December 10, 2021

Khargone Transmission Limited: Ratings upgraded; outlook revised to Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	1070.00	1070.00	[ICRA]A-; upgraded from [ICRA]BBB-; outlook revised to Positive from Stable
Letter of Credit (sublimit of term loans)	(856.00)	(856.00)	[ICRA]A- /[ICRA]A2+; upgraded from [ICRA]BBB- / [ICRA]A3; outlook revised to Positive from Stable
Total	**1070.00**	**1070.00**	

**Instrument details are provided in Annexure-1*

Rationale

The upward revision in the ratings factors in the receipt of forest clearance for the diverted route of the Khandwa pool – Dhule 765 kV D/C Hexa line (KD line), the last element of Khargone Transmission Limited's (KTL) ongoing project, and the subsequent completion of the pending work, thus mitigating project execution risks. As on November 30, 2021, the entire physical work for the project was completed and the commercial operations date (COD) is expected to be declared on or before December 31, 2021, after it receives certification from Power System Operation Corporation Limited (POSOCO) for the successful trial run of the KD line. The rating upgrade also factors in the partial operational nature of the project with the company generating 55% of the revenues since March 2020, with healthy line availability of above 99% and adequate collection efficiency.

The rating continues to draw comfort from the established track record of the Sterlite Group in implementing and operating power transmission projects. In India, the Group has completed 10 power transmission projects till date, and five more transmission projects, including KTL, are at various stages of implementation. The commissioned power transmission projects have been operating at healthy line availability. KTL also derives synergy from the flagship company of the Group and the ultimate parent - Sterlite Power Transmission Limited (SPTL; Sterlite Power Grid Ventures Limited has been merged into SPTL) - which is involved in the engineering, procurement and construction (EPC) of power transmission projects and the supply of power transmission conductors. Further, the project benefits from an assured offtake under the transmission service agreement (TSA) of 35 years secured through the bidding route, leading to stable cash inflows in the form of fixed monthly charges, provided the line availability is maintained above 98%. It will also benefit from the strong payment security under the pooling mechanism for inter-state transmission projects, wherein the central transmission utility (CTU; subsidiary of Power Grid Corporation of India Limited (PGCIL)) is responsible for billing and collection on behalf of all the inter-state transmission licensees.

The ratings, however, remain constrained by the limited track record of the project, with the KD line yet to demonstrate operations. The completion of commissioning formalities in December 2021 and the demonstration of satisfactory line availability thereafter remain key rating monitorable. Also, the project has witnessed significant time and cost overruns owing to the re-routing of the KD line as it falls under the submergence and dam seat area of the Jamphal dam. The COD for the project is expected by December 31, 2021, a delay of 29 months from the original scheduled COD of July 31, 2019 as per the transmission service agreement (TSA). The execution delays have also resulted in shifting the debt repayment schedule in conjunction with the shift in the COD, with the approval of the lenders. It is now scheduled to commence from June 30, 2022. The project has witnessed a significant cost overrun of Rs. 258.39 crore, given the delays in the execution along with the change in law and force majeure events. While the cost overrun has not led to any significant increase in borrowings as it has largely been funded by promoter funds, the debt service coverage ratio is expected to remain modest in the near term. In this context, the company's ability to reduce its cost of funding and secure timely approval from the Central Electricity Regulatory Commission (CERC) to compensate the increase in the capital cost through an increase in the transmission tariff remains important to achieve the desired returns for the project.

Additionally, the project will remain exposed to the variability in operations and maintenance (O&M) expenses, which might impact its profitability. However, the experience of SPTL in the power transmission business should ensure adequate resource allocation and cost-efficient execution of the O&M activity. The project also faces refinancing risk due to large bullet repayment of 39.57% for the project term loans at the end of the loan tenure. Nonetheless, the long concession period of the TSA of 35 years, extending well beyond the loan tenure, coupled with high certainty of cash flows for a power transmission project, mitigate the risk to a large extent. ICRA notes that KTL is a part of the framework agreement signed between the project sponsor and India Grid Trust, and will be eligible for acquisition by India Grid Trust after achieving the COD and demonstrating at least 12 months of revenue generation track record. ICRA will monitor the developments on this front.

The Positive outlook reflects ICRA's expectation that KTL's credit profile is likely to improve further over the near to medium term with the demonstration of a satisfactory track record of line availability for the full project and continuation of healthy collections leading to an enhanced liquidity position.

Key rating drivers and their description

Credit strengths

Physical completion of pending element achieved; COD expected to be declared by December 31, 2021 – While the project has achieved significant progress, it was stuck for the last couple of years as work could not be completed on the diverted route of the KD line (7-8 km) due to delays in receiving fresh forest approval. The execution was also impacted because of the lockdown restrictions imposed due to the Covid-19 pandemic. Nonetheless, the company has received the pending forest approval and work on the KD line has been completed. With this, the entire project has achieved physical completion and the COD is expected to be declared on or before December 31,2021, upon the receipt of the pending approval from POSOCO. Given this, the execution risk for the project stands completely mitigated, providing greater visibility towards the full recovery of the transmission charges as per the TSA.

Revenue generation track record of ~20 months for completed elements with line availability of over 99% – The company received the CERC's approval for delinking the other project elements from the KD line in October 2019. Subsequently, these elements were commissioned and revenue generation (equivalent to 55% of annual transmission charges) started from March 2020. Post commissioning, the average line availability has remained ~99%, while the collection efficiency has been satisfactory.

Assured offtake under long-term TSA and strong payment security – The company will enjoy assured offtake as well as stable cash inflows in the form of fixed monthly charges, provided the line availability is maintained above 98%, under the TSA signed with the long-term transmission customers. The project will benefit from the diversified counterparty risk and strong payment security under the pooling mechanism. Under this mechanism, the CTU collects monthly transmission charges from all the ISTS customers, which are distributed to all the ISTS licensees from the centrally collected pool.

Established track record of Sterlite Group in implementation and operation of power transmission projects – The Group is one the major private players in the power transmission sector in India and the project will benefit from its established track record.

Credit challenges

Limited track record of operations for all elements; ability to maintain transmission line availability within normative level over longer tenure remains crucial – While the first three elements (KK line, KI line and substations) of the project became operational in March 2020, the project attained full physical completion very recently. The remaining elements (KD line, line bays) are expected to be commercialised by December 31,2021. Given this, the combined operational track record of all the nine elements of the project remains limited. As revenues are linked to the stipulated line availability, the company's ability to maintain line availability at a normative level of 98% over a longer tenure remains to be seen and will be a key rating monitorable. Nevertheless, ICRA notes that till October 2021, the average line availability for the operational elements remained healthy above 99%.

Delays in project execution leading to time and cost overruns, thus impacting project returns– The project has faced execution challenges owing to the re-routing of a part of the KD line which falls under the submergence and dam seat area of the Jamphal dam. The delays in obtaining fresh forest approval from the Ministry of Environment and Forest (MoEF) to construct the additional transmission line of 7-8 km due to the change in route, and execution challenges because of the Covid-19 induced lockdown led to significant delays in project completion. There have been revisions in the scheduled COD over the last couple of years, which now stands as December 31, 2021, against the original COD of July 31, 2019. The project has witnessed a cost overrun of Rs. 258.39 crore owing to changes in laws, rise in interest during construction (IDC) and associated infrastructure cost. While the increase in the debt level is low given that a major portion of the cost overrun is funded by promoter funds, timely approval by the CERC to raise the transmission charges post achieving the COD to compensate the increase in capital cost owing to the changes in law and force majeure events remains important as any major disallowances could impact the project returns and debt service indicators.

Refinancing risk at maturity of project loans – KTL's quarterly repayments of project term loans will commence from June 30, 2022 and will end on March 31, 2034, with a final bullet repayment of 39.57% of the total drawn down amount, which exposes the company to refinancing risks. Nonetheless, the risk is partially offset by the fact that the tenure of the TSA is 35 years, which extends much beyond the term loan repayment tenor. This should enable the company to refinance the bullet repayment, given the high certainty of cash flows for an inter-state power transmission project.

Moderate O&M risk – As the company's revenues are subject to the maintenance of the stipulated line availability, it is important that the lines are maintained in a good condition, reducing instances of tripping and minimising the outage time. While KTL's profitability would remain exposed to the variations in O&M expenses, the risk is partially mitigated as O&M expenses form a small proportion of the revenues. Further, the experience of SPTL in the power transmission business should ensure adequate resource allocation and cost-efficient execution of the O&M activity.

Liquidity position: Adequate

KTL's liquidity profile is expected to be adequate in the near term. Cash inflows from the already commenced elements account for 55% of the annual transmission revenues, while inflows for the balance 45% revenue from the remaining elements - KD line and line bays - from January 2022 are expected to be sufficient to meet the debt servicing obligations. The shift in the repayment schedule for term loans from October 31, 2021 to June 30, 2022 after receiving consent from the consortium of lenders provides comfort. As on November 30, 2021, the company had free cash balance of approximately Rs 22 crore and an undrawn term loan of Rs 23 crore.

Rating sensitivities

Positive factors – An improvement in the annual debt servicing coverage ratio, driven by a reduction in the cost of debt funding, and maintenance of above-normative line availability along with healthy collections could lead to an upgrade in KTL's rating. Timely approval from the CERC to recover the cost overrun due to the changes in law/force majeure events without any major disallowance, through a hike in the annual transmission charges, could also trigger a rating upgrade.

Negative factors – The company's inability to maintain line availability within the normative levels on a sustained basis, or delays in receiving payments under the pooling mechanism adversely impacting the company's cash flows and liquidity profile may trigger a rating downgrade. Any weakening of the linkages with the parent, SPTL, or weakening of the credit profile of SPTL could also lead to a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Power Transmission Companies Rating approach - Implicit parent or Group support
Parent/Group Support	The rating assigned to the company factors in the high likelihood of its parent/ Group (Sterlite Grid 4 Limited/ SPTL/Sterlite Power Group) extending financial support, if required given the close business and financial linkages between the entities.
Consolidation/Standalone	The rating is based on the standalone financial profile of the company.

About the company

KTL was incorporated to construct a power transmission project to cater to system strengthening requirements associated with the Khargone Thermal Power Project in Madhya Pradesh. Incorporated on November 26, 2015, the company was established as a wholly owned subsidiary of Rural Electrification Corporation (PFC). KTL was transferred to Sterlite Grid 4 Limited (SGL4), which is a subsidiary of Sterlite Power Transmission Limited (SPTL), after it was awarded the project through tariff-based competitive bidding. KTL constructed a total line length of ~310 km, along with one substation, two-line bays and one LILO as part of the project. The project is implemented on built, own, operate and maintain basis (BOOM) basis and has a transmission service agreement (TSA) in place for 35 years with seven long-term transmission customers (LTTC).

Key financial indicators

Particulars	FY2021 (Audited)	H1 FY2022 (Provisional)
Operating Income (Rs. crore)	108.24	52.90
PAT (Rs. crore)	10.46	-1.13
OPBDIT/OI (%)	93.22%	92.30%
PAT/OI (%)	9.67%	-2.14%
Total Outside Liabilities/Tangible Net Worth (times)	-69.70	-68.01
Total Debt/OPBDIT (times)	14.24	15.49
Interest Coverage (times)	1.59	1.46

**PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation*
Source: Company, ICRA Research; All ratios as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

SN	Instrument	Current Rating (FY2021)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding *(Rs. crore)	Date & Rating on	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019
					Dec 10,2021	Feb 02,2021	Apr 13,2020	Aug 30,2019	Sep 25,2018
1	Term Loans	Long-term	1070.00	1046.54	[ICRA]A- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Stable)
2	Letter of Credit^	Long/Short-term	(856.00)	-	[ICRA]A- (Positive)/[ICRA]A2+	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Negative)/ [ICRA]A3	[ICRA]BBB- (Negative) / [ICRA]A3	[ICRA]BBB (Stable) / [ICRA]A3+

** as on September 30,2021, ^sublimit of term loans*

Complexity level of the rated instrument

Instrument	Complexity Indicator
Term Loans	Simple
Letter of Credit	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 analyzing 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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Lender	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs Crore)	Current Rating and Outlook
NA	L&T Finance Limited	Term loans	Jan-2017		Mar-2034	215.00	[ICRA]A- (Positive)
NA	IndusInd Bank Limited	Term loans	Jan-2017		Mar-2034	155.00	[ICRA]A- (Positive)
NA	IFCI Limited	Term loans	Jan-2017		Mar-2034	200.00	[ICRA]A- (Positive)
NA	Bank of Baroda	Term loans	Jan-2017		Mar-2034	100.00	[ICRA]A- (Positive)
NA	Union Bank of India	Term loans	Jan-2017		Mar-2034	200.00	[ICRA]A- (Positive)
NA	Bank of India	Term loans	Jan-2017		Mar-2034	200.00	[ICRA]A- (Positive)
NA	L&T Finance Limited	Letter of Credit				(172.00)	[ICRA]A- (Positive) / [ICRA]A2+
NA	IndusInd Bank Limited	Letter of Credit				(124.00)	[ICRA]A- (Positive) / [ICRA]A2+
NA	IFCI Limited	Letter of Credit				(160.00)	[ICRA]A- (Positive) / [ICRA]A2+
NA	Bank of Baroda	Letter of Credit				(80.00)	[ICRA]A- (Positive) / [ICRA]A2+
NA	Union Bank of India	Letter of Credit				(160.00)	[ICRA]A- (Positive) / [ICRA]A2+
NA	Bank of India	Letter of Credit				(160.00)	[ICRA]A- (Positive) / [ICRA]A2+

Source: *Company; Letter of Credit is a sublimit of Term Loans*

Annexure-2: List of entities considered for consolidated analysis

Company Name	KTL' Ownership	Consolidation Approach
Not Applicable	Not Applicable	Not Applicable

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About ICRA Limited:

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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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