August 21, 2024

H.G. Khammam Devarapalle Pkg-1 Pvt Ltd: 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	310.00	310.00	[ICRA]A (Stable); Reaffirmed
Long-term – Non-fund based – Bank guarantee	(84.94)	(84.94)	[ICRA]A (Stable); Reaffirmed
Total	**310.00**	**310.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation for H.G. Khammam Davarapalle PKG – 1 Private Limited (HGKD1) continues to factor in the healthy credit profile its sponsor – H.G. Infra Engineering Limited (HGIEL, rated [ICRA]AA- (Positive)/[ICRA]A1+), which is the engineering, procurement, and construction (EPC) contractor for the project being developed by HGKD1. 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 hybrid annuity model (HAM) based project including upfront availability of right of way (RoW), 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 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 creation of reserve for major maintenance (MMR) and restricted payment clause. The rating derives comfort from the stable revenue stream post commissioning with 60% of the inflation-adjusted BPC being paid out as annuity, along with interest at the average of one-year MCLR of the top five scheduled commercial banks (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, National Highways Authority of India [NHAI, rated [ICRA]AAA(Stable)], which is a strong counterparty.

The rating is, however, constrained by the execution risks involved in under-construction projects including time and cost overrun risks. The project has scheduled commercial operation date (SCOD) of December 31, 2024 for PCC-1 and March 31, 2025 for PCC-2 and had achieved 55% physical completion as on June 30, 2024. Its ability to commission the project within the approved timeline and budgeted costs would remain important from the credit perspective. HGKD1 is exposed to equity mobilisation risk as ~31% equity is yet to be infused (~Rs. 41 crore as on June 30, 2024 out of ~Rs. 133 crore). Nevertheless, HGIEL's healthy 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 DSCR. HGKD1'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.

ICRA notes that cross-default linkages exist between the loans taken by the HGKD1 and its promoter and personal guarantors. Despite this, the rating of the special purpose vehicle (SPV) is not constrained by the rating of its parent/ promoters. Based on the SPV's characteristics and interactions with the lender, ICRA expects that the latter would likely avoid invoking the cross-default clause so as to preserve its economic interests.

The Stable outlook on the rating reflects ICRA's opinion that HGKD1 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 sponsor and EPC contractor – HGKD1 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. Its financial profile is adequate to meet its equity commitment in the project, which is required to be infused over the construction period (~31% pending as on June 30, 2024). Additionally, HGIEL has provided an undertaking for cost overruns during the construction and for any shortfall in O&M expenses.

Benefits of hybrid-annuity model – The inherent benefits of the HAM project include upfront availability of RoW, 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 through a grant. Stable revenue stream post commissioning with 60% of the inflation-adjusted BPC being paid out as annuity, 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 NHAI, which is a strong counterparty, provide comfort.

Healthy coverage indicators and presence of structural features – The project is scheduled to achieve completion beyond two years from the appointed date (i.e., October 29, 2024 as per original schedule), given the delays already seen due to land acquisition, change in scope and utility shifting issues. The project has already received extension, with PCC-1 by December 2024 (60-day extension from original COD) and PCC-2 by March 2025 (150-day extension from original COD). If the overall project cost remains within the budgeted level, once operational, HGKD1 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

Project exposed to execution risk – The project received the appointed date on October 31, 2022 and achieved physical progress of ~55% as on June 30, 2024. With sizeable pending execution, 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. HGKD1 is also exposed to moderate equity mobilisation risk with ~31% equity yet to be infused as on June 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 returns exposed to inflation and interest rate 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. The project's cash flows and returns are also 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 lender's MCLR.

Proper maintenance of roads essential for receipt of annuity payments – 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 SPV does not maintain any significant liquidity. The total estimated project cost of Rs. 751.7 crore is planned to be funded by the NHAI's grant of Rs. 308.8 crore, external debt of Rs. 310 crore and equity of Rs. 132.9 crore. The liquidity position is supported by the undrawn sanctioned term loan, grants receivable from the NHAI and pending equity infusion from HGIEL (~Rs. 41 crore). Its liquidity profile is supported by the adequate liquidity of the sponsor.

Rating sensitivities

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

Negative factors – Negative 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 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 Devarapalle Pkg-1 Pvt Ltd (HGKD-1) is an SPV formed by H.G. Infra Engineering Limited (HGIEL). It is undertaking the greenfield development of a four-lane access-controlled expressway from Thallampadu village to Somavaram village (Design Length 33.6 Km) under inter corridor category in Telangana (Package-I), through a private public partnership (PPP) on a hybrid annuity mode. The appointed date for the project was October 31, 2022.

Key financial indicators

Key financial indicators are not applicable as HGKD-1 is a project stage company.

Status of non-cooperation with previous CRA: Not applicable

Any other information:

The company also faces prepayment risk, given the possibility 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 (FY2025)			Chronology of rating history for the past 3 years					
	Type	Amount Rated (Rs. crore)	Aug 21, 2024	FY2024		FY2023		FY2022	
				Date	Rating	Date	Rating	Date	Rating
Term loans	Long term	310.00	[ICRA]A (Stable)	June 05, 2023	[ICRA]A (Stable)	-	-	-	-
Bank guarantee	Long term	(84.94)	[ICRA]A (Stable)	June 05, 2023	[ICRA]A (Stable)	-	-	-	-

Amount in Rs. crore

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Term loan	Simple
Long term Non-fund based – 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*	310.00	[ICRA]A (Stable)
NA	**Bank guarantee**	FY2023	NA	NA	(84.94)	[ICRA]A (Stable)

Source: Company; Linked to 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

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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.

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