Patel KNR Heavy Infrastructure Limited

March 30, 2018

Rating

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities - External Commercial Borrowing (ECB)	112.43 (reduced from 118.25)	**CARE AA (SO); Stable [Double A; Outlook: Stable (Structured Obligation)]**	**Revised from CARE AAA (SO); Stable [Triple A; Outlook: Stable (Structured Obligation)]**
Long Term Instruments - Non Convertible Debentures (NCD)	344.20 (enhanced from 359.00)	**CARE AA (SO); Stable [Double A; Outlook: Stable (Structured Obligation)]**	**Revised from CARE AAA (SO); Stable [Triple A; Outlook: Stable (Structured Obligation)]**

Details of instruments/facilities in Annexure-1

The rating assigned to the NCDs and ECBs of PKHIL were put under credit watch with developing implications on account of the proposed sale of the entire equity stake of PKHIL by Patel Engineering Limited (PEL) and KNR Constructions Limited (KNRCL) to Express Way Developer Limited, step-down subsidiary of Essel Infraprojects Limited (EIL).* ***However, as per discussion with management of PKHIL as well as EIL the deal has been called off and hence credit watch has been removed.*

Detailed Rationale

The rating assigned to the NCDs and ECBs of Patel KNR Heavy Infrastructures Limited (PKHIL) has been revised on account of large deduction (Rs.15.29 crore) in annuity by National Highways Authority of India (NHAI - rated 'CARE AAA' for its bonds) in March 2018 due to delay in completion of last major maintenance and expected sizable increase in major maintenance expense going forward which have resulted in lower Debt Service Coverage Ratio (DSCR) for projected years vis-à-vis than what was earlier envisaged. As per Operation & Maintenance (O&M) support undertaking performance deduction will have to be reimbursed by the sponsors i.e. Patel Engineering Ltd and KNR Constructions Ltd. The sponsors have infused Rs.15.20 crore in the SPV post the annuity deduction. **Non-reimbursement of any committed undertaking by the sponsors is a key rating monitorable.**

The rating continues to positively factor in structured payment mechanism for servicing the NCDs and ECBs, in the form of escrow of semi-annual annuity receivables from NHAI, timely receipt of annuity payments, creation of Major Maintenance Reserve Account (MMRA) and Debt Service Reserve Account (DSRA), understanding that the sponsors will not withdraw any free cash available in the project and fixed price Operation and Maintenance (O&M) contract. The rating also takes into accounts good condition of the road reflected by a lower roughness index vis-à-vis the requirement, completion of the first major maintenance cycle, fixed interest rate and fully hedged foreign exchange risk.

Furthermore, any deterioration in the credit profile of the promoters or inability of the promoters to support the SPV in timely manner including non-reimbursement of performance deduction, delay in completion of major maintenance work in future, thereby resulting in any deduction in annuities impacting the liquidity, deterioration in the credit profile of the annuity provider-NHAI and occurrence of any force majeure event are the key rating sensitivities.

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

The revenue source for PKHIL is the bi-annual annuity of Rs.44.37 crore receivable from NHAI till FY28. PKHIL has a track record of timely receipt of annuity payments from NHAI and has received sixteen semi-annual payments from the Concession Authority till March 2018. PKHIL is an annuity project and is not exposed to any traffic risk. Further, as it is already operational project for more than 7yrs, no construction risk exists. A 'T+30' structure has been provided for NCD repayment with 'T' being the NHAI annuity receipt date to take care of any operational delay in receipt of annuity from NHAI.

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

Structure payment mechanism along with maintenance of MMRA and DSRA
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. PKHIL has created a fund-based DSRA of Rs.35 crore to address any cash-flow mismatch for payment to O&M contractor and/or debt servicing, invested in approved securities yielding at least 6% annually. The post-tax returns on the DSRA of Rs.35 crore shall always be retained in the escrow account till the maturity of the NCDs. As on December 31, 2017 PKIL had a cash/bank and cash equivalents of Rs.66.90 crore, which comprised DSRA of Rs.35.00 crore, MMRA of Rs.30.00 crore, free cash and bank balance of Rs.1.90 crore.
Fixed interest rate & hedged foreign currency risk
The repayment and the interest payments to the NCD's are to be made on semi-annual basis and are fixed which eliminates the interest rate risk, providing comfort from the credit perspective. The above repayments are slated to be made with a gap of 30 days from the receipt of annuity. Also PKHIL has hedged foreign currency and interest rate risk towards entire External Commercial Borrowings.

Key Rating Weaknesses
Reduction in annuity due to delay in completion of last Major Maintenance
PKHIL has received its 16th annuity in March 2018 from NHAI with a large deduction (Rs.15.29 crore) due to delay in completion of last Major Maintenance. As per Operation & Maintenance (O&M) support undertaking performance deduction will have to be reimbursed by the sponsors i.e. Patel Engineering Ltd and KNR Constructions Ltd. *The sponsors have infused Rs.15.20 crore in the SPV post the annuity deduction.*
Increase in O&M expense during the last Major Maintenance despite fixed price contracts
The actual Major Maintenance Cost has increased in FY15-16 more than the budgeted cost mainly due the increase in the specification (particularly thickness of overlay) and delay in undertaking the activities. The SPV has incurred higher major maintenance expenses than envisaged despite 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 road has been in a good condition and the roughness index at present is well within the stipulated limit of less than 2000 mm/km. Besides, non-performance of O&M contractor in carrying out routine and 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.

Analytical approach:
CARE has analyzed PKHIL's credit profile by considering the structured payment mechanism [biannual annuity is received from the NHAI in an escrow account for servicing of the ECB and NCD and adequate built-in liquidity cushions with favourable credit protection mechanisms.

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for placing on credit watch
Rating Methodology: Factoring Linkages in Ratings
Rating Methodology - Infrastructure Sector Ratings
Financial ratios - Non-Financial Sector

About the Company
Incorporated in 2006, Patel KNR Heavy Infrastructures Limited (PKHIL) is a Special Purpose Vehicle (SPV) floated by Patel Engineering Infrastructure Private Limited (PEIPL) (having stake of 60% in the equity share capital), which is wholly-owned subsidiary of PEL and KNRCL (having stake of 40%). During FY17, 18% stake of Enpro Industries Private Limited (EIPL) was taken over by PEL. The SPV was awarded the contract to undertake design, construction, development, financing and operations of the 48-km stretch in the Islamnagar-Kadthal section of National Highway 7 (connecting Hyderabad and Bangalore) from Km 230 to Km 278 in the Adilabad district, in Andhra Pradesh on a Build, Operate and Transfer (BOT) Annuity basis (semi-annual payment of Rs.44.37 crore until March 2028).
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 Commercial Operation Date (COD) certificate on December 26, 2016.
During 9MFY17, PEL and KNRCL signed definitive agreements for sale of 100% stake in PKIL and Patel KNR Heavy Infrastructures Ltd. (PKHIL), another SPV of the same promoters, to Express Way Developer Ltd. (Step down subsidiary of

Essel Highways Ltd. which in turn is a step down subsidiary of Essel Infraprojects Ltd. (EIL, rated CARE BBB+/A3+ in January 2017)). ***However, as per discussion with management of PKHIL as well as EIL the deal has been called off.***

Brief Financials (Rs. crore)	FY16 (A)	FY17 (A)
Total operating income	73.88	96.01
PBILDT	61.03	66.38
PAT	4.59	10.30
Overall gearing (times)	9.26	7.25
Interest coverage (times)	0.98	1.06

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

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

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About CARE Ratings:
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Annexure-1: Details of Instruments/Facilities

Name of the Instrument	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	-	-	-	95.63	CARE AA (SO); Stable
Debentures-Non Convertible Debentures	-	-	-	331.05	CARE AA (SO); Stable

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 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Fund-based - LT-Term Loan	LT	-	-	-	-	-	1)Withdrawn (10-Apr-14)
2.	Debentures-Non Convertible Debentures	LT	331.05	CARE AA (SO); Stable	-	1)CARE AAA (SO) (Under Credit watch with Developing Implications) (02-Mar-17)	1)CARE AAA (SO) (25-Jan-16)	1)CARE AAA (SO) (04-Feb-15) 2)CARE AAA (SO) (10-Apr-14)
3.	Fund-based - LT-External Commercial Borrowings	LT	95.63	CARE AA (SO); Stable	-	1)CARE AAA (SO) (Under Credit watch with Developing Implications) (02-Mar-17)	1)CARE AAA (SO) (25-Jan-16)	1)CARE AAA (SO) (04-Feb-15) 2)CARE AAA (SO) (10-Apr-14)

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