January 06, 2025

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; ^as sub-limit of term loan*

Rationale

The rating reaffirmation for H.G. Khammam Davarapalle PKG – 2 Private Limited (HGKD2) continues to factor in the healthy credit profile of its sponsor, H.G. Infra Engineering Limited (HGIEL; rated [ICRA]AA- (Positive)/[ICRA]A1+), which is also the engineering, procurement, and construction (EPC) contractor for the greenfield four-lane road project being developed by HGKD2 in Telangana (India) under the hybrid annuity model (HAM). 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 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 the low 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 creating a reserve for major maintenance (MMR) and a restricted payment clause. Comfort is also derived from the project's stable revenue stream after 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%. Additionally, the inflation-adjusted operation and maintenance (O&M) cost bid over the 15-year operation period by the project owner, the National Highways Authority of India [NHAI; rated [ICRA]AAA(Stable)], which is a strong counterparty, also provide comfort.

The rating is, however, constrained by the execution risks involved in the under-construction projects including time and cost overrun risks. ICRA notes that a settlement agreement has been entered into with the NHAI, wherein two provisional completion timelines, i.e., PCC-01 (non-Change of Scope (CoS) affected length of 19.663 km) and PCC-02 (CoS affected length of 9.850 km) have been stipulated with completion due date of December 31, 2024, and March 31, 2025, respectively. The project had achieved ~67% physical completion as of November end 2024. The company's ability to commission the project within the approved timeline and budgeted costs remains important from a credit perspective. HGKD2 is also exposed to some equity mobilisation risk as ~25% equity is yet to be infused (Rs. 27.5 crore as on November 30, 2024). Nevertheless, the sponsor's healthy financial risk profile provides comfort. Following commissioning, O&M of the project stretch will have to be

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[1] *At least 80% prior to the appointed date*

[2] *Based on annual change in price index multiple (PMI) from the base year – PMI is the weighted average of Wholesale Price Index (WPI) and Consumer Price Index (CPI) (IW) in the ratio of 70:30*

[3] *The authority shall declare the list of top five SCBs on 1st September of every calendar year based on the balance sheet size as declared in their annual reports. The one-year MCLR of the top five SCBs shall be taken at the start of every quarter.*

undertaken as per the concession agreement (CA) 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 the sponsor and EPC contractor – HGKD2 is a wholly-owned subsidiary of HGIEL (rated [ICRA]AA- (Positive)/[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.

Inherent benefits of hybrid annuity model – The inherent benefits of the HAM project include upfront availability of RoW, inflation-linked revisions to the BPC during the construction period and low 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 project will have a stable revenue stream post-commissioning as 60% of the remaining project cost will be paid out as annuity (adjusted for inflation), 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 project owner and annuity provider, the NHAI, a key Central Government entity that develops and maintains India's national highways.

Healthy coverage indicators and presence of structural features – The project is scheduled to achieve its commercial operations date (COD) by March 31, 2025 (within the timelines stipulated in the settlement agreement). 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

Exposed to execution risk as project is under construction – The project received the appointed date on September 13, 2022 and had achieved physical progress of ~67% as of November 30, 2024. It has witnessed delays for reasons beyond the control of the concessionaire, including excess rainfall and issues related to RoW. Accordingly, the NHAI and concessionaire entered into a settlement agreement, which bifurcated the completion into two PCCs, i.e., PCC-01 due on December 31, 2024, and PCC-02 due on March 31, 2025. Further, the authority shall provide the encumbered land of 0.40 km by November 30, 2024 (around 0.265 km pending as on November 30, 2024). With sizeable execution pending, 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 ~25% equity yet to be infused as on November 30, 2024. 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. Further, the project's cash flows and returns are sensitive to the spread between the interest to be paid by the NHAI on the outstanding annuities linked to the average of one-year MCLRs of top five SCBs and the interest rate payable on the outstanding debt, linked to lender's marginal cost of fund-based lending rate (MCLR).

Undertaking O&M and MM as per CA requirement – After commissioning, O&M of the project stretch will have to be undertaken 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 HGIEL. As of November 30, 2024, the pending equity infusion was Rs. 27.5 crore, undrawn debt was Rs. 121.0 crore and the estimated NHAI grant stood at Rs. 101.9 crore.

Rating sensitivities

Positive factors – The rating could be upgraded if the project is completed within the expected timelines and budgeted costs.

Negative factors – 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 the 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, 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 along the Khammam–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 of November 2024, the project had achieved ~67% 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

	Current (FY2025)			Chronology of rating history for the past 3 years					
	FY2025			FY2024		FY2023		FY2022	
Instrument	Type	Amount rated (Rs. crore)	06-JAN-2025	Date	Rating	Date	Rating	Date	Rating
Fund-based – Term loan	Long-term	256.00	[ICRA]A (Stable)	03-NOV-2023	[ICRA]A (Stable)	28-OCT-2022	[ICRA]A (Stable)	-	-
Interchangeable – Bank guarantee	Long-term	(70.09)^	[ICRA]A (Stable)	03-NOV-2023	[ICRA]A (Stable)	28-OCT-2022	[ICRA]A (Stable)	-	-

^as sub-limit of term loan

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term – Fund-based – Term loan	Simple
Long-term – Interchangeable – 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, ICRA Research; *linked to provisional COD/ COD; ^as sub-limit of term loan*

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.

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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