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Two infra bonds open, Should you invest?

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TAX DEDUCTION

Two infra bonds open. Should you invest?

IDFC and L&T Infra out with bonds offering 9% interest over 10 years. Both have buy-back options, too

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Two more infrastructure bonds, which will get you an additional tax deduction of ₹20,000 under section 80CCF of the Income-tax Act, are out: **IDFC Ltd** launched its bond on 21 November and **L&T Infrastructure Finance Co. Ltd** launched its issue on 24 November. The tax benefit is available only for fiscal 2012.

Just a month back, **Power Finance Corp. Ltd** and **Industrial Finance Corp. of India Ltd** launched their infrastructure bonds.

The tax deduction under 80CCF means an absolute tax saving of ₹6,180 for an investor who falls in the highest tax bracket 30.90%; ₹4,120 if you pay income-tax at the rate of 20.60%; and ₹2,060 if you fall in the last tax bracket of 10.30%.

Main features

The IDFC bond is open for subscription till 16 December, where as the L&T bond is open till 24 December.

Interest rate: The current bonds are quoting a higher interest rate of 9% per annum, in line with the yield on government securities (G-sec) of corresponding residual maturity.

These bonds work for both the issuer and the investor. For the issuer, they get long-term funds at relatively lower rates (compared with current bank financing) and for the investors, its tax saving at high returns.

Interest payment options: Both bonds have two series on offer, one which pays interest annually and the second gives cumulative interest, payable at the time of buy-back or redemption as the case may be.

Tenor: Both bonds come with a 10-year tenor with a lock-in period of five years. After the lock-in period is over, the bonds will be tradable on stock exchanges.

The investor has the option of holding bonds either in dematerialized form or in physical form, but trading in bonds (after the end of the lock-in period) can be done only if held in dematerialized form.

Minimum investment: For the IDFC bond, the face value is ₹5,000 and minimum subscription is ₹10,000 or two bonds. In case of L&T Infra bonds the face value is ₹1,000 and the minimum investment is ₹5,000 or five bonds.

Buy-back: In case of L&T bonds, the investor has the option to go for a buy-back (where the company will buy back the bonds) at the end of five and seven years; if that is not availed, the bond would be redeemed at the end of the 10-year tenor.

For IDFC bonds, there is a proposed buy-back at the end of five years and the maturity is at 10 years.

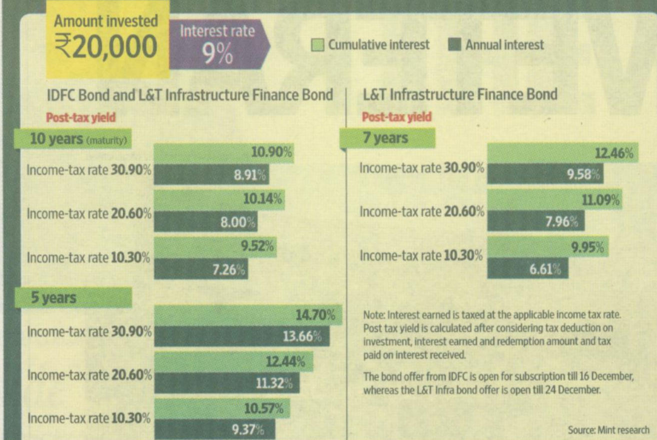
Opting for a buy-back makes sense if interest rates are rising; money can be reallocated to products offering higher interest rates. If rates are falling, it makes sense to remain invested in a high interest rate product for the tenor.

What you get

Unless you are looking for regular income at the end of each year, investing in the cumulative option is better. In case of both bonds investing ₹1 lakh in the cumulative option will return an absolute amount of ₹2,36,800 at the end of 10 years; ₹1,82,800 at the end of seven years (L&T bond only); and ₹1,53,900 at the end of five years.

While there is an initial deduction of ₹20,000 from the overall taxable income, the interest received is taxable. This means by investing in the cumulative option, you can earn a post-tax yield of 10.90% if you are in the highest tax bracket and remain invested for 10 years. If you choose to go for buy-back after five years, your post-tax yield will be 14.70%.

However, since these are long-term products real returns will be affected by annual inflation.



The risk factor

IDFC bonds have got a rating of (Icra) AAA from Icra Ltd and Fitch AAA (ind) from Fitch. AAA and equivalent rating represents best quality and minimal credit risk bonds compared with peers.

The IDFC issue, if subscribed fully, will comprise roughly 13.80% of total long-term debt and the overall long-term debt-equity ratio will move higher to 3.67 from 3.22. Since 2007, its debt-equity ratio has reduced from 5.06. IDFC has a comfortable capital adequacy ratio of 24.50% and currently has a gross non-performing asset ratio of around 0.20%. Says Vikram Limaye, executive director, IDFC, "Given the current situation, some restructuring may be warranted, but we will be able to maintain our level of NPAs (non-performing assets). Moreover, borrowing at this rate will be positive for the weighted average cost of funds." There are concerns about the execution ability of infrastructure companies and hence, their ability to repay debt. IDFC, however, is not sounding perturbed.

L&T Infra bonds are rated CARE AA+ by CARE and (Icra) AA+ by Icra; this represents high safety for debt servicing and very low credit risk.

Like IDFC, L&T Infrastructure Finance is also in the business of lending to infrastructure companies. Its bond issue, if subscribed fully, will comprise 14.50%, as on September-end, of the total long-term debt and the overall long-term debt-equity ratio will move higher to 5.85 from 5.01. Since 2008, debt-equity ratio of the company has increased from 2.49. Gross NPA ratio increased from 0.67% in March 2011 to around 0.88% in September 2011. Its high debt-equity ratio and rising NPAs could be a cause for concern.

Says, Suneet Maheshwari, chief executive officer, L&T Infrastructure Finance, "The debt-equity ratio is within our comfort range and we have enough access to equity from the holding company, so that's not a concern. Most NPAs today are structural in nature and as rates start to come lower this will get addressed."

What you should do

Says Jayant Pai, vice-president, Parag Parikh Financial Services Ltd, "These bonds make sense for investors up to the limit of ₹20,000." Beyond that amount, there is no tax advantage.

Both bonds offer attractive post-tax yields in the cumulative option. The yield is higher if you are invested for a shorter period as the tax liability on interest earned is less. So, it would make sense to invest in these bonds and opt for the earliest buy-back option.

The coupon offered for both is the same, but IDFC has a better credit rating and financials. If you are only going to choose one of the two, IDFC bonds can be your first choice. Pai adds, with the L&T bond you can't be sure if the parent will safeguard the investor in case of extreme eventualities.

Keep in mind that just because there is a basket of products available, you needn't over-allocate to this category. Come December, government-owned infrastructure companies, including National Highways Authority of India, are expected to launch tax-free (interest earned is not taxed) bonds with similar rate of interest (interest is linked to the recent closing of 10-year G-secs). These, however, may not have put or call option, neither will they provide additional deduction under 80CCF.