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India Ratings Downgrades Mangloor Highways' NCDs to 'IND AA+'/Negative

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India Ratings and Research (Ind-Ra) has downgraded Mangloor Highways Private Limited's (MHPL) non-convertible debentures' (NCDs) rating to 'IND AA+' from 'IND AAA'. The Outlook is Negative. The detailed rating action is as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
NCDs*	-	-	-	INR2,697.3 (reduced from INR2,765.6)	IND AA+/Negative	Downgraded

*Details in annexure

Analytical Approach: Ind-Ra continues to review MHPL's ratings on a standalone basis, considering the rated debt only. Therefore, any sponsor-injected funds, other than plain-vanilla equity, in the project have been considered equity-like instruments, such as sponsor-injected funds of INR363.8 million (as on 31 March 2023) in the form of optionally convertible debentures. Any deviation in the treatment of these instruments would affect the ratings.

The downgrade and Negative Outlook reflect the damages of INR1,348 million recommended by the regional officer (RO) of the National Highways Authority of India (NHAI; debt rated IND AAA/Stable) for the delay in repair and rectification work, to be recovered from the escrow account and future annuities of MPHL, against a levy of INR1.5 million that had been recommended earlier in June 2023. However, MHPL filed an application with High Court of Delhi, seeking an interim stay against the NHAI to prevent any coercive actions, and the court has granted an injunction, preventing the NHAI from taking any coercive steps for the recovery of damages until the final ruling. Furthermore, the NHAI has provided an assurance in the court order dated 16 January 2024, that it would not take any coercive action until the resolution of the arbitration. No amount was withheld or deducted in this regard from the fourth annuity that was received by MPHL in January 2024. Debenture holders also have the right to invoke a put option at the end of two years from the date of issuance i.e. 29 March 2024, and MHPL is engaged in discussion for the same, which will be a key monitorable. The project faced a one-time deduction of INR209.5 million from the fourth annuity due to a change in the consumer price index (CPI) benchmark by the NHAI and reduction in balance completion cost by INR340 million (about 5%) to INR6,246 million, leading to a slightly lower annuity payout in the future; however, the same is unlikely to have a significant impact on cash flows over the long term.

The rating considers the timely receipt of four annuities and the availability of adequate liquidity, including a debt service reserve (DSR) sufficient to meet two quarters of debt obligations. The project also stands to benefit from the increase in bank rates over the past 12 months with the coupon on NCDs being fixed until end-March 2024.

The rating takes comfort from the availability-based stable cash flows from the strong counterparty, NHAI, the inherent features of the hybrid annuity mode (HAM) project and the project's comfortable coverage ratios. Since the project was acquired by Cube Highways and Infrastructure III Pte Ltd (Cube Highways; new sponsor) in December 2021, the rating also factors in the new sponsor's strong executional and operational capabilities in managing road assets and its undertaking to meet any cost overruns and fund any shortfall in annuity payouts by the authority due to delays in achieving the commercial operations date (COD).

Key Rating Drivers

Change in CPI Benchmark and Overhang of Penalty Recommendation Leading to Moderate Revenue Risk Profile: After the project achieved the provisional commercial operations date on 15 December 2021, four annuities have been released by the NHAI in a timely manner. While the first annuity was received in full, the second annuity witnessed withholding of INR112.7 million (around 25% of the annuity amount) towards the non-maintenance of the road stretch (details mentioned in NRAC released on 19 January 2023) and INR41.2 million deducted towards a change in the CPI formula linkage based on the NHAI policy circular. The final damages recommended by independent engineer (IE) on the basis of the letter dated 3 June 2023 came much lower at INR1.56 million compared to the charges raised earlier (as per the company update dated 6 June 2023), acknowledging that the cost of rectification work was only INR12.8 million and the damages recommended earlier were not proportionate to the cost of work. The recommendation of the IE was also accepted by the project director and RO of the NHAI, and the RO referred the issue to the NHAI headquarters for final consideration. In the interim, the third annuity was released in full without any maintenance-related deduction, except INR28.5 million towards the change in CPI linkage, as clarity on the same is awaited from the NHAI's headquarters. The final recommendation by the RO to the NHAI headquarters mentioned that the damages should be levied at the higher of the following: i) 2% of performance bank guarantee for each day of delay in completion of rectification works amounting to INR1,348 million for 144 days, or ii) 0.1% of cost of rectification of works, which amounted to INR1.5 million, and requested a waiver/ reduction in the penalty of INR1,348 million worked out by the IE. The letter mentioned explicitly stated about completion of works within 144 days and issue was with NHAI HQ for guidance on necessary steps for reducing the damages.

As per the management, based on the discussions with the NHAI headquarters, the matter was proposed to be resolved through dispute resolution. However, at the time of fourth annuity payment in December 2023, the RO issued a letter directing the project director to deduct INR1,348 million from the escrow account, and if the same is not sufficient, then from future annuities. MHPL immediately filed a Section 9 application, seeking an interim stay against the NHAI, and based on this representation, the court has granted an injunction, preventing the NHAI from taking any coercive steps for the recovery of damages. The matter is currently under arbitration and the management does not expect any threat of deduction on any future annuity; Ind-Ra would monitor the same. In the interim, MHPL received the fourth annuity on 3 January 2024 post a one-time deduction of INR209.5 million due to the change in the CPI benchmark by the NHAI from Mancherial centre to Hyderabad Centre.

MHPL will have three revenue streams adjusted for the price index multiple, namely: i) 60% of the bid project cost spread over 15 years after the COD; ii) interest on the balance annuity payments on a reducing balance basis at bank rate plus 300bp, and iii) the first year's operation and maintenance (O&M) plus inflation bid quote of INR30 million per annum. The price index multiple comprises 70% of the wholesale price index and 30% of the CPI.

While the annuity payments are subject to variations in the inflation indices, any shortfall in the forthcoming annuity payments could arise due to deductions for the non-conformance to the maintenance requirements during the concession term. However, the satisfactory operating track record of Cube Highways in the highway sector, and the low complexity feature of the O&M model lend strength to the rating.

Strong Sponsors with Demonstrated Track Record: Cube Highways acquired 49% of the project from Dilip Buildcon Limited ('IND A'/Negative) in December 2021 and the balance 51% was acquired in August 2022. Cube Highways has also provided an undertaking to meet any cost overruns in achieving the COD and fund any shortfalls in amounts for making any payments due in the waterfall, caused due to any deductions in/ withholding of the annuity by NHAI on account of delays in the achievement of the COD, to the extent such shortfalls are not met from the surplus cash of the company.

Cube Highways, is promoted by I-Squared Capital (ISQ) and Abu Dhabi Investment Authority. ISQ is an independent global infrastructure fund with focus on energy, utility and transport sectors in the US, Europe and select high growth economies such as China and India. Abu Dhabi Investment Authority is a sovereign wealth fund owned by Emirate of Abu Dhabi, founded for investing funds on behalf of the government of Abu Dhabi. ISQ's overall assets under management amounted to USD45 billion at end-December 2022, spread across various asset classes, including energy vertical, utilities, telecom, social infrastructure and transport vertical spread across 36 countries. ISQ, through Cube Highways, has a portfolio of 26 projects with a total length of 8,700 lane km of projects in India.

Minimal O&M Risk: MHPL's O&M activities are largely handled internally by Cube Highways, and Ind-Ra has relied on the sponsor's capabilities for O&M. The project stretch comprises a bituminous pavement and the routine O&M costs are slightly higher than those of Ind-Ra-rated peers. As per the management, such practice helps saving cost during major maintenance (MM).

There are two MM cycles scheduled during the concession period, first in FY28-FY29 and second in FY35-FY36. The MM costs assumed in Ind-Ra's base case assumptions are similar to agency-rated bitumen road peers. However, according to the Schedule-K of the concession agreement, the repair & maintenance work (for rectification of defects) needs to be incurred within 180 days of the roughness index of the project stretch exceeding 2,750mm for every stretch of 1km (threshold value), the road surface for flexible pavement is within the stipulated levels under the concession agreement, based on the latest road test reports of MHPL dated December 2023, conducted in the presence of an independent engineer.

Liquidity Indicator - Adequate: The cash accruals of the company are adequate to service the debt obligations at an average debt service coverage ratio (DSCR) of over 1.25x over the loan tenor for the NCD structure. Furthermore, a DSR of two quarters of debt obligations has been created based on the NCD terms. The company had liquidity of INR872 million as on 12 January 2024, comprising INR215 million for the DSR and surplus cash of INR657 million.

The project is exposed to performance-related annuity deductions; however, Ind-Ra derives sufficient comfort from the strong credit profile, robust operational history of the sponsor to ensure no material delay or deductions in the upcoming annuities from the NHAI and the availability of adequate liquidity.

Suitable Debt Structure of NCDs: The rated NCDs include a top-up debt of INR192 million, which was used towards DSR creation. The principal repayment obligations comprise 27 unstructured half-yearly payments and the loan amortisation schedule is broadly in line with the annuity payment receipts with a 60-day cushion between the annuity receipt and debt service date. The project loan shall have a tail period of two annuities - the difference between the loan maturity and the concession maturity. Also, the financing documents stipulate a minimum DSCR of 1.10x post the COD, a breach of which shall lead to the discontinuation of restricted payments, until cured. The structure also stipulates a put/call option at the end of two years from the date of the allotment of NCDs which falls due at end-March 2024. The refinancing risk of the project due to the presence of a put option is largely mitigated, given the stable stream of cash flows, the availability of a three-month notice period for the repayment post exercising the put option by NCD lenders, the presence of reputed sponsor and healthy coverages. MHPL is engaged in discussions with the existing debenture holder/other potential investors for finding a solution with respect to the put option, which will be a key monitorable.

Furthermore, as the rate of interest on the NCDs is fixed for the first two years post disbursement, Ind-Ra expects the near-term interest rate risk to be substantially mitigated. The coupon rate is fixed for the first two years and is subject to change thereafter, as per a mutual agreement between the issuer and debenture holders.

Rating Sensitivities

Positive: Future developments that could, individually or collectively, lead to a positive rating action are:

- an established track record of nil performance deductions;
- limited to nil impact of arbitration outcome on project cashflows

Negative: Future developments that could, individually or collectively, lead to a negative rating action are:

- significant delays or deduction in annuities resulting in a weakening of the coverages, with the average DSCR reducing below 1.15x;
- arbitration ruled against MHPL, leading to significant impact on project cashflows
- the non-creation/depletion of the DSR; and
- deterioration in the credit profile of the NHAI

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on MHPL, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

Company Profile

MHPL has been granted a 17-year concession (including construction period of 730 days) by NHAI for the four-laning of 48.963km of Mangalore to Telangana/Maharashtra border section of National Highway-161 in the state of Telangana, on a design, build, operate and transfer basis under the Bharatmala Pariyojana scheme on hybrid annuity model. MHPL is 100%-owned by Cube Highways as on 31 March 2023.

The bid project cost was INR9.36 billion and the estimated total project cost of MHPL is INR7.24 billion, which was funded through INR0.87 billion of committed equity, INR3.74 billion of NHAI grants and sanctioned debt of INR2.63 billion.

FINANCIAL SUMMARY

Particulars (INR million)	**1HFY24**	**FY23**	**FY22**
Revenue from operations*	275.3	453	834.6
Other income	22.9	20.7	0.48
Profit after tax	52.6	66.0	-169.0
Cash and cash equivalents	205.6	33.1	335.0
Source: MHPL *Includes contract receipts as per IND-AS accounting			

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Rating History

APPLICABLE CRITERIA

Rating Criteria for Infrastructure and Project Finance

Rating Criteria for Availability-Based Projects

Evaluating Corporate Governance

The Rating Process

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook				
	Rating Type	Rated Limits (million)	Rating	7 July 2023	11 July 2022	25 March 2022	21 March 2022	18 January 2022
NCDs	Long-term	INR2,697.3	IND AA+/Negative	IND AAA/Stable	IND AAA/Stable	IND AA+/Positive	Provisional IND AA+/Positive	Provisional IND AA+/Positive

Annexure

NCDs

ISIN	Date of Issue	Coupon Rate*	Maturity date	Size of Issue (million)	Rating/Outlook
INE00PT07014 (Series A)	29 March 2022	6.64% p.a.	31 August 2035	INR2,513	IND AA+/Negative
INE00PT07022 (Series B)	29 March 2022	6.64% p.a.	31 August 2035	INR184.3	IND AA+/Negative
Total				**INR2,697.3**	

*Coupon rate until the second year from the date of issuance is fixed, post which it will be subject to the discussion between the issuer and debenture holders.

Key Financial Covenants

NCDs	MHPL
Minimum annual DSCR over debt tenor	1.10x (to be tested on annual basis)
Leverage	No further debt to be raised by the issuer without an approval from the lenders/NCD
Restricted payment conditions (RPC)	Surplus cash upstreaming to the sponsors is allowed subject to the fulfilment of follo • minimum rating of AA is maintained • the stipulated DSR and MM reserve are available • no breach in financial covenants or (potential) event of default subsists • repayment of the facility has commenced
Cash trap mechanism	In case the financial covenant trigger is hit (i.e. the DSCR falls below 1.10x), the sur Upon the occurrence of RPC trigger, the issuer will be able to access the funds only

Complexity Level of Instruments

Instrument Type	Complexity Indicator
NCDs	Low

For details on the complexity level of the instrument, please visit https://www.indiaratings.co.in/complexity-indicators.

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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

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