

Infrastructure/
Transportation
India
IPO Grading Report

IL&FS Transportation Networks Limited

Fitch IPO Grade 4(ind)

Fitch has assigned a grade of '4 (ind)' out of a maximum of '5 (ind)' to the proposed initial public offer of IL&FS Transportation Networks Limited (ITNL). The grade indicates the above-average fundamentals of the issue, relative to other listed equity securities in India

IPO Details

IPO Grading for IL&FS Transportation Networks Limited, in connection with an initial public offering of equity shares of face value of INR 10 each along with share premium aggregating INR7,000m. This includes an offer for sale of 42,78,844 shares by Trinity Capital Two Limited, an existing shareholder.

Financial Snapshot (Stand-Alone)

(INRm)	2009	2008
Revenues	2,277	2,499
EBITDA	1,423	1,458
EBIT	1,397	1,437
Net income	421	765
Total debt	7,640	4,332
Shareholders funds	7,665	7,362
EBITDA margin (%)	63	58
EBIT margin (%)	61	58
Net income margin (%)	18.50	30.60
Earnings per share	2.45	4.71
Total debt/equity	1.00	0.59

Source: Company, Fitch

Analysts

Venkataraman Rajaraman
+91 44 43401702
r.venkataraman@fitchratings.com

S. Nandakumar
+91 44 4340 1710
s.nandakumar@fitchratings.com

Grading Rationale

The grading assigned to IL&FS Transportation Networks Limited (ITNL) reflects its established presence in India's transportation sector - in particular roads. Both ITNL and prior to its incorporation, its promoter, Infrastructure Leasing & Financial Services Ltd (IL&FS, 'AAA(ind)'/Stable), have had a long and successful track record in the Indian infrastructure sector, many times playing a pioneering role in introducing new business models and execution formats. A mix of operating road assets, combined with projects that are under development or in various stages of construction, lend considerable visibility to the business prospects; recent forays outside of the road sector, such as managing city bus transport services and implementing a rail transit project, provide a measure of diversification, although they also carry risks by virtue of being relatively new models in the Indian context.

Aided by a long-term vision and expertise in the road sector, built up as an integrated player with experience in managing the various phases in the project lifecycle - eg concept to development, project management to operations - ITNL is well positioned to capitalize on the growing opportunities in the sector as the Government of India (GoI) and several state governments seek to secure greater private sector participation through the public private partnership (PPP) model.

Unlike several competitors - which have transformed from being construction companies to project developers - ITNL has been able to differentiate itself by its ability to generate value in the pre-construction phase, including through selling innovative concepts and ideas to various governments. The quality and stability of ITNL's management and the financial flexibility that it enjoys - including access to IL&FS's financial (though not explicitly articulated) and managerial resources - and its brand, give it an advantage in realizing very ambitious business plans. ITNL has a moderately sound financial history of growing revenues and dividend pay-outs, although it is now attempting to chart a growth trajectory that is substantially higher, in keeping with its market potential.

Fitch believes that the infrastructure sector in general, and the roads segment in particular, will see increasing activity in the medium term. That said, ITNL will still be confronted with a number of challenges in its quest to build a continuous and rapidly expanding pipeline of new project wins (which are critical to its current revenue model, which relies heavily on generation of upfront project development and supervision fees). Key risks emanate from policy changes, vagaries of the political discourse, and regulatory hurdles (which can slow the pace at which new projects are bid out by various governments, as was the case with the highways development programme in FY08 and FY09). Completion risk, frequently encountered by numerous road projects, can necessitate higher than anticipated investment outlays, calls for additional financial support, and also delay returns. As governments rely predominantly on a bidding process for awarding new projects, competitive pressures may stymie ITNL's growth plans and/or lower returns.

The proceeds from ITNL's proposed issue are expected to be largely applied towards retiring existing short-term debt and facilitating fund-raising for future investments, through broadening the equity base.

Key Grading Issues

Areas of Strength

- Established position in the sector; one of the earliest entrants.
- Strong parent; benefit of financial and managerial resources; ability to leverage relationships with government because of the brand.
- The government's strong impetus to create infrastructure as a key input to sustainable economic growth; the road sector has been at the forefront of India's PPP programme and is poised to see heightened activity in the next two to three years

Risks - Factors Constraining the Grading

- Changes in government policies/political preferences may slow the sector's growth.
- Construction and completion risk (many times caused by factors outside the company's control) and patronage risk, at least in the initial years of some of the toll road assets.
- Need to extend higher-than-budgeted financial support - during both construction and operations phases - to the special purpose vehicles (SPVs) sponsored by it; possible need to continue supporting the overseas subsidiary, Elsamax
- Since the government is the counterparty for bulk of the projects in the sector, concessions are awarded on the basis of 'lowest-cost bids'. This implies that ITNL's revenue and profits for a particular year depend upon the new concessions it is able to secure during the year in a competitive bidding scenario.

Company Background

ITNL was incorporated in the year 2000 to consolidate the parent, IL&FS's transportation (roads, rail and related services) initiatives under one roof. ITNL's role includes project development, project management, construction management, operations and maintenance Management, design engineering, and policy advisory. All of the road projects through various SPVs are domiciled in ITNL.

ITNL is one of India's largest Build-Own-Operate (BOT) road operators, with approximately 8000 lane kms under its management. In early 2008, ITNL established its global presence in the road sector by acquiring a 100% equity stake in Elsamax, S.A., a Spanish enterprise involved in construction and operations and maintenance (O&M) operations in the road sector in approximately 10 countries.

ITNL has a diverse portfolio of 16 road projects, one rail project and one urban transportation system project at various stages of development/construction/operation. ITNL has a mix of "annuity/assured payments" and "toll"-based projects, with "annuity" projects comprising the majority. ITNL also implements projects in partnership with local state governments, which include the states of Rajasthan, Chhattisgarh and Jharkhand.

Promoters

ITNL is a part of the IL&FS group, which was one of the earliest private sector entrants into the infrastructure development business. It has a demonstrated track record of developing, structuring and the commercialization of various infrastructure projects, particularly in the transportation sector. IL&FS is also involved in infrastructure advisory services and benefits from a strong and experienced management team. An unlisted company, Life Insurance Corporation of India (LIC) is the single largest shareholder in IL&FS, with a stake of 25.25%.

Utilisation of Proceeds

The proceeds of the issue are planned to be utilized to prepay INR4,000m of short-term debt, which the company has availed from commercial banks, and a INR1,000m inter-corporate deposit from one of its group companies. The balance will be utilized for general corporate purposes.

Business Overview

ITNL is an established surface transportation infrastructure company and is one of the largest private sector BOT operators in India. ITNL is involved in the development, operation and facilitation of surface transportation infrastructure projects, taking projects from conceptualization through commissioning to operation and maintenance. In March 2008, ITNL commenced its international operations through the acquisition of Elsamex SA, (Spain) a provider of maintenance services, primarily for highways and roads in Spain and other countries.

Besides six operating road projects, ITNL is developing 12 road projects in the states of Andhra Pradesh, Chattisgarh, Jharkhand, Kerala, Rajasthan and Maharashtra. Out of the 12 projects, six are under construction and six are in the pre-construction phase of development.

An ITNL led consortium comprising ITNL Enso Rail Systems Ltd and DLF has been selected for the development of the 5 km elevated metro rail link project in Gurgaon. Besides, ITNL through one of its subsidiaries also operates buses on a few selected routes in the Nagpur city on a BOT basis.

Presently, ITNL's revenue model depends upon the fee income that it generates from the various SPVs, formed for implementing projects won by the group. Concessions from the various governments vary from 10 to 30 years. Once a project is bid and won, ITNL invests in its equity to the extent of about 15% to 25%, sourcing the balance from a combination of debt (from banks) and sub-debt (from IL&FS). While the debt is raised on a non-recourse basis, ITNL is not averse to extending financial support, contractually (loan agreements usually require the sponsor to fund project cost overruns) as well as to help projects tide over temporary cash flow difficulties.

ITNL's major sources of revenue are fees received on account of rendering the following services:

- project development services;
- advisory and project management services;
- construction supervision services;
- Operations and maintenance (comprising an upfront fee and an annual recurring fee);
- tolling supervision;
- dividend and interest income on investments.

Since the projects have a long gestation, it usually takes between seven to 10 years to realize return from equity investments

Since the majority of the fees (except O&M fee) are one-time and non-recurring in nature, the company's annual revenue depends on the ability to keep winning new projects for development. This is dependent on external factors, including government policies, pace of economic growth and behaviour of competitors.

Market/Industry Position

The development and improvement of roads is a key ingredient in the Govt's efforts to place infrastructure at the heart of economic growth. The Road Transport &

Highways Ministry has an ambitious plan of developing 35000 km of national highways in the next five years. It is estimated that an investment of about USD70bn would be needed in the Indian road sector until 2012. Of this, private sector participation is expected to comprise approximately USD41bn. By the end of FY10, the government expects to invite bids for 135 road projects (with a total length of 14,395 km and an estimated cost of USD21bn).

ITNL's established track record in operating toll roads, its diversified revenue base, the strong support of IL&FS, and its experienced management team should equip it to capitalize on this huge opportunity. That said, given the competitive bidding process by which government concessions are granted, ITNL will have to strike a careful balance between aggressively bidding for new projects and managing the risk profile/return thresholds. Besides several established developers and construction companies, the market potential has also attracted a number of smaller players in recent years, making the landscape fiercely competitive. ITNL's experience in working with state governments - in evolving new formats for implementing projects - should give it a measure of diversification.

Financial Performance

The last three years have witnessed a surge in the number of new contracts won by ITNL via successful bids; a stand-alone financial profile follows:

On a consolidated basis, gross revenues increased to INR13320m in FY09 from INR1981.49m in FY07. EBITDA has grown at a compounded annual growth rate (CAGR) of 68% between FY07 to FY09. Net income fell from INR513.82m in FY07 to FY278.78m in FY09, primarily because of the steep rise in interest costs on account of rising borrowings (to INR19.25bn in FY09 from INR11.20bn in FY07).

Operations and Maintenance expenses rose to INR2.6bn (FY09) from INR72m (FY07), owing to expenses on newer projects and a rise in the cost of inputs. Net income/revenue steeply dropped to 2.09% (FY09) from 25.94% in FY07, due to an increase in interest costs, administrative and construction costs; for the same reason, earnings per share (EPS) dropped to INR1.52 from INR5.35 during the same period.

ITNL's leverage (debt/equity) has been at consistently low levels (2x) and the proposed equity infusion via the IPO should provide the company with financial flexibility to fund its growth plans. That said, the realisation of the aggressive growth plans will warrant higher levels of borrowing.

Outlook

The renewed impetus to the National Highway Development Programme (NHDP), coupled with the easing of financial market conditions, has increased market potential for players in the sector. Given its track record, financial strength and competitive advantage, Fitch expects ITNL to be well placed to exploit the opportunities in the sector and realise its growth plans, at least in the medium term.

Annex 1 – Financial Performance

Consolidated Summary (Year-Ended March 31)

(INRm)	M 09	M 08	M 07
Income statement			
Revenue	13,320.08	4,374.54	1,981.49
Revenue growth (%)	204.50	120.77	-
EBITDA	2,999.88	2,588.99	1,062.78
EBIT	2,546.44	2,412.85	926.95
Net income	278.78	932.55	513.82
Balance sheet			
Total debt	19,345.68	16,987.37	11,196.33
Shareholder funds	8,860.97	9,156.66	7,380.85
Share capital	1,714.15	1,714.15	1,624.90
Reserves	7,146.82	7,442.51	5,755.95
Average capital employed ^b	27,174.84	22,360.11	15,577.18
Average assets ^b	36,378.55	28,264.44	20,649.10
Cash flow			
Cash flow from operating activities	747.64	2,593.96	627.99
Capital expenditure	183.91	2,562.93	3,895.40
Ratios			
EBITDA/revenue (%)	22.53	59.18	53.64
EBIT/revenue (%)	19.12	55.16	46.78
Net income/revenue (%)	2.09	21.31	25.94
Earnings per share (basic)	1.52	5.62	5.35
Total debt/equity	2.18	1.85	1.52
Return on average equity (%) ^a	3.09	11.28	6.96
Return on average capital employed (%) ^a	1.03	4.17	2.77
Return on average assets (%) ^a	0.77	3.30	2.49
Number of shares (m) - weighted average	171.41	162.66	94.78

^a Based on Net Income

^b Figures for FY07 are not averaged

Source: Company, Fitch

Reproduction or retransmission in whole or part is prohibited except by permission. All rights reserved. The above grading ("Grading") assigned by Fitch is largely based on Fitch's assessment of the fundamental financial strength of the issuer. The Grading does not constitute a credit rating by Fitch. Our procedures for issuing a credit rating differ from the procedures used to issue the Grading. The Grading has been arrived at based on information and documents provided to us by the issuer and other parties. Fitch relies on these parties for the accuracy of such information and documents. Fitch did not audit or verify the truth or accuracy of any such information and does not take responsibility for the appropriateness of the information provided and used in our analysis. The Grading is provided "as is" and Fitch does not represent, warrant or guarantee (i) the accuracy, correctness, integrity, completeness or timeliness of any part of the Grading, or (ii) that the Grading (or any credit rating) and the information and analyses contained in, and constituting a part thereof, will fulfill any person's particular purposes or needs. The Grading reflects the opinion of Fitch as at the date of publication and will not be monitored, and therefore will not be updated to reflect changed circumstances or information that may affect the Grading. The report providing the Grading is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of securities. The Grading does not comment on the suitability of the issue process, the adequacy of market price, the suitability of any investment, loan or security for a particular investor (including, without limitation, any accounting and/or regulatory treatment), or the tax-exempt nature or taxability of payments made in respect of any investment, loan or security. Fitch is not providing any financial advice, or any legal, auditing, accounting, appraisal, valuation or actuarial services. The Grading should not be viewed as a replacement for such advice or services. In providing the Grading, Fitch is not making any recommendation or suggestion, directly or indirectly, to any 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 of any issuer. Any person who uses the Grading does so entirely at its own risk. Investors are advised to obtain individual financial advice based on their risk profile before taking any action based on the Grading. There is no fiduciary relationship between us and any third party, including, without limitation, any user of the Grading. Fitch is not responsible for any underwriting, credit, loan, purchase, strategic or investment decision, or damages or other losses resulting from use of the Grading. None of Fitch, its officers, employees, affiliated companies and their officers and employees shall have any liability in contract, tort, or otherwise (including, without limitation, for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits) in relation to the use of the Grading by any third party. Fitch receives fees from the issuer for performing the Grading exercise. Such fees vary from US\$5000 to US\$150000 per issue. Due to the relative efficiency of electronic publishing and distribution, the Grading may be available to electronic subscribers up to three days prior to print subscribers.