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Indian toll road projects – Short term challenges for managing cash flows albeit with favourable long term prospects

National Highways Authority of India (NHAI)'s directive for exempting toll collection till December 2, 2016 (for 23 days)is expected to pose short term challenges to operational toll road projects while testing a) sponsors' ability and willingness to support these projects in exigencies and b) authority's commitment of timely compensating developers for the loss of revenue. Slowdown in economic activity post demonetization is also expected to moderate the growth in toll collection during FY17 as compared to earlier estimates. Nevertheless, the downward trend in interest rates is expected to offset, to an extent, the impact of moderation in toll collection in the medium term and offer ample opportunities to the entities in the road sector, to replace existing high cost loans with mix of low cost loans and fixed coupon long term instruments.

Short term challenges considering toll exemption

Exemption of toll collection for 23 days works out to revenue loss of around 6% of overall toll collection during FY17. As per the standard provisions of the concession agreement, the respective authority is usually required to compensate developers for such a revenue loss either in the form of cash compensation or through extension of concession period. As per CARE's expectations, such payment of compensation would most likely take the form of cash disbursement by the authority. According to industry sources, compensation is likely to be worked out on the basis of average daily toll collection of October 2016 multiplied by number of exempted days in toll collection. NHAI is likely to allow deferment of premium payment for November 2016.

CARE has rated 76 operational toll road projects (special purpose vehicle (SPV)) of 21,735 lane km with aggregate outstanding debt of Rs.30,787 crore as on March 31, 2016as tabulated below:

Particulars	Lane km	Outstanding debt (Rs. crore)
National Highways projects	**13,843**	**22,054**
State Highways projects	**7,892**	**8,733**

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Apart from national highways projects, toll has also been exempted in majority of state highway projects where compensation is to be received from state authority mainly through budgetary allocation of respective state governments. For these projects, timely receipt of the compensation from state authority is crucial from the credit perspective for state highway projects.

Debt backed by unconditional and irrevocable corporate guarantee of sponsors constituted about 16% of the total debt and 33% of the CARE rated operational projects which rely on sponsor support. In balance SPVs, debt service reserve account (DSRA), wherever available, would play a crucial role in bridging short term funding requirements. We have seen that DSRA has been created mostly in the non-funded form which helped retaining of surplus liquidity by the sponsors in the interim period. Hence, sponsor's ability and willingness to infuse the required funds in timely manner is crucial for meeting debt servicing requirement in November and December 2016, in case of delay in the receipt of cash compensation from the respective authority.

Decline in traffic in the near term albeit with favourable long term prospects

Operational toll road projects had witnessed healthy growth of 11% per annum and 11.25% per annum in average daily toll collection during FY15 and FY16respectively despite subdued hike in toll rates. CARE expects moderated growth of 6-7% in toll collection in FY17 mainly due to prolonged monsoon and slowdown in the economic activity post demonetization.

Based on analysis, 57% of 67 operational projects with outstanding debt of around Rs.15,150 crore and length of 12,000 lane km are at relatively low risk considering their self sustainable operations or limited support requirement from strong sponsor. However, quantum of sponsor support required in FY17 is expected to increase to an extent in balance entities. Further, 28% projects with length of 3,700 lane km and debt of Rs.6,900 crore are owned by sponsors with moderate to weak credit quality and requiring sponsor support. Nevertheless, toll collection is expected to witness healthy growth again from Q1FY18 subsequent to this transitory phase.

Decline in interest rates as well as coupon rate for the AAA rated corporate bonds is expected to propel corporate bond issuances in this sector, including refinancing of high cost loans. Moreover, decline in interest rates by 75 to 150 bps is expected to offset the impact of lower toll collection as compared to earlier estimates for FY17. During last one year, debt of operational projects with established operational track record of over four years and aggregate debt of Rs.6,350 crore had been replaced with a mix of low cost loan and non convertible debentures (NCD) placed with infrastructure debt funds. CARE expects further increase in pace of refinancing in the medium term for operational toll projects which have(i) established track record of operations, (ii) controlling stake owned by strong or moderate sponsor and (iii) tail period of more than five years. CARE estimates replacement of additional high cost debt of around Rs,4000 crore with a mix of low cost debt and NCDs apart from increase in share of NCDs in current debt profile for road sector entities.

Conclusion

Operational toll road projects, especially which required sponsor support wherein sponsor has moderate or weak financial profile, are expected to face challenges in managing its cash flows in FY17 due to short term slowdown in the toll collections as compared to earlier estimates. Further, in state highway projects, state government's ability to compensate the developers in a timely manner, especially in the states where toll on the passenger vehicles has been exempted since long, shall also be crucial. Nevertheless, decline in interest rates is expected to provide relief from Q1FY18 onwards. Toll road projects with self sustainable operations or requiring marginal level of support with strong sponsor profile and adequate tail period are expected to be benefited in the medium term due to decline in cost of borrowing and possibilities for refinancing.

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