March 13, 2020

Kutch Railway Company Limited: Provisional [ICRA]A(Stable) assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	1,000.00	Provisional [ICRA]A(Stable); Assigned
Total	**1,000.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating factors in the operational track record, and the importance of the rail line operated by Kutch Railway Company Limited (KRCL) that provides connectivity to the two major ports [Mundra Port, and Deen Dayal Port (erstwhile Kandla port)] with the northern mainland, and the importance of the rail line as a feeder route to the upcoming western dedicated freight corridor (WDFC). KRCL has entered into a 32-year concession, signed in November 2005, with the Ministry of Railways (MoR) for operating the 301 km rail line between Gandhidham and Palanpur in Gujarat. The rating also favourably takes into account the healthy cargo volume transported on the route, primarily driven by strong growth in cargo volumes at the two ports and the diversified mix of bulk goods and containers being transported. Further, the rating factors in the healthy financial profile of the company with healthy accruals generated over the years, which has resulted in its strong net worth position and low dependence on external borrowing. This in turn has enabled KRCL to fund the majority of the ongoing capex from internal accruals. The rating also takes comfort from the strong sponsors with Rail Vikas Nigam Ltd (RVNL), a Government of India (GoI) undertaking being the largest shareholder. However, no financial support is envisaged from the sponsors.

The rating is, however, constrained by the project implementation risks associated with the ongoing and planned capex towards doubling of the railway line and electrification of the project stretch. Notwithstanding the significant progress on the capex, and the comfortable profile of the execution agency – RVNL – the capex programme exposes KRCL to risks of time and cost overruns. Further, the borrowing for the capex remains to be tied-up and therefore, adds to funding-related risks. The rating is also constrained by the increasing operations and maintenance (O&M) cost [O&M is done by Western Railways (WR) and the cost is apportioned to KRCL, depending on the carried route], primarily overhead cost, which has impacted its profitability. However, ICRA notes that in December 2019, KRCL has entered into a joint procedure order (JPO) with WR. The JPO will result in significant reduction in overhead cost in future and would be a key monitorable. Further, the rating is constrained by the dependence of the company's cash flows on timely payments from WR, as well as freight traffic growth and freight rates, which are controlled by the MoR.

ICRA expects the company to continue to benefit from its healthy operating profile, enabling it to meet its planned funding of capex from the proposed borrowings, and internal accruals. As the debt has not been sanctioned, KRCL has indicated some key terms for the proposed borrowing programme that have been taken into consideration for assigning the provisional rating, which includes a total borrowing of up to Rs. 1,000 crore with repayment schedule of 10 years starting from FY2023, and tentative interest rates of around 9%. ICRA will assess the final terms of the sanction and the consequent impact on KRCL's credit profile, if any.

Key rating drivers and their description

Credit strengths

Established track record of operations and concession from the MoR – KRCL was incorporated on January 22, 2004 as a special purpose vehicle (SPV) with the objective of the conversion of the existing meter gauge to broad gauge on the existing 301 km railway line between Gandhidham and Palanpur in Gujarat. The company entered into a concession agreement (CA) for a period of 32 years with the MoR, GoI, on November 8, 2005. The project achieved commercial operation date (COD) in November 2006 and has an operational track record of ~15 years.

Important route providing rail connectivity to Kandla Port and Mundra port to northern hinterland; the route will act as a feeder to WDFC – The Gandhidham-Palanpur corridor is an important rail line that provides the shortest connectivity to two major ports of Gujarat-Kandla and Mundra ports with the northern hinterland via the Delhi-Ahmedabad main line. The Kandla and Mundra ports are the two of the largest ports in the country, handling over 20% of all port cargo in the country. The commodity mix, besides petroleum and lubricants is diversified into edible oil, fertilisers, iron ore, coal and containers. Further, the project will merge with the upcoming WDFC at Palanpur and will act as a feeder route for the corridor. Given the prospective traffic on the WDFC and the cargo trend at the ports, the potential serviceable cargo volumes are expected to be healthy.

Revenues from diversified mix of commodities – The project stretch caters to a large volume of cargo transport, which is reflected in the ~36.86 million metric tonne (MMT) of cargo transferred using the project corridor in FY2019. Containers comprised almost 40% of the total cargo transported in FY2019, whereas fertiliser and coal accounted for the majority of the bulk cargo, i.e 27% and 21%, respectively. Over the years, the dependence on bulk cargo has reduced and the share of containers has increased. The project overall has a relatively diversified mix of commodities transported.

Strong net worth position supported by Healthy accruals over the years and low dependence on external borrowings for funding the ongoing capex – KRCL's healthy financial profile is reflected in stable revenues (excluding construction income) and a track record of healthy accretions to reserves that led a strong net worth position. The company has funded the capex till date from its internal accruals, and therefore does not have any borrowings at present. Further, given the expected accruals and the proposed borrowing programme, the debt coverage metrics are expected to be comfortable.

Credit challenges

Exposed to risk related to freight traffic growth and freight rates – The O&M of the project railway is being conducted by MoR through WR. The latter collects the freight from users and apportions the revenues to KRCL (on the basis carried route) after deducting O&M-related expenses. Thus, KRCL is dependent on WR's operating efficiencies and timely remittance of its revenue share from the same. The freight rates for bulk goods transport is decided by the MoR. Therefore, this can result in risk of lower growth in freight rates in future, despite increase in O&M costs. Like any rail project, KRCL is exposed to the risk of slowdown in the freight traffic, or competition from alternate modes of transportations which could impact its revenues and profits.

Increasing O&M cost impacts profitability; expected reduction in overhead cost will be a risk mitigant – KRCL's operating profitability has been gradually declining over the years, as the O&M costs have been increasing at a faster rate that freight revenues. One of the key components of O&M cost is the overhead expense charge being apportioned to KRCL by WR. In September 2019, the MoR issued an order for computation of overheads charged to KRCL be on comparable basis with the other project. Subsequently, in December 2019, KRCL entered into a JPO with WR, which is expected to result in a significant reduction in overhead cost and has been factored in by ICRA while assigning the rating. Hence, the actual reduction in overhead cost vis-à-vis anticipated decline would be a key monitorable. With this, the accruals of KRCL are expected to improve significantly from FY2021, which will support its credit profile.

Exposure to project implementation risks given the large capex programme – KRCL is undertaking the doubling of the single line between Palanpur–Samakhiali (247.73 kms). The project is being executed by RVNL at an estimated cost of Rs. 2,000 crore. Till January 2020, KRCL has achieved ~82% financial progress on this project. It is also executing electrification of the railway line, which is estimated to cost Rs. 743 crore. The total capex is proposed to be funded by Rs. 1,000 crore of debt and balance through internal accruals generated over the years

Notwithstanding the healthy progress on the capex and comfortable profile of the project implementation agency – RVNL – the capex programme exposes KRCL to risks of time and cost overruns. Further, the borrowing for the capex remains to be tied-up and therefore leads to funding-related risks. Besides timely and within budget completion of the capex, ramp-up of revenues, and cost benefits post completion of the capex will be the key monitorables.

Liquidity position: Adequate

KRCL's liquidity is supported by healthy cash accruals, and low debt servicing obligations in the medium term. While the company had sizeable cash and bank balance (Rs. 638 crore as of March 31, 2019), it is mainly utilised for the ongoing capex in the current financial year. For the balance capex funding, timely debt-tie up will be crucial to maintain the liquidity.

Rating sensitivities

Positive triggers: The rating maybe upgraded if the company completes the capex within the budgeted cost and time and with satisfactory ramp-up of revenues and profitability.

Negative triggers: The rating maybe downgraded if there are significant time and cost overruns in the ongoing capex that results in higher debt. The rating maybe also be downgraded if the expected reduction in overhead cost doesn't materialise, leading to lower-than-expected profitability.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on standalone financial statements of the rated entity

About the company

Kutch Railway Company Limited (KRCL) was incorporated on January 22, 2004 as an SPV with the objective of the conversion of the existing meter gauge to broad gauge on the existing 301 km railway line between Gandhidham and Palanpur in Gujarat. The company was formed as a joint venture between RVNL, Mundra Ports and SEZ Ltd (now Adani Ports and Special Economic Zone Limited; APSEZ), Kandla Port Trust (now Deendayal Port Trust), and the Government of Gujarat. The company entered into a CA with the MoR, GoI on November 8, 2005 for this project. The concession period is of 32 years. The O&M of the project is conducted by the MoR through WR. The project achieved COD on November 26, 2006. Subsequently, KRCL took up the project for doubling the exiting railway line and electrification of the same.

In FY2019, the company reported a net profit of Rs. 157.9 crore on an operating income (OI) of Rs. 1,188.0 crore compared to a net profit of Rs. 222.1 crore on an OI of Rs. 1,037.1 crore in the previous year.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	1,037.1	1,188.0
PAT (Rs. crore)	222.1	157.9
OPBDIT/OI (%)	19.0%	12.4%
RoCE (%)	29.1%	30.1%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.3
Total Debt/OPBDIT (times)	0.0	0.0
Interest Coverage (times)	7.9	5.7
DSCR	9.6	7.3

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					13-Mar-2020	-	-	-
1	Term Loan*	Long Term	1,000.0	0.0	Provisional [ICRA]A (Stable)	-	-	-

** Loan has not been sanctioned yet, Amount in Rs. crore*

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan*	-	-	-	1,000.0	Provisional [ICRA]A (Stable)

** Loan has not been sanctioned yet, Source: KRCL*

Annexure-2: List of entities considered for consolidated analysis: Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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