Dedicated Freight Corridor Corporation of India Limited

Update

Rating

Long Term Issuer Rating	IND AAA

Outlook

Long Term Issuer Rating	Stable

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Key Rating Drivers

Linkages with Union Government: Dedicated Freight Corridor Corporation of India Ltd.'s (DFCCIL) rating reflects its strong operational, managerial and financial linkages with the government of India (GoI). GoI owns 99.99% of DFCCIL and has regularly infused equity into the latter (FY13: INR11.91bn, FY12: INR2.15bn) through the budgetary provisions of the Ministry of Railways (MoR).

Strategic Importance: A dedicated freight line is of high strategic importance to GoI for regaining Indian Railways' lost freight share (FY12: 35.53%; FY61: 86.2%), decongesting existing passenger lines and accelerating industrial growth of the country. The development of a dedicated freight corridor will reduce the transaction time of shipment of goods and transaction costs. The project serves an important social purpose and acts as a critical enabler to India's economic growth. Therefore, any disruption in its services would cause dearly to the country's growth profile.

The government commitment is also reflected in its INR150m expenditure in FY15 (revised estimate) on a study of future dedicated freight corridors (FY16 (budget estimate): INR230m).

Project Funding: Of the total estimated project cost of INR733.92bn according to the concession agreement, 36.34% is accounted by the eastern corridor and the remaining 63.66% by the western corridor. The eastern corridor is being funded by World Bank's USD2.725bn loan and the western corridor by Japan International Cooperation Agency's (JICA) Special Terms of Economic Partnership Loan of JPY677bn. Though JICA's loan is hedged by GoI at a rate of 6.8%, DFCCIL is exposed to forex risk as the World Bank loan is not hedged. This loan will be serviced in rupee equivalent to USD at prevailing rates. However, DFCCIL has requested MoR for hedging the loan.

Construction Targets: DFCCL, alike other infrastructure projects, is marked with complex construction over long and difficult terrain, plausible costs and time overruns and a long gestation period. India Ratings and Research (Ind-Ra) thus considers possible delays, although the project is scheduled to be fully operational by FY19. Around 79.1% of land has been acquired, of which 32.9% (1,100km) of length has been awarded for civil construction up till December 2014. During FY16, another 750km of civil contracts and 1,300km of system contracts are envisaged to be awarded and 55km of eastern corridor would be completed.

Averting Operational Risk: We take support from the track access agreement entered into by and between MoR and DFCCIL. The agreement provides for a commitment by MoR to pay track access charges in lieu of using train paths and networks by authorised train users. It also directs MoR to transfer minimum 70% of freight traffic with the commencement of operations in FY17 and thereafter in every subsequent year. Ind-Ra believes that the project would support export competitiveness by reducing transaction cost by providing uninterrupted traffic movements at a higher speed.

Rating Sensitivities

Weakening of DFCCIL's linkages with GoI would be negative for the rating.

Genesis of Corporation

DFCCIL was set up by MoR, GoI as an SPV for the construction, operations and maintenance of a dedicated freight corridor. Subsequently, DFCCIL was incorporated under the Companies Act, 1956 on 13 October 2006 with an objective to enable Indian Railways capture market share in freight transport by developing a fully devoted freight capacity using latest technology.

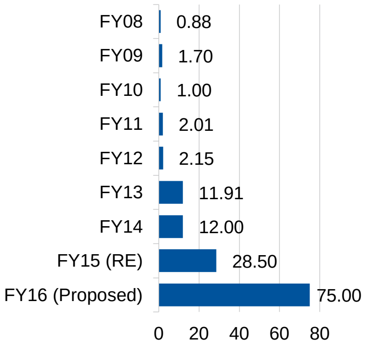
Principal Rating Factors

Legal and Support Factors

DFCCIL is a wholly union government owned entity. The company has an authorised share capital of INR80bn with the President of India holding 99.99% shares. Though the company was incorporated as an SPV, it is registered under the Companies Act, 1956. Subject to approval of the President, the board may increase the share capital.

Figure 1

Equity Infusion
(INRbn)



Source: DFCCIL and MoR

Integration with the Government

DFCCIL has strong operational linkages with the union government. Capital grants in the form of equity infusions into DFCCIL form a part of the union government's Railway Budget. There have been regular capital infusions, with INR11.91bn being infused in FY13. INR75bn has been proposed to be infused during FY16 (FY15(RE):INR28.5bn and FY14: INR12bn) into the corporation.

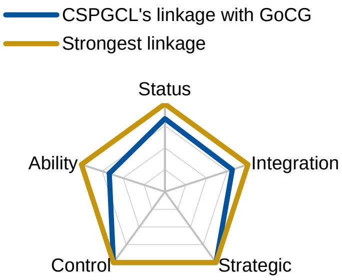
Control and Oversight

DFCCIL has been set up under the administrative control of MoR. The President of India nominates the corporation's directors. Though borrowing powers vest with the board of directors, prior approval of MoR is necessary. Activities of the corporation are governed by the provision of the Railways Act 1989 and the Memorandum and Articles of Association. DFCCIL has autonomy and independence from MoR in relation to implementing projects and performing its obligations. The auditors are appointed by the Comptroller and Auditor General of India and accounts are approved by the Parliament.

Strategic Importance

Figure 2

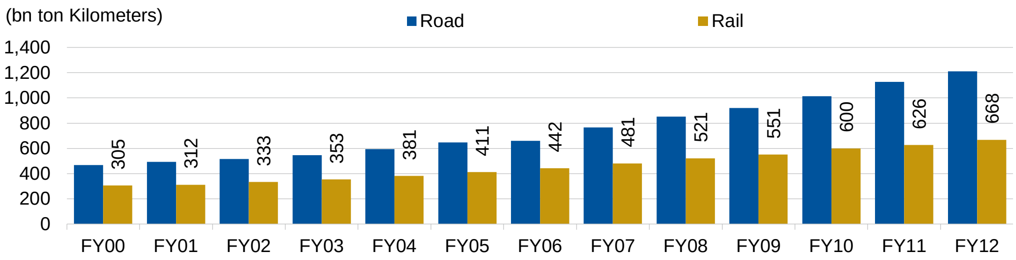
DFCCIL's Support Factors from Government of India



Source: Ind-Ra

Figure 3

India's Freight Movement



Source: Ministry of Railways and data.gov.in

Though India has the worlds' largest railways network comprising 115,000km of track route, Indian Railways' share in India's freight movement declined to 35.53% in FY12 from 86.2% in FY61. A dedicated freight line holds high strategic importance to GoI for regaining Indian Railways' lost freight share, decongesting existing passenger lines, accelerating industrial growth of the country and reducing time in export commitments.

The union government has incurred INR150m in FY15 (RE) and plans to incur INR230m in FY15 on study of future dedicated freight corridors. The project is also promoting other development activities along the corridor such as logistics parks in high industry concentration areas along the eastern and western corridors at Kanpur, Ludhiana, Mumbai, Vapi, Ahmedabad, Gandhidham, Jaipur and Delhi. As the project serves an important social purpose, any disruption in its services would hinder the states' developmental objectives.

Applicable Criteria

Rating of Public Sector Entities (September 2012)

Willingness and Ability

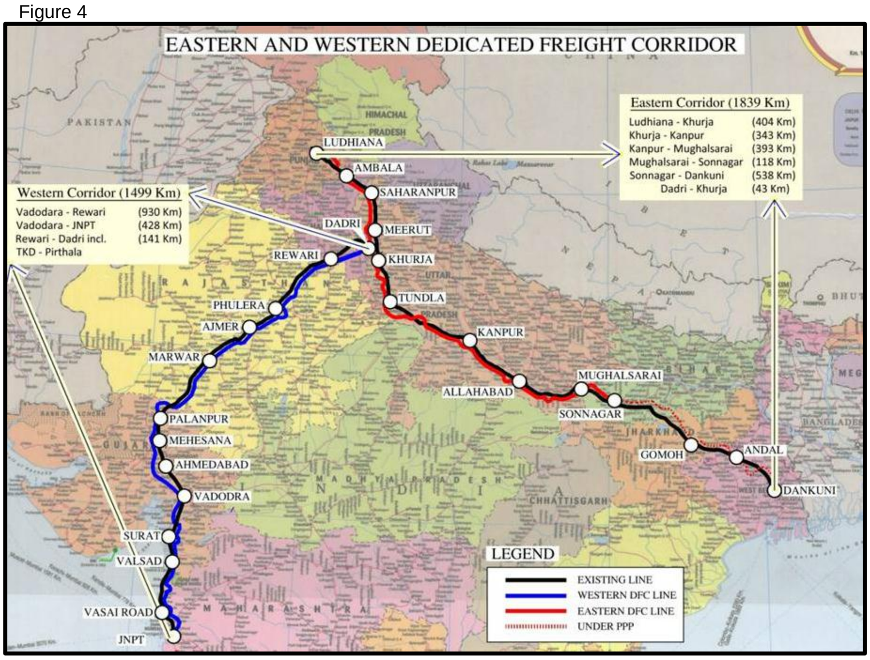
The willingness to support is demonstrated due to GoI's regular capital infusions and MoR's obligation to assist DFCCIL in procuring lucrative financing options from external lending agencies (including multilateral agencies) and in obtaining tax exemptions and waivers. MoR has facilitated multilateral/bilateral funding from JICA and World Bank for the project.

Ind-Ra views DFCCIL's control and strategy as very strong and status, integration and odds of receiving support as strong. Ind-Ra classifies DFCCIL as a dependent entity, and expects GoI to bail out DFCCIL in case of financial distress.

Business Profile

DFCCL is mandated to construct and operate and maintain the project (two dedicated freight lines) under the terms and conditions laid down in the concession agreement entered with MoR on 28 February 2014. Being envisaged on world class and state-of-the-art technology, the project has been bifurcated into two corridors – eastern and western. The capacity being constructed would enable Indian Railways to carry heavier loads at higher speeds.

Figure 4



Source : DFCCL

Stretching over 1,839km, the eastern dedicated freight corridor (EDFC) would cover six states. This corridor consists of an electrified double-track segment of 1392km between Dankuni (West Bengal) and Khurja (Uttar Pradesh) and an electrified single-track segment of 447km between Ludhiana (Dhandarikalan) in Punjab and Khurja in Uttar Pradesh. Mapping across four sates and covering 1,483km, the western dedicated freight corridor consists of a double-line electric (2 X 25 KV) track from Jawaharlal Nehru Port Trust (JNPT) to Dadri through Vadodara-Ahmedabad-Palanpur-Phulera-Rewari. The alignment of dedicated freight has been kept parallel to the existing Indian Railways lines except the provision of a detour at some stations. The corridors will be executed in a phased manner and shall connect at Dadri. Ind-Ra believes that DFCCIL has the potential to spur economic activities in Uttar Pradesh, West Bengal, Jharkhand, Rajasthan and Gujarat.

Figure 5

States' Coverage

Eastern Corridor State	Distance (km)	Western Corridor State	Distance (km)
Punjab	88	**Haryana**	192
Haryana	72	**Rajasthan**	553
Uttar Pradesh	1,049	**Gujarat**	588
Bihar	93	**Maharashtra**	150
West Bengal/Jharkhand	538		
Total	**1,839**		**1,483**

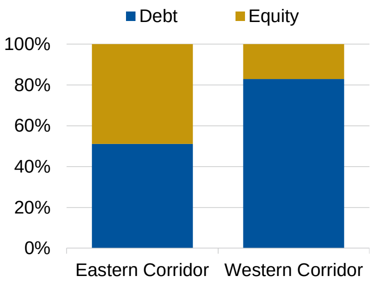
Source: DFCCIL

High dependence on roads for freight movement results in increased carbon dioxide emissions as road transport is the highest carbon dioxide emitter. A study by McKinsey illustrates that India has higher reliance on roads for freight movement than China (2007: 2.59x) and US (2007: 1.54x). A report by the Ministry of Environment and Forests shows that in 2007, road transport accounted for 87% of the total carbon dioxide equivalent emissions from the transport sector (142.04 million tons of carbon dioxide) and railways accounting for only 5%. Ind-Ra believes DFCCIL would help the country in improving its carbon footprints by increasing the share of railways in freight movement.

Funding

Figure 6

DFCCL Financing Mix



Source: DFCCIL

About 36.34% (INR266.74bn) of the total estimated project cost of INR733.92bn (according to the concession agreement) is accounted by the eastern corridor and the remaining 63.66% (INR467.18bn) by the western corridor. Besides construction cost, it also incorporates project related costs of DFCCIL's works and capitalised interest during the construction period. The project cost would be financed by a 71.32:28.67 mix of debt and equity. However, the debt portion of the western corridor (82.88%) is much higher than that for the eastern corridor (51.07%). Any shortfall in the estimated cost would be funded by way of soft loans or further equity subscription.

JICA in its feasibility report submitted to MoR in October 2007 revised the project cost to INR370bn from an initial estimate of INR280bn by Rail India Technical and Economic Services (RITES, 'IND A1+') in January 2007. This cost was subsequently revised to INR540bn according to the revised 2009 estimates. DFCCIL projects the completion cost to be about INR800bn in FY18.

DFCCL has three sources for funding its activities: equity infusion from the union government, funding from bilateral/multilateral donor agencies and market borrowings. While the western corridor is being 82.88% financed by JICA's loan, the eastern corridor is being part financed (51.07%) by World Bank's International Bank for Reconstruction and Development loan. The loan covers a stretch of 1,130km (train distance) between Ludhiana and Mughal Sarai. The remaining section from Mugal Sarai to Sonnagar will be funded directly by MoR while the section from Sonnagar to Dankuni will be financed through a public private partnership (PPP).

The World Bank funding of USD2.725bn for the eastern corridor is in three adaptable program loan tranches covering Khurja to Kanpur (EDFC1), Kanpur to Mughal Sarai (EDFC2) and Khurja to Ludhiana (EDFC3). Loan agreement for EDFC1 between World Bank and DFCCIL was executed for USD975m in October 2011 and EDFC2 of USD1,100m was executed in December 2014.

JICA's loan for the western corridor is a STEP (special terms of economic partnership) loan of JPY677bn for the construction of 1,839km of freight lines and procuring 200 electric locomotives. The loan is extended on soft terms for a period of 40 years with a moratorium of 10 years. The first tranche of the loan for JPY90.2bn for Phase I (Rewari to Vadodara) and JPY266bn for Phase II (Vadodara-JNPT) has been signed with JICA.

Figure 7

Loans' Terms & Conditions

		Interest terms				
Lender	Loan amount (bn)	Fixed/floating	Interest rate (%)	Moratorium (years)	Tenor (years)	Forex risk
JICA	JPY677	Fixed	7	10	40	Borne by GoI
World Bank	USD2.725	Floating	LIBOR + Variable spread	Not available	Not available	Borne by DFCCIL

Source: DFCCIL

PPP Project

A stretch of 546.22km on the eastern corridor is proposed to be implemented on a PPP mode in which DFCCIL would be acting as the facilitator. The project would be implemented in two phases with Phase I (Dankuni-Gomoh section) costing INR45.033 bn. Land for Phase I is fully acquired (278.39km) and the legal and technical consultants are being appointed. 79.4% of land has been acquired and a detailed project report is being prepared by DFCCIL.

The broad philosophy of DFCCIL financing is in line with Ind-Ra's views. We believe for smaller infrastructure projects, the government is better off in providing viability gap funding and leaving project execution and operation with private sector players. However, the government's equity, direction and control plays a major role in project completion with large and complex infrastructure projects.

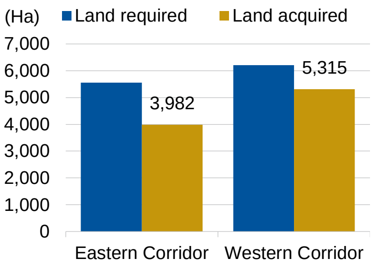
Project Status

MoR has given DFCCIL a license for the acquisition of land for the project. The land is being acquired under the Railway Amendment Act (RAA) 2008. Till end-December 2014, 79.1% land has been acquired. Civil structural and track work contract agreement have been signed with reputed national and international firms for Phase I of both the corridors.

Figure 8

Land Acquisition

(As on end December 2014)



Source: DFCCIL

Risk Matrix

Technology Risk

The corridors are being constructed with significantly higher design features so as to accommodate heavier loads (3.75x present trains) at higher speeds (1.33x present trains) with an ultimate aim of increasing Indian Railways' share in the country's freight movement. MoR has prepared the design brief. Though the designs have been reviewed by JICA and World Bank, MoR is solely responsible for it. These agencies are further assisting DFCCIL in incorporating latest technologies in all spheres by providing technical know-how and personnel with requisite experience.

Figure 9

Enhanced Design Features

	Existing Indian Railways	Dedicated freight corridors
Container stack	Single	Double
Train length (m)	700	1,500
Train load (ton)	4,000	15,000
Maximum speed (kmph)	75	100
Station spacing (km)	7-10	40

Source: DFCCL

Contractor Risk

The contractors are being selected through a two-staged bidding post prequalification process based on the applicable guidelines of World Bank and JICA. The western corridor project is also being governed by the stipulations of a STEP loan. The stipulations require the lead contractor to be a Japanese firm even in case of a JV. Though the selection procedure assures selection of well-experienced firms for the eastern corridor, the nationality clause of JICA restricts the number of eligible firms for the western corridor and might lead to delay in project completion.

Completion Risk

DFCCIL, alike other infrastructure projects, is marked with complex construction over a long terrain, plausible costs and time overruns and a long gestation period. With 79.1% land being acquired, 32.9% (1,100km) of length has been awarded as civil construction contracts up till December 2014. During FY16, another 750km of civil contracts and 1,300km of system contracts are envisaged to be awarded and 55km of EDFC would be completed. The corridors are being constructed simultaneously in a phased manner and are envisioned to be fully operational by FY19 (December 2018).

Figure 10
Phase-wise Targeted Schedule

		Year
Western Corridor		
Phase I	Rewari- Vadodara (920km)	2017
Phase II	Vadodara- JNPT(430km)	2018
Phase III	Rewari – Dadri(140km)	2018
Eastern Corridor		
Phase I-APL1	Khurja - Kanpur (343km)	2017
Phase II-APL2	Kanpur - Mughalsarai (390km)	2018
Phase III-APL3	Khurja-Ludhiana (397km)	2019
Phase IV (PPP funded)	Dankuni - Sonnagar (550km)	2019
Phase Ia (MoR funded)	Sonnagar - Mugal Sarai (125km)	2016

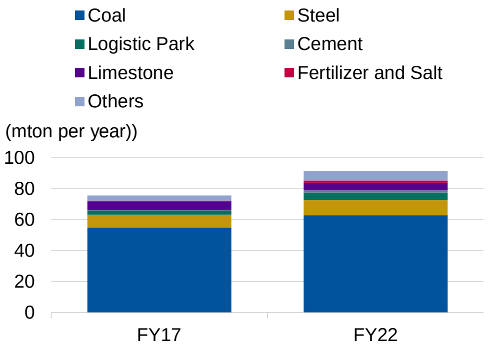
Source: DFCCIL

Operation and Revenue Risks

A minimum 70% (of traffic due) traffic transfer commitment with the commencement of operations in FY17 and thereafter in every subsequent years by MoR ensures adequate traffic allocation and mitigates revenue risk. Coal supply from Eastern Coalfields is projected to dominate the eastern corridor's traffic stream. The traffic on the western corridor would mainly comprise containers from JNPT and Mumbai port in Maharashtra and ports of Pipavav, Mundra and Kandla in Gujarat.

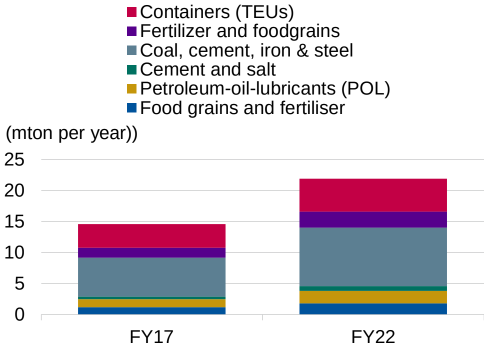
Freight movement on the eastern corridor is projected to grow at a CAGR of 3.85% from 75.61MT during FY17-FY22. Whereas freight movement (excluding containers movement) on the western corridor is projected to grow at a CAGR of 8.78% during FY17-FY22 from 10.9MT and container movement to grow at a CAGR of 6.88% from 3.8million TEUs. The growth projections are supported by a 6.75% CAGR growth witnessed by Indian Railways in the freight movement during FY00-FY12.

Figure 11
Eastern Corridor - Freight Movement



Source: DFCCIL

Figure 12
Western Corridor - Freight Movement



Source: DFCCIL

Furthermore, a track access agreement between MoR and DFCCIL for using train paths and networks by authorised train users in lieu of track access charge (TAC) insulates DFCCIL from operational risks. TAC payable by MoR provides for a reasonable rate of investment and incentives for handling incremental traffic and maintaining high performance standards. The charge has three main components namely: fixed capacity charge, variable charge and reward/penalty component. The finalised charges submitted by DFCCIL to MoR by an independent tariff regulatory authority assure fair consideration.

Figure 13
TAC Structure

Type of charge	Cost covered	Timings
Fixed capacity charge	It will at least cover debt servicing and repayment obligations, RoE, interest on working capital and fixed organisational cost	Monthly
Variable charge	It is levied based on a charge per gross ton km	Monthly
Additional reward/penalty	Linked to over or under achievement by DFCCIL against predefined key performance indicators	Yet to be finalised

Source: DFCCIL

Debt Structure and Funding Risks

The first charge of lenders (including JICA and World Bank) on the project's escrow account after meeting its statuary and O&M expenses mitigates DFCCIL from defaulting on its debt service obligations.

JICA loan is a sovereign loan and is hedged by GoI at a rate of 6.8%. The loan has been passed on to DFCCIL at an annual rate of 7.0% by MoR against the base rate of 0.2% being levied on MoR by JICA. However, DFCCIL is exposed to forex risk as World Bank loan is not hedged. The servicing of World Bank loan comprising principal and interest (LIBOR plus variable spread) is to be made in rupee equivalent to USD at prevailing rates. DFCCIL has notified MoR regarding the hedging options available for the loan and the matter is under consideration with the ministry.

Financial Performance

DFCCIL hopes to commence commercial operations from FY17. Till then, operating expenditure (establishment expenditure) along with the interest during construction is being capitalised. Interest income is the only source of income of the corporation. It grew 123.42% yoy to INR1.87bn in FY13. The entity had an outstanding external debt of INR9.86bn at end-March 2014.

Appendix A

Figure 14

Income Statement

(INRm)	FY12	FY13
Revenue	90.13	82.01
-Fare income	0	0
-Others	90.13	82.01
Operating costs	75.04	69.25
-Staff costs	4.57	3.73
-Other net operating expenditure	70.47	65.52
-Depreciation and amortisation	0	0
Operating profit from operations	15.09	12.76
Other non-operating items (+/-)	0	0
Profit pre-interest	15.09	12.76
Interest receivable	83.48	186.50
Interest expensed	0.11	0
Other financing income/(expense)	0	0
Net exceptional items (+/-)	0	0
Taxes	-31.14	-64.31
Surplus (deficit)	67.31	134.95

Source: DFCCIL

Appendix B

Figure 15

Balance Sheet

(INRm)	FY08	FY09	FY10	FY11	FY12	FY13
Infrastructure assets	10.30	91.23	171.51	370.40	664.84	991.11
Rolling stock	0.00	0.00	0.00	0.00	0.00	15.73
Other tangible assets	0.00	0.00	0.00	0.00	0.00	0.00
Intangible assets	0.00	0.00	0.43	0.69	0.81	3.10
Other non-current assets	0.99	78.33	153.23	187.54	228.59	1,312.22
Financial assets	0.00	0.00	0.00	0.00	0.00	0.00
Non-current assets	11.29	169.55	325.16	558.63	894.24	2,322.16
Stocks	0.00	0.00	0.00	0.00	0.00	0.00
Trade debtors	0.00	0.00	0.00	0.00	0.00	0.00
Other current assets	1.40	0.55	20.55	33.82	50.91	67.30
Cash, deposits & liquid investment	80.20	107.72	244.94	231.89	418.98	541.92
Current assets	**81.60**	**108.27**	**265.49**	**265.70**	**469.90**	**609.22**
Total assets	**92.89**	**277.82**	**590.65**	**824.34**	**1,364.14**	**2,931.38**
Borrowings, bonds & lease liabilities	0.00	0.00	0.00	0.00	0.00	0.00
Trade creditors	0.00	0.00	0.00	0.00	0.00	0.00
Other creditors	3.98	17.08	31.51	117.34	98.83	107.42
Accruals & deferred income	0.00	0.00	0.00	0.00	0.00	0.00
Short-term provisions	0.91	2.51	0.01	0.00	0.00	0.05
Current liabilities	4.89	19.59	31.52	117.34	98.83	107.47
Long-term borrowings, bonds & lease liabilities	0.00	0.00	0.00	38.00	93.49	94.28
Long-term trade creditors	0.00	0.00	0.00	0.00	0.00	0.00
Other long-term creditors	0.00	0.00	0.00	1.83	6.67	21.41
Deferred grants	0.00	0.00	0.00	0.00	0.00	0.00
Pension and healthcare	0.00	0.00	0.00	0.00	0.00	0.00
Provisions	0.00	0.00	0.00	0.03	0.10	0.48
Non-current liabilities	**0.00**	**0.00**	**0.00**	**39.87**	**100.26**	**116.17**
Net assets	**88.00**	**258.23**	**559.13**	**667.13**	**1,165.05**	**2,707.74**
Capital and reserves						
Issued ordinary shares	88.00	258.23	559.13	667.13	1,165.05	2,707.74
Revaluation reserve	0.00	0.00	0.00	0.00	0.00	0.00
Other reserves	0.00	0.00	0.00	0.00	0.00	0.00
Profit & loss/revenue reserves	0.00	0.00	0.00	0.00	0.00	0.00
Equity attributable to minority interests	0.00	0.00	0.00	0.00	0.00	0.00
Total shareholders' equity	**88.00**	**258.23**	**559.13**	**667.13**	**1,165.05**	**2,707.74**

Source: DFCCIL

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