THE OIC GROUP

HKG GROUP 6

Monthly Report

November 2024

IRB INFRASTRUCTURE DEVELOPERS LTD

OIC Research Group | Analyst Group Report

Associate: Harry Yeung **Analysts**: Scott Chan, Paul Fang, and Carmen Li November 2024

IRB Infrastructure seeks US$200 mn in reopening debt issuance within a total US$740 mn package

Issuance Summary

Announcement Date	October 14, 2024
Issuance Size	7.1100% US$200 mn
Initial Pricing Guidance (IPG)	Price: 99.91700, Yield: 7.125
Capital Rank	1st Lien

Issuance Regulations

The bond offering is under the **Rule 144A.** In a Rule 144A debt offering, the initial purchasers of securities from an issuer may resell the securities without the resale constituting a "distribution" subject to the registration requirements of the Securities Act of 1933.

Bond Info/Structure

	Data as of 18/11/2024 7.1100% 11/03/2032 Corp
Yield-to-Maturity	6.83
Z-Spread	288.8
Modified Duration	5.121
Convexity	0.330
DV01	525

Bond Comparable Analysis

	Data as of 18/11/2024
	7.1100% 11/03/2032 Corp
Yield	6.93 vs 6.40 (Avg.)
Z-Spread	299 bps vs 204 bps (Avg.)

Issuance Purposes

In a regulatory filing, IRB Infrastructure Developers stated its plan to **obtain term loans from different sources,** such as financial institutions, to fulfill its financial needs and create security. Additionally, the issuance aims to **provide collateral,** as deemed essential by the board, to **back the debt securities** and engage in **hedging contracts,** when necessary, as permitted by the Reserve Bank of India. This could help IRB to mitigate risks associated with financial transactions and protect the company's financial interests in the long run. Issuing USD bonds offshore with a coupon rate of 7% presents a **more cost-effective financing option** for the IRB compared to other available alternatives.

Issuer

IRB Infrastructure (NSE: IRB)

IRB Infrastructure Developers Limited is an infrastructure development and construction company in India, with significant experience in the roads and highways sectors. IRB is also involved in the real estate sector. The Company aims to maintain steady revenue growth through the addition of ***BOT*** (*Build-Operate-Transfer*) and ***TOT*** (*Toll-Operate-Transfer*) projects

Founded Year	1998
HQ	Mumbai, India
Sector	Transportation Services
Market Cap	INR$303.28 bn
FY23 Revenue	INR$64.02bn
FY23 EBITDA	INR$32.52 bn

Company Financials

	Data as of 31/03/2024, in INR millions
Total Debt	186,533.9
Net Debt	166,257.5
Enterprise Value	519,841.0
EV to LTM EBITDA	15.6
FFO / Debt	0.057
FFO / Interest Coverage	1.7x
EBITDA	33,317.9
Interest Expense	17,012.0
Net Income	2,223.5
Cash from Operations	26,597.2
Total Debt to EBITDA	5.6
Net Debt to EBITDA	5.0
Total Assets	449,203.1
Total Capital	431,212
Debt to Assets	0.42
Total Debt to Total Capital	0.43
Total Debt to Common Equity	3.74

Source: Bloomberg, Bloomberg Intelligence, and Bloomberg Law

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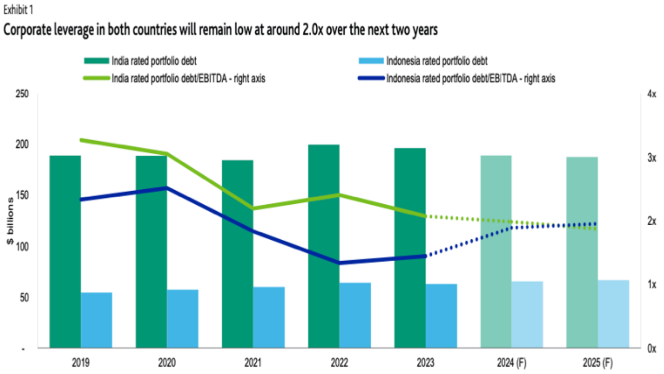
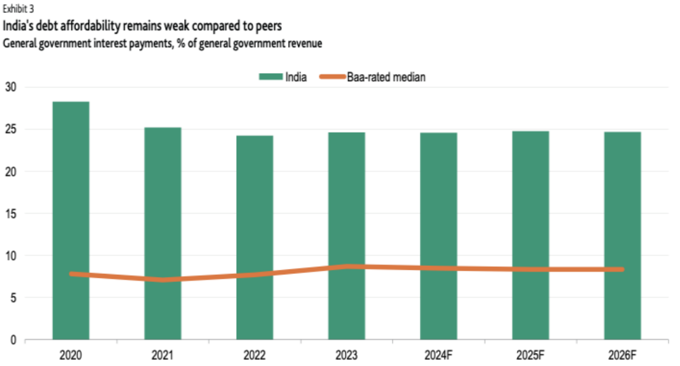
Country Overview: Improving Credit Quality in India

Emerging Market Debt/EBITDA, Indonesia and India



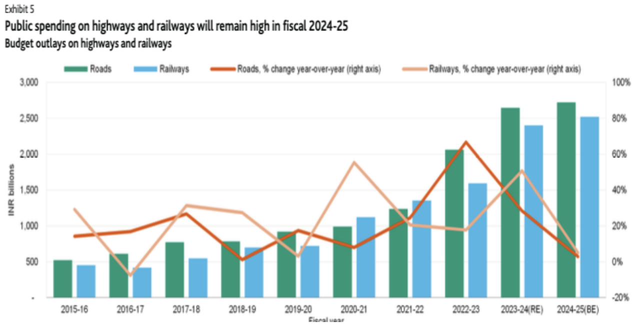
India's Interest Payments as % government revenue vs peers within same credit rating



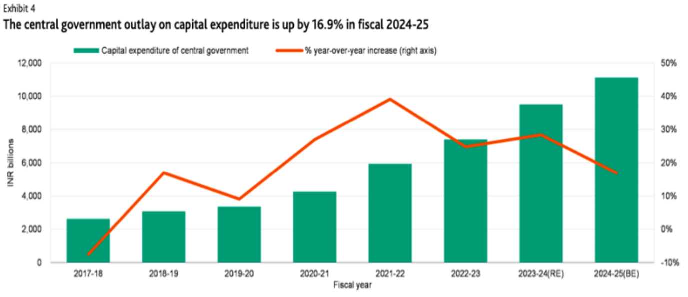
- Government support through greater fiscal budget allocations will drive earnings growth for corporations, improving corporate leverage, as Debt/EBITDA is expected to **remain low at 2.0x** over the next 12-18 months.
- Despite a stabilizing fiscal deficit of 4.9% of GDP in 2024/25, **India's interest payments are relatively high compared to other sovereign issuers with the same Baa3 credit rating**, at 25% of government revenue. However, this is expected to improve as domestic growth, and governmental support will push the economy towards a 7.25% YoY GDP growth trajectory.
- Considering these factors, we anticipate **further improvement in credit quality in India** and tighter spreads that reflect this growth outlook.

Industry Overview: Government Expenditure Fuels Growth in India Infrastructure

Changes in Government Spending on Highways and railways



Central Government outlay on capital expenditure in India



- The Indian government has proposed an **INR11.1 trillion capital expenditure outlay** on infrastructure projects. Railway, highway, and road development projects are expected to **have the highest growth of 3-5% in budget allocation within 2024**, aligning with the government's focus on economic development and connectivity.
- This capital outlay creates a credit boost for issuers within infrastructure-related sectors, especially for IRB as their portfolio comprises of 26 infrastructure projects, where governmental support may **increase Public-Private-partnerships and expand their project pipeline** (both Build-Operate Transfer and Toll-Operate Transfer).

Source: Moody's Research

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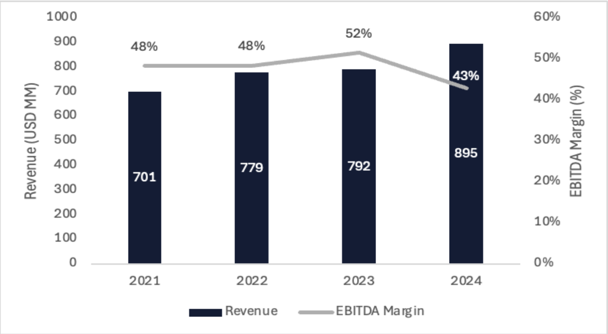
Revenue Breakdown: Infrastructure Projects and Pipeline

Revenue and EBITDA Margin



IRB's Project Pipeline

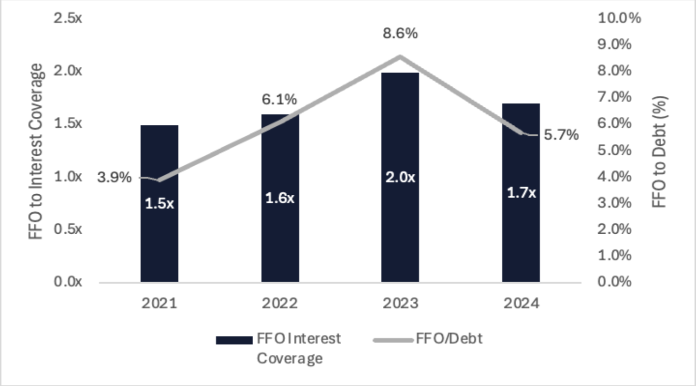
Projects	Type	Concession Period (Yrs)	Status (As of June 2024)
Ganga Expressway - Pkg 1	BOT	30	Under Construction
Samakhiyali Santalpur	BOT	20	Tolling/Under Construction
Palsit Dankuni	BOT	17	Tolling/Under Construction
Vadodara - Mumbai	HAM	15	Under Construction
Pathankot Mandi	HAM	17	Under Construction
Chittoor Thachur	HAM	17	Under Construction

Project overview	Current Projects: 26	Average concession: 21 years	Project Pipeline: 6

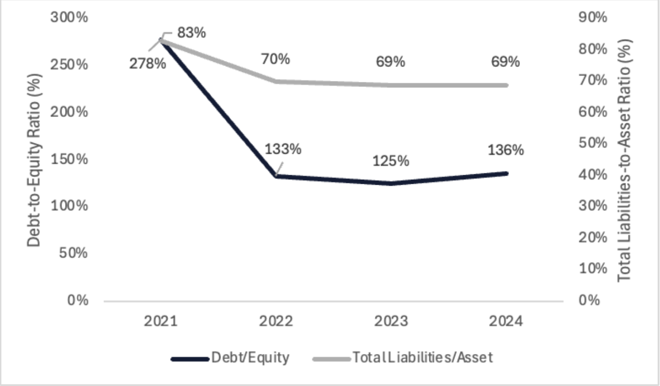
- As one of India's largest toll road operators, IRB benefits from **favorable long-term contracts**, including 16% toll fee hikes every three years until FY'31 under the National Highways Fee Rules (NHAI). With **average concession periods of 21 years**, IRB enjoys stable cash flows from its SPV vehicles. The diversified project pipeline supports this stability and is expected to grow in line with government policies.
- IRB's expanding project portfolio and toll price increases have contributed to **a steady 5% annualized revenue growth and healthy EBITDA margins**, which recently **improved to a range of 42-50%**.

Leverage/Coverage Analysis

FFO/Debt



Leverage/Coverage



- Funds From Operations (FFO), a common Non-GAAP accounting method that adjusts for non-cash expenses and gains from property sales, is typically used in real asset sectors. Despite a drop in FFO/Debt to 5.7% and FFO interest coverage to 1.7x due to IRB's expansion of its toll portfolio, **FFO/Debt remains above Moody's downgrade trigger of 4% below Ba1, indicating relatively healthy cash flow for financing.**

- IRB's long concession periods, despite extended payback periods may create substantial financial leverage. However, their Debt/Equity and Liabilities as a percentage of Assets are stabilizing. This will be further supported by **INR 53.5 billion in growth equity injections from GIC-owned entities**, which will **dilute their debt proportion**.

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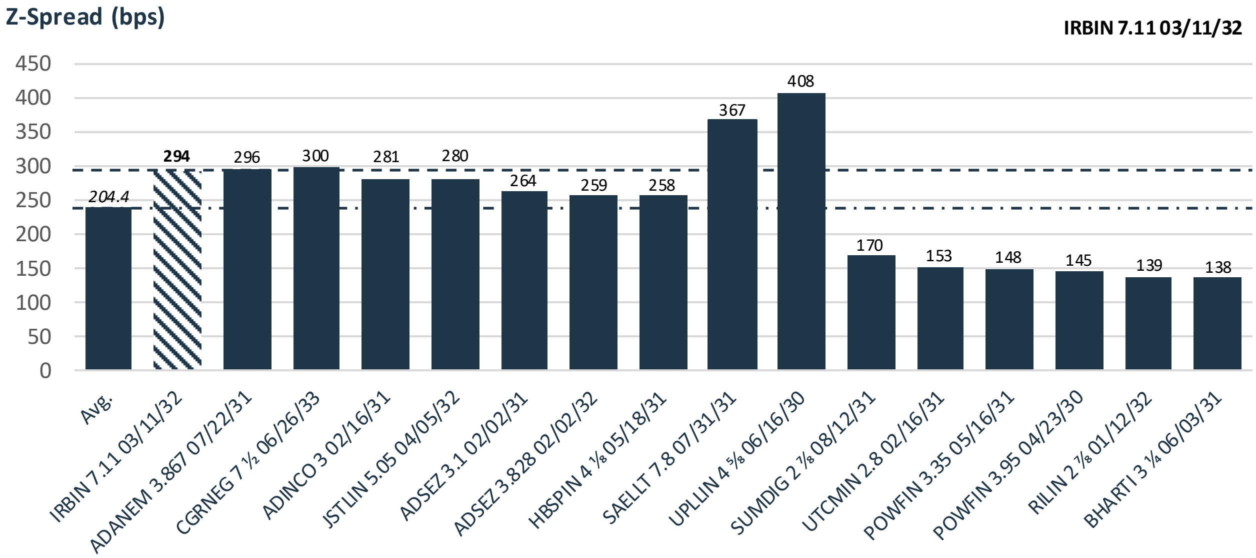
Bond Comparable Analysis

- **Z-Spread:** Also known as ***Zero-volatility Spread***, is defined as the constant spread that, when added onto the yield curve of ***risk-free sovereign debt*** (i.e. US Treasuries), makes the **Present Value** of a bond's cash flows **equal to its current market price.**
- **How is it useful?** The Zero-volatility Spread provides a holistic perspective, taking into consideration the shape of the yield curve, **applying a spread across all maturities on top of the yield curve** rather than a singular maturity.



Spread Analysis

- **Z-Spread:** Higher than the peer group average, while this may indicate increased credit risk being priced into spreads, noteworthy is the lack of truly immediate peers, the collection of issuers indicated above includes those with investment-grade as well as high-yield credit ratings; the reasoning behind this is the number of issuers in the peer group should there be filtering for solely high-yield issuers, which amounts to 0.
- **How is it useful?** Looking at the bigger picture, the ***ICE BofA US High Yield Index Option-Adjusted Spread*** stands at 264 bps, the tightest ever in the post-COVID era. While this may call into question whether the high yield index is trading too rich, credit quality remains optimistic given the realized default rate of approximately 2%, compared to the 5-6% expected at end of 2023.
- **IRB Infrastructure Default Risk**: The Bloomberg Default Risk model generates a 1-year default probability of 0.6035%, a historical analysis indicates that the 1-year default probability has soared from its May 2024 low of approximately 0.14%.
- **For the investor**: Despite the ever-tighter high-yield spreads, IRB Infrastructure's credit quality remains attractive due to the appeal of "***all-in yields***", which still stand at approximately 7%. The continuation of the BJP coalition under Prime Minister Modi is also expected to deliver policy continuum, with the infrastructure drive a credit strength for the issuer

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Upside Catalysts

Cash Inflow:

- The Yedeshi-Aurangabad SPV(BOT) will receive an arbitration award **of INR 1,720 crores**, including interest, **of which INR 1,680 crores will be directly distributed to IRB**, contributing to IRB's cash flow. Besides, there is an extension in the operating period of 689 days given to IRB, **prolonging its toll collection period and strengthen its revenue stream**.
- The Private InvIT declared a distribution of **INR 288 crores**, out of which **51% (~INR 147 crores) will flow into IRB's cash flow in the next quarter**.

Key Takeaway: The short-term cash inflow from the arbitration award and subsidiary payback will increase the liquidity of IRB in the short run, which may indicate stronger solvency hence tighten the bond yield.

Optimizing Financing and Operating Cost:

- IRB refinanced **INR 6,390 crores** of debt for five SPVs at a lower interest rate, **reducing the rate from 9.7% to 8.6%**. This results in a savings of **110 basis points**, translating to **INR 400 crores of savings over 4 years**.
- Amortization has also **reduced from 23.6% to 8.5% for the next 5 years,** saving INR 1,000 crores over this period.

Key Takeaway: The optimization of financing and operating cost will significantly improve liquidity and cash flow, reducing interest costs and freeing up cash for operations and distributions.

Strong Cash Flow Boost Dividend:

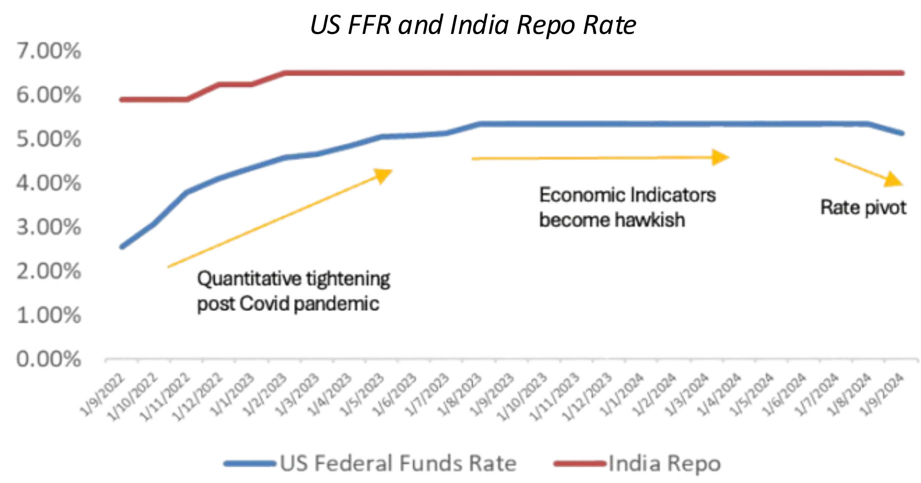
- IRB declared a **10% interim dividend**, marking the second for FY 2023-24. A total of **INR 120 crores** has been paid as dividends so far. Although this is an outflow, it reflects **strong cash flow generation**, enabling IRB to reward shareholders while managing operations smoothly.

Beat-the-market Financials:

- The company witnessed a robust financial performance in the third quarter with **consolidated income jumping by 32% to INR 2,077 crores**. Toll revenues and construction revenues also saw substantial uplifts by 15% and 42%, respectively. Margin improvements were reflected in a **22% increase in EBITDA**, although interest and depreciation expenses rose as well. Pre-tax profits improved by 35% with a notable 33% hike in profit after tax, signaling strong operational success and an impressive bottom line. **All these financial performance has drawn a floor for the bond price**.

Interest Rate Trend:

- Though Fed has entered the interest rate cut cycle in Sep, the Central Bank of India hasn't taken any action to bring the domestic interest rate down. Due to the **pressure on exchange rate and export**, a near-term interest rate cut cycle is predictable, which could **benefit IRB's operation with a low borrowing cost environment**
- Given **India's moderating inflation and pressure by Fed cut**, India's central bank took the first step toward an interest rate cut by easing its relatively hawkish stance at the monetary policy committee meeting in Oct, **shifting to "Neutral" for the first time since 2019**, laying foundation for an interest rate cut in Dec meeting. Market has reached **a consensus of an interest rate cut of 25bps** in Dec and partially priced in.



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Downside Catalysts

Cash Outflow:

- IRB has successfully bagged two major **Toll-Operate-Transfer (TOT)** projects and is expected to achieve the financial closure by the end of this fiscal year, implying **a large amount of capital expenditures coming on the way**

  TOT-12: Lalitpur-Sagar-Lakhnadon section with a payment of **INR 4,428 crores** for a 20-year concession

  TOT-13: Gwalior-Jhansi section and Kota Bypass with a payment of **INR 1,683 crores** for a 20-year concession
- Though the two projects is going to generate toll revenue in the coming 20 years, **the incoming Capex may drain IRB's liquidity in the short-run**

High Interest Cost:

- Interest costs have increased by 18% year-on-year, reaching INR 433 crores for Q3 2024. While the refinancing measures will help lower costs in the long term, current MCLR rates are high, **keeping quarterly interest expenses elevated**.

Leveraging Still Hiking:

- Adjusted Debt to Equity Ratio hiked from 0.75 in FY23 to 0.87 in FY24, whereas Interest Coverage Ratio decreased from 2.79 in FY23 to 2.61 in FY24, indicating the **leverage level slightly trending upwards**. However, Adjusted Current Ratio dropped from 3.84 in FY23 to 2.29 in FY24 and Long-Term Debt to Working Capital hiked from 3.11 in FY23 to 6.53 in FY24, resonating with IRB's effort to **restructure their debt to longer term**, which relieve the debt repayment pressure in the short run but arouse more concerns about the long-term solvency of IRB.
- Despite hiking leverage, Fitch and Moody's both **hold stable outlook on IRB's rating**.

As of Mar 31, 2024

Item	FY24	FY23
Adjusted Debt to Equity Ratio	0.87	0.75
Interest Coverage Ratio	2.61	2.79
Adjusted Current Ratio	2.29	3.84
Long-Term Debt to Working Capital Ratio	6.53	3.11

IRB Credit Rating and Outlook

Rating Agency	Foreign	Outlook
Moody's	Ba1 10-Oct-2024	Stable
Fitch	BB+ 10-Oct-2024	Stable

Instrument Rating (i.e. Rating of the Bond)

Rating Agency	Rating
Moody's	Ba2 9-Oct-2024
Fitch	BB+ 20-Mar-2024

Trump's Impact:

- As Trump got elected in the 2024 US Presidential Election, his policies of tariffs, large tax cut and expansionary government spending will inevitably push up US inflation
- In the short run, it will arguably result in a slowing down interest rate cut by the Fed, **reversing the tightening trend of bond yield in the short run**
- In the long run, high inflation may end the interest rate cut cycle earlier than planned and force interest rate hike policy, **widening yield thus pressure on bond price**

Implications:

Due to the mixed effects in the market, **we expect IRB bond's price to be fluctuate in the short run until Trump release his first series of policies**. Therefore, we have two recommendations:

- In the **short run**, either **stand on the sideline or buy in to seize capital gain amid fluctuation**.
- In the **long run**, IRB's bond comparable yield and spread are high above average, **making it a component for an EM fixed income portfolio to generate strong and stable cash flow**.

Source: Individual research, Q3 2024 Earning Call, Trading Economics, and Refinitiv