# *Journey of HAM - Credit story so far*

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### *Preface*

Over last few years the Indian road sector witnessed a series of government initiatives to tackle execution woes and revive investor confidence. However FY2019 (refers to the period April 1, 2018 to March 31, 2019) and FY2020 witnessed lower project award from National Highways Authority of India (NHAI, rated CARE AAA/Stable), while improved execution pace of roads salvaged the overall sector performance. As cited by CARE Ratings in its earlier reports, Public Private Partnership (PPP) investment including Hybrid Annuity Model (HAM) started losing its flavor; with Engineering Procurement and Construction (EPC) mode contributing lion's share in projects awarded during FY2020.

CARE Ratings in its previous commentary: 'Hybrid Annuity Model-Developing Cracks?' dated September 25, 2019, highlighted that the sector is facing:

- persistent challenges in de-scoping of unavailable land,
- difficulties in achieving financial closure of the HAM projects,
- lengthy process of issuing extension of time (EOT) by NHAI,
- expected increase in the working capital intensity of EPC contractors-cum-sponsors of the HAM projects, and
- non-linear transmission of bank rate over lending rate.

*In this write-up we present our findings gathered from study of NHAI HAM projects with aggregate Bid Project Cost (BPC) of approximately Rs.1,11,400 crore and aggregate length of 24,000 lane km (sample); these have 80% of ROW available. Total number of projects covered are ninety-eight and awarded between 2015-16 to 2018-19. Study also includes impact analysis on thirteen major sponsor-cum-EPC contractors executing these HAM projects.*

*Findings*

- ***Strong sponsors continue to deliver superior execution***

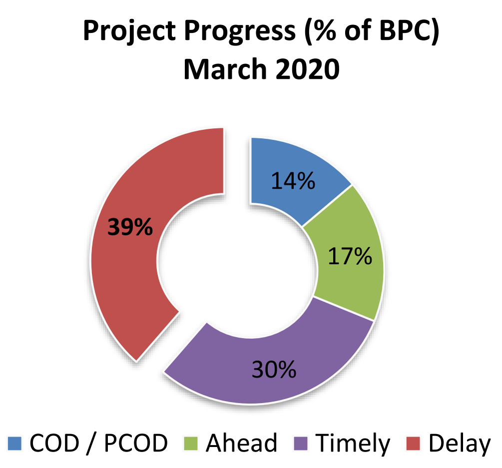
  Portfolio of NHAI HAM projects awarded to strong sponsors, have commenced operations within committed timelines. This is marked by achievement of provisional commercial operations date (PCOD) for one eighth of the sample till March 2020. Over and above these, 15% of the sample projects are expected to achieve PCOD after factoring extension of time for Covid-19 pandemic announced by NHAI.

  Sample comprises of sponsors of varying credit standing. Share of strong, moderate and weak sponsors is 64%, 26% and 10%, respectively, in the sample. Basis the sponsor strength, sample throws up following finding:

  a. all projects belonging to the weak sponsor are progressing with delays.
  b. three fourth of the portfolio belonging to the moderate sponsor are progressing with delays and
  c. Only twenty percent of the sample belonging to strong sponsor are progressing with delays.

- ***Execution bottlenecks affect larger project universe….***

  Execution woes have elevated with increase in number of projects progressing with delay beyond three months amounting to almost four tenth of the sample as on March 31, 2020 as against about one fourth as on March 31, 2019.



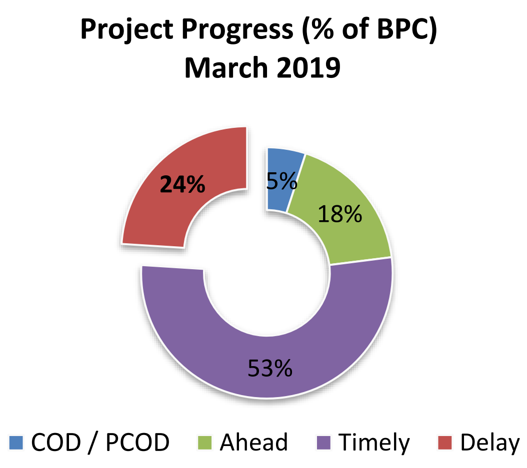




***Figure 1:*** *Project Progress- March 2020 Vs March 2019; Source-CARE Ratings*

Moderation in the credit profile of the sponsor, delay in de-scoping of the RoW, and deferral of term debt disbursement are the main reasons for execution challenges. It is also observed that co-efficient of correlation between moderation in credit profile of the sponsors and delay in project progress is strong at near unity.

Sixteen percent of the sample witnessed delay beyond scheduled project completion date (SPCD) especially due to delay in approval of extension of time or de-scoping of not available RoW. In case of delays attributable to the authority or due to force majeure event, the procedures for issuance of EOT are protracted. Similarly delays in granting EOT may translate in annuity deductions /lower annuities which in turn raise the reliance on the sponsor as loan repayments are linked to SPCD. CARE Ratings reiterates that absence of quick reassessment and approval of revised bid project cost post de-scoping continue to pose challenge for the sector as a whole. Consequently, withholding of the term debt disbursements by the lenders has impacted the progress of a few projects.

- ***…Credit Rating revisions follow***

  During FY2020 and Q1FY2021 CARE Ratings revised the credit ratings of seven HAM projects from ‘Single A’ category to ‘Triple B’ category due to reasons mentioned earlier.

- ***NHAI’s relief measures shall offer partial respite***

  In a bid to tackle major bottlenecks of poor enforcement of contractual terms of de-scoping, NHAI has recently issued standard operating process to ensure

  a) compulsory de-scoping of work pertaining to unavailable land immediately after lapse of twenty percent of construction period after the appointed date (i.e., around five to six months) as well as revision in BPC as per the reduced scope, and

  b) Issuance of provisional COD after completion of full work on the available land.

  CARE Ratings expects immediate benefit of reinforcement of this de-scoping modalities to the projects with aggregate BPC of around Rs.16,000 crore in FY2021 as they have already achieved seventy percent physical progress.

- ***Non-linear transmission of bank rate over lending rate emerging as a risk for operational HAM projects***

  During last two years, bank rate announced by Reserve Bank of India declined by around 250 bps, while benchmark lending rate of the Indian banks declined by 100 bps. Hence, variable nature of annuities with quantum of annuity linked to bank rate and delay in resetting the interest rate for project loans is an emerging risk for projects in the operational phase. Inflation indexed completion cost provides only partial cash flow cushion in case of adequate O&M assumptions and cost of project financed by lender is structured at BPC or lower. These projects shall have higher cash flow resilience even in the current situation of 4.25% bank rate and around 8.75% lending rate assumption in operational phase. Debt coverage indicators shall reduce significantly in case the project is structured at cost higher or equal to BPC along with aggressive O&M bidding translating into low cash flow resilience.

- ***Improved operating margins and easing out of increased working capital intensity for HAM sponsors after peaking out in FY2019***

  CARE Ratings observes that earnings before interest tax depreciation and amortization (EBITDA) margins expanded by around 100 bps in FY2019 over previous year and remained at healthy level of around eighteen percent during FY2020 for all the thirteen major sponsors cum EPC contractors considered in the sample. It is attributed to bidding prudence and efficient absorption of overheads due to execution of large-sized HAM projects. Nevertheless, working capital cycle of these developers increased by around thirty days during FY2019 due to

  i) preparatory site work during initial phase, pending receipt of the appointed date,

  ii) stricter pre-disbursement conditions by lenders, and

  iii) challenges in EOT or de-scoping leading to deferral in term debt disbursement.

  However, NHAI's initiative to provide working capital advances in lieu of grant upon achievement of intermittent milestone provided some relief to these developers and improved working capital cycle by around fifteen days for majority of developers in the sample. CARE Ratings expects further improvement in the working capital intensity of the road developers in FY2021 executing NHAI HAM projects due to implementation of mandatory de-scoping directive and shift towards monthly billing in place of milestone based billing for release of construction grant till Covid-19 intensity subsides.

- ***Capital structure continued to remain healthy*** marked by total outside liabilities/tangible net worth (TOL/TNW) of 1.01 times for all the thirteen road developers in the sample as on March 31, 2020. Healthy profitability and monetization of some of the operational assets of these road developers supported the capital structure despite substantial equity commitment towards HAM projects.

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