

North Karnataka Expressway Limited

January 30, 2019

Rating

Instrument	Amount (Rs)	Rating ¹	Rating Action
Non-Convertible Debentures (NCDs)@	28.90 (reduced from 44.5)	CARE BB (SO); (CARE Double B [Structured Obligation] [Credit Watch with Negative Implications]	Revised From CARE AA+(SO); (Double A Plus [Structured Obligation] [Credit Watch with Negative Implications]
Total	28.90 (Rs. Twenty Eight Crore Ninety Lakhs Only)		

Details of instruments/facilities in Annexure-1

@based on the various credit enhancement measures and structured payment mechanism for the NCD's repayment.

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the Non-Convertible Debentures (NCDs) of North Karnataka Expressway Limited is on account of recent management actions in one of the group SPVs, Jharkhand Road Projects Implementation Company Limited (JRPICL, rated: CARE D) wherein they delayed servicing its debt obligation. The company did not make payment despite adequate liquidity available. While JRPICL is part of bankruptcy remote special purpose vehicle which had a ring-fenced structure payment mechanism, management cited the interim order passed by National Company Law Appellate Tribunal (NCLAT) on October 15, 2018 for not making payment and requesting a reversal of the payment made earlier on October 20, 2018. CARE vide its communication dated Jan 19th 2019, had highlighted the increased risk of default in the upcoming debt repayment as a result of impinging the integrity of ring fenced structured payment mechanism despite the existence of a trustee monitored structured payment mechanism.

The rating takes note of the timely debt repayment which was due on January 15, 2019. Despite this, a similar action if undertaken by any of the other group companies including North Karnataka Expressway Limited (NREL), now cannot be ruled out and hence the rating action.

The rating assigned to the non-convertible debentures of North Karnataka Expressway Limited continues to remain on 'Credit Watch with Negative Implications' which is based on:

- Based on uncertainty that the NREL's management could possibly cease and desist upcoming further repayments citing the NCLAT order as done in JRPICL.
- Due to increased Operations & Maintenance (O&M) risks based on the weakening of the credit profile of the sponsor & contractor, i.e. IL&FS Transportation Networks Limited (ITNL, rated: CARE D).

CARE will resolve the CreditWatch, once it receives clarification and update on these matters.

On the other hand, the rating continues to factor in strong credit profile of the sole counter party- National Highway Authority of India (NHAI, rated CARE AAA; Stable), long and satisfactory track record of the project stretch resulting in sustained receipt of annuities without any performance related deductions. However, the company's willingness to make the repayments will remain a key rating sensitivity.

Detailed description of the key rating drivers

Key Rating Weaknesses

Impinging the ring-fenced structured payment mechanism by group SPV, JRPICL

The group's action of not making payment despite adequate availability of funds in case of JRPICL by citing the NCLAT order, leads to tantamount to impinging of the ring-fenced structure. The change in management's stance to protect the integrity of the stipulated waterfall mechanism has led to increased risk of servicing debt obligations in timely manner

Increased O&M and Periodic Maintenance risk: NREL has signed a fixed-price O&M contract with ITNL till the end of concession period. Moreover, the weak credit profile of sponsor and O&M contractor-ITNL restricts its ability to ensure and support the operations and maintenance contract as and when required. The fixed escalation of 6% year on year also makes the operating expenses predictable in nature. Major maintenance fixed-price contract for the road stretch has been signed with ITNL. Next major maintenance cycle is due in FY20. However given limited liquidity cushion after partial withdrawal of reserves, adequacy of cash flow from operation is essential to cover O&M and maintenance expenses. NREL also had proposed a short term credit line from the existing lender, in case of short-term timing mismatches between the expenses and inflows.

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

Materialisation of Contingent Liabilities: NKEL has reported a contingent liability of Rs.105.15 Crore in FY18. (Rs.11.02 Crore- FY17). The increase in liability is on account of tax disputes with the Karnataka government under the Karnataka Vat Act, 2003 amounting to Rs 91.97 crore. Contingent liability of Rs. 13.17 Crore is on account of dispute with the Income Tax Department. Based on the legal opinion and the supporting documents provided by NKEL, on which CARE has taken an independent legal opinion, NKEL is not expected to be liable to pay the liability relating to tax disputes with the Karnataka government, however materialisation of any such contingent claim remains a key rating sensitivity.

Key Rating Strengths

Strong credit profile of the sole counter party: NKEL annuity payments are backed by the strong credit risk profile of the sole customer– National Highway Authority of India (NHAI, rated ‘CARE AAA; Stable’). The project is operational since July 2004, and with the satisfactory track record of operations of the road. As on December 2018, NKEL has received 28 semi-annual annuity instalments of Rs.50.51 crore from NHAI without any deductions. During FY19 (refers to the period April 1 to March 31), NKEL has received semi-annual annuity on due dates i.e. on June 20, 2018 and December 20, 2018. Any adverse change in the credit profile of the counterparty is a key rating sensitivity.

Analytical approach:

Standalone considering various credit enhancement measures and structured payment mechanism for the NCD’s repayment.

Liquidity Analysis:

NKEL has liquidity in the form of DSRA reserves amounting to Rs. 63.54 Crore as on December 31, 2018. Repayment due on January 15, 2019 amounting to Rs. 31.85 was serviced in a timely manner. The next annuity receipt of Rs .50.51 crore is due on June 20, 2019. The next repayment of Rs. 31.56 crore is due on July 15, 2019. Although the company has adequate liquidity, however any steps taken by management to restrict the payments or reduction in annuities because of recent management actions and O&M performance will remain key rating sensitivities.

Applicable Criteria

[Criteria on assigning Outlook to Credit Ratings](#)

[CARE’s Policy on Default Recognition](#)

[Rating Methodology: Factoring Linkages in Ratings](#)

[Financial ratios – Non-Financial Sector](#)

[Criteria on Infrastructure sector](#)

About the Company

North Karnataka Expressway Limited (NKEL) is a Special Purpose Vehicle (SPV) incorporated in October 2001 to undertake the design, construction, development, finance, operation and maintenance of 77-km Belgaum Maharashtra Border on National Highway (NH-4) in Karnataka. NKEL is promoted by a consortium of ITNL Road Investment Trust (IRIT holds 74% stake), Infrastructure Leasing & Financial Services Limited (IL&FS, rated ‘CARE D;’, holds 6.50% stake), Punj Lloyd Limited (PLL-6.50% stake) and IL&FS Transportation Networks Limited (ITNL, rated ‘CARE D’, holds 13% stake).

The project involved strengthening and widening of the existing two-lane highway, and construction of two additional lanes with a dual carriageway, on a Build-Operate-Transfer (BOT-Annuity) basis.

NKEL had signed a 17.5-year concession agreement, including 2.5 years of construction period. The project became operational in July 2004, six months in advance of the scheduled project commencement date. NKEL refinanced the bank loans through Zero Coupon NCDs with fixed yield maturity of 9% p.a. in December 2010. NKEL has successfully operated and maintained the road so far as per the terms laid out in concession agreement and received 27 semi-annual annuities without any deductions in timely manner.

Brief Financials (Rs. crore)	FY17 (A)	FY18 (A)
Total operating income	47.52	38.59
PBILDIT	32.78	21.89
PAT	12.02	5.58
Overall gearing (times)	1.20	0.96
Interest coverage (times)	1.79	1.61

A: Audited

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:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

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
Debentures-Non Convertible Debentures	December 09, 2010	0	01/15/2020	28.90	CARE BB (SO) (Under Credit watch with Negative Implications)

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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Debentures-Non Convertible Debentures	LT	28.90	CARE BB (SO) (Under Credit watch with Negative Implications)	1)CARE AA+ (SO) (Under Credit watch with Negative Implications) (18-Jan-19) 2)CARE AA+ (SO); Negative (04-Sep-18)	1)CARE AAA (SO); Stable (30-Jun-17) 2)CARE AAA (SO); Stable (09-Jun-17)	1)CARE AAA (SO) (12-Jul-16)	1)CARE AAA (SO) (16-Jun-15)

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