India Ratings & Research
A Fitch Group Company

India Ratings Downgrades IL&FS Education & Technology's ICT Contract Receivables Backed NCDs to 'IND BBB(SO)'; Places on RWN

21

SEP 2018

By Arijeet Maji

India Ratings and Research (Ind-Ra) has downgraded IL&FS Education & Technology Services Limited's (IETSL) non-convertible debentures (NCDs) 2014 and placed the rating on Rating Watch Negative (RWN) as follows:

Instrument Type	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Principal Outstanding (million)	Rating/Rating Watch	Rating Action
Series C	INE896F07068	12 November 2014	11	10 April 2020	INR1,562 (outstanding as on 20 September 2018)	IND BBB(SO)/RWN	Downgraded; Placed on RWN

The downgrade follows a similar action on IETSL to 'IND BB+'/Negative from 'IND A+'/Negative, given that the rating of the NCDs was derived from IETSL's rating. The notching up was supported by low revenue risk on account of seasoned information communication technology (ICT) contracts with nine states, staggered payment mechanism that supports liquidity and presence of a debt service reserve account (DSRA). Ind-Ra will continue to monitor the Long-Term Issuer Rating of IETSL and take a consolidated view of IETSL, its wholly-owned subsidiary IL&FS Clusters Development Initiative Limited and its majority-owned subsidiary IL&FS Skills Development Corporation Limited as all operate in the same business. IETSL has also provided corporate guarantee to the bank debt facilities of both the subsidiaries.

KEY RATING DRIVERS

Deterioration in Credit Profile: During the tenure of the NCD, IETSL has provided liquidity support to the rated outstanding NCDs on several occasions to service the NCD obligations due to mismatch in timeliness of expected collections from government departments and scheduled NCD repayments on the charged ICT receivables from the nine states. Therefore, the agency has continued to link the rating of the NCD to IETSL's credit profile, despite the satisfactory performance of the ICT receivables during the last 12 months with the cumulative collection efficiency of around 95% as of 30 June 2018.

Moderate Liquidity Risk from Odisha ICT Project: The current transaction had 14.8% (INR802.3 million) of more than zero days past due overdues on the scheduled expected collections as on 30 June 2018. However, the company collected a significantly large amount of overdues of INR1,758.5 million in the nine months ended 30 June 2018 from the government departments, which had been due for more than a year. More than 85% of the total overdues outstanding are from the Odisha and Maharashtra contracts. Additionally, of the total future collectible amount of INR4,132.1 million, total amount contributing to overdues is INR1,566.9 million.

However, IETSL expects to collect approximately INR450 million and an additional INR300 million by September 2018 and October 2018 from Odisha ICT project of its total overdues pending as on 30 June 2018. Additionally, the bottleneck issues related to Odisha ICT project mainly submission of third-party assessment report by state to centre has been completed and IETSL does not foresee any further significant delays in project collections, as seen in the past.

Moderate Liquidity Risk from Maharashtra & Rajasthan ICT Projects: About INR559.2 million (35.7% of total overdues) and INR129.9 million (8.3% of total overdues) of collections were more than zero days due from Maharashtra and Rajasthan contracts, respectively, as of 30 June 2018. The company expects to collect a total amount of INR400 million from the Maharashtra ICT project partly by October 2018 and remaining by November 2018, subsequent to the recent approval of INR380 million by the central government to be transferred to the state government.

The key issue for delay in collections in Rajasthan is vast coverage of districts and considerably higher time consumed for district-wide collections than the remaining ICT projects (barring Odisha ICT project). IETSL expects a further streamlining of inflow and a fall in overdues.

Low Revenue Risk: Identified receivables are contributed by the hardware and services (training and operations and maintenance (O&M)) provided to schools under the ICT contracts. The contract repayment track record has been tested before and during the life of the transaction since 2015. This significantly mitigates revenue risk which is now contingent upon IETSL's ability to provide the remaining O&M services to realise the remaining revenue. The services revenue is to be received in equal quarterly instalments. Any capex in relation to these contracts is likely to be minimal.

Presence of DSRA: The debt programme has the benefit of a debt service reserve account (DSRA) equivalent to INR360 million as of date. The DSRA cover on the outstanding NCDs of INR1,562 million is 23.0%. The debenture trustee has the first and exclusive charge on the funded debt service reserve amount lying in this account. The DSRA to the extent of INR260 million is provided in the form of an unconditional and irrevocable bank guarantee with Axis Bank Ltd ('IND AAA'/Stable/'IND A1+'), while the remaining INR100 million is provided in the form of fixed deposits also with Axis Bank Ltd ('IND AAA'/Stable/'IND A1+'). The maturity date of the fixed deposits and the bank guarantee is in line with the NCDs maturity date.

Staggered Debt Service: The NCD repayment has been sculpted such that a minimum cumulative debt service coverage ratio (the total cumulative collection till cut-off date less total cumulative O&M expenses till cut-off date to total cumulative debt repayment till cut-off date) of 1.2x is maintained in each payment period. The cut-off date for the purpose of current review was 30 June 2018.

Security Charge on Identified Receivables: The debenture trustee has the first charge on identified receivables. The charge is permitted against the performance bank guarantees of INR1,510 million. Also, no additional charge will be levied on these receivables against any new indebtedness of the company.

Limited Operational, Maintenance Risk: IETSL has entered into service level agreements with vendors for servicing and maintenance. Any major cost related to the servicing and maintenance of computers and peripherals will be directly passed on to the vendors. Other costs which the company is entitled to bear, are fixed in nature. IETSL has also taken an insurance cover on assets against natural calamities, fire and theft.

RATING SENSITIVITIES

The RWN reflects indicates that the ratings may be downgraded or affirmed. The RWN may be resolved upon IETSL ability to maintain a stable Long-Term Issuer Rating in the medium-to-long term.

Future developments that could, individually and collectively, result in a negative rating action include:
- further downgrade of the issuer rating as the NCD ratings are linked with IETSL's rating
- utilisation of DSRA facility due to continuous non-collection of Odisha ICT's overdues and associated future receivables

TRANSACTION STRUCTURE

The transaction had a remaining door-to-door maturity of 1.75 years as of 30 June 2018. The NCDs have one outstanding series, namely Series C, with sequential payment structure of scheduled maturity in April 2020. The debentures would be repaid from IETSL's income arising out of identified receivables under nine ICT contract agreements with six different states (Bihar, Gujarat, Maharashtra, Odisha, Rajasthan and West Bengal).

The NCDs are secured by way of the first charge of the debenture trustee on identified receivables. The charge is permitted against the performance bank guarantees of INR1,510 million, as detailed in the transaction document. In the current structure, the debt programme also has the benefit of the DSRA. The total credit support available in the form of DSRA is 23.0% of the outstanding NCDs.

COMPANY PROFILE

IETSL is the education technology and training arm of IL&FS group, a pioneer in the development of physical and social infrastructure projects in the public private partnership formats. Started in 1997, IETSL has a well-diversified business model and offers comprehensive solutions in the fields of pre-primary, elementary, secondary and higher education using ICT tools.

FINANCIAL SUMMARY

Particulars	FY18^	FY17^
Revenue from operations (INR million)	5,373.5	4,179.4
Operating EBITDA* (INR million)	1,098.1	1,022.9
Operating EBITDA* margin (%)	20.4	24.5

Profit after tax (INR million)	275.5	207.3
Source: Company Audited Annual Financial Statements. ^Accounting norms for FY17 is Indian GAAP while that for FY18 is IND-AS *Operating EBITDA does not include other income; however, profit after tax includes other income		

RATING HISTORY

Instrument Type	Current Rating/Rating Watch			Historical Rating/Outlook		
	Rating Type	Principal Outstanding (million)	Rating	14 February 2018	21 February 2017	25 February 2016
Series C	Long-term	INR1,562	IND BBB(SO)/RWN	IND AA-(SO)/Stable	IND AA-(SO)/Stable	IND AA-(SO)/Stable

COMPLEXITY LEVEL OF INSTRUMENTS

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

SOLICITATION DISCLOSURES

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

ABOUT INDIA RATINGS AND RESEARCH

About India Ratings and Research: India Ratings and Research (Ind-Ra) is India's most respected credit rating agency committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

India Ratings is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.

DISCLAIMER

Applicable Criteria

Structured Finance Rating Criteria

Analyst Names

Primary Analyst

Arijeet Maji

Senior Analyst
India Ratings and Research Pvt Ltd Wockhardt Towers, 4th floor, West Wing Plot C-2, G Block. Bandra Kurla Complex Bandra (East), Mumbai 400051
+91 22 40001704

Secondary Analyst

Neeta Laud

Senior Analyst
+91 22 40001716

Committee Chairperson

Sandeep Singh

Senior Director and Head Structured Finance
+91 22 40001735

Media Relation

Namita Sharma

Manager – Corporate Communication
+91 22 40356121
