November 03, 2023

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

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based – Term loan	256.00	256.00	[ICRA]A(Stable); reaffirmed
Long-term – Interchangeable – Bank guarantee	(70.09)	(70.09)	[ICRA]A(Stable); reaffirmed
Total	**256.00**	**256.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation for H.G. Khammam Davarapalle PKG – 2 Private Limited (HGKD2) continues to factor in the healthy credit profile its sponsor – H.G. Infra Engineering Limited (HGIEL, rated [ICRA]AA- (Stable)/[ICRA]A1+), which is the engineering, procurement, and construction (EPC) contractor for the project being developed by HGKD2. HGIEL, which has a healthy financial profile and execution track record, has provided sponsor undertakings towards cost overrun and any shortfall in operations and maintenance (O&M) expenses for the project. The rating notes the inherent benefits of the hybrid annuity model (HAM) based project including upfront availability of right of way[1] (RoW), 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 through a grant. The rating positively considers the structural features of the debt, including the presence of escrow, cash flow waterfall mechanism, provision for debt service reserve (DSR, to be created out of the first two annuities), provision for creation of reserve for major maintenance (MMR) and restricted payment clause. The rating derives comfort from the 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 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 project owner, National Highways Authority of India [NHAI, rated [ICRA]AAA(Stable)], which is a strong counterparty.

The rating is, however, constrained by the execution risks involved in the under-construction projects including time and cost overrun risks. The project has scheduled commercial operation date (SCOD) of September 12, 2024 and achieved 21% physical completion as on September 11, 2023. The company has requested for extension of time (EOT) by 141 days, of which 91 days has already been recommended by the independent engineer (IE) to NHAI, though the final approval from the authority is awaited. Its ability to commission the project within the approved timeline and budgeted costs would remain important from the credit perspective. HGKD2 is exposed to equity mobilisation risk as ~55% equity is yet to be infused (Rs. 60.81 crore as on September 11, 2023). Nevertheless, HGIEL's healthy 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 the company's DSCR. 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 rating reflects ICRA's opinion that HGKD2 will benefit from the 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. 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.

Lower inherent risks in HAM projects from NHAI – The inherent benefits of the HAM project include upfront availability of RoW, de-scoping of RoW pending 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 a grant. 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 scheduled to achieve COD by September 12, 2024 (within two years from the appointed date). If the overall project cost remains within the budgeted level, once operational, HGKD2 is likely to have healthy debt coverage indicators with a cumulative DSCR of over 1.4 times. This provides adequate cushion to withstand any adverse movement in the interest on annuity and inflation to a major extent. The credit profile is supported by HGIEL's undertaking towards cost overrun during the construction phase 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 provide comfort.

Credit challenges

Execution risk related to project under construction – The project has received the appointed date on September 13, 2022 and achieved physical progress of ~21% as on September 11, 2023. With sizeable pending execution, the company continues to be exposed to project execution risks including risks of delays and cost overruns. However, the risk is mitigated, to an extent, by the fixed-price, fixed-time contract and HGIEL's strong project execution capabilities. HGKD2 is also exposed to moderate equity mobilisation risk with ~55% equity yet to be infused as on September 11, 2023. However, the comfortable financial profile of its sponsor provides comfort. 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 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.

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.

Liquidity position: Adequate

As the project is under construction, the company does not maintain any significant liquidity on its books. However, the liquidity position is supported by undrawn sanctioned term loan, grants receivable from the NHAI and pending equity infusion from HGIEL (pending: Rs. 60.78 crore as on September 11, 2023). 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	[Corporate Credit Rating Methodology] [Roads - Hybrid Annuity]
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. As on September 11, 2023, the project had achieved 21% physical completion.

Key financial indicators (audited)

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:

The company faces prepayment risk, in case of debt acceleration upon the breach of covenants, including financial covenants, operating covenants, and rating linked covenants. Upon failure to meet the covenants, if the company is unable to get waivers from the lender or the lender does not provide it with adequate time to arrange for alternative funding to pay off the accelerated loans, the rating would face pressure.

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on October 1, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					November 03, 2023	Oct 28, 2022	-	-
1	Term loan	Long-term	256.00	25.0*	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-
2	Bank guarantee	Long-term	(70.09)	(23.9)^	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-

*Amount in Rs. crore; *Balance amount yet to be disbursed, ^As on September 11, 2023*

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: 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	256.00	[ICRA]A (Stable)
NA	**Bank guarantee**	NA	NA	NA	(70.09)	[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.

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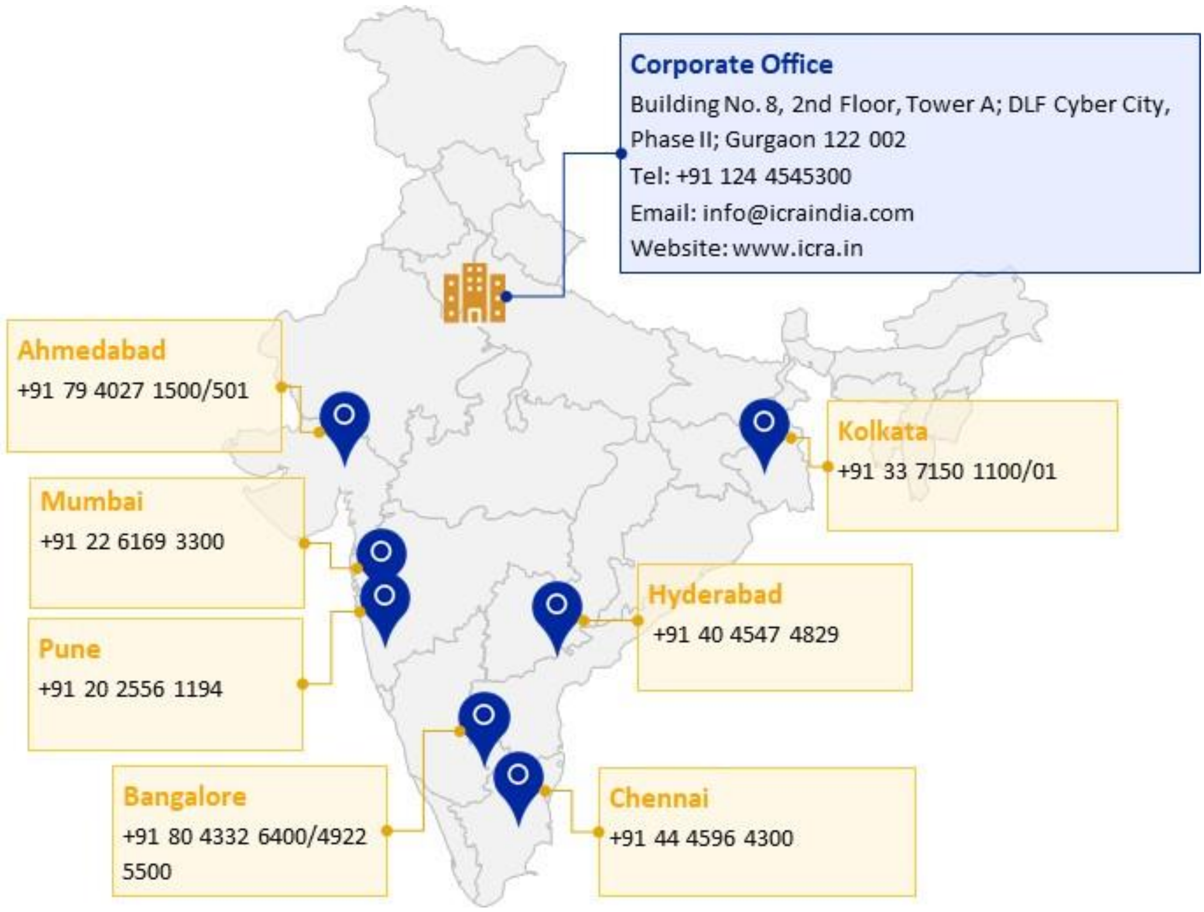

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