ICRA Lanka revises outlook to Negative from Stable while reaffirming [SL] A- rating of Vidullanka PLC

February 28, 2017

Instrument	Amount (in LKR Mn)	Revised Rating Action
Issuer Rating	-	SL[A]- (Negative); reaffirmed
Existing – Commercial Paper Programme(CP/2016/12/02)	100.00	[SL]A2+; reaffirmed
Existing - Commercial Paper Programme(CP/2016/06/01)	100.00	[SL]A2+; reaffirmed

ICRA Lanka Limited, subsidiary of ICRA Limited, a Group Company of Moody's Investors Service, while reaffirming the Issuer rating of [SL] A- (pronounced SL A minus) has revised the outlook to Negative from Stable for Vidullanka PLC's ("VLL"/ "the Company"). ICRA Lanka has also reaffirmed the short term ratings of [SL]A2+ (pronounced SL A two plus[1]) assigned to the two LKR 100.00 Million commercial paper programmes of the company, totaling LKR 200 Mn.

The revision of the rating outlook to Negative considers the dual impact of weakened profitability and increased leveraging, which has resulted in a moderation in the financial risk profile of the company. The lower profitability has followed from the expiry of PPA of one of the largest hydro plants which enjoyed high tariffs; and, the failure of the monsoon in the current year resulting in lower PLFs. The company's debt levels have also increased due to the acquisition of majority stake in Lower Kothmale project and the large ongoing debt-funded capital expenditure for the Ugandan hydro project.

The rating reaffirmation factors in the company's sole reliance on run-of-the-river MHPPs which are exposed to vagaries of the monsoon. The risk is accentuated by VLL's current modest scale of operations which exposes cash flows to volatility; during 6M FYE March 2017, 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. One of VLL's major plants – Bambarabatuoya's (BBO, contributing over 17% of revenues) PPA has expired in June 2016. Currently, the plant is fully operational although the new PPA is being negotiated with the CEB; 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.

The rating also factors in VLL's investments in two new plants (Muvumbe SHPP and Udawela MHPP in Badulla) and the proposed Dendro/biomass plant in Dehiattakandiya, Sri Lanka at a cost over LKR 1.0 billion, requiring significant debt funding (~70% of the cost). The Company has already invested in excess of US$ 2.85 Million in Uganda YTD and this project is expected to commence its operation in early March 2017. ICRA Lanka views positively a capital grant, which is available to the project under Getfit Program administered by the German KFW Development Bank, with 50% of the total capital grant being expected during FYE March 2018, while the balance is to be disbursed over the next four years. ICRA Lanka will monitor the disbursement of the first tranche of the capital grant, and this will aid the liquidity position substantially. The company has commenced the construction of 1.4 MW Udawela Mini Hydro Power Project in Nov 2016 and the commissioning of the same is expected during March FYE 2018.

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

The proposed fuelwood –based power project with installed capacity of 3.0 MW is expected to be constructed at a project cost of US$ 6.3 Mn in Dehiattakandiya, Sri Lanka. The timely completion and successful management of fuel supply risk will be critical and ICRA Lanka will monitor the same, when implemented. While 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.

The rating, however, 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 eight mini-hydro power plants (MHPPs) across Sri Lanka with a total generation capacity of 17.35 MW. Despite its small scale of operations (VLL's capacity represents less than 6% of total domestic installed MHPP capacity), 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). During FYE March 2016, the company's total power generation stood at 68 GWh, an 8% increase from the previous year's total power generation. During 6M FY17, the company's total power generation was negatively affected due to the adverse weather conditions that prevailed in the country. 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.

All of VLL's plants also 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 receivables pose limited counterparty credit risk. The company's revenues have increased substantially in FYE March 2016 as it had acquired a further 49.9% stake in Lower Kothmale plant (stake already held as a Joint Venture) and therefore, the revenues from plant (~LKR 240Mn annualized) are now being consolidated on the group's financial profile. ICRA Lanka further draws comfort from VLL's healthy financial profile which is characterized by robust profitability (RoCE in excess of 18%, except in 6M FY17), comfortable capital structure (moderate gearing of 0.1x as at 6 M ending FYE March 2017) 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.

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 overseas project. Notwithstanding the proposed debt restructuring program, the company's debt metric has skewed towards short term borrowings and as a consequence, debt repayment obligation has increased to ~LKR 450 Mn in FYE March 2016 from LKR 100 Mn in FYE March 2015. 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.

Company Profile

Incorporated in 1997 as a Board of Investment (BOI) venture, Vidullanka PLC (VLL) constructs, operates and maintains MHPPs. At present it operates eight mini hydro power projects. VLL operated 4 plants on its own and through subsidiaries, and 4 other plants through joint ventures. During FYE March 2016, VLL increased its stake in one of its JV, Lower Kothmale Oya Hydro Power (Pvt) Ltd following approval from Colombo Stock Excahnge(CSE) and shareholders. With this, the Company has 5 subsidiaries and 3 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. Though operating only in Sri Lanka to date, VLL is about to commence 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 2016, VLL's total power generation stood at 68 GWh, an 8% increase from the total power generation in the previous year. With the proposed two new plants, VLL's total power generation capacity would increase significantly to 26.85 MW from the present level of 17.35 MW.

On a consolidated basis, for FYE March 2016, VLL reported a net profit (concern share) of LKR 371.6 Mn on an operating income of LKR 723.2 Mn, as against a net profit (concern share) of LKR 355.0 Mn on an operating income of LKR 563.3 Mn in FYE March 2015. For 6M March 2017, VILL has recorded a net profit of LKR 108 Mn on operating income of LKR 359.5 Mn as against a net profit of LKR 202.3 Mn on an operating income of LKR 308.8 Mn during the same period in FYE 2016.

February 2017

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