

IRCON Davanagere Haveri Highway Limited

January 02, 2024

Facilities/Instruments	Amount (₹ crore)	Rating ¹	Rating Action
Long-term bank facilities	312.73 (Reduced from 474.50)	CARE AA-; Stable	Reaffirmed

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The reaffirmation in the rating of the long-term bank facilities of IRCON Davanagere Haveri Highway Limited (IDHHL) principally factors in the receipt of five annuities from National Highways Authority of India (NHAI; rated 'CARE AAA; Stable') post declaration of the provisional commercial operations date (PCOD) on May 28, 2021, for 71.738 km of the project stretch out of total project length of 78.923 km.

The rating continues to factor in the inherent strengths of hybrid annuity model (HAM)-based road projects lowering post-implementation risk by way of inflation-indexed annuities to be received towards construction, operations and maintenance (O&M) and bank rate-linked interest annuities. Furthermore, the rating continues to be underpinned by the strong credit quality of the underlying annuity receivables from NHAI (rated 'CARE AAA; Stable') and low leverage of the project. Various liquidity support mechanisms such as debt service reserve account (DSRA) and short-fall reserve for deficit in debt servicing along with sponsor undertaking to fund any deficiency in debt servicing lends additional credit strength. Furthermore, the tail period of 6.07 years for the current outstanding debt renders strong financial flexibility.

In May 2021, the bid project cost (BPC) of the project was reduced post descope of balance works for which hindrance-free land has not been provided by NHAI. CARE Ratings Limited (CARE Ratings) takes note of the subsequent discussions between the company and NHAI, wherein the descope portion have now been reinstated and a settlement agreement has been entered between NHAI and IDHHL in April 2023. As per the settlement agreement, IDHHL has to complete the rescope portion by October 2023. NHAI has also expressed in the agreement to provide the requisite escalation for the rescope works till October 2023. Post the completion of the rescope works the completion cost of the project shall be reassessed and the following annuities shall be provided at the revised completion costs.

Such rescoping, however, exposes the project to residual construction risk due to the cancellation in the unutilised term loan for the project of the project. The financial closure for the rescope works is underway with the lenders and the same is likely to be received in due course. Ircon International Limited (IRCON, 'CARE AAA; Stable/CARE A1+') as sponsor has extended an undertaking in favour of the lenders to meet any shortfall in the resources of IDHHL for completion of the project which mitigates the funding risk to an extent. Furthermore, the rated debt still has a corporate guarantee covering the tenure till the final COD is received from the authority. Additionally, the current tail period of 6.07 years shall also adequately allow the company to absorb the upcoming leverage.

The rating strengths are, however, partially offset by the inherent operations and maintenance (O&M) risk and interest rate fluctuation risk associated with the project. Furthermore, the absence of the stipulation of major maintenance reserve also heightens the O&M risk, maintenance of the short-fall reserve as stipulated by the lenders shall remain a key rating monitorable.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Change in debt structure leading to average debt service coverage ratio (DSCR) exceeding 1.15x on a sustained basis.

Negative factors

- Deterioration in the credit profile of sponsor (IRCON) or counter party (i.e. NHAI).
- Delay in completion of balance project stretch leading to levy of penalty by NHAI or reduced annuities leading to moderation in debt coverage indicators.
- Delay in sponsor support from IRCON.

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

Analytical approach:

Standalone while factoring sponsor's undertaking extended by Ircon International Limited.

Outlook: Stable

The Stable outlook assigned to the bank loan facilities of IDHHL considers the expectation of the timely receipt of annuities without any delays or deductions, presence of debt service reserve account (DSRA) and shortfall reserve, and the demonstrated track record of the sponsor in supporting the special purpose vehicles (SPVs).

Detailed description of the key rating drivers:**Key strengths****Sponsor undertaking**

IRCON, as sponsor, has extended an undertaking in favour of the lenders to meet any cost over-run and shortfall in the resource of the borrower, including shortfall in receiving construction grant from NHAI and to fund any shortfall in debt servicing, which is viewed as a credit positive.

Receipt of PCOD on partial length and five annuities

The project execution risk is significantly mitigated with IDHHL achieving PCOD on May 28, 2021, for 71.738 km of the project stretch out of total project length of 78.923 km. The company has also received first five annuity payments from NHAI.

Out of the total main carriageway length of 78.923 Km, 6.88 Km had been descoped along with service road to the extent of 45.705 Km out of total 154.656 Km. The BPC of the project was accordingly reduced in May 2021 post descoping of balance works for which hindrance-free land has not been provided by NHAI. The present annuities are being provided at the completion cost post descoping. However, as per the settlement agreement entered between IDHHL and NHAI, the annuities shall be revaluated at the increased completion cost post the rescoped works are completed and the differences in the past annuities will also be paid with the annuity falling due after the completion of rescoped works.

Cash flow visibility

As the project is operational, the project's 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 payments.

Comfortable debt coverage indicators

The project is being financed at a low debt-equity ratio of 2.18: 1. Post the receipt of PCOD and approval of descoping, the total debt availed till date stands at ₹362.97 crore against the completion cost of ₹1,055.47 crore for the operational section, which amounts to about 34% of the BPC. The project also has a tail period of about 6.07 years providing financial flexibility. The sanction terms also entail a reserve creation of ₹134.00 crore to be formed in the form of a fixed deposit receipt (FDR) or Financial Guarantee to offset any deficit in debt servicing, which is leading to comfortable debt coverage of the project. Out of the total stipulated reserve of ₹134.00 crore to be created by FY25, ₹67 crore of reserves have been created in the form of a bank guarantee from the sponsor- IRCON as per terms of sanction. Backed by the shortfall reserve, the debt coverage for the company is expected to be comfortable.

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.

Liquidity support mechanisms

As per the sanction terms, DSRA equivalent to one quarter of principal obligation and six months of interest in a fixed deposit has been created to cover any exigencies. Furthermore, the short-fall reserve of ₹134 crore to be created by FY25 (current creation ₹67 crore) also renders support to the debt servicing.

Key weaknesses

Residual construction risk amid pending financial closure for the rescoped works

While the settlement agreement entered between IDHHL and NHAI has rescoped the descoped works with escalation to be provided on the construction and provision for revision of annuities accordingly with approved extension of time till October 31, 2024. Such rescoping emanates residual construction risk for the company as completion of the rescoped works in the estimated cost and time parameters is crucial.

Furthermore, the financial closure for the rescoped works is underway with the lenders and is yet to be completed therefore the company is also exposed to funding risk. IRCON as the sponsor has extended an undertaking in favour of the lenders to meet any shortfall in the resources of IDHHL for completion of the project. The strong liquidity of IRCON and demonstrated track record of supporting its SPVs mitigates the funding risk to an extent. Additionally, the current tail period of 6.07 years shall also adequately allow the company to absorb the additional debt.

Inherent O&M risk associated with project

While the inflation-indexed O&M annuity partly mitigates the O&M risk, the disparate movement in inflation index (70% WPI; 30% CPI) and the O&M cost heads poses a risk. Besides, the company could face the risk of a sharp increase in the O&M cost in the event of wear and tear on the road is higher than the levels envisaged during bidding. However, IDHHL has entered into fixed-price item rate O&M contract for two years with IRCON, which mitigates O&M risk to an extent. Assumptions for O&M and major maintenance are relatively inferior and company has relatively higher repayment obligations in last five years of the loan tenor. Nevertheless, longer tail period and low leverage aids financial flexibility in the medium term.

Inherent interest rate risk

IDHHL is exposed to the inherent interest rate risk considering the floating rate of interest on its debt. Reimbursement of the interest cost in the form of interest annuity payable by NHAI biannually at 'bank rate-plus-3%' mitigates the risk to a limited extent, since there could be disparity between movements in bank rates and in lenders' benchmark rates.

Liquidity: Strong

IDHHL is envisaged to generate healthy cash flows backed by a steady revenue stream in the form of annuity payments throughout the tenor of the term loan. The SPV had free cash balances of ₹74.76 crore as on September 30, 2023, including DSRA of ₹26.40 crore covering six months of interest and one quarterly principal. The sponsor IRCON has also extended a BG of ₹67 crore, which pertains to the shortfall reserve as per stipulated sanctioned terms.

Assumptions/Covenants

Name of the Instrument	Detailed Explanation
A. Financial covenants	
I. DSRA	The company shall maintain fixed DSRA amount equivalent to six months of interest payment and one quarterly principal.
Ii. Additional reserve	The company shall submit either Fixed Deposit Receipt or financial guarantees for the deficit amount totalling to ₹134.00 crore (₹33.50 crore every year FY22 to FY25).
Iii. Debt equity ratio (DER)	The borrower shall maintain DER of 2.18x
B. Non-financial covenants	
I. Annual financial	The borrower shall submit annual financial on completion of audit or eight months from the end of financial year, whichever is earlier

Environment, social, and governance (ESG) risks

Not applicable

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](#)

About the company and industry

Industry classification

Macro Economic Indicator	Sector	Industry	Basic Industry
Services	Services	Transport Infrastructure	Road Assets–Toll, Annuity, Hybrid-Annuity

IDHHL, an SPV promoted by IRCON, has entered into 15-year concession agreement (CA; excluding construction period of 912 days from appointed date) with NHAI, for six-laning of Davanagere-Haveri section from Km 260.00 to Km 338.93 of NH-48 (Old NH-4) in the state of Karnataka under HAM. The BPC of the project was ₹1,177 crore. The project has achieved PCOD on May 28, 2021.

Brief Financials (₹ crore)	March 31, 2022 (A)	March 31, 2023 (A)	6MFY24 (UA)
Total operating income	7.98	19.75	26.03
PBILDT	-2.27	6.88	NA
PAT	5.87	26.37	12.51
Overall gearing (times)	1.94	1.67	1.53
Interest coverage (times)	NM	0.24	NA

A: Audited UA: Unaudited; NM: Not meaningful, NA: Not available Note: 'the above results are latest financial results available'

Status of non-cooperation with previous CRA:

Not applicable

Any other information:

Not applicable

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

Covenants of rated instrument / facility: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated: Annexure-4

Lender details: Annexure-5

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 - LT-Term loan		-	-	April 2030	312.73	CARE AA-; 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 2023-2024	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
1	Fund-based - LT-Term loan	LT	-	-	-	-	1)Withdrawn (20-Oct-21) 2)CARE AAA (CE); Stable (28-May-21)	1)Provisional CARE AAA (CE); Stable (06-Oct-20)
2	Unsupported rating-Unsupported rating (Long term)	LT	-	-	-	-	1)Withdrawn (20-Oct-21) 2)CARE A- (28-May-21)	1)CARE A- (06-Oct-20)
3	Fund-based - LT-Term loan	LT	312.73	CARE AA-; Stable	-	1)CARE AA-; Stable (04-Oct-22)	1)CARE AA- (CE); Stable (20-Oct-21)	-
4	Unsupported rating-Unsupported rating (Long term)	LT	-	-	-	1)Withdrawn (04-Oct-22)	1)CARE A (20-Oct-21)	-

LT: Long term

Annexure-3: Detailed explanation of covenants of the rated instruments/facilities- Covered above**Annexure-4: Complexity level of the various instruments rated**

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based - LT-Term loan	Simple

Annexure-5: Lender detailsTo view the lender wise details of bank facilities please [click here](#)

Note on the 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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