August 29, 2022

VRC SR Highways Private Limited: [ICRA]A-(Stable) assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term loan	208.75	[ICRA]A-(Stable); Assigned
Total	**208.75**	

**Instrument details are provided in Annexure-I*

Rationale

The rating assigned to VRC SR Highways Private Limited (VSRHPL) takes into account the financial profile as well as track record of its sponsor and engineering, procurement and construction (EPC) contractor – VRC Constructions (India) Private Limited (VRC, rated [ICRA]A(Stable)/[ICRA]A2+). 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[1] pending beyond 180 days from the appointed date, inflation-linked[2] 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 factors in 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, VSRHPL 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 contractor - VRC. VSRHPL is exposed to equity mobilisation as the sponsor has infused ~60% of equity by July 31, 2022, and the remaining 40% is expected to be infused over the construction period. However, VRC'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 VSRHPL'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, VSRHPL'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.

[1] *~90% has been achieved*

[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*

The Stable outlook on the rating reflects ICRA's opinion that VSRHPL will benefit from its strong execution capabilities and financial profile of the sponsor and EPC contractor - VRC.

Key rating drivers and their description

Credit strengths

Strong track record and financial profile of the sponsor and EPC contractor – VRC has long experience in the construction segment and is appointed as the EPC contractor for executing the project, which provides comfort, given its track record of project execution within the budgeted time and cost. The total estimated project cost of Rs. 581.42 crore is planned to be funded by NHAI's grant of Rs. 248.14 crore, external debt of Rs. 208.75 crore and equity of Rs. 124.52 crore. The sponsor has infused approx. 60% of equity by July 31, 2022. However, VRC's financial profile is adequate to meet its equity commitment in the project, which is required to be infused over the construction period.

Lower inherent risks in hybris 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 bid for project cost during the construction period. Moreover, it faces 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. 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, along with inflation-adjusted operations and maintenance (O&M) cost bid over the 15-year operations period by the NHAI, which is a strong counterparty, provides comfort.

Healthy coverage indicators and presence of structural features – Once operational, VSRHPL is expected to have healthy debt coverage indicators. This provides the special purpose vehicle (SPV) adequate cushion to withstand any adverse movement in the Bank Rate and inflation to a major extent. Moreover, the sponsor's undertaking towards cost overrun during the construction phase and any shortfall in O&M expenses offers comfort. Furthermore, the presence of structural features of the debt, including the presence of escrow, cash flow waterfall mechanism, provision for creation of six months' DSR (three months DSR to be created upfront one month prior to commercial operation date (COD) and the balance three months to be created out of the first two annuities), and MMR supports its credit profile. Additionally, presence of reserves to meet the regular O&M and interest obligations till the next scheduled annuity, cash sweep as decided by the lenders and restricted payment clause provide comfort.

Credit challenges

Execution risk related to project under construction – The project has received the appointed of June 10, 2022 from the NHAI and remains in its initial stages of execution. 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. 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 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 lenders. The interest on the outstanding annuities from the NHAI is linked to the average one-year MCLR of top five scheduled commercial banks, while the interest rate charged by lenders is linked to their respective MCLR. Further, VSRHPL'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 major maintenance (MM) from the budgeted level could impact its debt servicing coverage ratio.

Liquidity position: Adequate

The company's liquidity position is supported by undrawn sanctioned line of credit, grants receivable from the NHAI and equity infusion from VRC. The total estimated project cost of Rs. 581.42 crore is planned to be funded by NHAI's grant of Rs. 248.14 crore, external debt of Rs. 208.75 crore and equity worth Rs. 124.52 crore. The repayment will start from December 31, 2024.

Rating sensitivities

Positive factors – The rating could be upgraded if the project is completed within the expected timelines and budgeted costs, or if there is an improvement in the credit profile of the sponsor.

Negative factors – Negative pressure on rating could arise if the project progress is delayed, resulting in significant time and cost overruns. Additionally, deterioration in the credit profile of sponsor, 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 Rating Methodology for Roads - Hybrid Annuity
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

VRC SR Highways Private Limited (VSRHPL) is an SPV formed in November 2021 by VRC for undertaking a road project awarded by the NHAI. The project involves construction/ upgradation of two lanes with paved shoulders, from Sriganganagar to Raisinghnagar on NH-911, on HAM basis in Rajasthan. The construction period for the project is two years from the appointed date, and the operations period is 15 years from the COD. The project has received an appointed date of June 10, 2022.

Key financial indicators (audited)

Key financial indicators are not applicable as VSRHPL 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	Current rating (FY2023)				Chronology of rating history for the past 3 years		
	Type	Amount rated (Rs. crore)	Amount outstanding as on July 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
				Aug 29, 2022	-	-	-
1 **Term loan**	Long term	208.75	NIL	**[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	Long-term Term loan	March 23, 2022	-	June 30, 2037	208.75	[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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