March 05, 2024

VRC AC 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	466.00	[ICRA]A-(Stable); assigned
Total	**466.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating assigned to VRC AC Highways Private Limited (VACHPL) factors in the inherent benefits of the hybrid annuity model (HAM) based project and healthy credit profile of its sponsor – VRC Constructions (India) Private Limited (VRC, rated [ICRA]A (Stable)/[ICRA]A2+). VRC is the engineering, procurement and construction (EPC) contractor for the project being developed by VACHPL. 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. HAM projects have inherent benefits like upfront availability of right of way (RoW)[1], automatic 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 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, provision for creation of six months' debt service reserve (DSR) and major maintenance reserve (MMR). Once the project becomes operational, the presence of reserves to meet the regular 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 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, VACHPL 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 the contractor – VRC, which has demonstrated strong project execution capabilities. The project has received an appointed date of October 12, 2023. It had achieved physical completion of ~10% as of the end of January 2024. The company's ability to commission the project, in a timely manner and within the budgeted costs, would remain important from the credit perspective. VACHPL is exposed to equity mobilisation risk as majority of the equity was yet to be infused (~72%) as of February 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 servicing coverage ratio (DSCR). ICRA's rating factors in the exposure of VACHPL'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

[1] *~82% has been achieved as of February 2024*

[2] *Based on annual change in price index multiple (PIM) 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*

commercial banks and the interest rate on the project loans, which is linked to the base rate of the lead lender. Further, VACHPL'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 VACHPL 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 – VACHPL 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. 1,066.32 crore is planned to be funded by the NHAI's grant of Rs. 444.43 crore, external debt of Rs. 466.42 crore and equity worth Rs. 155.47 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. 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) within two years from the appointed date (viz. by October 2025). If the overall project cost remains within the budgeted level, once operational, VACHPL is likely to have comfortable 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), provision for creation of MMR and restricted payment clause with minimum DSCR of 1.20 times provide comfort.

Credit challenges

Execution risk related to under-construction project – The project received an appointed date of October 12, 2023 and remains in its initial stages of execution (10% completion till January end). 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 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 the lenders is linked to the base rate of the lead lender. Further, VACHPL'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 balance equity infusion from VRC. The total estimated project cost of Rs. 1,066.32 crore is planned to be funded by the NHAI's grant of Rs. 444.43 crore, external term loans of Rs. 466.42 crore and equity worth Rs. 155.47 crore.

Rating sensitivities

Positive factors – The rating could be upgraded if the project achieves Provisional COD without any time and cost overruns.

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

VRC AC Highways Private Limited (hereinafter referred to as VRCAC) is an SPV promoted by VRC Constructions India Private Limited for implementing a road project envisaging development of Memmadpur (Ambala) – Banur (IT City Chowk) – Kharar (Chandigarh) Corridor under Bharatmala Pariyojana, Package I, for six laning of Ambala – Chandigarh greenfield with Spur to Lalru (four lane) in Punjab on Hybrid Annuity Mode. The appointed date for the project is October 12, 2023. As on January 31, 2024, the project achieved 10% physical completion.

Key financial indicators (audited)

The key financial indicators are not applicable as VACHPL 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 Jan 31, 2024 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Mar 05, 2024	-	-	-
1	**Term loan**	Long term	466.00	0.00*	**[ICRA]A-(Stable)**	-	-	-

**Term loan is pending to be disbursed*

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**	FY2024	NA	FY2040*	466.00	[ICRA]A-(Stable)

*Source: Company; *The SPV is yet to drawdown any debt; the maturity date will be linked to the project COD.*

[*Please click here to view details of lender-wise facilities rated by ICRA*]

Annexure II: List of entities considered for consolidated analysis – Not Applicable

ANALYST CONTACTS

Rajeshwar Burla
+91 40 6939 6443
rajeshwar.burla@icraindia.com

Ashish Modani
+91 20 6606 9912
ashish.modani@icraindia.com

Ritu Goswami
+91 124 4545 826
ritu.goswami@icraindia.com

M Rajashekar Reddy
+91 40 6939 6423
m.rajashekarreddy@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

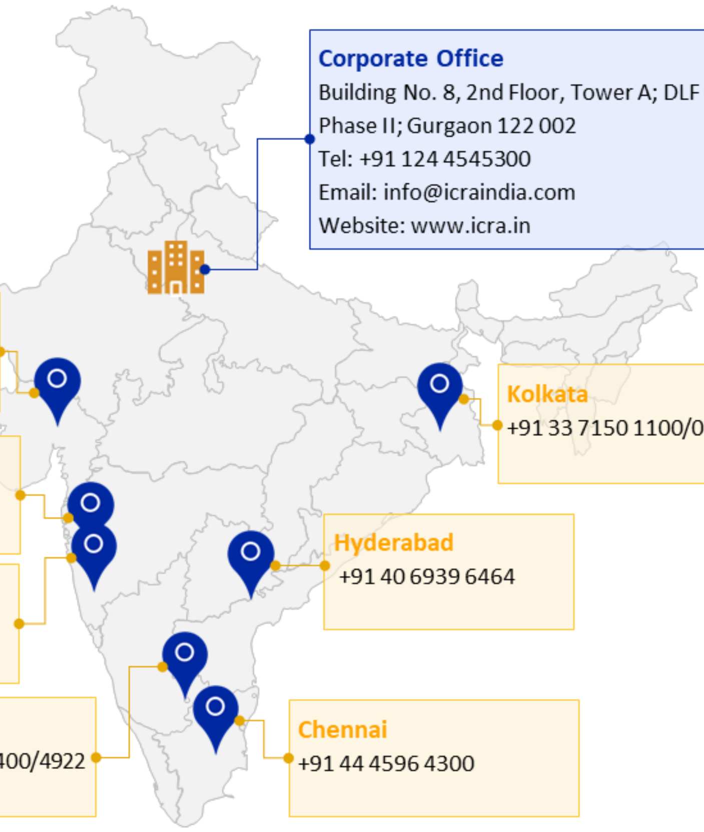
For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches



Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Ahmedabad
+91 79 4027 1500/501

Mumbai
+91 22 6169 3300

Pune
+91 20 2556 1194

Bangalore
+91 80 4332 6400/4922 5500

Kolkata
+91 33 7150 1100/01

Hyderabad
+91 40 6939 6464

Chennai
+91 44 4596 4300

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.