

October 28, 2022

## H.G. Khammam Davarapalle PKG - 2 Private Limited: Rating assigned

### Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - Term Loan	256.00	[ICRA]A (Stable) assigned
Non-fund based - Bank Guarantee	(70.09)	[ICRA]A (Stable) assigned
<b>Total</b>	<b>256.00</b>	

\*Instrument details are provided in Annexure I

### Rationale

The assigned rating derives comfort from the favourable financial profile as well as track record of its sponsor and engineering, procurement and construction (EPC) contractor – H.G. Infra Engineering Limited (HGIEL, rated [ICRA]AA- (Stable)/[ICRA]A1+). 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), automatic de-scoping of RoW pending beyond 180 days from the appointed date and inflation-linked 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 considers the support from 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). Additionally, presence of reserves to meet the regular operations and maintenance (O&M) and interest obligations till the next scheduled annuity and restricted payment clause offer comfort. The rating considers 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 one-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, H.G. Khammam Davarapalle PKG - 2 Private Limited (HGKD2) 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 - HGIEL. HGKD2 is also exposed to equity mobilisation risk as the sponsor has to infuse 40% of upfront equity, and the remaining 60% is likely to be infused over the construction period. However, HGIEL’s adequate financial risk profile 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 debt servicing coverage ratio. ICRA’s rating factors in the exposure of HGKD2’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, HGKD2’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.

The Stable outlook on the [ICRA]A rating reflects ICRA’s opinion that HGKD2 will benefit from its strong execution capabilities and financial profile of the sponsor and EPC contractor – HGIEL.

## Key rating drivers and their description

### Credit strengths

**Established track record and financial profile of sponsor and EPC contractor** - HGKD2 is a wholly-owned subsidiary of HGIEL, rated [ICRA]AA- (Stable)/[ICRA]A1+, which has been executing road projects since 2003. HGIEL is also the EPC contractor for this project and the contract is on a fixed-price, fixed-time basis, which provides comfort, given its track record of project execution within the budgeted time and cost. Additionally, HGIEL has provided an undertaking for cost overruns during construction and for any shortfall in O&M expenses.

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

**Healthy coverage indicators and presence of structural features** - Once the project becomes operational, HGKD2 is expected to have a healthy debt service coverage ratio during the debt tenure. Structural features of the debt, such as an escrow account, a cash flow waterfall mechanism, DSRA equivalent to six months of debt servicing obligation and creation of an MMR provide comfort.

### Credit challenges

**Project exposed to execution risk** - The company is vulnerable to project execution risks as the project is in the nascent stage of execution, with the appointed date of September 13, 2022. Nevertheless, the execution risk is mitigated to some extent by HGIEL's strong project execution capabilities. Further, the debt has been tied up and HGIEL has committed equity infusion of Rs. 114.7 crore, resulting in moderate funding risk.

**Project returns exposed to inflation and interest rate risks** - HGKD2's cash flows remain exposed to the interest rate risk due to the floating nature of interest rates for the project term loan. If the inflation rates are persistently low, the interest payments on the annuity might be lower than expected, impacting the debt coverage metrics.

**Proper maintenance of roads essential for receipt of annuity payments** - HGKD2's source of income includes the annuity, interest on outstanding annuities and annual O&M payments from the authority concerned. Hence, ensuring proper maintenance of roads, along with zero deduction in annuity receipts, will be the key credit sensitivity for HGKD2.

### Liquidity position: 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 HGIEL. The liquidity profile is supported by the adequate liquidity of the sponsor.

### 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, or if there is a deterioration in the credit profile of sponsor.

## Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Roads - Hybrid Annuity</a>
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

## About the company

H.G. Khammam Davarapalle PKG - 2 Private Limited (HGKD2), a special purpose vehicle (SPV), is a wholly-owned subsidiary of HGIEL. It was formed as per a 17-year concession agreement (including two years of construction period) on February 25, 2022 with the NHAI, wherein HGKD2 has to construct the proposed four-lane greenfield highway at Khammam to Devarapalle section of NH-365 BG from 33.604 km to 63.117 km in Telangana, through a private public partnership (PPP) on a hybrid annuity mode. The appointed date for the project is September 13, 2022 and construction is expected to start in October 2022.

## Key financial indicators

Key financial indicators are not applicable as HGKD2 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	Type	Current rating (FY2023)			Chronology of rating history for the past 3 years		
		Amount Rated (Rs. crore)	Amount Outstanding as on Mar 31, 2022 (Rs. crore)	Date & Rating on Oct 28, 2022	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					-	-	-
1 Term Loan	Long-term	256.00	~*	[ICRA]A (Stable)	-	-	-
2 Bank Guarantee	Long-term	(70.09)	NA	[ICRA]A (Stable)	-	-	-

Amount in Rs. crore; \*Yet to be disbursed

## Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term - Term Loan	Simple
Long-term - Bank Guarantee	Very 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](http://www.icra.in)

### Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	FY2023	NA	FY2038	256.00	[ICRA]A (Stable)
NA	Bank Guarantee	NA	NA	NA	(70.09)	[ICRA]A (Stable)

Source: H.G. Khammam Davarapalle PKG - 2 Private Limited

[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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