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Infrastructure Finance Companies
A Rating Agency's perspective

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Capital, leverage and Risks in the Infrastructure Finance Sector

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What are IFCs?

- Specialised institutions
- Eligibility Criteria of IFC
  - Minimum 75% of total assets deployed in infrastructure loans
  - Net owned funds of Rs. 300 cr or above
  - Minimum credit rating of ‘A’ from external rating agency
  - CRAR of 15% or above (Tier I : >10%)
- Benefits on exposure norms
- Access to ECB and low cost funds
- Lower risk weights for banks on lending to IFCs

General Rating Issues for IFCs

- Exposure only to Infrastructure Sector
  - Do recognise diversifications within "Infrastructure Sector"
- Current challenging operating environment
- Large ticket exposures
- Limited seasoning in relation to loan tenure
  - Large part of the book built in the last few years
- Risk appetite of the IFC
  - Ability to have mix of operational and under construction exposures
  - Quantum of equity / mezzanine exposures
- Stress on a number of project sponsors / groups / individual projects

Analysis of ICRA Rated IFCs

Operating Profitability Trends

4.50%
4.25%
4.00%
3.75%
3.50%
3.25%

FY10 FY11 FY12

Net Interest Margins
Operating Profit

- Decline in operating profitability in FY12
  - Pressures on Net Interest Margins
  - Moderation in fee income
  - Operating expenses under control

Net Profitability Trends

24.00%
21.00%
18.00%
15.00%
12.00%
9.00%
6.00%
3.00%
0.00%

FY10 FY11 FY12

ROA RONW

- RoA and RoNW continues to slide but better banking system averages

Asset Quality Trends

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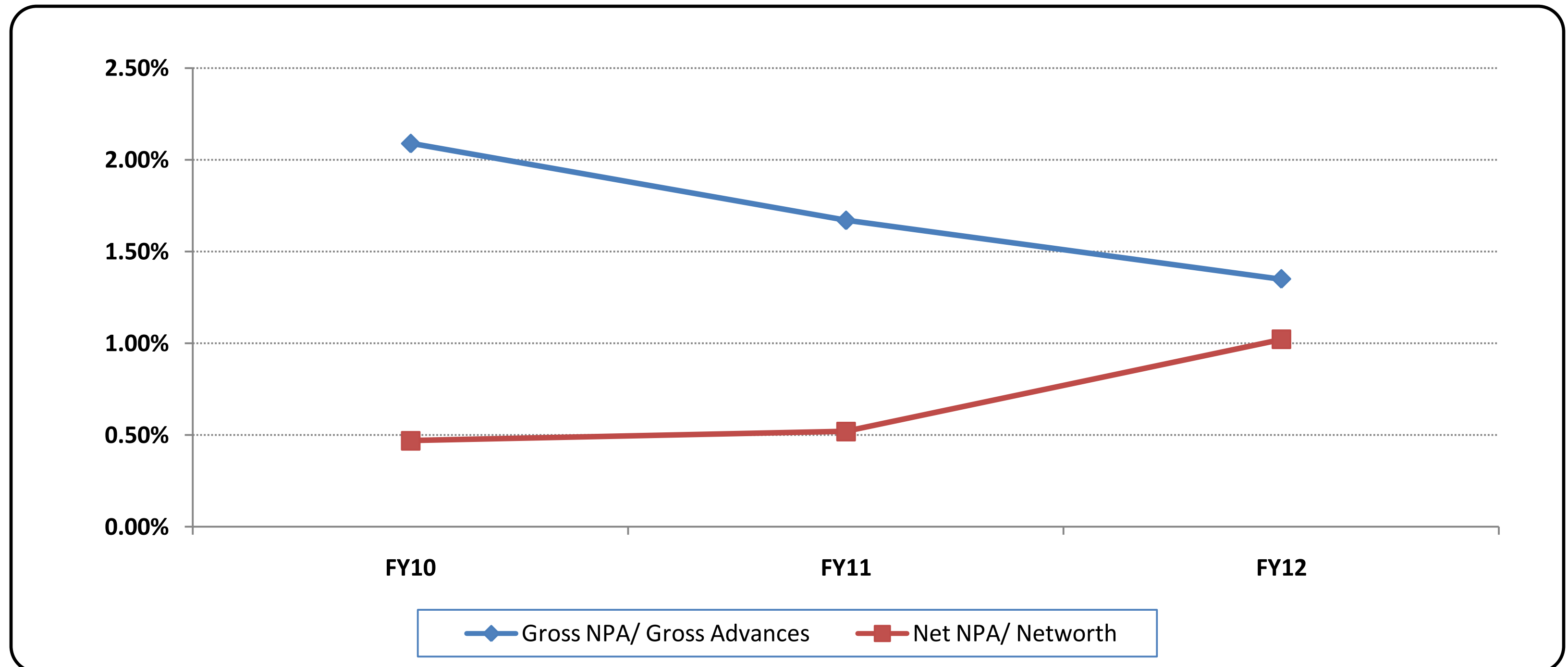
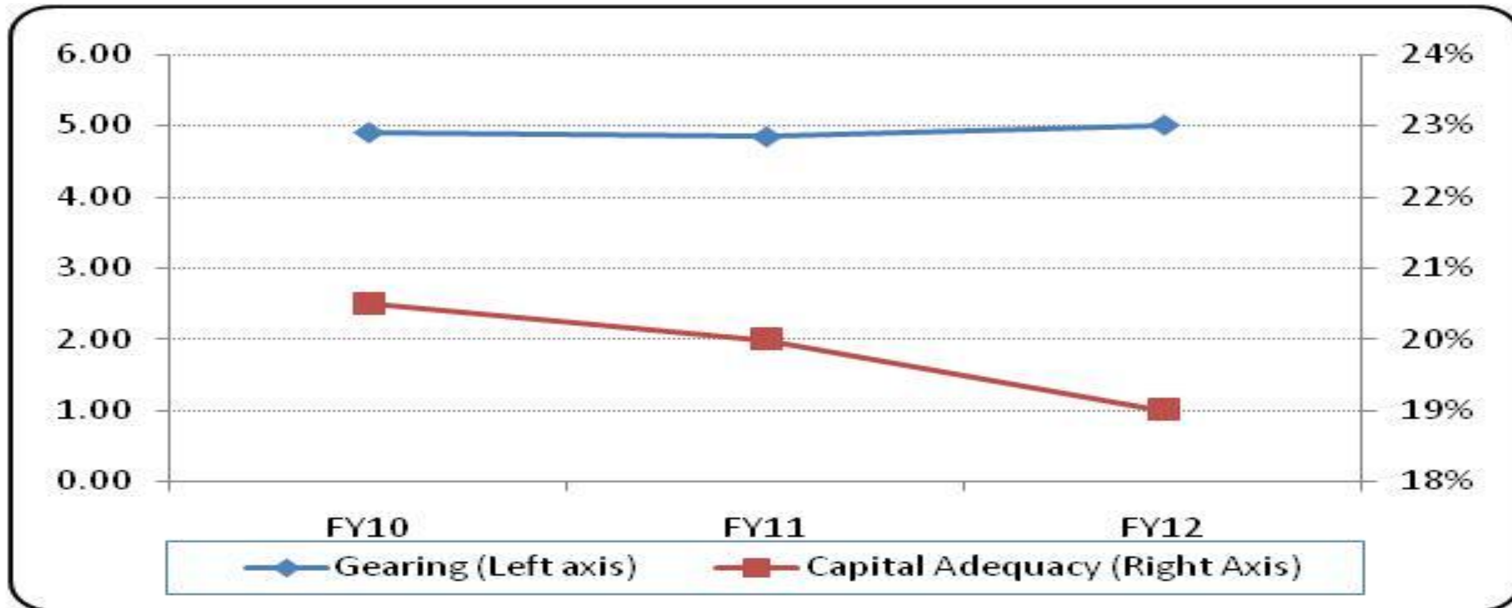


- Decline in Gross NPA% aided by sharper growth
  - Possibly an optical improvement not reflective of underlying stress
- Steady build up in delinquent exposures
  - Could see asset quality pressures in FY13

Gearing & Capital Adequacy



- Gearing range around 4.75 to 5x band
  - Unlikely to materially change in short term.
- Regulatory Capital adequacy comfortable
  - Sufficient room to raise Tier II debt.
- ICRA would assess economic capital

Infrastructure Sector – Key Concerns

- Aggressive bidding for projects
  - Valuation game and Competitive pressures
- Project Execution delays
- Multiple leveraging resulting in lower promoter equity contributions
  - Promoter Funding
  - Large scale Securitization of future receivables post commissioning
- Consolidated financial analysis due to multiple SPV/JV structures
- Private equity buy back commitments

Risks in Power Sector

- Fuel linkage and availability
- High counterparty risks
- Ability to tie up PPAs
- Tariff inadequacy
- Timely project execution risks
- Based on data from projects aggregating to over 50000 MW capacity (out of total capacity expansion around 70,000 MW over next four years), nearly half are highly vulnerable- this excludes projects for which disbursements have not started

Power projects

- Initiatives are positive; implementation challenges remain
- Cost of generation likely to increase significantly
- Domestic duel supply likely to remain inadequate
- Significant infrastructure related bottlenecks and costs
- Viability of some existing projects with competitively bid PPAs remains unclear
  - Even if contracts are renegotiated , tariffs will have to be increased sharply over and above the current increase required to cover past losses

Risks in Road Sector

- Delays in project completion
  - Primary reasons include land acquisition issues, delays in approval from railways, shifting of utilities, change in scope
  - Less than one-third projects completed on time
  - 6 to 9 months delay quite frequent
- Lower Actual traffic in the initial years
  - Subsequent growth rate better
  - Impacts liquidity and project profitability
  - Initial Project IRR of 10-16%; could decline to 6-10% because of delays, lower traffic
- Aggressive bidding – now getting partly rationalised
  - Lower bidding in new projects
- Excessive Leverage by project sponsors

Risks in Telecom Sector

- Impact of cancellation of 2G licences
  - Telecom companies
  - Tower companies
- Pressures on profitability and capital structure for telcos
  - Lower ability to raise equity / sell assets
  - Revised auctions to further strain balance sheets of telcos

To sum it up

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- Reported financials of IFCs better than banking averages
- Risks not fully reflected in financials
- Current operating environment remain an overhang
- Better to be prudent for some time with better opportunities to cherry pick assets

Thank you