land acquisition and regulatory clearances have collectively affected the credit profile of the developers in the past.

Analytical approach: Combined

CARE has taken a combined view of SEL (standalone) and SIPL (standalone) for analytical purpose. This is because majority of the long-term debt raised in SIPL is backed by unconditional and irrevocable corporate guarantee of SEL. Further, SEL and SIPL have operational and financial linkages for funding shortfall as well as up-streaming of cash flow of SPVs.

Applicable Criteria

Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology - Factoring Linkages in Ratings
Rating Methodology - Infrastructure Sector Ratings
Financial Ratios – Non-Financial Sector

About the company – SIPL

SEL had floated a 100% subsidiary, SIPL, in January 2007, as a holding company for its BOT projects. During FY11, SEL diluted 22.22% of its stake through issue of fresh equity of Rs.300 crore and compulsory convertible cumulative preference shares (CCCPS) of Rs.100 crore to private equity (PE) investors. Proceeds of PE were utilized by SIPL for fulfilling its equity commitment in BOT projects. During September 2015, SIPL raised Rs.425 crore through Initial Public Offer (IPO) of its equity shares. Sadbhav Group has a portfolio of 25 BOT projects (eleven operational, one partly operational and thirteen under construction HAM projects).

Brief Financials – SIPL (Standalone) - (Rs. crore)	FY17 (A)	FY18 (A)
Total operating income (TOI)	312	384
PBILDT	182	268
PAT	41	68
Overall gearing (times)	0.91	0.95
Interest coverage (times)	1.40	1.64

A: Audited; As per IND-AS accounting standard;

Based on un-audited results for Q1FY19, SIPL reported Total Income of Rs.79 crore (Q1FY18: Rs.92 crore) and profit after tax (PAT) of Rs.12 crore (Q1FY18: Rs.7 crore).

About the Guarantor - SEL

Incorporated in 1988, SEL has evolved as one of the prominent developers and EPC contractors in India. SEL operates majorly across four distinct business areas in the infrastructure sector viz. EPC of its own BOT road projects, cash contract-based road and metro rail EPC projects, irrigation and mining. During FY18, these segments contributed 34%, 49%, 9% and 7%, respectively, in SEL's contract receipts booked on a standalone basis.

During FY17, the founder of Sadbhav Group, Mr Vishnubhai Patel, became the Chairman Emeritus of SEL and SIPL. Mr Shashin Patel, became the Chairman and Managing Director of SEL and Chairman and Non-Executive Director of SIPL. Mr Vasistha Patel who is the Executive Director of SEL became the Managing Director of SIPL.

Brief Financials – SEL (Standalone) - (Rs. crore)	FY17 (A)	FY18 (A)
Total operating income (TOI)	3,395	3,535
PBILDT	432	445
PAT	186	221
Overall gearing (times)	1.07	0.80
Interest coverage (times)	2.83	2.33

A: Audited; As per IND-AS accounting standard;

Based on un-audited results for Q1FY19, SEL reported TOI of Rs.940 crore (Q1FY18: Rs.961 crore) and profit after tax (PAT) of Rs.63 crore (Q1FY18: Rs. 55 crore).

Brief Financials – Sadbhav Group - (Rs. crore)	FY17	FY18
TOI	3,659	3,862
PBILDT	565	657
PAT	227	288
Overall gearing (times)	1.02	0.83
Interest coverage (times)	2.42	2.20

Based on provisional results for Q1FY19, Sadbhav group reported TOI of 1001 crore (Q1FY18: Rs.1040 crore) and PAT of Rs.75 crore (Q1FY18: Rs. 63 crore).

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

Analyst Contact:
Name: Mr Maulesh Desai
Tel: 079-4026 5605
Mobile: +91-8511190079
Email: maulesh.desai@careratings.com

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Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debentures-Non Convertible Debentures	May 30, 2014	Floating interest rate. 1 year annualised G Sec benchmark rate + 4.94% - 5.62%	April 5, 2020	140.54	Withdrawn
Debentures-Non Convertible Debentures	December 16, 2014	12.14%	Nov 18, 2019	112.00	CARE A+ (SO); Stable
Debentures-Non Convertible Debentures	January 09, 2015	11.75%	April 13, 2020	120.00	CARE A+ (SO); Stable
Debentures-Non Convertible Debentures	September 21, 2016	10.30%	April 26, 2022	300.00	CARE A+ (SO); Stable
Debentures-Non Convertible Debentures	April 20, 2018	10.20%	May 2023	360.00	CARE A+ (SO); Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Fund-based - LT-Term Loan	LT	-	-	-	-	-	1)Withdrawn (02-Feb-16)
2.	Debentures-Non Convertible Debentures	LT	-	-	-	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)	1)CARE A+ (SO) (01-Mar-16)
3.	Debentures-Non Convertible Debentures	LT	112.00	CARE A+ (SO); Stable	-	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)	1)CARE A+ (SO) (01-Mar-16)
4.	Debentures-Non Convertible Debentures	LT	120.00	CARE A+ (SO); Stable	-	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)	1)CARE A+ (SO) (01-Mar-16)
5.	Debentures-Non Convertible Debentures	LT	300.00	CARE A+ (SO); Stable	-	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)	-
6.	Fund-based/Non-fund-based-LT/ST	LT/ST	400.00	CARE A-; Stable / CARE A2+	-	1)CARE A-; Stable / CARE A2+ (28-Nov-17)	-	-
7.	Debentures-Non Convertible Debentures	LT	360.00	CARE A+ (SO); Stable	1)Provisional CARE A+ (SO); Stable (16-Apr-18)	-	-	-

CONTACT

Head Office Mumbai

Ms. Meenal Sikchi
Cell: + 9198190 09839
E-mail: meenal.sikchi@careratings.com

Mr. Ankur Sachdeva
Cell: + 9198196 98985
E-mail: ankur.sachdeva@careratings.com

Ms.Rashmi Narvankar
Cell: + 9199675 70636
E-mail: rashmi.narvankar@careratings.com

Mr. Saikat Roy
Cell: + 9198209 98779
E-mail: saikat.roy@careratings.com

CARE Ratings Limited

(Formerly known as Credit Analysis & Research Ltd.)

Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022

Tel: +91-22-6754 3456 | Fax: +91-22-6754 3457 | E-mail: care@careratings.com

AHMEDABAD
Mr. Deepak Prajapati
32, Titanium, Prahaladnagar Corporate Road,
Satellite, Ahmedabad - 380 015
Cell: +91-9099028864
Tel: +91-79-4026 5656
E-mail: deepak.prajapati@careratings.com

BENGALURU
Mr. V Pradeep Kumar
Unit No. 1101-1102, 11th Floor, Prestige Meridian II,
No. 30, M.G. Road, Bangalore - 560 001.
Cell: +91 98407 54521
Tel: +91-80-4115 0445, 4165 4529
Email: pradeep.kumar@careratings.com

CHANDIGARH
Mr. Anand Jha
SCF No. 54-55,
First Floor, Phase 11,
Sector 65, Mohali - 160062
Chandigarh
Cell: +91 85111-53511/99251-42264
Tel: +91-0172-490-4000/01
Email: anand.jha@careratings.com

CHENNAI
Mr. V Pradeep Kumar
Unit No. O-509/C, Spencer Plaza, 5th Floor,
No. 769, Anna Salai, Chennai - 600 002.
Cell: +91 98407 54521
Tel: +91-44-2849 7812 / 0811
Email: pradeep.kumar@careratings.com

COIMBATORE
Mr. V Pradeep Kumar
T-3, 3rd Floor, Manchester Square
Puliakulam Road, Coimbatore - 641 037.
Tel: +91-422-4332399 / 4502399
Email: pradeep.kumar@careratings.com

HYDERABAD
Mr. Ramesh Bob
401, Ashoka Scintilla, 3-6-502, Himayat Nagar,
Hyderabad - 500 029.
Cell : + 91 90520 00521
Tel: +91-40-4010 2030
E-mail: ramesh.bob@careratings.com

JAIPUR
Mr. Nikhil Soni
304, Pashupati Akshat Heights, Plot No. D-91,
Madho Singh Road, Near Collectorate Circle,
Bani Park, Jaipur - 302 016.
Cell: +91 – 95490 33222
Tel: +91-141-402 0213 / 14
E-mail: nikhil.soni@careratings.com

KOLKATA
Ms. Priti Agarwal
3rd Floor, Prasad Chambers, (Shagun Mall Bldg.)
10A, Shakespeare Sarani, Kolkata - 700 071.
Cell: +91-98319 67110
Tel: +91-33- 4018 1600
E-mail: priti.agarwal@careratings.com

NEW DELHI
Ms. Swati Agrawal
13th Floor, E-1 Block, Videocon Tower,
Jhandewalan Extension, New Delhi - 110 055.
Cell: +91-98117 45677
Tel: +91-11-4533 3200
E-mail: swati.agrawal@careratings.com

PUNE
Mr.Pratim Banerjee
9th Floor, Pride Kumar Senate,
Plot No. 970, Bhamburda, Senapati Bapat Road,
Shivaji Nagar, Pune - 411 015.
Cell: +91-98361 07331
Tel: +91-20- 4000 9000
E-mail:pratim.banerjee@careratings.com

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