April 29, 2024

VRC MB Highways 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	222.00	222.00	[ICRA]A- (Stable); reaffirmed
Total	**222.00**	**222.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation for VRC MB Highways Private Limited (VMBHPL) continues to factor in the inherent benefits of the hybrid annuity model (HAM) project and healthy credit profile of its sponsor – VRC Constructions (India) Private Limited (VRC, rated [ICRA]A (Stable)/ [ICRA]A2+), which is also the engineering, procurement, and construction (EPC) contractor for the project being developed by VMBHPL. ICRA notes that VRC, which has an adequate financial profile and execution track record, has provided a corporate guarantee (CG) till the receipt of first two annuities, towards cost overrun during the construction phase, and to meet any shortfall in operations and maintenance (O&M) expenses. The rating factors in the inherent benefits of the HAM project including 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 (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 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, restricted payment clause and provision for creation of six months' debt service reserve (DSR; to be created 50% before COD and the balance from the first annuity) and major maintenance reserve (MMR). Once the project becomes operational, the presence of reserves to meet the 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 BPC 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 to the extent of fixed percentage of BPC without any price index multiple (PIM) as per the concession agreement 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 overrun. The project has scheduled commercial operation date (SCOD) of December 31, 2024 and it achieved only 20% physical completion by April 13, 2024 (pending NHAI approval). The NHAI has already approved extension of time (EOT) by 164 days, given the delay in land acquisition and RoW availability. 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 ~25% equity is yet to be infused (Rs. 28 crore as of March 31, 2024). 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 service coverage ratio (DSCR). Any significant deductions from annuities or increase in the routine and MM from the budgeted level could impact the company's DSCR. VMBHPL's cash flows 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. ICRA's rating also 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 loan, which is linked to the RBI's repo rate.

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

Established track record and financial profile of sponsor and EPC contractor – VMBHPL is a wholly-owned subsidiary of VRC, which has a longstanding experience in the construction segment. VRC is also the EPC contractor for executing 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. 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 (~25% pending as of March 2024). Additionally, it has provided an undertaking for cost overruns during the construction and for any shortfall in O&M expenses.

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 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 in the form of a grant. Stable revenue stream post commissioning with 60% of the inflation-adjusted BPC 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 to the extent of fixed percentage of BPC without any PIM as per the concession agreement 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) beyond two years from the appointed date (viz. by June 2025), given the delays already seen due to land acquisition and RoW availability issues. An EOT for 164 days has already been approved by the Authority due to the same. If the overall project cost remains within the budgeted level, once operational, VMBHPL is likely to have adequate debt coverage metrics. This provides the special purpose vehicle (SPV) adequate cushion to withstand any movement in the interest on annuity and inflation to an extent. The credit profile is supported by VRC's undertaking towards funding any 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 received the appointed date on December 31, 2022 and remains in its initial stages of execution (20% completion till April, 2024). 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 the lenders. The interest on annuities from the NHAI will be linked to the average one-year MCLR of top five scheduled commercial banks, while the interest rate charged by the lenders is linked to the RBI's repo rate (revised from earlier benchmark of the lender's 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

As the project is under construction, the company does not maintain any significant liquidity on its books. However, its liquidity position is supported by undrawn sanctioned term loans, grants receivable from the NHAI and the balance 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. As on March 31, 2024, the residual project cost is around Rs. 467.7, and it shall be funded through equity of Rs. 110.6 crore, pending debt drawdown of Rs. 164.5 crore and NHAI grant of Rs. 192.6 crore.

Rating sensitivities

Positive factors – The rating could be revised if the project is completed within the expected timelines and budgeted costs, and provisional commercial operations date (PCOD) is achieved.

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 BOT (Hybrid Annuity) Roads
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: 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 (FY2025)				Chronology of rating history for the past 3 years		
	Type	Amount rated (Rs. crore)	Amount outstanding as on Mar 31, 2024 (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
				April 29, 2024	-	January 18, 2023	-
1 Term loan	Long-term	222.00	57.4*	**[ICRA]A- (Stable)**	-	**[ICRA]A- (Stable)**	-

**Term loan is pending to be disbursed however an STL facility, sub-limit of TL is outstanding.*

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	FY2039*	222.00	[ICRA] A- (Stable)

*Source: Company; *May vary as the maturity date of the term loan is linked with the COD of the project.*

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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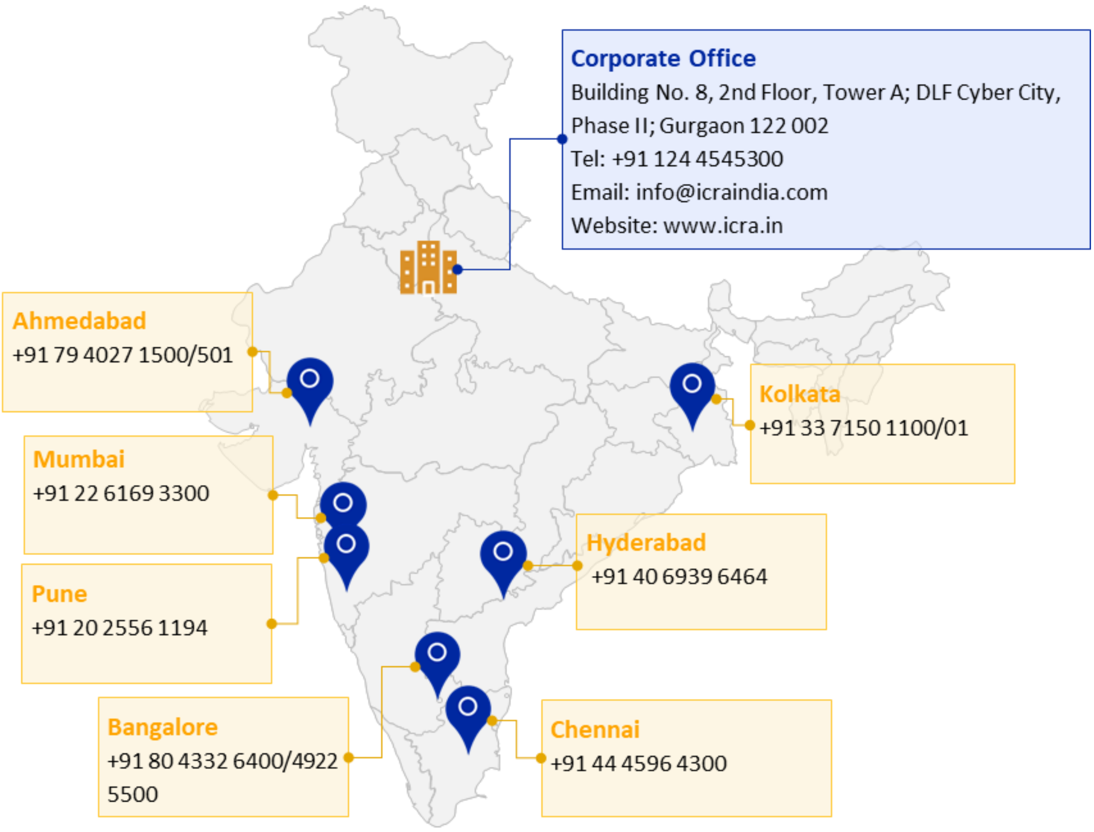

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