

# A Highway to Debt

## Chapter 1.

### **“He who promises runs in debt.” — The Talmud**

A November 2018 dated Draft Shelf Prospectus for a bond issue of The National Highway Authority of India (NHAI) contains a chilling line.

#### **FINANCIAL INDEBTEDNESS**

As on September 30, 2018, we had outstanding secured borrowings of approximately Rs. 98,27,569.40 lakh and unsecured borrowings of Rs. 50,00,000 lakh.

Chilling, because this entity, which is responsible for developing, maintaining and managing India’s national highways, has massively increased its use of borrowings in the last few years. Here are the numbers:

- 31 March 2014: Rs 24,068 cr.
- 31 March 2015: Rs 24,893 cr.
- 31 March 2016: Rs 45,270 cr.
- 31 March 2017: Rs 75,385 cr.
- 31 March 2018: Rs 121,327 cr.
- 30 September, 2018: Rs 148,276 cr.

## Chapter 2

### **An Egyptian Piece of Architecture?**

Chilling, because even if you believe NHAI’s accounting statements — which you shouldn’t — this entity doesn’t produce *any* earnings required to service its debt. See the latest available P&L below.

# NATIONAL HIGHWAYS AUTHORITY OF INDIA

G-5 & 6, Sector-10, Dwarka

NEW DELHI - 110 075

## PROFIT AND LOSS ACCOUNT FOR THE FINANCIAL YEAR ENDED 31<sup>ST</sup> MARCH, 2017

PARTICULARS	SCHEDULE	Year ended 31 <sup>st</sup> March, 2017 Rs. in Lakhs	Year ended 31 <sup>st</sup> March, 2016 Rs. in Lakhs
(1)	(2)	(3)	(4)
<b>I. INCOME</b>			
a) Value of Work done			
b) Other income	11	1,353.35	1,293.36
c) Interest (Gross)	12	1.06	0.88
d) Net Increase/Decrease in Work-in-progress (+)/(-)	13		
<b>TOTAL INCOME</b>		<b>1,354.40</b>	<b>1,294.24</b>
<b>II. EXPENDITURE</b>			
a) Construction Stores/Material consumed			
Other stores, spares & tools etc. consumed			
Work Expenses	14	0.00	-
Personnel & Administrative Expenses	15	27,282.06	22,537.20
Finance Charges	16	14.71	7.76
Depreciation		771.52	870.43
Assets of Small Value Charged Off		22.01	21.50
<b>Exceptional Item</b>			
Provision for diminution in the value of investment		40,310.88	-
Less: Provision transferred to Capital (Sch-1)		(40,310.88)	-
<b>TOTAL EXPENDITURE</b>		<b>28,090.30</b>	<b>23,436.89</b>
<b>Profit / (Loss) for the period</b>		<b>(26,735.89)</b>	<b>(22,142.65)</b>
Add: Prior Period Items net(+/-) (details to be given)	17	(1,135.83)	(747.01)
<b>Transfer of Net Establishment Expenses for the year to Sch-5</b>		<b>27,871.73</b>	<b>22,889.66</b>
Less/Add: Provision for Taxation		-	-
Net Profit			
Less: Transfer to Capital Reserve			
Less: Transfer to other specific Reserve/Fund			
Less/Add: Transfer to/Transfer from General Reserve (+/-)			
Less/Add: Surplus brought forward from previous year			
Surplus carried to Balance Sheet			

Not only NHAI's earnings are negative, so are its operating cash flows. See the latest available cash flow statement below:

# NATIONAL HIGHWAYS AUTHORITY OF INDIA

G-5 & 6, Sector-10, Dwarka

NEW DELHI - 110 075

## CASH FLOW STATEMENT FOR THE YEAR ENDED 31.03.2017

PARTICULARS	CURRENT YEAR Rs. in Lakhs	PREVIOUS YEAR Rs. in Lakhs
<b>A. Cash flow from operating activities:</b>		
Net profit before tax	(26,735.89)	(22,142.65)
Adjustments for:		
Depreciation	771.52	870.43
Profit/Loss on sale of assets	(2.77)	(3.55)
Interest income	(1.06)	(0.88)
<b>Operating profit before working capital changes</b>	<b>(25,968.20)</b>	<b>(21,276.65)</b>
Adjustments for:		
Increase in Deposits, Loans & Advances	(7,17,489.15)	(11,51,482.74)
(Decrease)/Increase in liabilities	5,50,900.39	10,08,785.80
Increase in Provision for gratuity and Leave encashment	438.95	609.89
<b>Cash flow before extraordinary item &amp; prior period items</b>	<b>(1,92,118.01)</b>	<b>(1,63,363.70)</b>
Prior period items	(1,135.83)	(747.01)
<b>Net cash generated from operating activities</b>	<b>(1,93,253.85)</b>	<b>(1,64,110.71)</b>
<b>B. Cash flow from investing activities:</b>		
Purchase of fixed assets	(803.66)	(757.79)
Realisation from sale of assets	12.16	13.13
Increase in Capital Work in progress	(38,66,631.06)	(34,50,701.69)
Increase/Decrease in investment	30,693.88	(27.88)
Interest Income	1,62,085.61	96,759.82
Capital Reserve (Receipts)	20,349.00	11,188.98
<b>Net cash used in investing activities</b>	<b>(36,54,294.06)</b>	<b>(35,66,295.75)</b>
<b>C. Cash flow from financing activities:</b>		
Cess funds received from Govt of India	2,32,650.00	15,42,000.00
Capital additional budgetary receipts	5,64,902.00	37,027.00
EAP Grant utilised towards Revenue Expenditure	(637.31)	(621.09)
Transfer of "Premium on Bonds" to "Capital Reserve"	(748.68)	
Adjusted Plough back of Toll Remittance, etc.	6,50,681.46	5,20,390.71
Net decrease in loan from ADB due to Exchange Loss after Adjustment of Repayments	(6,133.29)	(159.09)
Proceeds from issue of 54EC Capital Gains Tax-Free Bonds	5,57,274.20	4,28,117.00
Proceeds from issue of Tax Free Bonds 2015-16, including Premium	-	19,00,703.22
Proceeds from issue of Taxable bonds	27,54,500.00	-
Redemption of Capital Gains Tax-Free Bonds	(2,94,212.90)	(2,90,206.80)
Interest and other expenditure on Bond	(4,06,816.15)	(2,22,770.32)
<b>Net cash generated from financing activities</b>	<b>40,51,459.33</b>	<b>41,37,250.94</b>
<b>Net increase/(decrease) in cash and cash equivalents (A+B+C)</b>	<b>2,03,911.43</b>	<b>4,06,844.49</b>
Opening cash and cash equivalents	6,74,079.72	2,67,235.23
<b>Closing cash and cash equivalents</b>	<b>8,77,991.14</b>	<b>6,74,079.72</b>
<b>Notes:</b>		
Cash and cash equivalents include:		
Cash and cheques in hand / in transit	114.81	4.39
Balance with banks: - In Current Account	8,11,682.59	73,702.37
- In FD account	25,882.86	6,00,372.95
<b>Balance as per books of account</b>	<b>8,37,680.26</b>	<b>6,74,079.72</b>

The cash flow statement shows that given: (1) the insufficiency of its operating cash flows; (2) its requirements for enormous cash outlays for highway construction; and (3) the

relatively meagre cash support from government of India, NHAI has to sell *new* bonds to raise cash to pay *interest* on *existing* bonds.

It should be repeated that we are not even talking about principal repayments here. Given the capex requirements of NHAI, the funds received from the central government are *insufficient for funding even the interest* on its debt. For example, in FY17, 83% of NHAI's net cash generated from financing activities came from issue of new bonds.

And to redeem existing bonds when they mature, NHAI has to issue new bonds too. Doesn't that remind you of an Egyptian piece of architecture that looks like a triangle?

Clearly, NHAI is *hugely* dependent on the bond market. But why?

The nineteenth "Report on National Highways Authority of India" presented to the Lok Sabha in August 2017 by the Committee on Public Undertakings (2017-18) provides a compelling reason:

The Committee also note that apart from being dependent on the Gross Budgetary Support from the Government, NHAI is also exploring the opportunities to raise funds through 'Internal and Extra Budgetary Resources' (IEBR). However, at the end of the financial year it could only raise ₹ 5,518.92 cr. through IEBR against the budgetary provisions of ₹ 59,279 cr. From the information furnished by NHAI, the Committee note that in view of the growing non-performing assets (NPAs) of banks and inability of banks to provide long term financing for infrastructure projects, NHAI is planning to raise required funds through bond market as raising funds through these routes is comparatively cheaper and provides long term financing option for infrastructure development. Further, since institutions like EPFO and LIC are also keen to invest in long term bonds in infrastructure sector, the NHAI is exploring the opportunity of raising funds from these sources as per the broader budgetary provisions.

Translation: *Government won't give a lot and that banks won't lend us the kind of money we need, so let's go to the bond market.*

### Chapter 3.

**"To say [some types of] accounting... is like a sewer is an insult to sewage." — Charlie Munger**

Chilling, because the audit report of the Comptroller and Auditor General of India (CAG) states that "proper books of accounts and other relevant records have not been maintained." Indeed, CAG has been heavily qualifying NHAI's financial statements since FY14.

NHAI's audit reports are a thrill to read. Here's just one chilling excerpt from FY17 audit report:

Assets held on behalf of Government of India (completed & ongoing) shown under Fixed

Assets represent the amount spent on various National Highways... These assets were developed by NHAI and the ownership of these National Highways... vests with GoI only. Since the assets owned by entity are only depicted as the entity's Fixed Assets in its Balance Sheet, depiction of assets belonging to GoI in the books of NHAI as 'Assets held on behalf of GoI (completed & ongoing)' under Fixed Assets is incorrect... Due to disclosure of 'Assets held on behalf of GoI (completed & ongoing)' under Fixed Assets, Fixed Assets of NHAI are overstated Rs. 2,17,726.57 crore.

Here's the latest available balance sheet of NHAI:

<b>NATIONAL HIGHWAYS AUTHORITY OF INDIA</b> G-5 & 6, Sector-10, Dwarka NEW DELHI - 110 075 <b>BALANCE SHEET AS AT 31<sup>st</sup> MARCH, 2017</b>				
	PARTICULARS	SCHEDULE	As on	
	(1)	(2)	31 <sup>st</sup> March, 2017 Rs. in Lakhs	31 <sup>st</sup> March, 2016 Rs. in Lakhs
	(1)	(2)	(3)	(4)
I.	<b>SOURCES OF FUNDS</b>			
1	<b>Shareholders' Fund</b>			
	a) Capital	1	1,39,59,380.47	1,25,51,457.89
	b) Reserves & Surplus	2	0.00	748.68
2	<b>Grants</b>			
	a) Capital	3	13,65,643.01	13,66,280.32
3	<b>Borrowings</b>	4	75,38,464.71	45,27,036.70
	<b>TOTAL</b>		<b>2,28,63,488.18</b>	<b>1,84,45,523.58</b>
II.	<b>APPLICATION OF FUNDS</b>			
1	<b>Fixed Assets</b>	5		
	a) Gross Block		12,533.36	11,870.62
	b) Less: Depreciation		7,857.39	7,217.40
	c) Net Block		4,675.97	4,653.21
	d) Less: Assets created out of Grants		612.58	612.58
	e) Assets held on behalf of GoI (completed & ongoing)		2,17,72,656.62	1,76,45,402.50
	<b>Total</b>		<b>2,17,76,720.00</b>	<b>1,76,49,443.14</b>
2	<b>Investment</b>	6	<b>90,959.00</b>	<b>1,21,652.89</b>
3	<b>Current Assets, Loans and Advance</b>	7		
	a) Inventories		-	-
	b) Deposits, Loans & Advances		32,95,320.19	25,77,831.04
	c) Interest accrued but not due on deposits		1,399.71	2,826.98
	d) Interest accrued and due on CALA deposits		52,628.05	59,569.52
	e) Cash & Bank Balance		8,37,680.26	6,74,079.72
	f) Inter Unit Account		0.00	-
	<b>sub total</b>		<b>41,87,028.21</b>	<b>33,14,307.25</b>
	<b>Less: Current Liabilities and Provisions</b>			
	a) Liabilities	8	31,87,098.88	26,36,198.49
	b) Reserves & Provisions	9	4,120.15	3,681.20
	<b>sub total</b>		<b>31,91,219.03</b>	<b>26,39,879.69</b>
	Net Current Assets		9,95,809.18	6,74,427.56
4	<b>Misc. Expenditure</b> (to the extent not written off)	10		
5	<b>Profit &amp; Loss Account</b> (Debit balance if any)			
	<b>TOTAL</b>		<b>2,28,63,488.18</b>	<b>1,84,45,523.58</b>

In its report, CAG states that the Assets held on behalf of GoI amounting to Rs 2,17,72,656 lacs do not belong to NHAI and the "ownership of these National Highways vests with GoI only."

Which is why, one guesses, that NHAI does not provide *any* depreciation on those "fixed assets" of Rs 2,17,72,656 cr. on its books. If it did, one wonders what debt-service ratios will look like...

Here's a paradox: While NHAI does not own these highways, according to its Draft Shelf Prospectus, its secured bonds are

secured by way of pari-passu mortgage over the ... *fixed assets of NHAI*, being highway projects comprising of all superstructures including highway lightings, road barriers and

dividers, culverts, bridges, flyovers and all other super structures constructed on national highways as entrusted to NHAI

On one hand, NHAI says those highways are not its property and hence there's no need to depreciate them. On the other hand, they appear on its balance sheet as if NHAI owns them.

Like that Schrödinger's cat who was both dead and alive at the same time, those highways are NHAI's assets and not its assets at the same time.

And to top it all, those very highway assets are used as collateral by NHAI for securing its bond issues.

How can NHAI mortgage things ("the fixed assets of NHAI???" ) that *don't belong to it?*

## Chapter 4

### AAA Ratings

Chilling, because NHAI's bonds enjoy AAA rating from all the rating companies. For example, CRISIL's "Rating Rationale" document dated 29 March 2018 states:

CRISIL has assigned its rating on the long-term borrowing programme of Rs 62,000 crore and reaffirmed its 'CRISIL AAA/Stable' rating on the tax-free bonds of Rs 34,000 crore and Rs 92,118 crore tax-free bonds and long-term borrowing programme of National Highways Authority of India (NHAI).

NHAI has a strong financial position, predominantly because of the continuous GoI support for its projects, by way of allocation of fuel cess funds and budgetary resources, as well as flexibility to raise funds through capital gains bonds and tax-free infrastructure bonds.

And so it isn't the *ability* of NHAI to service its bonds from its operating cash flow that impresses CRISIL (and other rating companies). Rather the AAA rating is derived from the belief that the government will continue to support NHAI *and so will the bond markets*. Indeed, the table below, taken from the Rating Rationale document of CRISIL, shows that the rating company doesn't even bother to provide any financial information to justify its AAA rating to NHAI's bonds.

Key Financial Indicators

As on / for the period ended March 31		2017	2016
Revenue	Rs crore	NA	NA
Profit after tax	Rs crore	NA	NA
PAT margins	%	NA	NA
Adjusted Debt/Adjusted networkth	Times	NA	0.33
Interest coverage	Times	NA	NA

## Chapter 5.

## **“Hey, You’ve Gotta Hide Your ~~Love~~ Debt Away” — The Beatles**

Chilling, because NHAI’s debt doesn’t get consolidated with central government’s debt figures.

But here’s the funny thing: While bond market investors believe that, in terms of credit risk, NHAI’s bonds are the functional equivalent of treasury bonds (why, one wonders, don’t they simply buy treasury bonds instead?), the government of India, when it reports its debt numbers, doesn’t consider NHAI’s bonds as its own debt.

### **Chapter 6.**

#### **AAA Bonds**

Chilling, because in the absence of government support, the *fundamentals* of NHAI do not warrant AAA ratings. And yet these bonds enjoy AAA ratings. Those AAA ratings are assigned because NHAI is a government undertaking. However, the government support for servicing NHAI’s enormous debt burden is *minimal*. The *main* source of servicing that debt is *more* debt.

And the reason bond markets will provide *more* debt to NHAI is because that *more* debt will also enjoy AAA ratings. Those AAA ratings will be assigned because NHAI is a government undertaking. However, the government support for servicing NHAI’s enormous debt burden is *minimal*. The *main* source of servicing that *more* debt will be *even more* debt.

And the reason bond markets will provide *even more* debt to NHAI is because that *even more* debt will also enjoy AAA ratings. Those AAA ratings will be assigned because NHAI is a government undertaking. However, the government support for servicing NHAI’s enormous debt burden is *minimal*. The *main* source of servicing that *even more* debt will be *even even more* debt.

As Yul Brynner declared in “The King and I”: [et cetra et cetra et cetra...](#)

### **Chapter 7.**

**“If something cannot go on forever, it will end.” — Herb Stein**

The End.

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Sanjay Bakshi

January 24, 2019