February 05, 2020 Revised

THDC India Limited: Rating placed on watch with developing implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non Convertible Debenture	1500.00	1500.00	[ICRA]AA &; Rating placed on watch with developing implications

**Instrument details are provided in Annexure-1*

Rationale

The rating has been placed on watch with developing implications following the in-principal approval of NTPC Limited's (NTPC) board on January 27, 2020 for acquisition of the Government of India (GoI) stake (74.5% as on September 30, 2019) in THDC India Limited (THDC). The GoI has in the past provided equity support for hydro power projects developed by THDC. Given that substantial hydro power capacity is currently under construction (1,444 MW) THDC will require equity support from its parent (Government of Uttar Pradesh or GoUP holds a 25.5% stake in THDC). ICRA will remove the ratings from watch and take the final action based on clarity on the funding support and dividend payout policy of the parent (for THDC).

The rating continues to factor in the strategic importance of THDC for the GoI and the GoUP, the cost-plus tariff for the company's projects resulting in regulated returns, the efficient operation of the running plants, the presence of power purchase agreements (PPAs) for all its projects, and the stable regulatory regime. The rating is constrained by company's exposure to significant execution risks (2,764 MW under-construction capacity), presence of counterparty credit risks, high cost of power that limits cost competitiveness, uncertainty regarding the eventual extent of approval of costs by Central Electricity Regulatory Commission (CERC) for under-construction projects and the expected deterioration in capital structure as the company avails project loans to fund capital expenditure.

Key rating drivers and their description

Credit strengths

Strategically important entity with multiple purposes apart from power generation: THDC's flagship 2,400-MW Tehri project is a multi-purpose project and therefore, is strategically important for the GoI (a 74.5% stake) and the GoUP (a 25.5% stake). Apart from power generation, the company's projects provide flood control, irrigation water to UP, and drinking water to UP and Delhi. The 1,000-MW Tehri hydro power project (HPP) assisted in restoration of electricity grid in July 2012. The under-construction 1,000-MW pumped storage plant (at Tehri), once commissioned, will not only provide peaking power, but also assist in supporting the grid by providing the balancing power in the presence of several intermittent renewable sources of power.

Cost-plus tariff to result in regulated returns: All commissioned hydro projects, and under-construction projects (except the 24-MW Dhukwan SHEP that has fixed tariff from the GoUP and wind projects that have feed-in tariff from Gujarat Urja Vikas Nigam Limited) have cost-plus tariff. This ensures adequate recovery of fixed charges, resulting in comfortable debt servicing and earning regulated return (subject to meeting the normative operating requirements). Therefore, the coverage indicators of THDC are very strong at present. Accumulation of regulated returns over the years has enabled

THDC to part fund the equity portion and part fund the debt portion of its under-construction projects through internal accruals.

Operational plants continue to run efficiently: Generations from both operating hydro plants (1,000-MW Tehri HPP and 400-MW Koteshwar HPP) have consistently remained close to or above their respective design energy. The generation has been healthy in case of wind power projects (commissioned in FY2017) as well. In fact, the generation in Patan (50 MW) was close to design capacity utilisation factor (CUF), while in case of Dwarka (63 MW) it was higher than the design CUF in FY2019. Although the generation in hydro plants was lower in 9M FY2020 than the previous year, the same remained above the design energy.

Regulatory clarity in place: Tariffs for both the operational hydro projects are based on CERC regulations. In the recent regulations (FY2020–FY2024), CERC has continued its cost-plus tariff with regulated return on equity of 16.5% for storage-type hydro projects (norms tightened, receivable days of 45 from 60, escalation 4.77% instead of 6.64%). The tariff order for 2014–2019 was issued in March 2017 for Tehri and October 2018 for Koteshwar.

Power purchase agreements in place: PPAs are in place for all the projects, which mitigate offtake risk. The two wind projects of 50-MW and 63-MW capacity have fixed tariff of Rs. 4.15/unit and Rs. 4.19/unit, respectively (with generation-based incentive of Rs. 0.5/unit) and one small hydro project of 24 MW (Dhukwan in Jhansi, UP) has a fixed tariff of Rs. 4.87/unit. All other projects have a cost-plus PPA.

Credit challenges

Significant project capacity under construction: THDC is undertaking construction of four projects with aggregate capacity of 2,764 MW (1,444-MW hydro and 1,320-MW thermal). This exposes the company to significant project execution risks (completion within budgeted time and cost estimates), especially on account of the existing time and cost overruns in under-construction hydro projects and the nascent stage of construction of the 1,320-MW Khurja Super Thermal Power Project and the associated Amelia coal block.

Significant exposure to counterparty risks: Even though THDC has a distributed PPA profile, it is still exposed to the risk of delayed payments from utilities with weak financials (close to half the allocated capacity). Increased receivables in H1 FY2020 (billing of income for prior years post tariff finalisation for 2014–2019 block in FY2019) is expected to normalise going forward with strong enforcement of payment security mechanism since August 2019. However, the risk of delayed payments will persist with exposure to the financially weak discoms.

High cost of power: The levelised tariff for operational hydro projects of THDC is above Rs. 4 per unit, while that of under-construction projects is even higher (more than Rs. 7 per unit for 1,000-MW Tehri Pumped Storage Plant and more than Rs. 5 per unit for Vishnugad Pipalkoti HPP) at the current cost estimates (which too can escalate, given the time remaining for construction). This limits the ability to regulate power supplies to third party in the event of prolonged delay in payments from discoms.

Uncertainty regarding approval of costs by CERC: While the under-construction projects are expected to earn regulated returns on account of cost-plus tariff (subject to achieving normative operating parameters), uncertainty remains regarding the quantum of costs that will be eventually approved by CERC. To the extent the costs are disallowed, the cushion available for debt servicing for the respective project loans will be lower. The low gap between CERC approved and incurred project costs of operational hydro projects offers comfort.

Capital structure to deteriorate going forward: For the ongoing projects, THDC is expected to incur cumulative expenditure of ~Rs. 17,000 crore over the next six years. Going forward, the company is likely to avail sizeable debt to fund the incremental capex and finance the already incurred capex to achieve the planned funding mix of 70:30 (debt:equity). This is expected to result in a substantial increase in debt and with tapering OPBITDA of the existing hydro projects. The Total Debt/OPBITDA is expected to increase to 10.7 times in FY2022 from the current 2.0 times as of FY2019. While the capital structure will be substantially leveraged, the commencement of interest and principal servicing on these project loans post commissioning of the respective projects is a source of comfort.

Liquidity position: Adequate

THDC's liquidity is **adequate**, supported by the cost-plus nature of operations. This coupled with higher-than-normative operating performance in the past has resulted adequate cover for debt servicing. The liquidity is also supported by strong financial flexibility and strong parentage of THDC, which results in enhanced ability to tie-up funds.

Rating sensitivities

Positive triggers: Following the resolution of watch, ICRA may upgrade the ratings if the under-construction projects are commissioned within the current budgeted estimates and the respective project costs are approved by CERC.

Negative triggers: Following resolution of watch, ICRA may downgrade the ratings if there are significant time or cost overruns in the under-construction projects, resulting in deterioration in cost competitiveness of these projects or ability to earn regulated returns, subject to disallowances by CERC. Significant delay in payment of dues by discoms resulting in the weakening of the company's liquidity profile may also trigger a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on standalone financial profile of the company

About the company

THDC is a joint venture of the GoI and the GoUP. The company was incorporated in July 1988 for setting up of 2,400-MW Tehri HPP. Two of the three projects, the 1,000-MW Tehri HPP and the 400-MW Koteshwar HPP, are operational, while the 1,000-MW pumped storage project is expected to be commissioned by June 2022. In addition, the company has two operational wind projects of aggregate capacity of 113 MW. Apart from these projects, the key under-construction projects of the company include the 1000-MW Tehri Pumped Storage Plant (PSP) and the 444-MW Vishungadh Pipalkoti HPP. These projects are expected to be commissioned in June 2022 and December 2022, respectively. In addition, the 24-MW Dhukwan SHEP has been commissioned in December 2019, although commercial operation date is yet to be approved. The company has also received investment approval in March 2019 for the development of the 1,320-MW Khurja Super Thermal Power Project and the associated Amelia coal block.

In FY2019, the company reported a net profit of Rs. 1255.6 crore on an operating income (OI) of Rs. 2,768.0 crore against net profit of Rs. 771.2 crore on an OI of Rs. 2185.1 crore in FY2018.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	2185.1	2768.0
PAT (Rs. crore)	771.2	1255.6
OPBDIT/OI (%)	78.0%	78.0%
RoCE (%)	13.5%	21.3%
Total Outside Liabilities/Tangible Net Worth (times)	0.5	0.5
Total Debt/OPBDITA (times)	2.4	2.0
Interest Coverage (times)	7.5	12.3

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)					Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	Rating	FY2019	FY2018	FY2017
					5 Feb 2020	30-Aug-2019	-	-	-
1	Non Convertible Debenture	Long Term	1500.00	1500.00*	[ICRA]AA&	[ICRA]AA (Stable)	-	-	-

**as on December 31, 2019*

&: Under rating watch with developing implications

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE812V07021	Non Convertible Debenture	NA	NA	NA	1500.00	[ICRA]AA&

&: Under rating watch with developing implications
Source: THDC India Ltd

Annexure-2: List of entities considered for consolidated analysis: Not applicable

Corrigendum

Document dated February 5, 2020 has been corrected with revisions as detailed below:

The first sentence of the first para on page 1 of the rationale has been modified and now includes the date of Material event, i.e. January 27, 2020.

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About ICRA Limited:

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