DBL Chandikhole Bhadrak Highways Limited

July 04, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	545.00	CARE A-; Stable (Single A Minus; Outlook: Stable)	Reaffirmed
Total Bank Facilities	**545.00 (₹ Five Hundred Forty-Five Crore Only)**		

Details of facilities in Annexure-1.

Detailed rationale and key rating drivers

The rating assigned to the bank facilities of DBL Chandikhole Bhadrak Highways Ltd (DCBHL) continues to factor in the inherent strengths of hybrid annuity model (HAM) based road projects such as (i) low project funding risk with inflation-indexed annuity to be received along with Low credit risk of the Counter party – National Highways Authority of India (NHAI; rated CARE AAA; Stable) (ii) lower post implementation risk on account of inflation-indexed annuity to be received for operations and maintenance (O&M) of the road and (iii) receipt of bank rate linked interest annuity. However, unlike the clauses contained in the CA, delay in de-scoping of the unavailable project land has been witnessed in some of the on-going HAM road projects.

The rating continues to derive strength from the established track record of its sponsor and engineering, procurement and construction (EPC) contractor i.e. Dilip Buildcon Ltd (DBL; rated 'CARE A-; Stable/ CARE A2+') in executing large sized road projects along with meaningful project progress in DCBHPL with a physical progress of 84% till May 2022. Albeit the project is slightly delayed owing to cyclones and floods in the region, COVID-19 related disruptions and issues in handing over of land, the same is expected to be completed by end of July 2022.

The rating continues to remain underpinned by low counterparty risk towards annuity receivables from NHAI post commencement of operations, presence of defined cashflow mechanism by way of escrow arrangement, proposed liquidity support mechanisms such as the envisaged creation of debt service reserve account (DSRA) and major maintenance reserve account (MMRA) post commencement of operations along with relatively lower debt levels as against bid project cost (BPC) leading to adequate debt coverage indicators.

The above rating strengths are, however, tempered by the inherent construction risk associated with timely completion of the project along with O&M risk and inherent interest rate risk.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Completion of the project before the revised scheduled project completion date (SPCD).
- Establishment of track record of timely receipt of annuities post commencement of operations and creation of stipulated DSRA.

Negative factors – Factors that could lead to negative rating action/downgrade:

- Significant delay in project progress impacting COD beyond 90 days from revised SPCD.
- Deterioration in the credit profile of the sponsor (i.e .DBL) or the counter-party (i.e. NHAI).

Detailed description of the key rating drivers

Key rating strengths

Favourable clauses in model CA of HAM projects to address execution challenges; albeit certain instances of delay in actual de-scoping of unavailable project land has emerged as a concern for the industry: The model CA of HAM projects includes favourable clauses such as achievement of atleast 80% RoW before declaring appointed date for the project and provision for granting deemed completion of the project in case 100% of the work is completed on the RoW which becomes available to it within 180 days of the appointed date. These clauses were expected to address some of the issues which were plaguing the sector primarily on account of delay in land acquisition during construction phase. However, pending de-scoping of unavailable land despite significant time having lapsed from the appointed date has been affecting the project progress in some of the projects awarded under this model which has emerged as a cause of concern from the credit perspective for the industry. Hence, timely de-scoping of unavailable project land within 180 days from appointed date as per terms of CA will be a key monitorable for HAM-based road projects. However, during July 2020; NHAI released an SOP pertaining to the approach towards de-scoping whereby, immediately after the expiry of the period of appointed date plus 20% of the construction period, the pending RoW will be removed from the scope of work and the BPC shall be suitably reviewed. In case of DCBHL, the RoW available is 93.97% for the main carriageway and 81.69% for service road as on March 31, 2022.

Low funding risk and permitted price escalation: HAM model entails lower sponsor contribution during construction period considering 40% construction support from NHAI and availability of 10% mobilization advance on bid project cost (BPC) at bank rate. Furthermore, BPC and O&M cost shall be inflation indexed (through a Price Index Multiple [PIM]) which is the weighted

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

average of Wholesale Price Index (WPI) and Consumer Price Index (CPI) in the ratio of 70:30. Inflation indexed BPC protects the developers against price escalation to an extent.

Assured cash flow due to the annuity nature of the revenue stream linked to inflation indexed O&M annuity and bank rate linked interest annuity: During operational phase, cash flow is assured in the form of annuity payments from NHAI on semi-annual basis covering 60% of the project completion cost along with interest at 'bank rate plus 3%' on reducing balance and inflation indexed O&M annuity. However, non-linear transmission of bank rate over lending rate is expected to impact the company's debt coverage indicators to an extent.

Low counterparty credit risk: Incorporated by the Government of India (GoI) under an Act of the Parliament as a statutory body, NHAI functions as the nodal agency for development, maintenance and management of the national highways in the country. The outlook on NHAI reflects the outlook on the sovereign, whose direct and indirect support continues to be the key rating driver.

Demonstrated track record of DBL in executing road projects: DBL has demonstrated track record of successfully operating and maintaining build-operate and transfer (BOT) projects for more than a decade. DBL has pan India presence in more than 15 states with diversified execution capabilities in roads & bridges, mining, water sanitation, sewage, dams, irrigation, industrial, commercial and residential buildings. DCBHL has also entered into fixed price EPC contract with DBL for execution of the project. Also, 86.79% of the sponsor contribution has been infused as per CA certificate dated April 20, 2022. Furthermore, DBL has also entered into a binding agreement with Shrem for transfer of 10 SPVs to Shrem InvIT (including DCBHL) upon achieving of COD and upon receipt of requisite NOC from investors of DIAL, against which DBL shall receive consideration by way of mix of cash and InvIT units.

Key rating weaknesses

Inherent execution risk albeit partly offset by meaningful project progress: DCBHL is exposed to inherent construction risk attached to BOT road projects. However, till May 31,2022 the project achieved physical progress of 84%. The project has achieved 77.88% physical progress till March 31, 2022, as against planned progress of 90.76%. The project was primarily delayed due to impact of COVID-19 along with effect of major cyclones (fani and Yass), floods and rains in the region along with delay in handing over of land. Accordingly, DCBHL has received a total EOT of 407 days and the revised SPCD stands at July 24, 2022. However, demonstrated execution capability of DBL as an EPC contractor in executing large sized road projects is expected to mitigate the execution risk to an extent.

Furthermore, DCBHPL has entered into a settlement agreement with NHAI in February 2021 w.r.t. to change in scope of work, wherein additional work of Rs.70.68 crore has been added in the scope, to be completed in 18 months from the date of agreement with payment of the same being received on a monthly basis. Furthermore, a bridge on river kharasrota river along with some portion of service roads is proposed to be descoped, final approval for which is pending from the authority.

The main carriageway and the service road of the project stretch are to be designed with flexible pavement. Also, the company is likely to be benefitted in terms of higher annuities on the back of completion cost of the project being expected to be lower than the BPC while annuities are to be received on BPC.

Inherent O&M risk associated with the project: Although inflation indexed O&M annuity partly mitigates O&M risk, developers would still face the risk of sharp increase in the O&M cost due to more than envisaged wear and tear and aggressive bidding in O&M cost. The project stretch consists of flexible (bituminous) pavement which is prone to higher O&M cost compared to rigid pavement. The O&M cost assumed by the company is relatively lower than other similar projects rated by CARE. However, DCBHL shall enter into fixed price and fixed time O&M contract with the sponsor whereby DBL shall be responsible for the maintenance of the stretch, which provides some comfort.

Inherent interest rate risk: DCBHL is exposed to inherent interest rate risk since the project debt is sanctioned with a floating rate of interest reset periodically. While the risk is partially mitigated on account of receipt of the interest annuity at the applicable bank rate + 300 bps, DCBHL remains exposed to interest rate risk owing to the timing difference between a change in the bank rate & lending rate and non-linear transmission of change in bank rates to lending rates. However, a steep impact on debt coverage indicators is precluded due to the higher expected gap between inflation-indexed completion cost and the project cost considered for financial closure.

Liquidity: Adequate

DCBHPL's liquidity is adequate as it has access to timely need-based support from DBL as well as from the fact that as a sponsor, it has extended contractual commitment in the form of unconditional and irrevocable corporate guarantee to meet the shortfall in servicing debt obligations. Furthermore, DBL has extended undertaking to fund any cost overrun and shortfall in resources of DCBHPL during construction period. Shortfall in resources can be attributed to delay/part receipt/lower than budgeted receipt of construction support irrespective of reasons; to fund any variations/change in scope for whatsoever reasons; to meet any shortfall in respect of lenders dues in the event of termination of the CA. As per the terms of sanction of the project debt, the company shall maintain DSRA, of an amount equivalent to ensuing six months of interest and principal repayment in form of fixed deposit receipts (FDR) or Bank Guarantee in respect of the facility which is expected to provide liquidity cushion to DCBHPL.

Analytical approach
Standalone while factoring execution track record of EPC contractor i.e., DBL along with sponsor support undertakings extended by it to meet any shortfall in debt servicing during construction phase.

Applicable criteria
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE Ratings' Policy on Default Recognition
Liquidity Analysis of Non-Financial Sector Entities
Consolidation and Factoring Linkages in Ratings
Financial Ratios – Non financial Sector
Rating Methodology: Hybrid Annuity Road Projects

About the company
DCBHL, a special purpose vehicle (SPV) incorporated and owned by DBL, has entered into a 17.5-year concession agreement (CA) (including construction period of 910 days from the appointed date) with NHAI for the design, build, operate and transfer (DBOT) of 74.50 km road on hybrid annuity basis. The project under consideration aims at six laning of existing four-lane carriageway from Chandikhole at km 62 (existing chainage of new NH 16 at Km 62) to Bhadrak at Km 136.500 (existing chainage of new NH 16 at Km 136.500) of NH-16 in the state of Odisha. The bid project cost for the project is ₹1522.00 crore. Completion cost for the project is envisaged at ₹1261.26 crore, which is to be funded through construction grant from NHAI of ₹654.08 crore (including inflation), debt of ₹485 crore and balance through promoter's contribution.

Brief Financials (₹ crore)	31-03-2020 (A)	31-03-2021 (A)	31-03-2022 (A)
Total operating income	NA	NA	NA
PBILDT	NA	NA	NA
PAT	NA	NA	NA
Overall gearing (times)	NA	NA	NA
Interest coverage (times)	NA	NA	NA

A: Audited; NA: Not applicable as DCBHL is a project stage company.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Please refer Annexure-3

Complexity level of various instruments rated for this company: Please refer Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based-Long Term		-	-	February 2035	485.00	CARE A-; Stable
Non-fund-based - LT-Bank Guarantee		-	-	-	60.00	CARE A-; Stable

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based-Long Term	LT	485.00	CARE A-; Stable	-	1)CARE A-; Stable (07-Jul-21)	1)CARE A-; Stable (07-Jul-20)	1)CARE A-; Stable (14-Nov-19) 2)CARE A-; Stable (09-Oct-19)
2	Non-fund-based - LT-Bank Guarantee	LT	60.00	CARE A-; Stable	-	1)CARE A-; Stable (07-Jul-21)	1)CARE A-; Stable (07-Jul-20)	1)CARE A-; Stable (14-Nov-19)

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities – Not Applicable

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Fund-based-Long Term	Simple
2	Non-fund-based - LT-Bank Guarantee	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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