Patel KNR Heavy Infrastructures Ltd

October 16, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities - External Commercial Borrowing (ECB)	56.79 (reduced from 79.51)	**CARE AA+; Stable [Double A Plus; Outlook: Stable]**	**Reaffirmed and removed from INC**
Long Term Instruments - Non Convertible Debentures (NCD)	277.40 (reduced from 306.80)	**CARE AA+; Stable [Double A Plus; Outlook: Stable]**	**Reaffirmed and removed from INC**

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of rating assigned to the NCDs and ECB of Patel KNR Heavy Infrastructures Limited (PKHIL) continues to factor track record of timely receipt of annuity payments without deduction, receipt of final completion certificate, presence of structured payment mechanism for servicing NCDs and ECB by way of escrowing semi-annual annuity receivables from NHAI, presence of fixed price Operation and Maintenance (O&M) contract with contractor having strong credit profile, sponsor undertaking for infusion of funds for any shortfall in meeting Major Maintenance, strong liquidity position coupled with presence of Major Maintenance Reserve Account (MMRA) to meet estimated 2nd major maintenance and presence of Debt Service Reserve Account (DSRA) to meet 5 months of interest and one semi-annual principal installment, fixed interest rate and fully hedged ECB loan to mitigate fluctuation in foreign currency.

The rating also takes into account the favorable arbitral tribunal award and part realization from NHAI towards interest on arbitral claims and timely receipt of twentieth and twenty first semi-annuity payments without any deductions.

The rating is however constrained by delay in completion of 2nd Major Maintenance (MM) due to COVID-19 outbreak and incessant rainfall due to monsoon, however relief measures are extended by Ministry of Road Transport & Highway (MORTH) by way of extension of time to Contractor / Concessionaire, pending amendments in fixed Major Maintenance contract in line with revised MM estimates albeit reduced MM funding risk.

<u>Rating Sensitivities</u>

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

- Minimum Debt service coverage ratio (DSCR) should be more than 1.10 x for every year for the projected period (post factoring all the requisite provisions and excluding interest income) and completion of second MM with 40MM Bituminous Concrete (BC) thickness

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

- Delay in completion of second major maintenance beyond envisaged cost and timelines
- Non-receipt/delayed/reduced receipt of annuities
- Withdrawal of cash balance lying in escrow account

Detailed description of the key rating drivers

Key Rating Strengths

Strong financial risk profile of annuity provider i.e. NHAI: Incorporated by the Government of India under an act of Parliament, NHAI (rated 'CARE AAA' for bonds) functions as the nodal agency for development, maintenance and management of National Highways in the country. By virtue of being a quasi-government body and its strategic importance to GOI, the risk arising on account of NHAI defaulting on annuity payments is very low.

Timely receipt of annuity from NHAI: PKHIL is an annuity project and is not exposed to any traffic risk. The revenue source for PKHIL is the bi-annual annuity (i.e. due on March 1st and September 1st of every year) of Rs.44.37 crore receivable from NHAI up to March 1, 2028. PKHIL has a track record of timely receipt of annuity payments from NHAI and has received twentieth and twenty first semi-annual payments from the Concession Authority up to September 1, 2020. Further, as it is already an operational project since June 11, 2010 having final completion certificate in place negates the construction risk.

Favorable Arbitral Tribunal Award and part realization of award: The Company contested the deduction of Rs 15.20 Crore from the 16th annuity amount on account of delay in execution of first major maintenance cycle by the Authority in the Arbitral Tribunal. Arbitral Tribunal in its order dated November 7, 2019 has asked the Authority to refund Rs 14.72 Crore (post deduction of Rs 0.47 crore towards damages on account of concessionaire delay) along with interest at a rate of 15.45% from March 3, 2018 till the realization of the same. In addition to above, the Arbitral Tribunal in its order dated February 11,

[1] *Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

2019 has awarded a total of Rs 89.09 crore towards various claims submitted by the Concessionaire along with interest (SBI PLR +2%) till realization. In view of the above award, the company has received Rs 17.93 Crore from NHAI on August 28, 2019 towards interest on delay of annuity receipt. However, the arbitral award can be contested by NHAI in courts of law thereby the same has not been factored in the project cash flows.

Structured payment mechanism: PKHIL has opened and maintained an 'Escrow account' with the bank with the first priority assigned towards statutory payments if any, O&M expenses followed by debt servicing (interest and principal) of the ECB and NCDs and appropriation to Major Maintenance Reserve Account (MMRA) and other relevant expenses, in that order. A 'T+30' structure has been provided for NCD/ECB repayment with 'T' being the NHAI annuity receipt date to take care of any operational delay in receipt of annuity from NHAI.

Fixed interest rate & fully hedged foreign currency loan: The principal and interest payments to the NCD's and ECB are to be made on semi-annual basis. (i.e. due on September 30th and March 31st of every year). The interest rates on NCDs are fixed thereby eliminates interest rate risk. In order to mitigate the forex risk arising out of fluctuation in foreign currency towards the ECB loan, the company has purchased call options with lender for entire tenor of the ECB loan (i.e. up to September 2023) at a strike price of Rs 70 per USD. The hedging premium purchased for the call option is fixed for the entire tenor of the ECB loan and is paid as per the schedule at the end of each quarter up to Sep 2023. Irrespective of currency movement beyond Rs 70 per USD, there exists certainty in maximum cash outflow to the company on account of interest, principal and hedging premium payments for the entire tenor of the loan. Further, the company has purchased interest rate swap option for the balance tenor of the loan at 10.9% p.a (fixed), thereby mitigating the interest rate risk arising out of fluctuation in LIBOR.

Significant sponsor experience coupled with strong credit profiles: KNR Constructions Ltd (KNRCL) was set up in 1995 and provides Engineering, Procurement, and Construction (EPC) services across sectors such as roads and highways, irrigation, and urban water infrastructure management. On a total income of Rs.2,451.68 crore in FY20 (consolidated; refers to the period April 1 to March 31), KNRCL earned profit after tax (PAT) of Rs.255.94 crore (consolidated) compared with a PAT of Rs.264 crore on a total income of Rs.2,291.5 crore in FY19. Further, the company has a strong outstanding order book of Rs 5,229.7 crore as on March 31, 2020.
Incorporated in 1949, Patel Engineering Limited (PEL) has been engaged in the construction of dams, bridges, tunnels, roads, piling works, industrial structures and other kinds of heavy civil engineering works in areas like hydro, irrigation & water supply, urban infrastructure and transport. During FY19 on a standalone basis, PEL reported total income of and PAT of Rs. 2,555 crore ((Rs.2,210 crore in prev. yr.) and Rs.31 crore (Rs.59.08 crore prev. yr.). Further, the company has a strong outstanding order book of Rs 10,215 crore as on March 31, 2019

Key Rating Weaknesses
Absence of amendments in the fixed price contract for major maintenance on account of revised estimates: The incurred major maintenance expenditure in FY15-16 was more than the budgeted cost mainly due to the change in the specification (particularly thickness of overlay) and delay in undertaking the activities. The SPV has incurred higher major maintenance expenses than envisaged despite having a fixed price O&M contract with KNRCL, due to instructions from NHAI for overlaying the renewal coat on the road with 40mm Bituminous Concrete (BC) as against 30mm BC overlay as per the agreement.
The company has revised estimates for its 2nd and 3rd major maintenance cycle, which is 38% and 27% higher than the initial estimates of the respective maintenance cycles. Post revision in estimates of major maintenance expenditure, the company has not amended the fixed price contract entered with KNRCL for execution of major maintenance. However, the promoters have provided undertaking to cover the cash shortfall. Besides, non-performance of O&M contractor in carrying out Major Maintenance Activity (MMA) may translate into reduction in annuity receivables. Such shortfall in annuity will have a direct bearing on the envisaged debt servicing capability of PKHIL.

Impact of Covid-19 pandemic and MORTH Support: The receipt of annuity from NHAI is fixed and is not linked to the Toll revenue on the project road, the risk of non-payment of annuities for the FY2020-2021 is very low. During the FY20 and H1FY21, the company have received 3 annuities on due dates without deductions and had no impact of covid-19 on the performance of the company. Further, the company did not avail any moratorium as a relief provided by the RBI.
Ministry of Road Transport & Highway (MORTH) in its circular "Relief for Contractors/ Developers of Road Sector under Atmanirbhar Bharat" dated June 3, 2020 have given under Sl. No. (ii) Extension of Time to Contractor / Concessionaire for meeting their Obligations under the Contract for 3 months to 6 months depending on site conditions. In addition to the above, Government has decided to extend the relief measures notified in MORTH Letter No. COVID-19/Road Map/JS(H)/2020 dated 03/06/2020 for a further period of 3 months. Thereby the Concessionaire/ Contractor eligible for a total extension of up to 9 months.

Second major maintenance cycle EOT and presence of adequate funds in Major Maintenance Reserve: The second Major Maintenance (MM) cycle is envisaged to be undertaken during FY20 and FY21 at an estimated cost of Rs.38.75 crore (Rs.29.06 crore in FY20 & Rs.9.69 crore in FY21). The execution was delayed due to pending decision on thickness of Bituminous Concrete (BC) to be laid on Project Highway. IE communicated in its letter dated April 7, 2020, with regard to thickness of BC to be laid as 40MM. However, the activity could not be taken by the Concessionaire on account of strict lockdown due to Covid, which was extended by Telangana Government up to June 30, 2020. Meanwhile, the Company has taken all necessary approval during June 2020 and July 2020. In spite of having approvals in place, the Company was not in a position to take up the work due to onset of monsoon and incessant rainfall.
In view of the relief provided by MORTH in its circular "Relief for Contractors/ Developers of Road Sector under Atmanirbhar Bharat", the Company has request extension of time up to May 5 2021 to IE in its letter dated July 22, 2020. IE in the letter dated August 21, 2020 has recommended extension of time up to February 2, 2021 from October 1, 2020 to PD, NHAI. As on September 30, 2020, the company has adequate MMRA funds of Rs 39.66 Crore to complete the works. This apart, the company has liquid funds of Rs 17.38 crore to meet any exigencies. Considering, the Company has completed the first major maintenance cycle in 5 months 3 days the company is confident of achieving the same before March 31, 2021

Liquidity: Strong
Strong liquidity position of the company is characterized by presence of **liquid investments of Rs 93.46 Crore** towards DSRA of Rs 35 Crore, Debenture Redemption Reserve of Rs 3.65 Crore, Major Maintenance reserve of Rs.39.66 Crore and surplus funds of Rs 15.15 Crore to meet any exigencies. This apart, the company has free cash and bank balances Rs 3.32 Crore as on March 31, 2020. **As on September 30, 2020, the liquid investments stands at Rs 95.69 Crore and free cash and bank balances stands at Rs 3.32 Crore.**

Analytical Approach: Standalone

Applicable criteria:
Criteria on assigning 'Outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology-Infrastructure Sector
Financial Ratios - Non-Financial Sector
Liquidity analysis of Non-financial sector entities

About the Company
Patel KNR Heavy Infrastructures Limited (PKHIL/the company) is a Special Purpose Vehicle (SPV) incorporated in 2006 for design, construction, development, financing and operations of four laning of 48 km stretch in the Islamnagar – Kadthal section of National Highway 7 (connecting Hyderabad and Bangalore) from Km 230 to Km 278 in Adilabad district in the state of Telangana (Erstwhile Andhra Pradesh) under DBFOT (Annuity) basis. The company is jointly promoted by KNR Constructions Ltd with 40% (KNRCL), Patel Engineering Infrastructures Limited (PEIL) with equity share of 42%, a wholly-owned subsidiary of Patel Engineering Limited (PEL) and Fornido Developers Ltd (erstwhile Enpro Limited) with 18% of shareholding of the company.
The project got commissioned and PKHIL received Provisional Completion Certificate dated June 11, 2010. The scheduled project completion date for the project was March 01, 2010; the project cost was initially estimated at Rs.592 crore. However, the project got delayed on account of public agitation/bandhs and delay in handing over of land for construction, resulting in cost overrun to the tune of Rs.5.48 crore. The concession is for a period of 20 years, including a 24-month construction period and ending on March 1, 2028. PKHIL has received the final completion certificate on December 26, 2016.

Brief Financials (Rs. crore)	FY19(A)	FY20 (A)
Total operating income	67.21	81.31
PBILDT	46.80	59.38
PAT	(8.82)	9.42
Overall gearing (times)	6.06	4.40
Interest coverage (times)#	0.84	0.80

Audited; #-interest coverage ratio based on IND AS methodology works out to below unity, however based on cash flow analysis it is more than unity.
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 for this company: Annexure 4

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-External Commercial Borrowings		-	-	September 30, 2023	56.79	CARE AA+; Stable;
Debentures-Non Convertible Debentures	INE555J07013	September 03, 2013	10.04%	September 30,2025	110.55	CARE AA+; Stable;
	INE555J07161	September 03, 2013	10%	March 31,2021	4.45	
	INE555J07179	September 03, 2013	10%	September 30,2021	5.90	
	INE555J07187	September 03, 2013	10%	March 31,2022	5.90	
	INE555J07195	September 03, 2013	10%	September 30,2022	5.60	
	INE555J07203	September 03, 2013	10%	March 31, 2023	5.60	
	INE555J07211	September 03, 2013	10.35%	September 30,2023	11.00	
	INE555J07229	September 03, 2013	10.35%	March 31, 2024	11.00	
	INE555J07237	September 03, 2013	10.35%	September 30,2024	13.05	
	INE555J07245	September 03, 2013	10.35%	March 31, 2025	13.05	
	INE555J07252	September 03, 2013	10.35%	March 31, 2026	30.40	
	INE555J07260	September 03, 2013	10.35%	September 30,2026	30.45	
	INE555J07278	September 03, 2013	10.35%	March 31, 2027	30.45	

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Debentures-Non Convertible Debentures	LT	277.40	CARE AA+; Stable	1)CARE AA+; Stable; ISSUER NOT COOPERATING* (05-Oct-20)	1)CARE AA+; Stable (04-Oct-19)	1)CARE AA+ (SO); Stable (05-Oct-18) 2)CARE AA+ (SO); Stable (30-Aug-18)	1)CARE AA (SO); Stable (30-Mar-18)
2.	Fund-based - LT-External Commercial Borrowings	LT	56.79	CARE AA+; Stable	1)CARE AA+; Stable; ISSUER NOT COOPERATING* (05-Oct-20)	1)CARE AA+; Stable (04-Oct-19)	1)CARE AA+ (SO); Stable (05-Oct-18) 2)CARE AA+ (SO); Stable (30-Aug-18)	1)CARE AA (SO); Stable (30-Mar-18)

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

Annexure 4: Complexity level of various instruments rated for this Company

Sr. No.	Name of the Instrument	Complexity Level
1.	Debentures-Non Convertible Debentures	Simple
2.	Fund-based - LT-External Commercial Borrowings	Simple

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

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