

# Ratings



## Rating Rationale

January 18, 2019 | Mumbai

### North Karnataka Expressway Limited

Rating downgraded to 'CRISIL A+(SO)'; continues on 'Watch Negative'

#### Rating Action

Rs.28.9 Crore Non Convertible Debentures <sup>1</sup>	CRISIL A+(SO) (Downgraded from 'CRISIL AA+(SO)'; Continues on 'Rating Watch with Negative Implications')
Rs.32.2 Crore Non Convertible Debentures <sup>1</sup>	CRISIL AA+(SO)/Watch Negative (Withdrawn)

<sup>1</sup> crore = 10 million

Refer to annexure for Details of Instruments & Bank Facilities

<sup>1</sup> Refers to the issue value of the zero coupon bonds yet to be redeemed

#### Detailed Rationale

CRISIL has downgraded its rating on the non-convertible debentures (NCDs) of North Karnataka Expressway Ltd (NKEL) to '**CRISIL A+(SO)**' from '**CRISIL AA+(SO)**'. The rating remains on '**Rating Watch with Negative Implications**'.

CRISIL has also **withdrawn** its rating (*details in Annexure 1*) on NCDs that were redeemed, after obtaining independent confirmation from the trustee.

NKEL is a subsidiary of IL&FS Trust Company Ltd - ITNL Road Investment Trust and part of Infrastructure Leasing and Financial Services Ltd (IL&FS) group.

The rating action follows a reversal of the management's earlier stance of maintaining the integrity of ringfenced structure and structured payment waterfall in some of its special purpose vehicles (SPVs), including Jharkhand Road Projects Implementation Co Ltd (JRPICL; 'CRISIL BB(SO)/Watch with Negative Implications'), by invoking the National Company Law Appellate Tribunal's (NCLAT) interim stay order. Since the order covers all SPVs in the group including NKEL, this development has spawned untested legal risks for other bankruptcy-remote SPVs in the group as well. Consequently, uncertainties regarding future debt servicing by NKEL has increased sharply.

NKEL is an SPV where annuities are received in a ringfenced, trustee-controlled escrow account. This and the waterfall mechanism protects its cash flows from stress at the sponsor company. Further, a Debt Service Reserve Account (DSRA) is also created in NKEL to ensure timely debt servicing in case of any procedural delay in annuities or any other contingencies. Together, these structural features ensure high certainty of timely debt servicing.

NKEL has a strong track record of smooth operations and receives its annuities in a timely manner. As a result, it can comfortably service NCDs from its own cash flows with the additional comfort of a DSRA equivalent to one semi-annual debt service. As on December 31, 2018, NKEL had Rs 44 crore liquidity available for debt servicing (~1.4 times the semi-annual debt servicing of Rs 31 crore due in January 2019).

CRISIL had, through its Credit Bulletin on JRPICL and NKEL on January 15, 2019, informed about the likely impact of the management's action to withhold debt servicing in JRPICL by invoking Clause 6 of NCLAT's order dated October 15, 2018, on specific lender actions. The management had, on January 4, 2019, written a letter to IDBI Trusteeship Services Ltd, the trustee of its NCDs, to stop further debits from the company's escrow account to service debt obligations.

CRISIL notes that management's action is contrary to its earlier stance (*please refer to CRISIL's Rating Release on NKEL dated November 5, 2018*) that the proposed resolution plan of the IL&FS group will not compromise on JRPICL's ringfenced structure, structured payment waterfall, or debt servicing. This also indicates management's lack of willingness to service debt in a timely manner.

Further, JRPICL and NKEL are recognised as separate legal entities under the Companies Act, 2013, distinct from its parent and shareholders. The invocation of NCLAT's order by JRPICL challenges the legal standing of ringfenced nature and bankruptcy-remoteness of the SPV and its validity will be tested in a court of law. At the same time, this has led to the emergence of legal risk for the ringfenced transactions in bankruptcy-remote entities such as NKEL as well. Though NKEL has not invoked the NCLAT order to restrict debt servicing so far, this cannot be ruled out in future as NKEL is also covered under the NCLAT order. At present, NKEL is fully capable of servicing its debt from its own resources and the most recent debt repayment due on January 15, 2019, was serviced on time. Incidentally, NKEL has not availed of any subordinated debt from its sponsors.

However, due to the emerging legal risk and the group's lack of willingness to service debt in timely manner, NKEL is also witnessing increased risk of irregular debt servicing.

At present, the matter is sub-judice and the next hearing in NCLAT is scheduled on January 28, 2019. CRISIL will monitor the proceedings very closely and take appropriate rating action based on the outcomes at NCLAT.

CRISIL has kept the rating on 'Watch Negative' due to uncertainty over:

- trustee actions towards making the payment
- NCLAT's final view on debt sustenance of self-sufficient ringfenced projects of IL&FS in the debt resolution plan of the group
- any steps that the parent may take to rationalise the reserve or alter terms of the transaction that enable them to tap into the surplus cash at NKEL

CRISIL will keep a close watch on the developments and resolve the watch once clarity emerges on these aspects. Adverse developments on aforesaid events may result in a potential breach of the ringfenced payment waterfall mechanism which could precipitate a default on the NCDs issued by the SPVs.

CRISIL continues to closely monitor developments for any potential impact on NKEL. While operations and maintenance (O&M) work is being undertaken by IL&FS Transportation Networks Ltd (ITNL), NKEL should be able to build up sufficient MMR to undertake the remaining maintenance activities.

The rating continues to reflect the benefits that NKEL derives from the annuity nature of its ongoing build-operate-transfer project, healthy

operational track record, and adequate DSRA and major maintenance reserve account (MMR). These strengths are partially offset by increased legal risks, exposure to risk relating to O&M, and uncertainties regarding the management's intent to timely service NKEL's debt.

### Analytical Approach

The structured obligation (SO) suffix to the rating on NKEL's debt instruments reflects the escrow mechanism through which annuity payments are routed.

### Key Rating Drivers & Detailed Description

#### Strengths

##### \* Strong counterparty providing annuities

The rating factors in the strong credit quality of NKEL's sole counterparty, the National Highways Authority of India (NHAI; rated CRISIL AAA/Stable), and the annuity nature of NKEL's ongoing build-operate-transfer project that ensure steady revenue visibility. As per the concession agreement, the NHAI has provided a letter of comfort to NKEL that can be invoked if the annuity is not received on time or in full.

##### \* Robust transaction structure, with a well-defined payment mechanism

The rating also factors in NKEL's adequate DSRA and debt service coverage ratio, the payment mechanism, and the legal structure of the transaction. As per the structure, the annuity from NHAI, which will be received semi-annually, will first be used by NKEL for debt servicing, necessary reserves, and expenses. Any excess cash thereafter will be used for other payouts.

Despite the robust payment waterfall mechanism, the recent letter sent by JRPICL to the trustee and investors (dated January 4, 2019) underscores the lack of management intent to protect the integrity of the ringfenced payment structure and ensure timely debt servicing to NCD holder from project cash flows. Any similar event for NKEL would be a key rating monitorable.

##### \* Good quality of the road, though timely and full receipt of remaining annuities is crucial

The quality of the road is good with recent tests (such as bump integrator and character deflection) exceeding benchmarks. However, the reduction in reserve means that timely and full receipt of the annuities is crucial to meet operating expenses, including major maintenance expenses, and avoid dipping into the DSRA. NKEL has tied up a bridge facility of Rs 10 crore with the lender to avoid cash flow mismatches and start incurring the major maintenance expense before receipt of the final annuity.

#### Weakness

##### \* Increased legal risks

As per the letter sent by JRPICL to their trustees, the company considers that the NCLAT stay order encompasses normal debt servicing as well. Although in the trustee's view, the stay is only against lender action (unauthorised set-offs etc.), there is now heightened legal risk linked to the final interpretation of this, which could impact NKEL as well. Additionally, there is a risk that the NCLAT may not ensure the integrity of the SPV's ringfenced structure, given the ongoing resolution at the IL&FS group.

##### \* Exposure to O&M and major maintenance risk

NKEL appointed ITNL as its O&M and major maintenance contractor with a fixed-price contract. Although the maintenance is being carried out by a related party, the presence of adequate maintenance reserves (though lower than before) and the execution track record of ITNL mitigate risks. Nevertheless, weakening financial position of the sponsor and ability to continue to adequately perform O&M and major maintenance will be the key monitorables.

#### Liquidity

As on January 16, 2019, NKEL had surplus cash and DSRA of Rs 44 crore, after servicing Rs 31.8 crore debt on January 15, 2019. Additionally, the company is maintaining an MMR of Rs 21 crore. The company is likely to have cash accrual of Rs 67 crore in fiscal 2020 (excluding MMR provisioning of Rs 19 crore) against debt obligation of Rs 64 crore. NKEL also has a liquidity line of Rs 10 crore available.

#### About NKEL

NKEL is an SPV promoted by IL&FS, ITNL, and Punj Lloyd Ltd to design, develop, construct, operate, and maintain a 77 km stretch of the Belgaum-Maharashtra border road on National Highway 4. The project involved strengthening and widening of the existing two-lane highway, and constructing two additional lanes with dual carriageway, on an annuity basis.

NHAI has signed a 17.5-year concession agreement, including 2.5 years' construction period (thus, effective operating period for the concession is 15 years) with NKEL. NKEL is the concessionaire for implementation and O&M of the project. The project became operational in July 2004, and NKEL has operated and maintained the road so far. The company has been receiving semi-annual annuity payments of Rs 50.51 crore as per the agreement schedule from NHAI.

NKEL had reported standalone revenue of Rs 31 crore and profit after tax of Rs 9 crore for fiscal 2018 against Rs 37 crore and Rs 12 crore, respectively, for the previous fiscal, based on the restated financial statement under the Indian Accounting Standards (Ind AS). In the restated financials as per Ind AS, receipt of annuity from the concession granting authority is apportioned as finance income, O&M income, major maintenance and repair income, and allocation towards recovery of the receivables from the concession granting authority (receivables under service concession arrangements) based on annual effective rate/internal rate of return.

#### About ITNL

ITNL was incorporated in 2000, by IL&FS to consolidate its road infrastructure projects and to pursue new projects in the area of surface transportation infrastructure through the public-private-partnership model. ITNL is primarily engaged in development, operations, and maintenance of national and state highways. The company has diversified into other transportation segments such as mass rapid transport system, urban transportation infra system, car parking, and border check-post.

ITNL's credit risk profile deteriorated due to elevated debt. ITNL and many of its SPVs reported defaults over the past 6-9 months.

#### About IL&FS

IL&FS is one of India's leading infrastructure development and finance companies. IL&FS was promoted by the Central Bank of India ('CRISIL A+/CRISIL A/Stable'), Housing Development Finance Corporation Ltd ('CRISIL AAA/FAAA/ Stable /CRISIL A1+') and Unit Trust of India. Over the years, IL&FS has broad-based its shareholding and inducted Institutional shareholders including State Bank of India ('CRISIL AAA/CRISIL AA+/FAAA/Stable/CRISIL A1+'), Life Insurance Corporation of India, ORIX Corporation - Japan and Abu Dhabi Investment Authority.

IL&FS and its group companies (including ITNL) are going through severe financial stress. IL&FS has been defaulting on some of its outstanding debt since August 2018. In the wake of continued financial stress at both the sponsor, ITNL, and the ultimate parent IL&FS, the Government of India had, on October 1, 2018, replaced the board of directors at IL&FS. The move was an effort to turn around the group and restore the confidence of financial markets after the spate of recent defaults by IL&FS and its group companies.

#### Key Financial Indicators\*

Particulars	Unit	2018	2017
Revenue	Rs crore	31	37
Profit after tax	Rs crore	9	12

<b>PAT margin</b>	<b>%</b>	<b>30.7</b>	<b>32.1</b>
<b>Adjusted debt/adjusted network</b>	<b>Times</b>	<b>0.96</b>	<b>1.20</b>
<b>Interest coverage</b>	<b>Times</b>	<b>1.02</b>	<b>1.24</b>

\*reported financials as per IndAS

**Any other information:** Not applicable

**Note on complexity levels of the rated instrument:**

CRISIL complexity levels are assigned to various types of financial instruments. The CRISIL complexity levels are available on [www.crisil.com/complexity-levels](http://www.crisil.com/complexity-levels). Users are advised to refer to the CRISIL complexity levels for instruments that they consider for investment. Users may also call the Customer Service Helpdesk with queries on specific instruments.

**Annexure - Details of Instrument(s)**

ISIN	Name of the instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs cr)	Rating assigned with outlook
INE898G07187	Debentures <sup>^</sup>	09-Dec-10	9%	15-Jul-19	14.8	CRISIL A+(SO)/Watch Negative
INE898G07195	Debentures <sup>^</sup>	09-Dec-10	9%	15-Jan-20	14.1	CRISIL A+(SO)/Watch Negative
INE898G07161	Debentures*	09-Dec-10	9%	16-Jul-18	16.6	Withdrawn
INE898G07179	Debentures*	09-Dec-10	9%	15-Jan-19	15.6	Withdrawn

\*Refers to the issue value of the zero coupon bonds

<sup>^</sup>Refers to the issue value of the zero coupon bonds yet to be redeemed

**Annexure - Rating History for last 3 Years**

Instrument	Type	Current		2019 (History)		2018		2017		2016		Start of 2016
		Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Non Convertible Debentures	LT	28.90 18-01-19	CRISIL A+(SO)/(Watch Negative)	15-01-19	CRISIL AA+(SO)/Watch Negative	05-11-18	CRISIL AA+(SO)/Watch Negative	07-06-17	CRISIL AAA(SO)/Stable	15-12-16	CRISIL AAA(SO)/Stable	CRISIL AAA(SO)/Stable
						15-10-18	CRISIL AA+(SO)/Negative					
						03-09-18	CRISIL AA+(SO)/Negative					
						30-07-18	CRISIL AAA(SO)/Stable					
						30-06-18	CRISIL AAA(SO)/Stable					

All amounts are in Rs.Cr.

**Links to related criteria**

[CRISILs Approach to Financial Ratios](#)

[The Infrastructure Sector Its Unique Rating Drivers](#)

[Rating Criteria for Toll Road Projects](#)

[Understanding CRISILs Ratings and Rating Scales](#)

**For further information contact:**

Media Relations	Analytical Contacts	Customer Service Helpdesk
<p><b>Saman Khan</b> Media Relations <b>CRISIL Limited</b> D: +91 22 3342 3895 B: +91 22 3342 3000 <a href="mailto:saman.khan@crisil.com">saman.khan@crisil.com</a></p> <p><b>Naireen Ahmed</b> Media Relations <b>CRISIL Limited</b> D: +91 22 3342 1818 B: +91 22 3342 3000 <a href="mailto:naireen.ahmed@crisil.com">naireen.ahmed@crisil.com</a></p> <p><b>Vinay Rajani</b> Media Relations <b>CRISIL Limited</b> D: +91 22 3342 1835 M: +91 91 676 42913 B: +91 22 3342 3000 <a href="mailto:vinay.rajani@ext-crisil.com">vinay.rajani@ext-crisil.com</a></p>	<p><b>Subodh Kumar Rai</b> Senior Director - CRISIL Ratings <b>CRISIL Limited</b> D:+91 124 672 2000 <a href="mailto:subodh.raai@crisil.com">subodh.raai@crisil.com</a></p> <p><b>Manish Kumar Gupta</b> Director - CRISIL Ratings <b>CRISIL Limited</b> D:+91 124 672 2000 <a href="mailto:manish.gupta@crisil.com">manish.gupta@crisil.com</a></p> <p><b>Priyanka Daga</b> Rating Analyst - CRISIL Ratings <b>CRISIL Limited</b> D:+91 22 3342 8462 <a href="mailto:priyanka.daga@crisil.com">priyanka.daga@crisil.com</a></p>	<p>Timings: 10.00 am to 7.00 pm Toll free Number:1800 267 1301</p> <p>For a copy of Rationales / Rating Reports: <a href="mailto:CRISILratingdesk@crisil.com">CRISILratingdesk@crisil.com</a></p> <p>For Analytical queries: <a href="mailto:ratingsinvestordesk@crisil.com">ratingsinvestordesk@crisil.com</a></p>

**Note for Media:**

This rating rationale is transmitted to you for the sole purpose of dissemination through your newspaper / magazine / agency. The rating rationale may be used by you in full or in part without changing the meaning or context thereof but with due credit to CRISIL. However, CRISIL alone has the sole right of distribution (whether directly or indirectly) of its rationales for consideration or otherwise through any media including websites, portals etc.

**About CRISIL Limited**

CRISIL is a leading agile and innovative, global analytics company driven by its mission of making markets function better. We are India's foremost provider of ratings, data, research, analytics and solutions. A strong track record of growth, culture of innovation and global footprint sets us apart. We have delivered independent opinions, actionable insights, and efficient solutions to over 1,00,000 customers.

We are majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

For more information, visit [www.crisil.com](http://www.crisil.com)

Connect with us: [TWITTER](#) | [LINKEDIN](#) | [YOUTUBE](#) | [FACEBOOK](#)

**About CRISIL Ratings**

CRISIL Ratings is part of CRISIL Limited ("CRISIL"). We pioneered the concept of credit rating in India in 1987. CRISIL is registered in India as a credit rating agency with the Securities and Exchange Board of India ("SEBI"). With a tradition of independence, analytical rigour and innovation, CRISIL sets the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 24,500 large and mid-scale corporates and financial institutions. CRISIL has also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and microfinance institutions. We also pioneered a globally unique rating service for Micro, Small and Medium Enterprises (MSMEs) and significantly extended the accessibility to rating services to a wider market. Over 1,10,000 MSMEs have been rated by us.

---

**CRISIL PRIVACY**

CRISIL respects your privacy. We may use your contact information, such as your name, address, and email id to fulfil your request and service your account and to provide you with additional information from CRISIL. For further information on CRISIL's privacy policy please visit [www.crisil.com](http://www.crisil.com).

**DISCLAIMER**

This disclaimer forms part of and applies to each credit rating report and/or credit rating rationale that we provide (each a "Report"). For the avoidance of doubt, the term "Report" includes the information, ratings and other content forming part of the Report. The Report is intended for the jurisdiction of India only. This Report does not constitute an offer of services. Without limiting the generality of the foregoing, nothing in the Report is to be construed as CRISIL providing or intending to provide any services in jurisdictions where CRISIL does not have the necessary licenses and/or registration to carry out its business activities referred to above. Access or use of this Report does not create a client relationship between CRISIL and the user.

We are not aware that any user intends to rely on the Report or of the manner in which a user intends to use the Report. In preparing our Report we have not taken into consideration the objectives or particular needs of any particular user. It is made abundantly clear that the Report is not intended to and does not constitute an investment advice. The Report is not an offer to sell or an offer to purchase or subscribe for any investment in any securities, instruments, facilities or solicitation of any kind or otherwise enter into any deal or transaction with the entity to which the Report pertains. The Report should not be the sole or primary basis for any investment decision within the meaning of any law or regulation (including the laws and regulations applicable in the US).

Ratings from CRISIL Rating are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities / instruments or to make any investment decisions. Any opinions expressed here are in good faith, are subject to change without notice, and are only current as of the stated date of their issue. CRISIL assumes no obligation to update its opinions following publication in any form or format although CRISIL may disseminate its opinions and analysis. CRISIL rating contained in the Report is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment or other business decisions. The recipients of the Report should rely on their own judgment and take their own professional advice before acting on the Report in any way. CRISIL or its associates may have other commercial transactions with the company/entity.

Neither CRISIL nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, "CRISIL Parties") guarantee the accuracy, completeness or adequacy of the Report, and no CRISIL Party shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of the Report. EACH CRISIL PARTY DISCLAIMS ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY, SUITABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall any CRISIL Party be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages.

CRISIL Ratings may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of the instruments, facilities, securities or from obligors. CRISIL's public ratings and analysis as are required to be disclosed under the regulations of the Securities and Exchange Board of India (and other applicable regulations, if any) are made available on its web sites, [www.crisil.com](http://www.crisil.com) (free of charge). Reports with more detail and additional information may be available for subscription at a fee – more details about CRISIL ratings are available here: [www.crisilratings.com](http://www.crisilratings.com).

CRISIL and its affiliates do not act as a fiduciary. While CRISIL has obtained information from sources it believes to be reliable, CRISIL does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives and / or relies in its Reports. CRISIL keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of the respective activity. As a result, certain business units of CRISIL may have information that is not available to other CRISIL business units. CRISIL has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process. CRISIL has in place a ratings code of conduct and policies for analytical firewalls and for managing conflict of interest. For details please refer to: <https://www.crisil.com/en/home/our-businesses/ratings/regulatory-disclosures/highlighted-policies.html>

CRISIL's rating criteria are generally available without charge to the public on the CRISIL public web site, [www.crisil.com](http://www.crisil.com). For latest rating information on any instrument of any company rated by CRISIL you may contact CRISIL RATING DESK at [CRISILratingdesk@crisil.com](mailto:CRISILratingdesk@crisil.com), or at (0091) 1800 267 1301.

This Report should not be reproduced or redistributed to any other person or in any form without a prior written consent of CRISIL.

All rights reserved @ CRISIL