Credit downgrade of SPV – IL&FS Group

Why in news?

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Recently, the credit rating agencies downgraded the credit profile of the Special purpose vehicles (SPV) within the IL&FS Group, to default status.

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What is the background?

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- Jharkhand Road Projects Implementation Company Ltd (JRPICL) and West Gujarat Expressway Ltd (WGEL) are two of the subsidiaries of IL&FS.
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- According to data on the India Ratings website, the former has outstanding non-convertible debentures (NCDs) of Rs. 1,730 crores and the latter has outstanding non-convertible debentures of Rs. 141.26 crore.
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- The next debt servicing for JRPICL and WGEL is scheduled on 21 January and 31 January, respectively.
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- Last October, IL&FS had filed an application at the Mumbai bench of the National Company Law Tribunal (NCLT) asking for a moratorium on creditor proceedings against itself and its subsidiaries.
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- On appeal, the National Company Law Appellate Tribunal (NCLAT) passed an interim order.
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- The order imposes a stay on "other financial facilities or obligations availed by 'IL&FS' and its 348 group companies in respect of the principal or

interest.
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- The IL&FS management extended the NCLAT's ruling to even its special purpose vehicles (SPV) and not only limited to the parent company.
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- But whether SPVs of IL&FS fall under the ambit of the 348 group companies is open to interpretation.
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- The case is still being heard at the NCLAT.
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- The two IL&FS subsidiaries (SPV) have used this interim order now, to demand that their lenders should release their debt repayments made to them after the ruling date (15 October).
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- They have also put on hold their current debt repayments till clarity emerges on NCLAT's stay order.
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What is the consequence?

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- Following this interpretation, JRPICL has stopped repaying its debt obligation that is due on Jan 24, despite having enough cash-flows coming into the project and the related escrow account to service its debt.
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- On Dec. 31, 2018, JRPICL had Rs 345 crore worth of surplus cash available to service the debt obligation of Rs 76 crore due in January 2019.
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- The project is also likely to generate net cash accruals worth Rs 147 crore by FY20 as against principal debt obligations of Rs 133 crore.
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- Yet the company defaulted on the NCD redemption.
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- Hence, both India Ratings and Research and Crisil Ratings downgraded the credit rating on the non-convertible debentures of the road construction company to 'D' or default.
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- JRPICL earlier had a rating of BB (SO)/Watch Negative.
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- **Rating D** is assigned by Crisil to instrument, which are in default or are expected to be in default soon.
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- Also, IL&FS continues to have several operational SPVs at various stages of project execution.
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- If the IL&FS management continue to interpret NCLAT's ruling on the same way to default on dues of even other SPVs, the incremental debt at risk will rise significantly.
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- The perception of rising risk on the debt held by IL&FS' SPVs is reverberating across mutual funds, banks and the infrastructure sector.
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- Rating agency ICRA has already placed six mutual fund schemes under "rating watch with negative implications" due by their exposure to SPVs of the IL&FS Group.
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- More such actions could follow if other SPVs of IL&FS default.
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What might be the risks for the infrastructure sector?

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- Special Purpose Vehicle structures are ring-fenced with escrow accounts so that the cash-flows coming into the project are used solely by the developer to repay the debt obligations raised for the specific project or for further investments.
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- This makes lending for infrastructure projects safer.
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- However, failure to adhere to repaying norms, like in the recent case, could increase the risk premium on such funding and even put future debt issuances at risk.
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- It will also lower the trust of investors in the infrastructure sector in the future.
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- Precedence of profitable and cash-rich SPVs defaulting can send lenders running for cover and lead to larger systemic risk for India debt markets.
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- The government recently said it would seek easier provisioning norms from the RBI against debt given to cash-generating SPVs.
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- However, prompt debt repayments on part of infrastructure companies will only ensure a consistent long-term infrastructure financing in the sector.

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Source: Business Standard, Economic Times

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Quick Facts

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Non-convertible debentures

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- Whenever a company wants to raise money from the public it issues a debt paper for a specified tenure where it pays a fixed interest on the investment, which is known as a debenture.
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- Some of the debentures are termed as convertible debentures since they can be converted into equity share on maturity.
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- A Non - Convertible debenture or NCD do not have the option of conversion into shares and on maturity the principal amount along with accumulated interest is paid to the holder of the instrument.
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- There are two types of NCDs-secured and unsecured.
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- A secured NCD is backed by the assets of the company and if it fails to pay the obligation, the investor holding the debenture can claim it through liquidation of these assets.
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- Contrary to this there is no backing in unsecured NCDs if company defaults.
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- However, any company seeking to raise money through NCD has to get its issue rated by agencies such as CRISIL, ICRA, CARE and Fitch Ratings.
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- A high rating (e.g. CRISIL AAA or AA-Stable) means the issuer has the ability to service its debt on time and carries lower default risk.
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- A lower rating signifies a higher credit risk.
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