January 18, 2023

VRC MB 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	222.00	[ICRA]A- (Stable); assigned
Total	222.00	

**Instrument details are provided in Annexure-I*

Rationale

The rating assigned to VRC MB Highways Private Limited (VMBHPL) considers the financial profile as well as track record of its sponsor and engineering, procurement and construction (EPC) contractor – VRC Constructions (India) Private Limited (VRC, rated [ICRA]A(Stable)/[ICRA]A2+). ICRA notes that VRC 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 for project cost during the construction period. The rating notes the relatively lower equity mobilisation risk with 40% of the bid project cost to be funded by the authority during the construction period in the form of a grant. 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 creation of six months' debt service reserve (DSR) and major maintenance reserve (MMR), as per the base case business plan, which provides comfort. Once the project becomes operational, the presence of reserves to meet the regular O&M and interest obligations till the next scheduled annuity and restricted payment clause offer comfort. The rating factors in the stable revenue stream post commissioning with 60% of the inflation-adjusted bid project cost being paid out as annuity, along with interest at average of onev-year MCLR of top five scheduled commercial banks plus 125 bps and the inflation-adjusted O&M cost bid over the 15-year operations period by the project owner and authority - National Highways Authority of India [NHAI, rated [ICRA]AAA(Stable)], which is a strong counterparty. Once operational, VMBHPL is expected to have healthy debt coverage metrics.

The rating is, however, constrained by the execution risks involved in the under-construction projects including the risk of time and cost overruns. However, the risk is mitigated, to an extent, by the fixed-price, fixed-time EPC contract and strong project execution capabilities of the contractor – VRC, which has demonstrated strong project execution capabilities. The project has achieved an appointed date of December 31, 2022. The company's ability to commission the project in a timely manner and within the budgeted costs would remain important from the credit perspective. VMBHPL is exposed to equity mobilisation risk as majority of the equity was yet to be infused as on December 31, 2022. However, VRC's adequate financial risk profile provides comfort. Post commissioning, it 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 debt servicing coverage ratio (DSCR). ICRA's rating factors in the exposure of VMBHPL's cash flows to the spread between the interest earned on the outstanding annuities, which is linked to the average one-year MCLR of top five scheduled commercial banks and the interest rate on the project loans, which is linked to the lender's MCLR. Further, VMBHPL's cash flows are exposed to inflation risk as O&M receipts, though linked to inflation

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1 *~82.5% has been achieved*

2 *Based on annual change in price index multiple (PMI) from the base year – PMI is the weighted average of Wholesale Price Index (WPI) and Consumer Price Index (CPI) (IW) in the ratio of 70:30*

index (70% WPI and 30% CPI), may not be adequate to compensate for the actual increase in O&M/periodic maintenance expenses.

The Stable outlook on the rating reflects ICRA's opinion that VMBHPL will benefit from the strong execution capabilities and financial profile of the sponsor and EPC contractor - VRC.

Key rating drivers and their description

Credit strengths

Strong track record and financial profile of sponsor and EPC contractor – VRC has longstanding experience in the construction segment and 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. 590.04 crore is planned to be funded by the NHAI's grant of Rs. 257.46 crore, external debt of Rs. 222.00 crore and equity worth Rs. 110.58 crore. VRC'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 hybrid annuity mode (HAM) projects from NHAI – The inherent benefits of the HAM project include upfront availability of RoW, automatic de-scoping of RoW pending beyond 180 days from the appointed date, inflation-linked revisions to bid for project cost during the construction period. Moreover, it faces relatively lower equity mobilisation risk with 40% of the bid project cost to be funded by the authority during the construction period in the form of a grant. Stable revenue stream post commissioning with 60% of the inflation-adjusted bid project cost being paid out as annuity, and interest at the average of one-year MCLR of top five scheduled commercial banks plus 125 bps, along with inflation-adjusted O&M cost bid over the 15-year operations period by the NHAI, which is a strong counterparty, provide comfort.

Adequate 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. If the overall project cost remains within the budgeted level, once operational, VMBHPL is likely to have healthy debt coverage indicators with cumulative DSCR of over 1.20 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 VRC'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) and provision for creation of MMR provide comfort.

Credit challenges

Execution risk related to under-construction project – The project has received the appointed date of December 31, 2022 from the NHAI and remains in its initial stages of execution. Thus, the company is exposed to project execution risk including risks of delays and cost overruns. However, the risk is mitigated, to an extent, by VRC's fixed-price, fixed-time contract and strong project execution capabilities. It has a long execution track record in the road sector, which mitigates the execution risk to an extent. Its ability to commission the project in a timely manner and within the budgeted costs would remain important from the credit perspective.

Project's cash flows and returns exposed to interest rate and inflation risks – The project's cash flows and returns are exposed to the interest rate risk and are dependent on the spread between the interest rate applicable to annuities and the interest rate charged by lenders. The interest on the outstanding annuities from the NHAI is linked to the average one-year MCLR of top five scheduled commercial banks, while the interest rate charged by the lenders is linked to their respective MCLR. Further, VMBHPL's cash flows 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.

Undertaking O&M as per concession requirement and risk of deductions from annuity – 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.

Liquidity position: Adequate

The company's liquidity position is supported by undrawn sanctioned line of credit, grants receivable from the NHAI and equity infusion from VRC. The total estimated project cost of Rs. 590.04 crore is planned to be funded by the NHAI's grant of Rs. 257.46 crore, external debt of Rs. 222.00 crore and equity worth Rs. 110.58 crore.

Rating sensitivities

Positive factors – The rating could be upgraded if the project is completed within the expected timelines and budgeted costs.

Negative factors – Negative pressure on the rating could arise if the project progress is delayed, resulting in significant time and cost overruns. Additionally, deterioration in the sponsor's credit profile, or delays in receipt of grant or equity infusion resulting in increased funding risks for the project may trigger a downward rating revision.

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

Incorporated in 2022, VRC MB Highways Private Limited is a subsidiary of VRC Constructions (India) Private Limited (VRC), established as an SPV for four laning of Dhillon Nagar (Moga) to Bajakhana (Lambiwali) section of NH-105B from design chainage 0.000 km to 43.319 km under Bharatmala Pariyojana, in Punjab, on HAM basis. The authority for the project would be the NHAI. The concession agreement was signed on March 07, 2022 and the appointed date has been received as December 31, 2022. The construction period for the project is two years from the appointed date, and the operations period is 15 years from the COD.

Key financial indicators (audited)

The key financial indicators are not applicable as VMBHPL 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 Dec 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					January 18, 2023	-	-	-
1	**Term loan**	Long term	222.00	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	222.00	[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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About ICRA Limited:

ICRA 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. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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