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India Ratings Assigns Shrem InvIT's Proposed Rupee Term Loan 'Provisional IND AAA'/Stable

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By Rishabh Jain

India Ratings and Research (Ind-Ra) has assigned Shrem InvIT's proposed rupee term loan a rating of 'Provisional IND AAA' with a Stable Outlook, as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Proposed rupee term loan#	-	-	-	INR33,880	Provisional IND AAA/Stable	Assigned

#The rating is provisional and is based on the draft terms. The final rating will be assigned based on completion of the debt issue, submission of executed transaction documents in line with the proposed debt terms, transfer of assets under the InvIT structure and on conformance of key metrics in line with Ind-Ra's base case assumptions hold true post the issuance.

Analytical Approach: The sponsor, Shrem Infra Structure Private Limited, has floated an infrastructure investment trust called Shrem InvIT. Shrem InvIT will own 24 operational special purpose vehicles (SPVs) through three holding companies – Shrem Infraventure, Shrem Roadways Private Limited and Shrem Tollway Private Limited. For the rating purpose, Ind-Ra has taken a consolidated cash flow of all the 24 SPVs acquired by the Shrem Group from Dilip Buildcon Limited (DBL; 'IND A+'/Stable).

The debt will be raised at the InvIT level and will be used to pay off all the external liabilities in the 24 SPVs and other intermediate holding companies, and will be injected in the SPVs in the form of senior debt from the InvIT. All the SPVs will cross guarantee the Shrem InvIT debt, thereby ensuring the complete consolidation of cash flows. The management has confirmed that the project manager and the investment manager will have no other business apart from managing the InvIT during the currency of the loan.

The rating reflects a diversified pool of assets involving 10 state annuity plus toll projects, six state annuity projects and one state toll project, five National Highway Authority of India (NHAI; 'IND AAA/Stable) awarded hybrid annuity (HAM) projects, one Ministry of Road Transport and Highway (MoRTH) awarded HAM project and one NHAI awarded national highway toll project. It also reflects a fixed-price operations and maintenance (O&M) contract with DBL, the likely deleveraging (around 20% of the existing debt), healthy coverage ratios of over 1.7x and comfortable liquidity including a peak debt service reserve of two quarters and a liquidity reserve to address annuity delays, if any. The sufficient operational track record of the combined portfolio and the fungible cash flows among the SPVs of the InvIT structure bolster the overall credit profile. The InvIT's cash flows show considerable resilience to stress cases, reflecting ample cushion for timely debt servicing in potential downside scenarios. The debt from Shrem InvIT to the SPVs will be utilised to repay the entire existing external debt. The cash flows from the 24 SPVs, in the form of dividends, interest on InvIT debt and the repayment of InvIT loans, will flow to the InvIT and the net cash generated by the InvIT is proposed to be distributed to investors every quarter.

KEY RATING DRIVERS

Deleveraging to Result in Strong Coverage Metrics: The rating reflects the proposed significant deleveraging, with the overall debt reducing to INR33.88 billion from the current INR42.85 billion at a reduced interest rate. The proceeds from the units to be issued to investors will be utilised towards deleveraging. The management confirms that the debt shall be less than or equal to 49% of the InvIT valuation. The proposed reduction in the debt is reflected in the projected coverage metrics, with the base case showing a healthy average debt service coverage ratio (DSCR) of over 1.70x and a project life coverage ratio of over 1.80x. The pool of projects is likely to receive around 44 annuity payments spread during the year and toll collection from two projects, ensuring a steady stream of cash flows.

Right Mix of Operational Assets: The cash flows from a pool of 24 operating toll road and annuity assets with the average operational life of more than four years are robust. Of the 24, 22 projects have predictable cash flows by way of semi-annual annuities from the NHAI, MORTH and state road authorities and at regular intervals, cash inflow from toll income. The pool received 12 annuities from the NHAI and MoRTH HAM projects on time and annuities from the 13 state annuity projects (except Karnataka project) with nominal delays over FY17-FY20.

Although the first annuity received from MoRTH saw some deductions, the management expects to receive the rest of the annuities in full. The management has highlighted that the annuities were deducted incorrectly and this was also reinforced by MoRTH's appointed independent engineer letter. Also, some delay was observed in Karnataka projects in September 2019 and September 2020 annuities; however, the March 2019 and March 2020 annuities were received on time.

While there have been some deductions in Karnataka annuities in the past due to pending construction works, the September 2020 annuity was received in full. Furthermore, any deduction due to the pending construction work or the non-compliance of the O&M obligation, as defined under the concession agreement in annuities, is compensated by DBL under the O&M contracts.

Ind-Ra's projections factor in the moderate growth rates for toll projects – Jalpa Devi Toll Ltd (JDTL) road project and Suryavanshi Infrastructure Private Limited. The growth in toll revenue factors in toll rates revision, linked to a fixed 3% and 40% change in the Wholesale Price Index and traffic growth in a decreasing trend. JDTL has an operational history of over two years. It forms a part of NH-3, which is an important connecting link for the traffic moving between the northern states and Maharashtra, Andhra Pradesh, Tamil Nadu and other the southern states, as this highway is 120-150km shorter than NH-8 that connects Mumbai and Agra. The toll collection for JDTL surpassed the pre-COVID-19 levels in June 2020.

Of the overall cash flow available for debt servicing during the currency of the proposed loan, nearly 50% is from the NHAI and MoRTH HAM projects (which covers around 85% of debt obligations). Given the comfortable cover from NHAI and MoRTH HAM projects, the debt obligations can be adequately serviced even in an event of delay in the state annuities and/or lower-than-expected growth in the toll revenue.

Diversified Sponsor Profile: The Shrem Group, with interests in real estate, hospitality and infrastructure, entered into the infrastructure space through its acquisition of 24 road projects from DBL in 2017. The group had also invested in Nanavati Hospital and developed two hotels in Goa, which were subsequently divested. It is developing a luxury hotel near Chhatrapati Shivaji International Airport, Terminal 2, Mumbai under the Fairmont Brand and recently monetised its investment in Route Mobiles Limited through an initial public offering. Two of the Shrem Group entities, which are not a part of the InvIT structure, have been mentioned in Grant Thornton (GT) report dated 5 December 2020 in connection with Dewan Housing Finance Limited Corporation's Insolvency and Bankruptcy Board of India proceedings. The sponsor has confirmed that there has been no irregularity by any of the Shrem Group entities with regards to the transaction mentioned in the GT report. Any adverse development affecting the debt structure could be a rating sensitivity.

Moderate Debt Structure: The debt proposed to be raised at the InvIT level is INR33,880 million; it would be adjusted for any repayment post 31 December 2020. If in any quarter the DSCR falls below 1.20x, the entire surplus will be trapped in the InvIT. Any increase in the debt adversely affecting the coverage metrics will be a credit negative. A peak debt service reserve account (DSRA), equivalent to six months of debt obligations, will be created upfront. The debt will be amortised over a period of 14 years and six months on a quarterly basis and the project has a tail period of seven years (JDTL; the difference between the loan maturity and the concession maturity). Also, there will be a structure to ensure that the cash flow of all the SPVs at all the time is available for the timely debt service of the InvIT loan.

Liquidity Indicator - Adequate: The cash accruals of the project are strong enough to meet the debt obligations of the InvIT with an average DSCR of over 1.7x. Additionally, the debt structure proposes the creation of INR900 million of liquidity over and above the DSRA from the surplus cash flows of the InvIT prior to any distribution. This additional reserve provides adequate cushion to mitigate the risk of a shortfall in debt servicing due to delays in annuity payments, if any.

While the project is exposed to performance-related annuity deductions, Ind-Ra derives sufficient comfort from the strong executional experience and creditworthiness of the O&M contractor during the operations period to ensure no material deductions in annuities, which, in any case, would be adjusted from the O&M payments.

Future Acquisitions Shall Hold the Key: Although the Securities and Exchange Board of India (Infrastructure Investment Trust) Regulations 2014 (InvIT regulations) allow an acquisition of under construction assets, the investment manager intends to acquire only operational assets based on yield thresholds, annuity projects from strong counterparties (NHAI and MoRTH). Shrem Financial Private Limited, the investment manager, will assess the potential acquisitions and propose the same for the decision of the unit holders. The project manager and the investment manager will not have any business interest other than managing business activities for the InvIT. The investment management fees and project management fees will be capped at 1.5% of the operational surplus cash (interest and dividend from SPVs). The agency will evaluate all the future acquisitions; this will be a key monitoring event for a rating review.

Low Operational Risk: Each project SPV has signed a fixed-price O&M contract with the intermediate holding companies (Shrem Infraventure, Shrem Tollways, Shrem Roadways), which have entered into a back-to-back sub-contract O&M agreement with DBL for taking up the routine and major maintenance expenses. Post InvIT, O&M agreements will be between the SPVs and DBL for taking up the routine and major maintenance expenses and Shrem Road Projects Private Limited, the project manager will manage the project assets held by InvIT. The O&M costs, factored-in by the management, are based on the O&M contract executed with DBL. The O&M costs in most of the projects are largely comparable to the average cost of Ind-Ra-rated peers. For projects where the O&M cost is lower than those of Ind-Ra-rated peers, the agency has assumed a cost in line with the peers. The debt service coverage metrics remain strong, despite a significant increase in the routine O&M and major maintenance costs. Any significant increase in the O&M costs affecting the coverages can lead to a negative rating action.

The O&M cost, according to the O&M agreement, for 13 Madhya Pradesh annuity, toll plus annuity and toll projects and one Gujarat annuity project will be compensated by the total toll collection from 10 Madhya Pradesh annuity-cum-toll projects and one Madhya Pradesh toll project. For the balance projects, there is a fixed-price contract with DBL. Furthermore, the rating factors in the indemnification provided by DBL towards any deduction in the annuity if, on account of pending construction work or non-compliance of O&M obligation, as defined under the concession agreement for all the 17 projects, thereby providing stability to the surpluses likely from the projects. Considering DBL's vast experience in the highway sector, the O&M (both routine and periodic maintenance) of the project stretches is not a concern. The repudiation of contract by DBL or the replacement of contractor is a key rating sensitivity.

Pass-through Structure for O&M Risk: In accordance with the amended engineering, procurement and construction agreement, DBL has provided a defect liability period (DLP) deposit of INR3,041.3 million, equivalent to the initial four years' O&M payments for six NHAI/MoRTH HAM projects to the Shrem Group. According to the management, the entire exercise of the DLP deposit to be created at the SPV level will be completed before the InvIT cut-off date, which will also be a condition precedent for the debt disbursement. The liability of the DLP deposit to be repaid will rest with the SPV and there will be no O&M obligations for any entity during such period; hence, the O&M agreement with the project manager will be amended accordingly. The DLP deposit liability at the SPV level will be repaid to DBL out of the annuity payment received by HAM SPVs i.e. out of the project cash flows. In case there are any deductions in the annuity on account of the non-maintenance of the projects, the DLP amount released will be reduced to that extent. The DLP deposit provides additional comfort towards the maintenance aspect of the project.

RATING SENSITIVITIES

Negative: Future developments that may, individually or collectively, result in a negative rating action are:

- substantial delays and deduction in annuities
- a fall in the average DSCR, basis Ind-Ra's base case, below 1.50x
- a weakening of the credit profile of the O&M contractor
- significant deterioration in the credit profile of the counterparties
- any adverse regulatory changes
- any external debt at the SPV level or an increase in the debt at the InvIT level
- any changes that affect the consolidation approach

COMPANY PROFILE

The sponsor, Shrem Infra Structure, has floated an infrastructure investment trust called Shrem InvIT and hived-off 24 operational SPVs through three holding companies – Shrem Infraventure, Shrem Roadways and Shrem Tollway under the said trust. The InvIT has been formed under the Indian Trust Act, 1882 and an approval has been received from SEBI for the InvIT.

FINANCIAL SUMMARY

Particulars (INR million)	FY20
Total income	NA
PAT	NA
PAT margin (%)	NA
Adjusted debt/ adjusted net worth	NA
Interest coverage	NA

COMPLEXITY LEVEL OF INSTRUMENTS

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

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Applicable Criteria

Rating Criteria for Infrastructure and Project Finance
Rating Criteria for Availability-Based Projects

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