

September 12, 2022

Kallagam - Meensurutti Highway Private Limited: Rating upgraded to [ICRA]AA; outlook revised to Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term loan	455.60	455.60	[ICRA]AA upgraded from [ICRA]AA-; Outlook revised to Positive from Stable
Total	455.60	455.60	

*Instrument details are provided in Annexure-I

Rationale

The upgrade in the rating of Kallagam-Meensurutti Highway Private Limited (KMHPL) positively factors in the healthy execution progress on the pending portion of the project and achievement of provisional completion certificate (PCC-II, pertaining to cumulative financial progress of 87.6%) by the company w.e.f. May 31, 2022. Further, KMPHL has also received its first semi-annual annuity payment of Rs. 29.33 crore on May 06, 2022, corresponding to PCC-I completion. The receipt of annuity payments largely eliminates the risks around timings of future annuity payments. Till July 2022, the company had completed ~94.7% of the project and is well placed to achieve PCC-III within the scheduled timeline of December 2022. Earlier, the company had achieved PCC-I in October 2021 for 73% of the BPC. The achievement of PCC-I & PCC-II, and the progress post that mitigates the execution risk to a major extent, thereby having a positive impact on the project's risk profile.

The rating also positively considers the availability of reserves, KMHPL has a debt service reserve (DSR) of Rs. 27.1 crore, equivalent to six months' debt servicing obligations (basis current debt o/s), and an O&M reserve of Rs. 10.0 crore equivalent to six months of O&M expenses, as on July 31, 2022. ICRA also draws comfort from the 1.5 months' buffer between the annuity receipt date and the scheduled debt servicing date.

The rating continues to derive comfort from the strong financial profile and operational track record of its sponsor and engineering, procurement, and construction (EPC) contractor – Oriental Structural Engineers Private Limited (OSEPL, rated [ICRA]AA- (Stable)). The rating positively notes the stable revenue stream post-commissioning with 60% of the remaining project cost being paid out as annuity (adjusted for inflation) over the term of the concession from the project owner and annuity provider, the National Highways Authority of India [NHAI; rated [ICRA]AAA (Stable)], a key Central Government entity responsible for the development and maintenance of India's national highway programme.

The rating, however, is constrained by the exposure of KMHPL's cash flows to the spread between the interest earned on the outstanding annuities linked to the bank rate of Reserve Bank of India (RBI) and the interest rate payable on the project loan. While the project execution was slower than scheduled in the past, owing to various reasons such as delays caused by heavy monsoon in the region, unavailability of pond ash for filling, non-availability of encumbrance-free land and the temporary disruption caused by the Covid-19 pandemic, among others. Nonetheless, successful achievement of PCC-I & PCC-II and the presence of requisite approvals from the NHAI for executing the pending work PCC-III (12.4% of BPC) to be completed by December 31, 2022, provides comfort. Any reduction of scope on account of the pending work will result in a change in total project cost and consequently, annuities; however, the drawdown of the term loan is also expected to be proportionately lower. Nevertheless, it can have an impact on the project credit metrics, depending on the actual project funding pattern, and is likely to be monitorable.

The 'positive' outlook on the rating reflects ICRA's expectation that KMHPL will achieve PCC-III within scheduled timelines and budgeted costs, which will eliminate the pending project risks and consequently improve its credit profile.

Key rating drivers and their description

Credit strengths

Achievement of provisional completion for 87.6% of the project – The project attained PCC-II on May 31, 2022, for cumulative 87.6% completion and the same thereby further reduces the project execution risk to an extent. Further, the company had completed around 94.7% of the project as on July 31, 2022 and is well placed to achieve PCC-III within the scheduled timeline of December 2022. Nonetheless, completion of PCC-III will decide the final bid project cost, which will be the base for calculation of future semi-annuities. The achievement of provisional completion for a major part of the project, reduces majority of uncertainties around the annuity payments. The annuities are expected to be sufficient to meet the debt servicing obligations.

Strong profile of annuity provider with track record of receipt of first semi-annuity payment – As per the concession agreement, KMPHL will receive annuity, interest on outstanding annuities and the annual O&M payments from the NHAI – a strong counterparty. KMPHL has received the first semi-annuity payment of Rs. 29.33 crore on May 06, 2022, corresponding to PCC-I completion (73% of BPC). The receipt of annuity payments eliminates the risks around timings of future payments and reduces the uncertainties around adjusted BPC (adjusted for PIM), to an extent.

Benefits of projects under HAM model - The inherent benefits of a HAM project include upfront availability of RoW, inflation-linked revisions to bid for project cost during the construction period and relatively low equity mobilisation risk with 40% of the project cost to be funded by the authority during the construction period in the form of a grant. The project will have a stable revenue stream post commissioning with 60% of the project cost being paid out as annuity (adjusted for inflation) over the terms of the concession from the project owner and the annuity provider, NHAI. The inflation-linked revision is based on the annual change in the price index multiple (PIM) from the base year (PIM is the weighted average of wholesale price index (WPI) and consumer price index (CPI) in the ratio of 70:30).

Healthy projected debt coverage indicators - KMPHL is expected to have a healthy debt service coverage ratio during the debt tenure. The company has created DSRA of Rs. 27.1 crore and O&M reserve of Rs. 10.0 crore as of July 2022. Further, there is a buffer available of 1.5 months between the annuity receipt date and the scheduled debt servicing date. Structural features of the debt, such as the presence of escrow, a cash flow waterfall mechanism, DSRA equivalent to ensuing six months of debt servicing obligation and creation of MMR, presence of reserves to meet regular O&M and interest obligations till the next scheduled annuity, cash sweep and restricted payment clause with a minimum DSCR of 1.15 times, provide comfort.

Credit challenges

Achievement of PCC-III and bid project cost finalisation - The appointed date for the project was April 23, 2019, and its scheduled COD was April 23, 2021. However, the project execution had been slower than scheduled in the past owing to various force majeure events such as the impact of the monsoons, the onset of the Covid-19 pandemic and other factors such as non-availability of encroachment-free land and absence of RoW for the entire lane requirement. The NHAI has taken cognisance of the same and has approved providing provisional completion for the project stretch in a phased manner - in three phases (PCC-I, PCC-II, PCC-III). The company had achieved PCC-I in October-2021, and PCC-II in May-2022, while PCC-III is scheduled for Dec-2022. As of August 2022, the company has already completed nearly 95% of the project making it better placed to achieve PCC-III within the scheduled timelines. Nonetheless, any delays in execution of pending portion of the projects or any reduction of scope on account of the pending portion will result in a change in the total project cost and consequently the annuities and may impact the project credit metrics, depending on the actual project funding pattern.

Ensuring routine and periodic maintenance expenses in a timely manner and within budgeted levels – Post commissioning, the company will have to undertake the O&M of the project stretch as per the concession agreement to avoid any deductions from annuities. Any significant deduction from annuities or increase in routine and major maintenance (MM) from the budgeted level could impact its debt servicing coverage ratio. KMPHL's cash flows are exposed to inflation risks as the O&M receipts, though linked to inflation (70% WPI and 30% CPI), may not be adequate to compensate for the increase in the

O&M/periodic maintenance expenses. Hence, adequate and within budgeted O&M will be a key rating sensitivity during the operations stage.

Project returns exposed to the spread between RBI's bank rate and the interest rate charges by lenders - The project's cash flows and returns are exposed to 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 the lenders is linked to their respective MCLR. The spread between the RBI's bank rate and bank's MCLR, if widened, could adversely impact the projected cash flows.

Liquidity position: Adequate

The cash flows from operations are expected to be sufficient to meet the debt servicing obligations with a projected cumulative DSCR of over 1.3 times. The liquidity position of the company is also supported by the availability of DSRA of ~Rs. 27.1 crore and O&M reserve of ~Rs. 10.0 crore as of August 2022.

Rating sensitivities

Positive factors – The rating could be upgraded if the company executes the rest of the project and achieves project completion in a timely manner and there is a timely track record of receipt of semi-annual annuities and O&M payments without any significant deductions.

Negative factors – Negative pressure on rating could arise if the risk profile of the SPV increases due to delays in project execution, or if there are major deductions or delays in receipt of semi-annual annuities and O&M payments; or if O&M expenses significantly exceed the estimates. The rating can also come under pressure if there is a significant increase in the indebtedness that impacts its coverage indicators.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for BOT (Hybrid Annuity Model) Roads
Parent/Group support	NA
Consolidation/Standalone	Standalone

About the company

Kallagam-Meensurutti Highway Private Limited (KMHPL) is an SPV incorporated in March 2018, by OSEPL to undertake the project, in a Concession Agreement with the NHAI, for four-laning of Kallagam to Karuppur from km. 38.700 to km. 50.382 and two-laning with paved shoulders from Karuppur to Meensurutti from km. 50.382 to km. 98.433 under NHDP phase-IV in Tamil Nadu (the project) on a design, build, operate and transfer (the hybrid annuity) basis.

The project had an initial construction period of 730 days from the appointed date of April 23, 2019, and an O&M period of 15 years thereafter. The project suffered delays on account of the initial non-availability of pond ash, heavy monsoon in the region and the Covid-19 pandemic-related disruption. The company correspondingly applied for extension of the timeline and the same has been approved by the NHAI, whereby the NHAI has approved to provide provisional completion in a phased manner, to the extent of the land available and the completion of execution.

The company received its provisional completion certificate I (PCC-I)/ Provisional COD on October 19, 2021, for 73% of project completion. Subsequently, it received PCC II on May 31, 2022, for a length of 9.983 km (16.7% of the project length). The cumulative work completed till PCC -II was 87.6% of BPC. Under PCC-III, the balance 12.4% of the BPC is to be incurred and the scheduled target date for the same is December 31, 2022.

Key financial indicators

Key financial indicators are not applicable as KMHPL is a project company.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2023)			Chronology of rating history for the past 3 years				
		Amount rated (Rs. crore)	Amount outstanding as of July 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021			Date & rating in FY2020
						Sep 12, 2022	Feb 11, 2022	Feb 04, 2021	
1	Term loans	Long term	455.60	410.17	[ICRA]AA (Positive)	[ICRA]AA- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (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: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based facility – Term Loan	July 2021	NA	FY2036	455.60	[ICRA]AA (Positive)

Source: KMHPL and ICRA;

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

ANALYST CONTACTS

Rajeshwar Burla
+91 40 4067 6527
rajeshwar.burla@icraindia.com

Ashish Modani
+91 20 6606 9912
ashish.modani@icraindia.com

Abhishek Gupta
+91 124 4545 863
abhishek.gupta@icraindia.com

Saurabh Singhal
+91 124 4545 855
saurabh.singhal@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)
info@icraindia.com

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ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



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