

ICRA Lanka reaffirms the ratings of Vidullanka PLC;

January 28, 2019

| Instrument* | Current Rated Amount (LKR Mn) | Rating Action |
|--|----------------------------------|----------------------------|
| Issuer Rating | - | SL[A]- (Stable) reaffirmed |
| Commercial Paper Programme(COR/IR/15/08) | 100.00 | [SL]A2+ reaffirmed |
| Commercial Paper Programme(COR/IR/16/04) | 100.00 | [SL]A2+ withdrawn |

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) with Stable outlook, assigned for Vidullanka PLC's ("VLL"/"the Company"). ICRA Lanka has also reaffirmed the short term rating of [SL]A2+ (pronounced [SL] A two plus¹) assigned to the LKR 100.00 Mn outstanding commercial paper programme of the company. The rating of [SL]A2+ (pronounced [SL] A two plus²) on the other LKR 100 Mn Commercial programme has been withdrawn at the request of the company.

Rationale

The reaffirmation of the ratings considers the improvement in the Company's profitability in FY2018 and 6MFY2019 and consequently the reduction in leverage. This was mainly due to the favorable weather conditions that prevailed in Sri Lanka - especially from the Northeast and Southwest Monsoons since the latter part of 2017. The heavy rainfalls have continued and with the onset of the Northeast Monsoons in CY2018/19, 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 going forward. A positive development during FY2018, was the commissioning of the Muvumbe SHPP in Uganda as well as the construction of Udawela MHPP in Badulla, which was commissioned in Dec CY2017. The Muvumbe project was completed on schedule and below the budgeted capital cost. The company had also received the initial and the interim grant components of US\$ 2.3 Mn in July CY2017 and US\$ 0.45 Mn in H2CY2018 (this facility is available to projects under Getfit Programme administered by the German KFW Development Bank), while the balance is spread over the next four years of the operations.

The ratings reaffirmation factors in the company's sole reliance on run-of-the-river MHPPs which are exposed to vagaries of the monsoon. Notwithstanding the company's geographic diversification, the risk is accentuated by VLL's current modest scale of operations which exposes cash flows to volatility. The PPA of one of VLL's major plants - Bambarabatuoya's (BBO, contributing currently about 5% of revenues), has expired in June 2016. Currently, the plant is fully operational. 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

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

² For complete rating scale and definitions please refer to ICRA Lanka's Website www.icralanka.com or other ICRA Rating Publications

sensitivities. Moreover, the company has not received the outstanding deemed hydrology payments ~US\$ 0.25 Mn for the Muvumbe SHPP in Uganda, pending regulatory approvals. Although, the company has sizable banking guarantees for the default of such payments, the ability of the management to collect all the receivables would be a key factor towards determining the liquidity and credit profile of the company.

The ratings also consider the various large capex projects being undertaken/ planned which would have an impact on the long term capital structure. The company intends to construct its second overseas mini hydro project, Bukinda-SHPP with 6.5 MW capacity in Uganda in Mid CY2019. The company is also currently constructing its first Dendro power project with 3.3 MW capacity in Dehiathakandiya, Sri Lanka. ICRA Lanka will continue to monitor the ability of the company to successfully carryout the construction of these projects without any cost overruns and delays.

Key Rating Drivers

Credit strengths

Engineering track record; good project appraisal systems: The ratings consider 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 ten mini-hydro power plants (MHPPs) across Sri Lanka and a first overseas mini hydro project in Uganda, with a total generation capacity of 27.5 MW. Despite its relatively small scale of operations, the company has been efficiently managing its operations through prudent selection of locations and strong control over operations and maintenance. As a consequence, a majority of VLL's plants have been running at peak achievable plant load factors (PLFs). Moreover, ICRA Lanka also notes positively the company's recent divestment of Haloya Mini hydro power plant, which has been underperforming over the past several years due to relatively high agricultural diversions in the catchment area. VLL 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.

Diversification strategy; 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 the Eastern part of the country through Redeepana 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 catchment areas are within 10-100 square kilometers region, whereas in Uganda, this is generally within 800-2,000 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 has a growth element due to exchange gains, given the depreciation of LKR, which in turn has improved the consolidated performance of the company.

Strong revenue visibility and limited counterparty risks: All of VLL's domestic 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 has commissioned its overseas Muvumbe SHPP in

April 2017 while, Udawela MHPP was also commissioned by the end of CY2017. The company further intends to expand its capacity overseas as well as locally, over the next two years.

Comfortable Financial Profile: VLL's financial profile is characterized by relatively robust profitability (ROCE in excess of 15-20%, except in FY17), relatively comfortable capital structure (moderate gearing of 1.0x as at 6MFY2019) 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 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 conditions that prevailed in Sri Lanka had 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. However, this risk is mitigated to a large extent by the recent geographical diversification.

New Investments in Biomass Project: The rating also factors in VLL's investments in the proposed Dendro/biomass plant in Sri Lanka at a cost over US\$ 8.4 Mn, and requiring significant debt funding (~70% of the cost). This project has an installed capacity of 3.3 MW and is currently under construction in Dehiattakandiya, Sri Lanka. The total investment commitment by VILL for this project is about LKR 221 Mn for 51% stake and the company has already invested ~90% of the total capital commitments. This project is expected to commence its operation in Mid-2019. ICRA Lanka views positively the concessionary trade terms that has been provided by suppliers for this project in addition to the engagement of a specialized EPC contractor to carry out the same. Moreover, the new investor of this project, OC Energy Lanka Ltd-fully owned subsidiary of Obayashi Corporation of Japan, is also expected to infuse their expertise into this segment going forward. The timely completion of the project and successful management of fuel supply risk will be critical and ICRA Lanka will continue to monitor the same.

Increased investments in Uganda: Vidullanka has been actively seeking to add more overseas power plants to its portfolio. During FY2018, the company has fully acquired Bukinda Hydro(U) Ltd (Uganda), which holds the approvals to develop 6.5 MW Bukinda SHPP. The company has currently invested ~YTD LKR 200 Mn in this venture and intends to start the construction in Mid-2019. Although, these plants are expected to help diversify VLL's revenue streams and contribute to overall profit growth, the ability of the Company to minimize cost overruns, regulatory risks and thereby achieve commercialization of the plants within targeted timelines will be a key sensitivity to the ratings.

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 towards its expansion programme. 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 ratings. Notwithstanding the recent debt restructuring exercise, which has reduced the company's short term borrowings to a large extent, the company's debt serviceability indicators still remain relatively stretched. Given the increased debt funded investments over the past two years, capital

repayment obligation in FY2019 is expected to increase ~LKR 500-600 Mn. Nevertheless, ICRA Lanka takes comfort from the financial flexibility of the Group which is expected to aid in timely refinancing.

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%20Methodology.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 ten mini hydro power projects. VLL operates 7 plants on its own and through subsidiaries, and 3 other plants through joint ventures and associates. During FY2016 VLL increased its stake in one of its subsidiaries, Lower Kothmale Oya Hydro Power (Pvt) Ltd. During April CY2017, the company has commissioned its first overseas mini hydro power project in Uganda. During FY2018, the company has also commissioned Udawela MHPP (1.4 MW). Moreover, during H1FY2019, VILL has divested one of its JVs, Haloya MHPP. With these developments, the Company has eight subsidiaries, two JVs and one associate company. 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. VLL also intends to diversify into other NCRE energy sources. During FYE March 2018 VLL's total installed power generation capacity stood at 27 MW with an estimated energy potential of 108 GWh power annually.

Key financial indicators (audited)

| Revenue and profitability indicators-Figs are in LKR Mn (Consolidated Level) | FY15 | FY16 | FY17 | FY18 | 6MFY19* |
|---|--------|--------|--------|---------|---------|
| Operating Income | 563.3 | 723.2 | 534.8 | 1,328.0 | 770.0 |
| OPBDITA | 274.6 | 395.7 | 232.7 | 949.9 | 587.2 |
| PAT | 355 | 371.6 | 41.7 | 509.2 | 344.8 |
| ROCE (%) | 24.30% | 19.00% | 5.40% | 19.30% | 20.83% |
| NWC / OI(%) | 34.10% | 45.90% | 21.40% | 38.34% | 44.77% |
| Total Debt | 630.9 | 1448.4 | 2604.6 | 2,629.5 | 2,814.2 |
| Networth | 1447.2 | 1865.4 | 1801.8 | 2,184.3 | 2,721.2 |
| Gearing (x) | 0.4 | 0.8 | 1.4 | 1.20 | 1.03 |
| OPBDITA/Interest & Finance Charges(x) | 6.6 | 4.2 | 1.4 | 3.7 | 4.0 |
| Total Debt/OPBDITA (x) | 2.3 | 3.7 | 11.2 | 2.8 | 2.4 |

*-Unaudited Financials, Note- the capital grant receipts during FY18 and 6MFY19 are consolidated into the total operating income during these respective periods

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 2019 | 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-(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+ | [SL]A2+ | |
| 3 Commercial Paper (COR/IR/16/04) | Short Term | 100.00 | 100.00 | Withdrawn | [SL]A2+ | [SL]A2+ | [SL]A2+ | N/A | |

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