Sadbhav Infrastructure Project Limited

January 07, 2020

Ratings

Instruments*	Amount (Rs. crore)	Ratings[1]	Rating Action
Long-term Non-Convertible Debentures-II	120.00	**CARE A (CE) [Single A (Credit Enhancement); (Under Credit Watch with Developing Implications)]**	Continues on Credit watch with Developing Implications
Long-term Non-Convertible Debentures-III	250.00	**CARE A (CE) [Single A (Credit Enhancement); (Under Credit Watch with Developing Implications)]**	Continues on Credit watch with Developing Implications
Long-term Non-Convertible Debentures-IV	170.00	**CARE A (CE) [Single A (Credit Enhancement); (Under Credit Watch with Developing Implications)]**	Continues on Credit watch with Developing Implications
Long-term Non-Convertible Debentures-V	190.00	**CARE A (CE) [Single A (Credit Enhancement); (Under Credit Watch with Developing Implications)]**	Continues on Credit watch with Developing Implications
Long-term Non-Convertible Debentures-I	-	**-**	Withdrawn#
Total Instruments	**730.00 (Rupees Seven Hundred Thirty Crore Only)**		

Details of instruments in Annexure – 1
#withdrawn based on confirmation by the company and debenture trustee regarding full and final redemption to debenture holders
**backed by unconditional and irrevocable corporate guarantee of Sadbhav Engineering Limited [SEL; rated CARE A / CARE A1 (Under Credit watch with Developing Implications)]*

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; rated CARE A / CARE A1 (Credit watch with Developing Implications)].

The ratings assigned to the bank facilities and instruments of SEL continue to be on 'Credit watch with Developing Implications' in view of impending impact of proposed divestment of Sadbhav Infrastructure Project Ltd.'s [SIPL; rated CARE A- / CARE A2+ (Under Credit watch with Developing Implications); a subsidiary of SEL] entire stake in its nine operational road special purpose vehicles (SPVs) to InvIT portfolio of IndInfravit Trust (IndInfravit) as well as scheme of merger and arrangement of SIPL with SEL subject to various statutory and regulatory approvals including approval of National Company Law Tribunal (NCLT). Post the stake sale transaction to IndInfravit, SIPL shall continue to be the maintenance contractor for these assets, along with having 10% stake in IndInfravit and right of first offer (ROFO) option with IndInfravit for its current and future operational assets.

CARE takes cognizance of fulfillment of majority of the conditions precedent (CPs) for stake sale, including receipt of in-principle no-objection certificates (NOCs) from concessioning authorities for six projects and final NOCs for two projects, NOC from majority lenders, debenture holders, debenture trustees and tax authorities. Further, Sadbhav group claims to be at an advance stage of fulfilling all CPs for stake sale including crucial CPs like obtaining final approval from NHAI, approvals of all debenture trustees and lenders. CARE also notes reduction in pace of execution in six out of eight under-construction HAM projects of Sadbhav group due to various execution challenges faced by these projects like issues related to land acquisition, de-scoping/de-linking approvals, alongwith challenging fund raising scenario and paucity of funds which has led to stretched current asset days during H1FY20 as against expectation of improvement of operating cash flows due to expected completion of some of HAM projects.

Successful and timely completion of the afore-mentioned transaction is expected to result in rationalization of both SEL's and SIPL's (referred to as Sadbhav group[2]) debt levels along with significant reduction in reliance on internal accruals and debt for

[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*

funding equity commitment in its under-construction road SPVs, which is likely to improve its debt coverage indicators, pace of execution and financial flexibility. Equity commitment of SIPL has reduced significantly because of mutual termination of three HAM projects due to unavailability of land in those projects.

Proposed holding of listed InvIT units by SIPL is also expected to provide annual income and project management fees. SIPL is expected to receive additional cash flows with receipt of approval for extension of concession period in one of its SPVs and, potential upside from car revenues in another SPV. As such, CARE Ratings would await further developments to unfold so as to enable it to assess the exact impact of the above stake sale transaction on the future funding requirement and debt levels of Sadbhav group in light of high working capital intensity of SEL before arriving at a view on its credit rating.

The ratings continue to derive strength from established track record of SEL in road construction segment along with its healthy and diversified order book.

The ratings however, continue to be constrained by various issues related to land acquisition (although extension of time (EoT) have been granted by NHAI), clearances and delay in de-scoping of un-available land leading to delay in execution of some of the projects (though approvals have been received in some of the projects subsequently) and increased working capital intensity of SEL. Further, the ratings are also constrained by financial support being extended to its special purpose vehicles (SPVs) operating and under-construction HAM projects for meeting operational and debt servicing requirements.

The ratings also factor in stretched current asset days of SEL leading to high working capital borrowings, higher debt repayment obligations in the medium term, Sadbhav group's exposure to inherent risks associated with BOT projects and inherent challenges faced by the construction sector, including the current challenging fund raising scenario for the sector.

Rating sensitivities

Positive factors

- Rationalization of debt levels of Sadbhav group with TOL/TNW of less than unity on a sustained basis especially from the funds raised from stake sale along with significant improvement in the stretched current assets days to less than 150- 180 days

Negative factors

- Delay in receipt of sale proceeds for majority of the SPVs beyond February 2020
- Inability to rationalize the current asset days in the near to medium term
- Sustained delay in construction of HAM projects resulting in meaningful increase in cash flow support from the sponsor

Detailed description of the key rating drivers of guarantor - SEL

Key Rating Strengths:

Proposed stake sale in its SPVs with an aim to rationalise its debt levels and reduce reliance on debt for equity commitments towards under-construction road SPVs: As per announcement on stock exchange dated July 1, 2019, SEL along with SIPL have executed Share Purchase Agreements with IndInfravit Trust for selling their entire equity stake in their nine operational BOT SPVs (seven toll and two annuity based projects) for a consideration of around Rs.2,546 crore, out of which partial consideration would be received by SIPL in the form of listed and marketable units equivalent to 10% stake in IndInfravit having estimated value of Rs.646 crore and the balance amount of Rs.1,900 crore in cash. Further, as per announcement on stock exchange, SIPL is expected to receive additional cash flows for receiving extension of concession period by 7.5 years for one of its SPVs. As articulated by the management, the funds raised through stake sale are primarily expected to be utilised towards rationalisation of current debt levels, both for SEL and SIPL, along with significant reduction in reliance on debt for meeting future equity commitments in their under-construction road SPVs. Transfer of these assets to IndInfravit and proposed holding of some InvIT units by SIPL is also expected to provide annual dividend income to it along with ROFO option of monetizing current & future operational projects. SIPL shall continue to carry out routine and major maintenance for these projects post stake sale which is likely to maintain its revenue visibility. Approximate value of these contracts is Rs.4,000 crore over the balance concession period. Delay in receipt of proceeds for majority of SPVs beyond February 2020 shall be a key negative sensitivity.

Established track record in the Indian road construction sector: SEL has a sound track record of over two decades in the Indian road construction sector. SEL has successfully completed construction of more than 8,400 lane km of road projects since its establishment with majority of the BOT projects completed in a timely manner.

Healthy and diversified order book, albeit reduction due to termination of concessioning agreements of own HAM projects: The order book is diversified across four broad segments: EPC of third party road projects, EPC of own BOT/HAM road projects, mining and irrigation. The order book of the company is geographically diversified with presence across various states of the country. SEL had a healthy and diversified order book of Rs.9,521 crore [2.69 times of its contract receipts for

FY19 (refers to the period April 1 to March 31)] as on September 30, 2019; however, this has declined from Rs.11,981 crore as on March 31, 2019 largely on account of recent termination of the concession agreement for two of its HAM SPVs and application for termination for another HAM SPV. The overall contribution of road & highway segment in the total order book of the company which is its core strength has also decreased to 74% as on September 30, 2019 as compared to 78% as on March 31, 2019. However, execution of orders in mining segment constituting around 22% of outstanding order book is slower than envisaged on account of payment and land issues as articulated by company.

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, release of 75% of arbitration award against submission of bank guarantee and 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. After witnessing steady increase in pace of award during last three years, pace of award has declined in FY19 due to moderation in the bidding appetite due to challenging fund raising scenario. EPC is, thus, envisaged to be the preferred mode of award till improvement in fund raising environment and bidding appetite of the developers.

Interest bearing working capital advance

As per NHAI's policy guidelines dated November 19, 2019, the concerned Project Director, NHAI (PD,NHAI), with prior approval of Regional Office, NHAI (PD, NHAI) may disburse an interest bearing working capital advance to the EPC contractor against unbilled executed work, which is not qualifying for payment under milestone based payment mechanism. This is expected to improve liquidity for the developers of HAM projects.

Key Rating Weaknesses:

Delay in rationalization of debt levels primarily due to various execution hurdles and higher working capital intensity on a sustained basis: Nine on-going HAM projects of Sadbhav Group constituted Rs.4,056 crore in SEL's total order book as on September 30, 2019. However, six of these nine projects are running behind schedule due to various hindrances encountered by these SPVs like land acquisition, utility shifting, delay in other clearances, delay in disbursement of term debt etc. Consequently, these SPVs have received in-principle approval from NHAI for Extension of Time (EOT)/de-scoping/de-linking.

SEL's working capital intensity increased during H1FY20 with stretched current asset days (299 days) as against expectation of improvement of operating cash flows due to expected completion of some of the HAM projects. The current asset days have elongated mainly due to increase in debtors pertaining to escalation portion and change of scope in some of its on-going HAM projects apart from GST receivables as well as due to relatively higher time required for term debt disbursement in its HAM SPVs owing to challenging fund raising environment prevailing in the construction sector.

Its working capital utilization was at ~95% for the trailing twelve months ended November, 2019. SEL has continued to reduce its reliance on outside consortium working capital borrowings during H1FY20 by raising medium term debt for meeting working capital requirements.

Exposure of the group to inherent risks associated with BOT projects along with subdued performance of two of its SPVs, however, expected to reduce subsequent to sale of stake in operational SPVs: As on March 31, 2019, Sadbhav group had total investment (including loans and advances) of Rs.3,341 crore. Subsequent to stake sale, exposure in BOT projects is expected to be reduced significantly to around 60% based on the combined net-worth as of March 31, 2019 as against 112% as on March 31, 2019. SIPL has already infused Rs.593 crore as on September 30, 2019 in eight on-going HAM projects. Further, the under construction HAM projects of the group have equity commitments Rs.415 crore spread over H2FY20, FY21 & FY22. SIPL has availed bridge loan for interim equity infusion in HAM projects till receipt of stake sale proceeds. Further, Maharashtra Border Check Post Network Limited (MBCNL; rated CARE A; Stable) has received disbursement of new long-term debt which has largely been up streamed to its parent, SIPL. The equity commitments for these HAM projects (as stated above) and shortfall in two operational SPVs (not getting transferred) and some under construction HAM SPVs are expected to be fulfilled through the funds raised from the proposed stake sale transaction and up-streaming of cash flows from MBCNL through tie-up of aforementioned debt. With the ROFO agreement, there is an enhanced financial flexibility for meeting the future equity requirement once the HAM projects are commissioned.

Challenging environment for the construction industry: The construction sector is facing hurdles in fund raising due to delay in enhancement of working capital limits (including non-fund based 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.

Liquidity: **Adequate**

High working capital utilization due to stretched current assets; albeit expected to improve post stake sale in road SPVs: Stretched current assets primarily marked by high gross current asset days (299 days in H1FY20, as against 203 days in FY19) and scheduled repayment obligations have resulted in moderation in liquidity indicators of Sadbhav group marked by higher reliance on working capital borrowing and moderate debt coverage indicators during FY19 and 8MFY20. Utilization of fund based limits continues to remain high at around ~95% for past twelve months ended November 2019.

However, SEL and SIPL has leveraged their financial flexibility of being listed on stock exchange as is evident from raising of short term debts in the form of bridge loan and other working capital demand loans for refinancing their debt obligations and meeting interim equity infusion requirements till receipt of stake sale proceeds even in the present challenging fund raising scenario. Further, up streaming of cash flows from MBCNL through disbursement of new term debt is expected to provide liquidity cushion to Sadbhav group.

SIPL is expected to receive cash of in the range of Rs.1,600 to Rs.1,900 crore from the proposed stake sale transaction which, as articulated by the management, would primarily be used to rationalise the debt at Sadbhav group level along with meeting future equity commitments and cash flow support for debt servicing in its under-construction HAM SPVs. SIPL would receive the balance portion of sale consideration in the form of units of IndInfravit equivalent to 10% stake (having estimated value of around Rs.646 crore) which shall also provide financial flexibility to SIPL since the same are listed on stock exchange.

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 investment in new projects, bridging of shortfall in select SPVs as well as up-streaming of cash flow of SPVs.

Applicable Criteria

Criteria on assigning 'Outlook' and 'Credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Criteria of Rating Credit Enhanced Debt
Rating Methodology - Infrastructure Sector Ratings
Rating Methodology – Consolidation and Factoring Linkages in 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.

On July 1, 2019, SIPL has announced that they have executed Share Purchase Agreements with IndInfravit Trust (IndInfravit) for selling their entire equity stake in their nine operational BOT SPVs (seven toll and two annuity based projects). The transaction has been executed considering enterprise value of Rs.6,610 crore. Total sale consideration for the transaction is Rs.2,550 crore, out of which partial consideration would be received by SIPL in the form of units equivalent to 10% stake in IndInfravit having estimated value of Rs.650 crore and the balance amount of Rs.1,900 crore in cash. Further, as per stock exchange announcement dated October 19, 2019, SIPL would be merged with SEL with effect from April 1, 2019 subject to various statutory and regulatory approvals including approval of National Company Law Tribunal (NCLT). In consideration of the merger, SEL shall issue one equity share of SEL against three equity shares of SIPL to every shareholder of SIPL.

Covenants of rated instruments: *Detailed explanation of covenants of the rated instruments is given in* ***Annexure-3***

(Rs. Crore)

Brief Financials – SIPL (Standalone)	FY18 (A)	FY19 (A)
Total Operating Income	384	356
PBILDT	268	271
PAT	68	57
Overall Gearing	0.95	1.08
Interest Coverage (times)	1.64	1.55

A: Audited

About the Guarantor - SEL

Incorporated in 1988, SEL has evolved as one of the prominent developers and EPC contractors in India. SEL had floated a wholly-owned subsidiary – SIPL as a holding company of BOT projects in 2007. Sadbhav Group has a portfolio of 25 BOT projects (eleven operational, one partly operational and thirteen under construction HAM projects). 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 FY19, these segments contributed 23%, 69%, 4% and 4%, respectively, in SEL's contract receipts booked on a standalone basis.

(Rs. Crore)

Brief Financials – SEL (Standalone)	**FY18 (A)**	**FY19 (A)**
Total operating income (TOI)	3,534	3,650
PBILDT	445	528
PAT	221	187
Overall gearing (times)	0.80	0.73
Interest coverage (times)	2.33	3.02

A: Audited;

(Rs. Crore)

Brief Financials – Sadbhav Group#	**FY18**	**FY19**
TOI	3,862	3,945
PBILDT	657	739
PAT	288	243
Overall gearing (times)	0.83	0.83
Interest coverage (times)	2.20	2.55

 # combining SEL (standalone) and Sadbhav Infrastructure Project Limited (SIPL; standalone) financials

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

Annexure-1: Details of Instruments

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debentures-Non Convertible Debentures-I	INE764L07058	December 16, 2014	12.14%	Nov 18, 2019	0.00	Withdrawn
Debentures-Non Convertible Debentures-II	INE764L07074, INE764L07082	January 09, 2015	11.75%	April 13, 2020	120.00	CARE A (CE) (Under Credit watch with Developing Implications)
Debentures-Non Convertible Debentures-III	INE764L07108, INE764L07116, INE764L07124, INE764L07132, INE764L07140, INE764L07157, INE764L07165	September 21, 2016	10.30%	April 26, 2022	250.00	CARE A (CE) (Under Credit watch with Developing Implications)
Debentures-Non Convertible Debentures-IV	INE764L07173	April 23, 2018	10.20%	April 23, 2023	170.00	CARE A (CE) (Under Credit watch with Developing Implications)
Debentures-Non Convertible Debentures-V	INE764L07181	June 06, 2018	10.20%	June 06, 2023	190.00	CARE A (CE) (Under Credit watch with Developing Implications)

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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Bonds	LT	-	-	-	1)Withdrawn (18-Sep-18)	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)
2.	Debentures-Non Convertible Debentures- I	LT	-	-	1)CARE A (CE) (Under Credit watch with Developing Implications) (30-Oct-19) 2)CARE A (CE) (Under Credit watch with Developing Implications) (10-Jul-19)	1)CARE A (SO); Stable (20-Feb-19) 2)CARE A+ (SO); Stable (18-Sep-18)	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)
3.	Debentures-Non Convertible Debentures- II	LT	120.00	CARE A (CE) (Under Credit watch with Developing Implications)	1)CARE A (CE) (Under Credit watch with Developing Implications) (30-Oct-19) 2)CARE A (CE) (Under Credit watch with Developing Implications) (10-Jul-19)	1)CARE A (SO); Stable (20-Feb-19) 2)CARE A+ (SO); Stable (18-Sep-18)	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)
4.	Debentures-Non Convertible Debentures - III	LT	250.00	CARE A (CE) (Under Credit watch with Developing Implications)	1)CARE A (CE) (Under Credit watch with Developing Implications) (30-Oct-19) 2)CARE A (CE) (Under Credit watch with Developing Implications) (10-Jul-19)	1)CARE A (SO); Stable (20-Feb-19) 2)CARE A+ (SO); Stable (18-Sep-18)	1)CARE A+ (SO); Stable (08-Jan-18)	1)CARE A+ (SO) (14-Oct-16)
5.	Fund-based/Non-fund-based-LT/ST	LT/ST	400.00	CARE A- / CARE A2+ (Under Credit watch with Developing Implications)	1)CARE A- / CARE A2+ (Under Credit watch with Developing Implications) (30-Oct-19) 2)CARE A- / CARE A2+ (Under Credit watch with Developing	-	1)CARE A-; Stable / CARE A2+ (28-Nov-17)	-

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
					Implications) (10-Jul-19) 3)CARE A-; Stable / CARE A2+ (04-Apr-19)			
6.	Debentures-Non Convertible Debentures- IV	LT	170.00	CARE A (CE) (Under Credit watch with Developing Implications)	1)CARE A (CE) (Under Credit watch with Developing Implications) (30-Oct-19) 2)CARE A (CE) (Under Credit watch with Developing Implications) (10-Jul-19)	1)CARE A (SO); Stable (20-Mar-19) 2)CARE A+ (SO); Stable (18-Sep-18) 3)Provisional CARE A+ (SO); Stable (16-Apr-18)	-	-
7.	Debentures-Non Convertible Debentures- V	LT	190.00	CARE A (CE) (Under Credit watch with Developing Implications)	1)CARE A (CE) (Under Credit watch with Developing Implications) (30-Oct-19) 2)CARE A (CE) (Under Credit watch with Developing Implications) (10-Jul-19)	1)CARE A (SO); Stable (20-Mar-19) 2)CARE A+ (SO); Stable (18-Sep-18) 3)Provisional CARE A+ (SO); Stable (16-Apr-18)	-	-

Annexure-3: Detailed explanation of covenants of the rated instruments

Name of the Instrument – Non Convertible Debentures	Detailed explanation
A. Financial covenants	
1. SIPL's Total Debt/ Equity not exceeding 0.8 times	All financial covenants are met.
2. SIPL's Total Debt not to exceed Rs.1,000 crore	
3.SEL's Total Debt/Equity not to exceed 1.25 times	
4. No loss on PAT basis in SEL on an annual basis	
5. SEL's Total Debt / EBITDA not to exceed 3.5 times	
B. Non-financial covenants	
1.Unconditional and irrevocable corporate guarantee from SEL	SEL has provided unconditional and irrevocable corporate guarantee for NCDs of SIPL.
2.Early redemption in case of downgrade of existing rating by two or more notches by any rating agency (i.e., to BBB+)	
3. Option of step-up of coupon rate in case of downgrade of external credit rating to A- for balance period	
4. SIPL/SEL's networth to remain positive during tenor of issue	
5. Prior approval of investor for any transaction of merger, de-merger, consolidation, re-organization or scheme of arrangement, etc.	
6. Not to undertake any new business if equity commitment for single project is more than Rs.500 crore	
7. Prescribed cash flow to be followed in case of stake sale in step-down subsidiaries	

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.*

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