January 05, 2023

KCC Chittoor Highways Private Limited: [ICRA]A-(Stable) assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long-term - Fund-based – Term loan	550.00	[ICRA]A- (Stable); assigned
Total	**550.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating assigned to KCC Chittoor Highways Private Limited (KCHPL) takes into account the financial profile and track record of its sponsor and engineering, procurement and construction (EPC) contractor – KCC Buildcon Private Limited (KCC, rated [ICRA]A(Positive)/[ICRA]A2+). ICRA notes that KCC has provided a sponsor's undertaking towards cost overrun during the construction phase, and to meet any shortfall in operations and maintenance (O&M) expenses. The rating favourably factors in the inherent benefits of the hybrid-annuity based nature of the project including upfront availability of right of way (RoW)[1], automatic de-scoping of RoW pending beyond 180 days from the appointed date, inflation-linked[2] revisions to the bid project cost (BPC) during the construction period, and relatively lower equity mobilisation risk with 40% of the BPC to be funded by the authority during the construction period in the form of NHAI grant payment. The rating positively considers the credit support provided by the structural features of the debt, including the presence of escrow, cash flow waterfall mechanism, provision for debt servicing reserve (DSR, to be created out of the first two annuities), provision for creation of major maintenance reserve (MMR), as per base case business plan and restricted payment clause with a minimum debt service coverage ratio (DSCR) of 1.1 times, which provides comfort. The rating notes the stable revenue stream expected post commissioning with 60% of the inflation-adjusted BPC being paid out as annuity, along with interest at the average of one-year MCLR[3] of the top five scheduled commercial banks (SCBs, to be reset every quarter) plus spread of 1.25%, and the inflation-adjusted O&M cost bid over the 15-year operations period by the strong counterparty, National Highways Authority of India [NHAI, rated [ICRA]AAA(Stable)].

The rating is, however, constrained by the execution risks involved in the under-construction projects including risk of time and cost overruns. The project was yet to receive appointed date as of December 2022. However, the risk is mitigated, to an extent, by the fixed-price [subject to pass-through of the price index multiple (PIM) component received from the NHAI], fixed-time contract and strong project execution capabilities of KCC. The company's ability to commission the project in a timely manner and within the budgeted costs would remain important from the credit perspective. KCHPL is exposed to equity mobilisation risk as majority of the equity was yet to be infused as on December 31, 2022. However, healthy financial risk profile of KCC provides comfort. Post commissioning, the company will have to undertake O&M of the project stretch as per the concession agreement to avoid any deductions from annuities. Any significant deductions from annuities or increase in routine and major maintenance (MM) from the budgeted level could impact its DSCR. Further, KCHPL's cash flows are exposed to inflation risk as O&M receipts, though linked to inflation index (70% WPI and 30% CPI), may not be adequate to compensate for the actual increase in O&M/periodic maintenance expenses.

Key rating drivers and their description

Credit strengths

Above average financial profile of sponsor and EPC contractor – KCHPL is a subsidiary of KCC, which has long experience of more than two decades in the road construction segment and has been executing road projects since 1999. KCC is appointed as the EPC contractor for executing the project, which provides comfort, given its track record of project execution within the budgeted time and cost. The total estimated project cost of Rs. 1,277.8 crore to be funded by NHAI's grant of Rs. 572.4 crore, external debt of Rs. 550.0 crore and promoter's contribution/equity of Rs. 155.4 crore. KCHPL is exposed to equity mobilisation risk as the entire equity (~98%) was yet to be infused as on December 31, 2022. KCC's financial profile is adequate to meet its equity commitment in the project, which is required to be infused over the construction period.

Lower inherent risks in HAM projects from the NHAI – The inherent benefits of the hybrid annuity model (HAM) project include upfront availability of RoW, de-scoping for non-availability of RoW beyond 180 days from the appointed date, inflation-linked revisions to the BPC during the construction period. Moreover, it faces relatively lower equity mobilisation risk with 40% of the BPC to be funded by the authority during the construction period through NHAI grant payments. Stable revenue stream post commissioning with 60% of the inflation-adjusted BPC being paid out as annuity, along with interest at the average of one-year MCLRs of the top five SCBs (to be reset every quarter) plus spread of 1.25%, and the inflation-adjusted O&M cost bid over the 15-year operations period by the NHAI, which is a strong counterparty, provide comfort.

Healthy coverage indicators and presence of structural features – The project is anticipated to achieve the commercial operations date (COD) within two years from the appointed date, which is yet to be announced (expected to be announced shortly). If the overall project cost remains within the budgeted level, once operational, KCHPL is likely to have healthy debt coverage indicators with a cumulative DSCR of over 1.3 times as per ICRA's estimates. This provides the special purpose vehicle (SPV) adequate cushion to withstand any movement in the interest on annuity and inflation to a major extent. The credit profile is supported by KCC's undertaking towards cost overrun during the construction period and any shortfall in O&M expenses. Further, the presence of structural features of the debt, including the presence of escrow, cash flow waterfall mechanism, provision for DSR (to be created out of the first two annuities), provision for creation of MMR and restricted payment clause with a minimum DSCR of 1.1 times provide comfort.

Credit challenges

Execution risk related to under-construction project – The project is yet to receive the appointed date, which exposes the SPV to execution risk including risks of delays and cost overruns. However, the risk is mitigated to an extent by the fixed-price (subject to pass-through of PIM component), fixed-time contract executed with KCC. It has a long execution track record in the road sector, which mitigates the execution risk to an extent. Nevertheless, KCC's ability to commission the project in a timely manner and within the budgeted costs would remain important from the credit perspective.

Undertaking O&M and MM as per concession requirement – Post commissioning, the company will have to undertake O&M of the project stretch as per the concession agreement to avoid any deductions from annuities. Any significant deductions from annuities or increase in routine and MM expenses from the budgeted level could impact its DSCR.

Project cash flows and returns exposed to inflation risks – The project's cash flows and returns are exposed to inflation risk as O&M receipts, though linked to inflation (70% WPI and 30% CPI), may not be adequate to compensate for the increase in O&M/periodic maintenance expenses.

Liquidity position: Adequate

The liquidity position is supported by undrawn sanctioned term loan facility, grants receivable from the NHAI and equity infusion from KCC.

Rating sensitivities

Positive factors – The rating could be upgraded once the project achieves completion without any significant delays or cost overruns, or if there is an improvement in the credit profile of the sponsor.

Negative factors – Negative pressure on the rating could arise if the project progress is delayed, leading to significant time and cost overruns, or if there is a deterioration in the credit profile of the sponsor, or if delays in receipt of grant or equity infusion results in increased funding risks for the project.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Roads - Hybrid Annuity
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

KCHPL is an SPV formed in June 2021 by KCC for undertaking a road project awarded by the NHAI. The project involves developing the six-lane Chittoor-Thatchur highway from km 0.000 to km 43.800, under Bharatmala Pariyojna, in Andhra Pradesh and Tamil Nadu (Package-I) on HAM basis. The concession agreement was signed on November 10, 2021 and the appointed date is yet to be announced. The construction period for the project is two years from the appointed date, and the operations period is 15 years from the COD. The total estimated project cost of Rs. 1,277.8 crore to be funded by the NHAI's grant of Rs. 572.4 crore, external debt of Rs. 550.0 crore and promoter's contribution of Rs. 155.4 crore.

Key financial indicators (audited)

The key financial indicators are not applicable as KCHPL is a project-stage company.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
	Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
				January 5, 2023	-	-	-
1 **Term loan**	Long term	550.00	0.00*	**[ICRA]A- (Stable)**	-	-	-

**Term loan is pending to be disbursed*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term - Fund-based – Term loan	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term loan**	FY2023	NA	FY2038	550.00	[ICRA] A- (Stable)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA]

Annexure II: List of entities considered for consolidated analysis – Not Applicable

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