Dhrol Bhadra Highways Limited

November 09, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	299.00	CARE A-; Stable (Single A Minus; Outlook: Stable)	Reaffirmed
Total Bank Facilities	**299.00 (₹ Two Hundred Ninety-Nine Crore Only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The rating assigned to the bank facilities of Dhrol Bhadra Highways Limited (DBHL) factors 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 construction agreement (CA), delay in de-scoping of the unavailable project land has been witnessed in some of the ongoing 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 Limited (DBL; rated 'CARE A-; Stable / CARE A2+') in executing large sized road projects along with DBHL's ahead of schedule financial progress of 52.75% till October 18, 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, inherent interest rate risk and inherent O&M risk post commencement of operations.

CARE Ratings notes the trigger of one of the previous negative rating sensitivities (as mentioned in press release dated August 11, 2021) related to deterioration in the sponsor i.e DBL's credit profile. Yet ahead of schedule project progress, availability of right of way (RoW), relatively lower complexity of the project scope, equity infusion to the extent of 64% of the required contribution by the sponsor along with DBL's strong execution capability have partially supported DBHL's credit profile.

Rating sensitivities

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

- Completion of project before the 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 the project progress impacting COD beyond 90 days from SPCD.
- Non-receipt of timely need-based support from the sponsor during construction and operational period.
- Deterioration in the credit profile of sponsor- DBL or counter party (i.e. NHAI).

Detailed description of the key rating drivers

<u>Key rating strengths</u>

Favourable clauses in model CA of HAM projects to address execution challenges; albeit certain instances of delay in actual de-scoping of the unavailable project land have 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

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

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 DBHL, the RoW available is 91.18% as on October 18, 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 advances on bid project cost (BPC) at bank rate. Furthermore, the BPC and O&M costs shall be inflation-indexed (through a Price Index Multiple [PIM]) which is the weighted average of Wholesale Price Index (WPI) and Consumer Price Index (CPI) in the ratio of 70:30 which protects the developers against price escalation to an extent.

Assured cash flow due to annuity nature of the revenue stream linked to inflation-indexed O&M annuity and bank rate linked interest annuity: During the operational phase of the project, cash flow is largely assured in the form of annuity to be received 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. DBHL has entered fixed price EPC contract with DBL for execution of the project. Further, larger fleet of construction equipment as compared to its peers enables it to complete most of the projects ahead of schedule and consequently earn early completion bonus. Also, 64% of the sponsor contribution has been infused as per CA certificate dated October 18, 2022.

<u>Key rating weaknesses</u>

Inherent execution risk albeit partly offset by ahead of schedule project progress: DBHL is exposed to inherent construction risk attached to BOT road projects. Till October 18, 2022 the project achieved physical progress of 44%. The project has achieved financial progress of 52.75% till October 18, 2022, which is ahead of the planned progress of 42.17%.
Project stretch is to be constructed with rigid pavement. Structural cost constitutes around 24% of the total EPC cost indicating comparatively lower complexity of the project. The project is adequately bid with bid project cost (BPC) being 26% above NHAI cost. Furthermore, 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

Inherent O&M risk: Although receipt of inflation-indexed O&M annuity partly mitigates O&M risk, developers would still face the risk of a 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 rigid pavement which is prone to lower O&M cost compared to flexible pavement. DBHL plans to enter into fixed price and fixed time O&M contract with the sponsor prior to the achievement of COD, thereby mitigating the O&M risk to an extent. Also, DBHL is also required to maintain major maintenance reserve account (MMRA) out of the project cash flow to conduct major maintenance of the project stretch.

Inherent interest rate risk: DBHL is exposed to interest rate risk since the project debt is sanctioned with a floating rate of interest which is reset periodically. The interest rate risk is partially mitigated on account of receipt of the interest annuity at the applicable bank rate + 300 bps. However, DBHL remains exposed to interest rate risk due to non-linear transmission of bank rate and time lag between reduction in the bank rate and lending rate.

Liquidity: Adequate

DBHL's liquidity is underpinned from the fact that it has access to timely need-based support from DBL. Furthermore, DBL has extended undertaking to fund any cost overrun, funding of shortfall in the debt servicing of DBHL in case of delayed payment or non-payment or shortfall in annuity payments for any reason whatsoever. Also, as per the terms of sanction of the project debt, DBHL shall create and maintain DSRA equivalent to the ensuing six months principal and six months interest obligations after meeting the debt service obligations during the operational phase which provides cushion for the debt servicing. Furthermore, there is also provision of maintenance of major maintenance reserve which is expected to provide liquidity cushion to DBHL.

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 as well as operational phase.

Applicable criteria

Policy on default recognition
Factoring Linkages Parent Sub JV Group
Financial Ratios – Non-financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Hybrid Annuity Model based road projects
Policy on Withdrawal of Ratings

About the company

DBHL is a special purpose vehicle (SPV) incorporated by DBL to undertake four lanning of existing two lane road of Dhrol-Bhara Patiya section of NH9 151A and Bhadra Patiya-Pipaliya Section in the State of Gujarat under Hybrid Annuity Model (HAM). The project stretch is to be constructed with rigid pavement. The concession period shall be of 17 years including two years of construction period from the appointed date. DBHL has received appointed date as October 28, 2021. The bid project cost for the project is Rs.882.00 crore. However, the financial closure is achieved at project cost of Rs.726.55 crore to be funded through construction grant from NHAI of Rs.352.80 crore, debt of Rs.299.00 crore and balance through promoter's contribution.

Brief Financials (₹ crore)	31-03-2021 (A)	31-03-2022 (A)	H1FY23 (UA)
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; UA: Unaudited; NA: Not applicable as DBHL 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 (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based-Long Term		-	-	November 10, 2036	299.00	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	299.00	CARE A-; Stable	-	1)CARE A-; Stable (11-Aug-21)	-	-

*Long term.

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

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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About us:

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