

July 28, 2022

Aquatech Water Solutions Private Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term loan	40.00	40.00	[ICRA]BBB (Negative); reaffirmed
Total	40.00	40.00	

*Instrument details are provided in Annexure-I

Rationale

ICRA maintains its Negative outlook on the rating of Aquatech Water Solutions Private Limited (AWSPL) due to the continued uncertainty in Hinduja National Power Corporation Limited's (HNPC's) power purchase agreement (PPA) related dispute with Andhra Pradesh Distribution Company (APDISCOM). Due to the dispute, HNPCL is operating at suboptimal capacities leading to low volume offtake from AWSPL, resulting in subdued variable income, lower profitability and coverage indicators for the latter. ICRA notes that the Hon'ble Supreme Court has decided in favour of HNPCL, so the PPA and tariffs are expected to be finalised soon. However, timely resolution of the matter and consequent ramp up of the project capacity utilisation will be crucial for sustaining AWSPL's liquidity and debt coverage metrics over the next few quarters, given that the fixed revenue is expected to decline by ~36-37% from May 2023 onwards, as per the terms of the agreement. The rating is also constrained by the high client concentration risk with all revenue generated from a single customer (HNPCL) and from a single project.

However, the rating draws comfort from the strong ring-fencing mechanism around debt repayments with a debt service reserve account (DSRA) holding funds equivalent to two quarters of interest and principal obligations, along with one quarter of instalment being retained either in the escrow account or as fixed deposit. AWSPL's revenues are routed through the escrow account, which prioritises debt repayments over operational expenses, providing additional comfort to its credit profile. Moreover, the rating factors in the project's revenue visibility, post satisfactory scale-up, with an assured offtake contract for 25 years (from May 2014) with HNPCL. The rating notes the existence of the take-or-pay arrangement for fixed charges, ensuring a stable stream of revenues, adequate to meet the debt obligations and operational costs. There also exists a tail period of 12 years for the project, lending it flexibility to raise additional funds and refinance debt, if required. ICRA notes that the company has received the timely payment of fixed charges from HNPCL, which has helped to serve its debt on time.

Key rating drivers and their description

Credit strengths

Long-term revenue visibility due to 25-year contract and take-or-pay arrangement for part revenues – AWSPL has established a 25-year contract (from May 2014) for supplying treated water to HNPCL's power plant in Visakhapatnam, Andhra Pradesh. According to the contract, HNPCL will pay a pre-specified fixed charge for the entire tenure of the contract, even in case of minimal offtake from AWSPL. According to the contract, the fixed charges will remain the same for the initial nine years (May 2014 to May 2023), after which there will be a downward revision by ~36-37%. Further, a variable charge is paid on the quantity of water treated, which is escalated at the rate of 8.5%, and is primarily linked with AWSPL's capacity utilisation. Revenue from the variable component in the recent times has remained significantly lower than the initially anticipated level owing to the lower offtake by HNPCL.

DSRA and ring-fencing arrangement by lender supports overall credit profile – According to the sanction letter, AWSPL is required to maintain two quarters of repayments in the DSRA. Apart from this, the company maintains one quarter of

repayment either in the escrow account or fixed deposit, as stipulated by the lender. AWSPL's receipts from HNPCL are routed through the escrow account where statutory payments, debt repayments and DSRA replenishment are prioritised over operational expenses. Further, there is a cash sweep mechanism, where 50% of the surplus, after meeting operational expenses and capital expenses, goes towards debt prepayment.

Significantly long tail period lends flexibility to refinance current debt or raise additional funds – While the scheduled repayment tenure is until FY2028, the contract period is until FY2040. The company has a tail period of 12 years to refinance its current debt at a lower cost or a longer tenure or raise additional debt to fund its capital requirements or expansion plans.

Credit challenges

Significant client concentration risk; HNPCL's stabilisation issues impact AWSPL's capacity utilisation – AWSPL derives 100% of its revenues from HNPCL, exposing the former to client concentration risks. Its revenues were impacted by low capacity utilisation because of the stabilisation issues in HNPCL's power plant. Thus, the company's revenue growth is incumbent upon HNPCL ramping up its power plant.

Low capacity utilisation leads to modest capitalisation and coverage indicators – AWSPL's capacity utilisation has remained below 35% since its inception due to persisting operational issues in HNPCL. This has resulted in lower operating income leading to stretched capitalisation and coverage indicators with gearing of 1.8 times, and DSCR of 1.1 times in FY2022.¹ Nevertheless, the waterfall mechanism ensuring debt repayment and DSRA top-up is prioritised over operational expenses provides comfort. ICRA notes that given the downward revision of 36-37% in fixed revenue from May 2023, as per the terms of the agreement, lower than anticipated increase in project capacity utilisation could exert pressure on the company's debt coverage indicators and liquidity profile. Thus, timely ramp up of capacity utilisation over the next few quarters will be critical for maintaining the company's credit profile.

Modest scale of operations with limited scope of expansion – The water treatment plant is the only project executed by AWSPL and it operates at an installed capacity of 12.5 million litres per day. The company's operations are constrained by low capacity utilization; and being a captive plant, it has limited scope for expansion or obtaining other customers. Owing to its single unit within HNPCL's manufacturing plant, AWSPL is also exposed to high asset concentration risk.

Liquidity position: Adequate

AWSPL's liquidity is **adequate** supported by cash and cash equivalents of Rs. 8.42 crore as on March 31, 2022, which includes DSRA of two quarters of interest and principal payments and one quarter of principal repayment in the form of fixed deposit. Apart from this, there is a tight ring-fencing mechanism prioritising debt repayment and DSRA replenishment over operational expenses, ensuring adequate liquidity for debt repayments.

Rating sensitivities

Positive factors – The outlook can be revised to Stable in case of increase in AWSPL's revenue driven by improved capacity utilisation of the project, aiding the improvement in the company's liquidity and coverage metrics

Negative factors – Negative pressure on AWSPL's ratings could arise if capacity utilisation of the project does not increase in the near term leading to lower variable revenue and coverage against scheduled debt repayment over the next financial year, as fixed revenue (capital recovery payment) is expected to decline from May 2023. Additionally, increase in counterparty risk, i.e., deterioration in credit profile of HNPCL or dilution of ring-fencing arrangement with lenders may trigger a rating downgrade.

¹ As per provisional financials

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

AWSP is an SPV started by Aquios Development Pte Limited (Aquatech Group holding 49% stake in the company) in 2013 to build and operate a water treatment plant for HNPCL in Palavalasa (Vishakhapatnam, Andhra Pradesh). The total project cost was Rs. 57.8 crore, funded through a Rs. 40-crore bank debt, Rs. 10.4-crore promoter debt and Rs. 7.4-crore equity. The total tenure of the contract with HNPCL is for 25 years, starting from May 2014. Currently, the company has only one project and plans to execute more contracts for other Hinduja Group companies. The construction, operations and maintenance have been subcontracted to the associate company, Aquatech Systems Asia Private Limited (ASA).

Established in 1981 and based out of Pennsylvania, USA, Aquatech International Inc. (AIC), the flagship company of the Aquatech Group, is a global leader in water purification technology for industrial and infrastructure markets with a focus on desalination, water recycle and reuse, and zero liquid discharge (ZLD). The company has significant presence in North America, Europe, West Asia, India and China, and is expanding its presence around the world through its subsidiaries. AIC has successfully executed more than 1,000 water management projects in over 60 countries. ASA is the Indian subsidiary of AIC and jointly manages the West Asian and the Asia Pacific markets with AIC.

Key financial indicators (audited)

AWSP	FY2020	FY2021	FY2022*
Operating income	14.5	14.1	14.0
PAT	1.3	1.4	2.2
OPBDIT/OI	59.5%	58.2%	59.4%
PAT/OI	9.0%	9.7%	15.6%
Total outside liabilities/Tangible net worth (times)	4.2	3.6	2.8
Total debt/OPBDIT (times)	4.8	4.6	3.6
Interest coverage (times)	1.7	1.9	2.6

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore, *Provisional

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2023)		Chronology of rating history for the past 3 years			
		Amount rated (Rs. crore)	Amount outstanding as of March 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
				July 28, 2022	Sep 09, 2021	Oct 06, 2020	Nov 04, 2019
1	Term loans	40.0	18.4	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Term Loan	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan -I	FY2019	11.50%	FY2028	20.00	[ICRA]BBB(Negative)
NA	Term Loan -II	FY2016	12.65%	FY2028	20.00	[ICRA]BBB(Negative)

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not Applicable

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