ICRA

FINANCIAL MARKETS & BANKING UPDATE

APRIL 2019

GoI – Fully Serviced bond issuances supports growth in corporate bond issuance for FY2019

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Manushree Saggar
+91 124 4545 316
manushrees@icraindia.com

OVERVIEW

Background: During FY2017, Ministry of Finance (MoF) - Government of India (GoI) accorded its approval to four ministries, i.e. Ministry of Power (MoP), Ministry of New and Renewable Energy (MNRE), Ministry of Shipping (MoS) and Ministry of Water Resources, River Development and Ganga Rejuvenation (MoWR) to raise extra-budgetary resources (EBR) to be borrowed by various government agencies by issuances of bonds.

These bonds termed as GoI-Fully serviced bonds (GoI-FSBs) were to be raised by PFC Limited / REC Limited under MoP, IREDA under MNRE, Inland Waterways Authority of India (IWAI) under MOS and National Bank for Agricultural and Rural Development (NABARD) under MoWR. The total allocation of these GoI-FSBs to these four ministries during FY2017 stood at Rs 16,300 crore, against which these entities borrowed Rs 9,167 crore as per ICRA's estimates. Refer exhibit 2.

Features: The key features of these GoI-FSBs included servicing of these bonds by GoI by making suitable provisions in the budget of the borrowing ministries. In view of servicing of these bonds by GoI through its budgetary provisions, requirements of an explicit guarantee have not been provided for these GoI-FSBs.

Purpose: The purpose of these borrowings has been to meet the expenditure towards various schemes of GoI, which otherwise would have required a budgetary provision from GoI in the year of these borrowings itself. Under the current arrangement, the interest servicing on these borrowings will be accounted for in GoI's budget for the year, in which interest payments are made; and later on, upon redemption of these bonds, it will reflect in the expenditure and fiscal deficit of GoI for the specific year.

Impact on Fiscal Deficit: With this arrangement, GoI has been able to meet the targeted spending for various social schemes while maintaining its fiscal deficits within the budgeted levels as such borrowings are not included in its fiscal deficit.

The public sector entities (PSEs) eligible to issue such GoI-FSBs have increased subsequently and the quantum of borrowings have increased and stood at Rs 64,192 crore during FY2019 as compared to Rs 15,095 crore during FY2018 and Rs 9,167 crore during FY2017. The total outstanding value of these GoI-FSBs stood at Rs 88,454 crore at the end of FY2019. Had these borrowings been accounted as part of expenditure during the respective years, these borrowings would have accounted for 0.34%, 0.09% and 0.06% of GDP for FY2019, FY2018 and FY2017 respectively. Refer exhibit 2.

Borrowing Costs: Further, as per the initial suggestion given by MoF to various PSEs to borrow these GoI-FSBs at 10-20 bps over the Government security (G-sec) rate of corresponding maturity, the actual borrowing cost stood much higher. For example, the daily average yield on new 10-Yr G-sec during Q4FY2019 stood at 7.37% (maximum and minimum of 7.64% and 7.22% respectively), against which the value weighted average coupon on GoI-FSBs issuances during Q4FY2019 stood at 8.36% (with minimum being 8.12% and maximum at 8.80%). Refer exhibit 4.

Though the coupon on these GoI-FSBs bonds was lower than the standalone borrowing cost of these PSEs, however it was significantly higher than GoI's own borrowing costs.

Trends in GoI serviced bond issuances

EXHIBIT 1: Quarterly trend in GoI serviced bond issuances

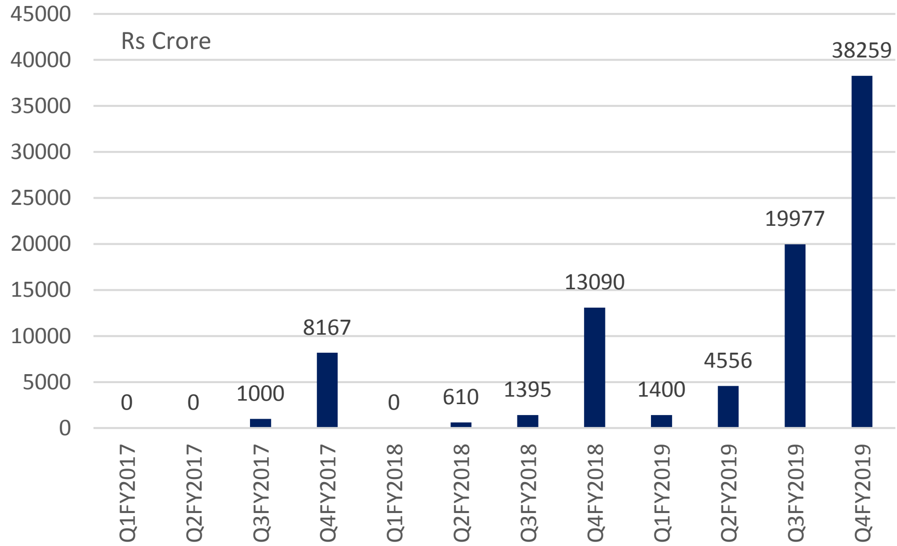
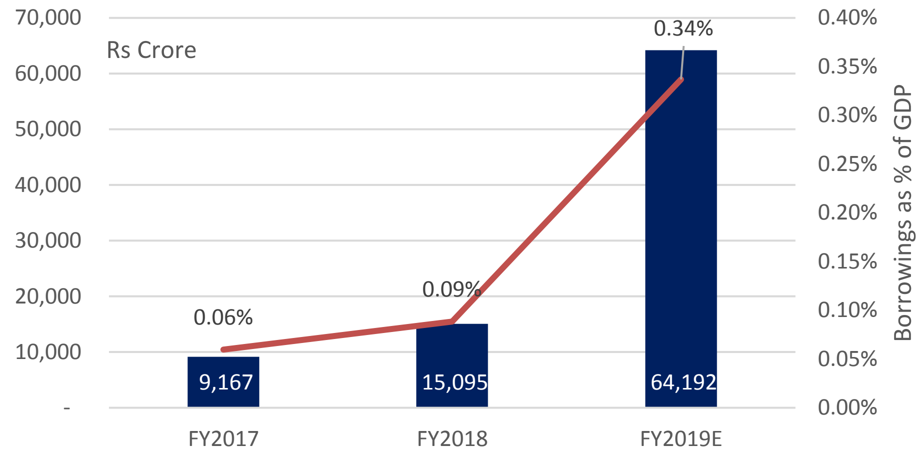


EXHIBIT 2: Annual Trend in GoI service bond issuances



Source: BSE, NSDL, issuers offer documents, ICRA research

As can be seen from exhibit 1, the issuances of GoI-FSBs have significantly shot-up during FY2019 and as seen from exhibit 2, such borrowings accounted for 0.34% of GDP. It is pertinent to note that, GoI's net borrowings from markets have largely remained stable at Rs 4.1-4.3 lakh crore from markets during FY2017-19 and with GDP growth, the fiscal deficit as % of GDP went down to 3.4% in FY2019E from 3.5% during FY2018 and FY2017, however accounting for such GoI-FSBs, the fiscal deficit of GoI would have been higher.

GoI serviced bond issuances accounted for sizeable share of overall corporate bond issuances during H2FY2019

EXHIBIT 3: Share of GoI-FSBs in corporate bond issuances

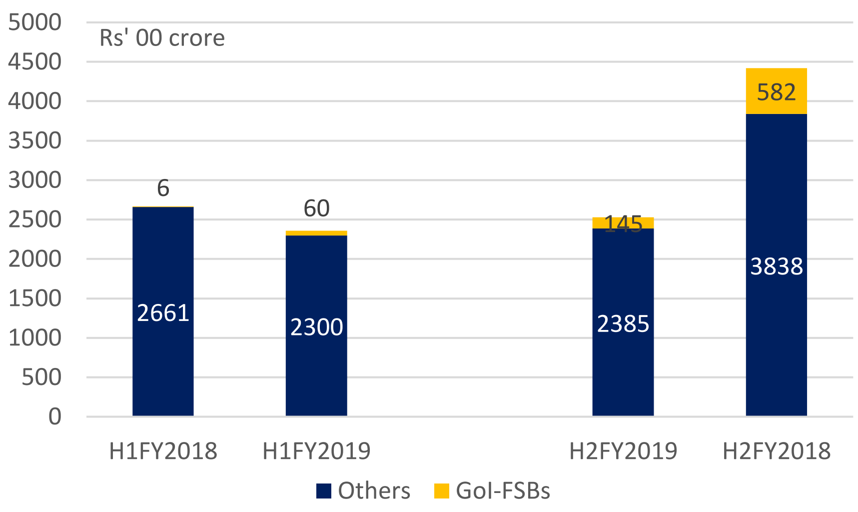
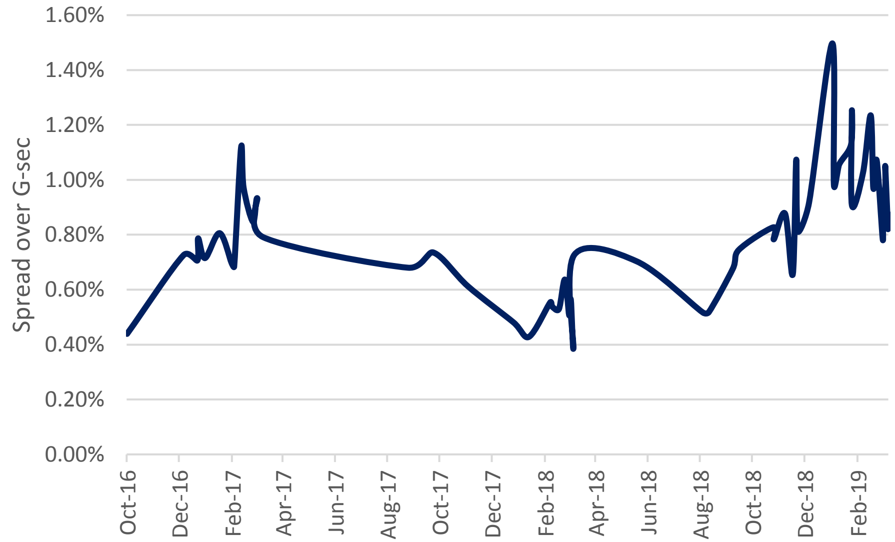


EXHIBIT4: GoI-FSB spread over 10-Yr G-sec on date of issuance



Source: Bloomberg, BSE, NSDL, issuers offer documents, ICRA research

Bond issuances surge during FY2019: As can be seen in exhibit 3, GoI-FSBs accounted for significant share of the overall corporate bond issuances during FY2019. In addition, decline in bond yields and preference for long-term debt to reduce asset liability mismatches supported the 75% rise in corporate bond issuance to Rs 4.42 lakh crore during H2FY2019 from to Rs 2.53 lakh crore during H2FY2018. In contrast, rising bond yields and widening interest rate differential between long-term and short-term rates had resulted a 12% YoY decline in corporate bond issuances during H1FY2019 to Rs 2.4 lakh crore Rs 2.7 lakh crore during H1FY2018. Overall the corporate bond issuances are estimated to have increased by 30% on YoY basis during FY2019 to Rs 6.8 lakh crore as compared to Rs 5.2 lakh crore during FY2018 as per the data from Bloomberg.

Issuances and maturity of GoI serviced bonds

EXHIBIT 5: Issuances

Rs Crore	FY2017	FY2018	FY2019	Total
Total	9,167	15,095	64,192	88,454
Borrowing cost^	7.52%	8.05%	8.43%	8.27%

EXHIBIT 6: Maturity Profile

Rs Crore	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032	FY2033	FY2034	Total
Total	4,980	13,990	60,099	0	0	2,187	3,105	4,093	88,454

Source: BSE, NSDL, issuers offer documents, ICRA research. ^ Value weighted borrowing cost for all entities during the year

EXHIBIT 7: Objects of the issue as stated in offering documents:

	Purpose
HUDCO	To augment the financial resources for implementation of Pradhan Mantri Awaas Yojna (PMAY) - Urban
IREDA	Grid Interactive Renewable Power, Off Grid/Distributed & Decentralized Renewable power and Investment in Corporate and Autonomous Bodies
NABARD	To fund the GoI's share for implementation of irrigation projects, PMAY - Gramin and Swach Bharat Mission
NHPC Limited	To meet the accrued liabilities and as grants for creation of capital assets under power system development fund (PSDF)
PFC Limited	To meet Government of India's requirement for the purpose of central sector schemes.
PGCIL	To meet the accrued liabilities and as grants for creation of capital assets under power system development fund (PSDF)
REC Limited	The funds will be provided to Government of India for implementation of Deen Dayal Upadhyaya Gram Jyoti Yojna Scheme
IWAI	To Meet GoI expenditure for the development of infrastructure on National waterways

Source: BSE, NSDL, issuers offer documents, ICRA research

As can be seen from exhibit 6, most of the issuances have been of 10 year with some of the issuances from NABARD (largely for irrigation projects) spilling over to 15 years.

Payment Structure: While GoI has agreed to service these bonds, the debenture trustee deeds and offer documents of such bonds, mention these borrowings as the liabilities of the issuing PSE, with servicing being done through budgetary allocations of GoI.

Further as per above documents, these borrowings stand pari-passu with other borrowings of the issuing PSEs. In addition, the budgetary allocations from GoI will be transferred to designated accounts held in the name of the issuing PSE. The issuing PSE is then responsible for making the payments for servicing these bonds.

Though the above structure may not be bankruptcy remote, as per the term-sheets for most of the issuances, cross-default clauses are not applicable, in case of these bonds, thereby not triggering event of default in case of default on other liabilities of PSE and vice-versa. At the same time, high credit ratings for these entities supported by the sovereign ownership could be some protective factors for these bonds, nonetheless, the rating on these bonds may continue to have some linkages with the standalone credit profile of the issuing PSE.

Accounting: As a part of issue and administrative expense, GoI also compensates these PSEs as % of overall borrowings and may vary from entity to entity. The accounting for such borrowings by PSEs has been different with some recognizing the interest income and expense in their P&L accounts; additionally, fee income for compensation of administrative expenses is also accounted in their P&L statements. Another treatment of interest received from GoI is subsidy received with corresponding expense towards interest payment on GoI-FSBs. All these bonds have been accounted by the respective PSEs as liabilities on their balance sheets and recognized these bonds as their liabilities as part of the debenture trustee deeds and term sheets. On the asset side, these are reflected as amount recoverable on account of fully serviced bonds from GoI / advances towards the projects identified by GoI.

Rating sensitivity: As mentioned above, the rating of these GoI-FSBs will have linkages to the standalone credit profile of issuing PSE. Any change in ownership, leading to change in material standalone credit profile of the issuing PSE may translate into a rating change on these GoI-FSBs issued by such entities.

Outlook: While the continuity of similar issuances in future will depend on GoI's stance with respect to accounting for such spending as part of the budgeted expenditure or not. Given the pressure to reduce its fiscal deficit while continuing with social sector spending, similar issuances in future cannot be ruled out. Even though GoI-FSBs optically reduce the reported fiscal deficit of GoI, in our view, such borrowings and hence the expenditure, should be accounted as part of the its fiscal deficit, as such borrowings have been agreed to be serviced by GoI on a future date.

ICRA

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

1809-1811, Shapath V,
Opposite Karnavati Club
S.G. Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,
10th Floor,1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar,Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.icraresearch.in