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India Ratings Affirms IHB at 'IND A+'; Outlook Stable

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By Ankur Rustagi

India Ratings and Research (Ind-Ra) has affirmed IHB Private Limited's (IHB) Long-Term Issuer Rating at 'IND A+'. The Outlook is Stable. The instrument-wise rating action is as follows:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Term loan*	-	-	March 2034	INR67.25	IND A+/Stable	Assigned

* The final rating has been assigned following the receipt of the sanction letter by Ind-Ra.

Analytical Approach: Ind-Ra continues to factor in the strong support from IHB's sponsors Indian Oil Corporation Ltd. (IOC; 'IND AAA'/Stable; holds 50% stake in IHB), Hindustan Petroleum Corporation Ltd (HPCL; 'IND AAA'/Stable; 25% stake) and Bharat Petroleum Corporation Ltd (BPCL; 25% stake), collectively referred to as oil marketing companies (OMCs), to arrive at the ratings.

KEY RATING DRIVERS

Strong Sponsor Support: The affirmation reflects IHB's strong operational and strategic linkages with its sponsors. The sponsors share control over IHB's board of directors in the ratio of their shareholding. The chief executive officer is nominated by IOC, and the chief financial officer and chief operating officer, are nominated on rotational basis by HPCL and BPCL. The project would benefit from the experience of all the sponsors in laying and operating pipelines for moving petroleum products, crude, gas and liquefied petroleum gas (LPG). Also, the sponsors have committed to offtake volumes on a ship-or-pay basis to ensure a minimum debt service coverage ratio (DSCR) of 1.0x on a year-on-year basis, infuse project equity (INR33.6 billion), arrange financing to fund any cost overruns and maintain an equity holding of 51% through the loan tenor.

Ind-Ra believes IHB provides a business advantage for the sponsors by providing a dedicated facility for moving LPG from their own facilities and import terminals to the consumer market in the parts of western, central and eastern India. The proposed pipeline will connect 22 LPG bottling plants of the OMCs in Gujarat, Madhya Pradesh and Uttar Pradesh. The pipeline also becomes important from the point of cost savings, given that bulk of the current demand is being moved by road transport which is expensive compared to pipeline transportation.

Liquidity Indicator - Adequate: The entire debt portion (INR67.3 billion) of the total project cost of INR100.9 billion has been tied up. As per the loan agreement, 25% of the equity contribution (INR8.4 billion) needs to be infused upfront before the first disbursement of loan. As of June 2020, the promoters infused equity amounting to INR1.05 billion with zero debt outstanding. The liquidity is further supported by the sponsor undertaking to arrange financing to fund any cost overruns and the maintenance of a minimum DSCR of 1.0x on a year-on-year basis.

Low Offtake Risk: Ind-Ra assesses the offtake risks associated with the pipeline to be low, given the promoters have entered into a ship-or-pay arrangement for ensuring a minimum offtake of 65% of the committed volumes. Additionally, the demand growth seen in LPG, on account of the push by the government, is likely to ensure that the pipeline has adequate capacity utilisation. Coverage of the pipeline across the three states in western, central and eastern parts of India, consisting of a significant portion of domestic LPG connections further highlights the importance of the pipeline. With the growth in LPG demand outpacing domestic production, increased reliance on imported LPG further increases the importance of the pipeline as it would connect to LPG importing facilities at Kandla, Mundra, Dahej and Pipavav, thus lowering offtake risk. During 1HFY21, the share of imported LPG further increased to 57.1% (FY20: 51.5%, FY19: 48.6%) amounting 7.6 million tonnes (mt; 13.6mt, 12.1mt) of the total LPG consumption.

Competitive Tariff Mechanism: IHB emerged as the sole bidder for the pipeline and the competitive tariff bid out is fixed year-wise for 10 years, post the commissioning of the pipeline. The tariff is subject to review by the Petroleum and Natural Gas Regulatory Board (PNGRB) post 10 years. IHB's base year tariff of INR3.95/mt/km is 2.0x higher than LPG pipelines, where PNGRB determines the tariff on 100% train load basis for equivalent rail distance. The tariff for IHB increases at around 5% annually thereafter. The fixed yearly nature of the tariff, coupled with the minimum 65% ship-or-pay obligation, provides an assured income stream for IHB post project completion and also ensures a healthy average DSCR of more than 1.3x. Furthermore, the loan repayment period of 10 years (post one-year moratorium) mitigates risk of any adverse tariff movement after the 10th year on the company's expected DSCR.

Project Update: As of September 2020, IHB incurred capex of INR0.4 billion of the planned capex of INR15.7 billion in FY21 and INR63.1 billion in FY22, achieving a cumulative physical progress of 17.5%. Purchase order for supply of 2,097km of pipeline has been placed with delivery of the pipeline to commence from December 2020. IOC has been appointed for project management and contracts for providing support for the required land acquisition have been placed. Management has informed Ind-Ra that PNGRB is periodically informed about the progress of the project and also about the impact of COVID-19 on the project. The response from PNGRB is awaited regarding the grant of the extension of the project timeline, on account of the disruptions caused by the COVID-19 pandemic as force majeure conditions. Management has further articulated that minimal cost or time overrun is expected in the project execution on account of COVID-19, as the network laying work is likely to start from December 2020.

High Construction Risks: On 1 December 2018, PNGRB authorised the implementation of Kandla-Gorakhpur LPG pipeline with a construction period of three years. The company is required to seek right of use/right of way approvals for laying the pipeline, as well as forest clearance, Coastal Regulatory Zone clearance and environmental clearance for a total of around 40kms. Given the cross-country nature and the length of the pipeline, the company could take longer-than-expected as seen in other pipelines, thereby exposing the project to time and cost overruns risks. Considering the same, the zero date, as per the loan agreement, has been considered as 1 April 2020 with 36 months construction period, followed by 12 months moratorium and a 10-year loan amortisation period. Also, accelerated payment clause has been included in the agreement enabling preponement of repayment schedule in case the commercial operation date of the project is achieved before the scheduled commercial operation date of 1 April 2023.

Furthermore, the management has articulated that the project cost has a built in contingency provision of INR3.7 billion and escalation of 3.35% per annum, which provide some cushion to any cost increase. The project has also factored in INR5.1 billion of interest during construction. Additionally, the execution strength of the sponsors and their experience in laying pipelines (IOC: 14,701km, HPCL: 3,775km, BPCL: 3,178km) provide comfort. However, if the project cost increases by 10%, Ind-Ra estimates the average DSCR to remain comfortable at around 1.2x assuming the same debt/equity ratio and 65% offtake.

RATING SENSITIVITIES

Positive: Timely completion of the project and utilisation of the pipeline by the sponsors could be positive for the ratings.

Negative: Significant debt-funded cost or time overruns, leading to a significant change in DSCR could result in a negative rating action. Any weakening of the linkages with the sponsors could also be negative for the ratings.

COMPANY PROFILE

IHB is a joint venture between IOC, HPCL and BPCL for implementation of 2,805km long LPG pipeline from Kandla (Gujarat) to Gorakhpur (Uttar Pradesh) with additional feeder lines of Pipavav-Ahmedabad, Dahej-Koyali and associated branch lines to Bina Refinery and BPCL/HPCL's bottling plants, with a system capacity of 8.25mt per annum.

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook
	Rating Type	Rated Limits (billion)	Rating	23 September 2019
Issuer rating	Long-term	-	IND A+/Stable	IND A+/Stable
Term loan	Long-term	INR67.25	IND A+/Stable	Provisional IND A+/Stable

COMPLEXITY LEVEL OF INSTRUMENTS

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

SOLICITATION DISCLOSURES

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Applicable Criteria

Corporate Rating Methodology
Parent and Subsidiary Rating Linkage
Short-Term Ratings Criteria for Non-Financial Corporates

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