March 21, 2023

VRC DC Highways Private Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based – Term Loan	252.62	252.62	[ICRA]A(CE)(Stable); reaffirmed
Total	**252.62**	**252.62**	

**Instrument details are provided in Annexure-I*

Rating Without Explicit Credit Enhancement	[ICRA]A-

Note: The (CE) suffix mentioned alongside the rating symbol indicates that the rated instrument/facility is backed by some form of explicit credit enhancement. This rating is specific to the rated instrument/facility, its terms and its structure and does not represent ICRA's opinion on the general credit quality of the entity concerned. The last row in the table above also captures ICRA's opinion on the rating without factoring in the explicit credit enhancement.

The CE rating is supported by corporate guarantee from VRC Constructions (India) Private Limited

Rationale

For the [ICRA]A(CE)(Stable) rating

The above rating is based on the strength of the corporate guarantee provided by VRC Constructions (India) Private Limited (VRC, rated [ICRA]A(Stable)/[ICRA]A2+), the parent of VRC DC Highways Private Limited (VDCHPL), for the rated term loan programme. The Stable outlook on this rating reflects ICRA's outlook on the rating of the guarantor VRC.

Adequacy of credit enhancement

The guarantee is legally enforceable, irrevocable, unconditional, covers the entire amount and tenor of the rated instrument. Given these attributes, the guarantee provided by VRC is adequately strong to result in a rating enhancement of the said instrument to [ICRA]A(CE) against the rating of [ICRA]A- without explicit credit enhancement. If the rating of the guarantor or the Unsupported Rating of VDCHPL were to undergo a change in future, the same would have a bearing on the rating of the aforesaid facility. The rating of this instrument may also undergo a change in a scenario, whereby in ICRA's assessment there is a change in the strength of the business linkages between the guarantor and the rated entity, or there is a change in the reputation sensitivity of the guarantor to a default by the rated entity or there is a change in the strategic importance of the rated entity for the guarantor. For detailed rating rationale of VRC, please click here.

Salient covenants of the rated facility

» Debt service reserve (DSR) of six months (Principal + Interest); three months DSR to be created seven days prior to scheduled completion date (SCoD) and balance three months to be created out of the first two annuities;

» Major maintenance reserve (MMR) to be created as per the base case plan;

» Presence of reserves to meet the regular operations and maintenance (O&M) and interest obligations till the next scheduled annuity;

» Minimum debt service coverage ratio (DSCR) of at least 1.15 times, debt to equity ratio of not more than 2:1 to be maintained;

» If DSCR>1.2 times; 50% of surplus cash flows above 1 times (after creating all types of reserves and meeting all debt obligations) shall be used for pre-payment of debt (applied in inverse order of maturity);

» Restricted payments clause for payment of dividends, extension of loans, etc.

Key rating drivers and their description

Credit strengths

Corporate guarantee from VRC, the sponsor and EPC contractor – VRC has provided an unconditional and irrevocable corporate guarantee for the term loan of VDCHPL. VRC has long experience in the construction segment and is appointed as the engineering, procurement and construction (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. 745.93 crore is planned to be funded by the National Highways Authority of India's (NHAI) grant of Rs. 367.0 crore, external debt of Rs. 252.62 crore and equity of Rs. 126.31 crore. VDCHPL is exposed to equity mobilisation as the sponsor infused ~81% of equity as on February 14, 2023. However, VRC's financial profile is adequate to meet its equity commitment in the project, which is required to be infused over the balance construction period.

Lower inherent risks in HAM projects from NHAI – The inherent benefits of the hybrid annuity mode (HAM) project include upfront availability of right of way (RoW), automatic de-scoping of RoW pending beyond 180 days from the appointed date, inflation-linked revisions to the bid 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, along with interest at Bank Rate plus 300 bps 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 – VDCHPL is expected to maintain healthy debt coverage indicators post completion of the project, which is likely to provide adequate cushion to withstand any adverse movement in the Bank Rate and inflation to a major extent. The credit profile is supported by the undertaking towards cost overrun during the construction phase, any shortfall in O&M expenses and corporate guarantee to meet any shortfall in debt servicing. Further, the presence of structural features of the debt, including the presence of escrow, cash flow waterfall mechanism, provision for six months' DSR (three months DSR to be created seven days prior to SCoD and the balance three months to be created out of the first two annuities), provision for creation of MMR, presence of reserves to meet the regular O&M and interest obligations till the next scheduled annuity, cash sweep for DSCR>1.2 times and restricted payment clause provide comfort.

Credit challenges

Execution risk related to under-construction project – The project has received the appointed date of January 24, 2022 from the NHAI and achieved 40% physical progress till December 31, 2022. 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. Its ability to commission the project in a timely manner and within the budgeted costs would remain important from the credit perspective.

Project 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 RBI's Bank Rate and the interest rate charged by lenders. The interest on the outstanding annuities from the NHAI is linked to the RBI's Bank Rate, while the interest rate charged by lenders is related to their respective MCLR. The debt structure also has credit-rating linked debt acceleration clause, which if materialises, could expose the company to refinancing risk. Further, VDCHPL'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

For the [ICRA]A(CE)(Stable) rating: Adequate

The liquidity position of the guarantee provider (VRC) is adequate. Its cash flow from operations is expected to be adequate to meet the debt servicing obligations and the near-term equity commitment towards the under-construction HAM project. This apart, VRC reported free cash and bank balances of Rs. 84 crore as on June 30, 2022, sufficient cushion in the form of unutilised fund-based limits (of around Rs. 23.36 crore as on June 30, 2022).

For the [ICRA]A- rating: Adequate

As the project is under construction, the company does not maintain any significant liquidity. However, the 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. 745.93 crore is planned to be funded by the NHAI's grant of Rs. 367.0 crore, external debt of Rs. 252.62 crore and equity of Rs. 126.31 crore. The repayment will start seven months from the commercial operations date (COD).

Rating sensitivities

Positive factors – The rating could be upgraded if the project achieves PCOD/COD within the expected timelines and budgeted costs, along with maintenance of adequate DSRA. The rating may be upgraded if there is an improvement in the credit profile of the sponsor/guarantor.

Negative factors – Negative pressure on the rating could arise if the project progress is delayed, resulting in significant time and cost overruns, or if there is a deterioration in the credit profile of sponsor/guarantor, 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 Hybrid Annuity Rating Approach - Explicit third-party support
Parent/Group support	Parent: VRC Constructions (India) Private Limited (VRC) The assigned rating is based on the unconditional, irrevocable corporate guarantee extended by VDCHPL's parent company, VRC.
Consolidation/Standalone	Standalone

About the company

VDCHPL is a special purpose vehicle (SPV) formed in February 2021 by VRC for undertaking a road project awarded by the NHAI. The project involves development of six-laning of Mandi Dabwali (Punjab/Haryana Border) – Chautala road section from the proposed Mandi Dabwali Bypass (Design Ch. 27.400) to Chautala (Design Ch. 62.200) of NH-54 (design length 34.800) in Haryana under HAM. 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. 745.93 crore is planned to be funded by the NHAI's grant of

Rs. 367.0 crore, external debt of Rs. 252.62 crore and equity of Rs. 126.31 crore. The project received an appointed date of January 24, 2022 from the NHAI.

About the guarantor

Incorporated in 1996, VRC is involved in all types of civil construction and has executed various projects in the field of refinery and petrochemical, power, cement, steel, nuclear, and other infrastructure sectors. In the recent past, the company has diversified into road construction sector as well and has been increasing its exposure in the road sector since then. Its major clients include the NHAI, HPCL Rajasthan Refinery Ltd, Indian Oil Corporation Ltd. (IOCL), etc.

Key financial indicators

Key financial indicators are not applicable as VDCHPL 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 on Feb 14, 2023 (Rs. crore)	Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Mar 21, 2023	May 20, 2022	Sep 24, 2021	-	-
1	Fund-based – Term Loan	Long Term	252.62	100.00	[ICRA]A(CE) (Stable)	[ICRA]A(CE) (Stable)	[ICRA]A-(CE) (Stable)	-	-

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	**Long-term – Fund-based - term loan**	July 23, 2021	-	FY 2038*	252.62	[ICRA]A(CE)(Stable)

**-Linked with COD, 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:

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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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