

ICRA Lanka reaffirms the ratings of Vidullanka PLC; revises the outlook from Negative to Stable

January 05, 2018

Instrument*	Current Rated Amount (LKR Mn)	Rating Action
Issuer Rating	-	SL[A]- ; reaffirmed and Outlook revised to 'Stable' from 'Negative'
Existing Commercial Paper Programme(COR/IR/15/08)	100.00	[SL]A2+; reaffirmed
Existing Commercial Paper Programme(COR/IR/16/04)	100.00	[SL]A2+; reaffirmed

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a Group Company of Moody's Investors Service, has reaffirmed the Issuer rating of [SL] A- (pronounced SL A minus) assigned for Vidullanka PLC's ("VLL"/ "the Company"), while revising the outlook to Stable from Negative. ICRA Lanka has also reaffirmed the short term ratings of [SL]A2+ (pronounced [SL] A two plus¹) assigned to the two LKR 100.00 Million commercial paper programmes of the company, totaling LKR 200 Mn.

Rationale

The revision of the rating outlook from Negative to Stable considers the improvement in the Company's profitability in 6MFY18 and consequently the reduction in leveraging. ICRA Lanka draws comfort from the favorable weather conditions that prevailed in Sri Lanka - especially from the Southwest Monsoons since early 2017. The heavy rainfalls have continued and with the onset of the Northeast Monsoons, the forecast is for higher rainfalls and therefore, the hydro power plants based in the Eastern part of the country are expected to perform well. A positive development during 6MFY18, was the commissioning of the Muvumbe SHPP in Uganda as well as the construction of Udawela MHPP in Badulla, which is expected to be commissioned in Dec CY2017. The Muvumbe project was completed on schedule and below the budget. The company has also received the initial grant component of US\$ 2.3 Mn in July CY2017 (50% of the total Grant facility of US\$ 4.5 Mn, which is available to projects under Getfit Program administered by the German KFW Development Bank), while the balance is spread over the next five years of the operations. ICRA Lanka will monitor the disbursement of the other tranches of the capital grant, and this will aid the company's liquidity position substantially.

The rating reaffirmation factors in the company's sole reliance on run-of-the-river MHPPs which are exposed to vagaries of the monsoon. Notwithstanding the recent geographical diversifications, the risk is accentuated by VLL's current modest scale of operations which exposes cash flows to volatility; One of VLL's major plants - Bambarabatuoya's (BBO, contributing about 10% of revenues) PPA has expired in

¹ For complete rating scale and definitions please refer to ICRA Lanka's Website www.icralanka.com or other ICRA Rating Publications

June 2016. Currently, the plant is fully operational and although the new PPA is being negotiated with the authorities, the tariff rates are expected to be set considerably lower as compared to the average tariff that was enjoyed by the company during the previous contract period. Ability of the Company to negotiate favorable PPA terms for the plant or achieve further revenue diversification would be key rating sensitivities.

Key rating drivers

Credit strengths

Engineering excellence; good project appraisal systems: The rating considers favourably the experience of the management team and VLL's strong operational track record which has enabled the Company to record healthy growth in revenues and profits over the past several years. VLL currently operates nine mini-hydro power plants (MHPPs) across Sri Lanka and a first overseas mini hydro project in Uganda, with a total generation capacity of 25.25 MW.

Despite its small scale of operations, the Company has been efficiently managing its operations through prudent selection of locations and strong control over operations & maintenance. As a consequence, a majority of VLL's plants have been running at peak achievable plant load factors (PLF). Vidullanka has also developed engineering expertise in the hydro power space over the past several years. This enables the company to respond quickly to outages at their power plants and restore normal service with quick turnaround times.

Geographical Diversification; Although the company's operations were focused on the southern part of the country initially, which is under S/W Monsoon period, the company had diversified geographically into Eastern part of the country through Redeepana MHPP, Haloya MHPP and the new power plant-Udawela MHPP. Further, with the recently started Muvumbe SHPP in Uganda, the company has further diversified their geographical presence into Africa. Sri Lanka's river catchments areas are within 10-100 square kilometers region, whereas in Uganda, this is generally within 800 square kilometers radius, providing better hydrological constant flow compared with the Sri Lankan conditions. Moreover, as the revenue from Muvumbe SHPP operations is in USD, the revenues in rupee terms would have a growth element due to exchange gains, given the depreciation of LKR, which in turn will improve the consolidated performance of the company.

Strong revenue visibility and limited counterparty risks: All of VLL's plants have firm power purchase agreements (PPAs) with the CEB for 15-20 years and these are extendable upon mutual agreement after expiry. These PPAs have provided strong revenue visibility over the long term; given the government backing of CEB and the receivables pose limited counterparty credit risk. Given the robust economic outlook and Government of Sri Lanka's (GoSL) focus on Non-Conventional Renewable Energy Sources (NCRE), demand prospects also augur well for the Company.

The company's revenue generating capacity increased substantially over the past two years as it had acquired a further 49.9% stake in Lower Kothmale plant in FYE 2016 (stake already held as a Joint Venture). Moreover, the company has commissioned its Muvumbe mini hydro project in July CY2017 while Udawela MHPP was commissioned by the end of CY2017.

Comfortable Financial Profile: VLL's financial profile is characterized by relatively robust profitability (RoCE in excess of 10-15%, except in FY17), relatively comfortable capital structure (moderate gearing of

1.2x as at 6MFY2018) and adequate coverage metrics. VLL's liquidity profile has also traditionally been strong with adequate cash balances and liquid investments, besides access to bank funding, given their strong relationship with financial institutions. The Company, in the past, has also been able to successfully raise equity funds from the capital markets, which provides adequate comfort on the Company's fund raising ability.

Credit challenges

Fluctuations in rainfall leading to risk of volatile cash flows: The Company's power generation solely relies on run-of-the-river MHPPs which are exposed to vagaries of the monsoons. The risk is accentuated by VLL's current modest scale of operations which exposes cash flows to volatility; during FY2017, severe drought condition that prevailed in Sri Lanka has adversely affected the plant load factors of most mini hydro plants in Sri Lanka and consequently the profitability. During FY2017, the company's total power generation stood at 48.5 GWh, a 28% reduction from the previous year's total power generation.

New Investments in Biomass Project: The rating also factors in VLL's investments in the proposed Dendro/biomass plant in Dehiattakandiya, Sri Lanka at a cost over LKR 1.3 billion, and requiring significant debt funding (~70% of the cost). This project has an installed capacity of 3.3 MW and is expected to be constructed in Dehiattakandiya, Sri Lanka. The Company has already invested in excess of LKR 120 Mn in YTD and this project is expected to commence its operation in early Dec 2018. ICRA Lanka positively views the concessionary trade terms that has been provided by suppliers under this project in addition to the engagement of a specialized EPC contractor to carry out the same. The timely completion of the project and successful management of fuel supply risk will be critical and we will continue to monitor the same.

New investment proposal in Uganda: Vidullanka is actively seeking to add more overseas power plants to its portfolio. The company is waiting for the regulatory approval (grid connectivity clearance) for the acquisition of Bukinda Hydro(U) Ltd(Uganda), which holds the approvals to develop 6.5 MW Bukinda SHPP. The company has currently invested only a minimal amount in this venture and intends to buy the full stake of this project from the original investor- Timex Garments (Private) Limited in Sri Lanka after the full regulatory clearance is granted. Although, these plants are expected to help diversify VLL's revenue streams and contribute to overall profit growth over the near to medium term, ability of the Company to minimize cost overruns and achieve commercialization of the plants within targeted timelines will be a key sensitivity to the rating.

Debt funded capital expansion is likely to result in adverse capital structure over the medium term: Going forward, ICRA Lanka expects some moderation in VLL's debt metrics (i.e. TD/OPBDITA, NCA/Debt), due to high capital expenditures in its expansion program. Therefore, ICRA Lanka will continue to monitor the company's debt metrics going forward and hence, this is a key rating sensitivity to the reaffirmed rating. Notwithstanding the proposed debt restructuring program, the company's debt metric has skewed towards short term borrowings. Given the increased debt funded investments over the past two years, capital repayment obligation has increased to ~LKR 450 Mn in FYE March 2018. Nevertheless, ICRA Lanka takes comfort from the financial flexibility of the Group which is expected to aid in timely refinancing of the short term borrowings.

Analytical approach: For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below.

Links to applicable criteria: <http://www.icralanka.com/images/pdf/Corporate%20Rating%20Methology.pdf>

About the company:

Incorporated in 1997 as a Board of Investment (BOI) venture, Vidullanka PLC (VLL) constructs, operates and maintains MHPPs. At present it operates nine mini hydro power projects. VLL operated 5 plants on its own and through subsidiaries, and 4 other plants through joint ventures. During FY2016 VLL increased its stake in one of its JV, Lower Kothmale Oya Hydro Power (Pvt) Ltd. During April CY2017, the company has commissioned its first overseas mini hydro power project in Uganda. With this, the Company has 6 subsidiaries and 4 JVs. Vidul Engineering Ltd, a subsidiary of VLL is into designing of its plants and rendering of energy consultancy services to in-house operations and to third parties. The Company commenced the power generation of its first foreign power project, Muvumbe SHPP in Uganda in March 2017. The plant capacity is designed at 6.5 MW and would generate and transmit electricity to the Ugandan national grid. VLL also intends to diversify into other NCRE energy sources. During FYE March 2017, VLL's total installed power generation capacity stood at 25.5 MW with an estimated energy potential of 102 GWh power annually.

Key financial indicators (audited)

Revenue and profitability indicators-Figs are in LKR Mn	FY15	FY16	FY17	6MFY18*
Operating Income	563.3	723.2	534.8	797.7
OPBDITA	274.6	395.7	232.7	612
PAT	355.0	371.6	41.7	381.7
ROCE (%)	24.3%	19.0%	5.4%	26.0%
NWC / OI(%)	34.1%	45.9%	21.4%	9.9%
Total Debt	630.9	1448.4	2604.6	2591.3
Networth	1447.2	1865.4	1801.8	2070.0
Gearing (x)	0.4	0.8	1.4	1.2
OPBDITA/Interest & Finance Charges(x)	6.6	4.2	1.4	4.7
Total Debt/OPBDITA (x)	2.3	3.7	11.2	2.1

*-Unaudited Financials

Rating history for last three years

Instrument	Type	Current Rating (2018)		Chronology of Rating History for the past 3 years			
		Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating Jan 2018	Date & Rating Feb 2017	Date & Rating Aug 2016	Date & Rating March 2016
1 Issuer Rating(COR/ER/15/07)	-	-	-	[SL]A-(Stable)	[SL]A-(Negative)	[SL]A-(Stable)	[SL]A-(Stable)
2 Commercial Paper (COR/IR/15/08)	Short Term	100.00	100.00	[SL]A2+	[SL]A2+	[SL]A2+	[SL]A2+
3 Commercial Paper (COR/IR/16/04)	Short Term	100.00	100.00	[SL]A2+	SL]A2+	[SL]A2+	-

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