

August 09, 2019

SJVN Arun-3 Power Development Company Pvt. Ltd.: Provisional [ICRA]AA+(SO)(Stable) assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	6333.48	Provisional[ICRA]AA+ (SO) (Stable) ¹ ; Assigned
Total	6333.48	

**Instrument details are provided in Annexure-1*

Rationale

ICRA's rating action factors in the strategic importance of SJVN Limited (SJVN) for the Government of India (GoI) and the Government of Himachal Pradesh (GoHP), the cost-plus tariff for SJVN's operating hydro projects resulting in regulated returns, efficient operation of running plants, presence of power purchase agreements (PPAs) for operational projects and stable regulatory regime. Rating concerns emanate from its exposure to significant execution risks (2,280 MW under-construction capacity), presence of counterparty credit risks, uncertainty regarding eventual extent of approval of costs by Central Electricity Regulatory Commission (CERC) for under-construction projects and expected deterioration in capital structure as the company avails project loans for funding capital expenditure. Nevertheless, the counterparty credit risks are mitigated by the cost competitive power supplied by SJVN. The cost-plus tariff should ensure adequate cushion in debt servicing in the future, once the repayment commences for project debt of under-construction projects despite the deterioration in capital structure. While the financial profile of the company is strong, simultaneous development of new projects (in addition to 2,280 MW under-construction capacity) and/or high dividend payouts can drain the internal accruals of the company (for funding equity portion of new project capacity) and therefore subdue the cushion available for debt servicing.

The assigned rating is based on an unconditional and irrevocable guarantee to be provided by SJVN (the guarantor) for the Rs. 6333.48-crore term loans (of which Rs. 3,053.68 crore is yet to be tied-up) of SJVN Arun-3 Power Development Company Pvt. Ltd. (SAPDC) and an undertaking from the guarantor to ensure that the debt obligations are serviced on or prior to the due date, irrespective of the invocation of the guarantee by the beneficiary.

Outlook: Stable

ICRA believes that SJVN will continue to benefit from its cost-plus tariff operations, which will be supported by healthy generation in its plants. The outlook may be revised to positive if the under-construction projects are commissioned within the current budgeted estimates and the respective project costs are approved by CERC. The outlook may be revised to Negative if there are significant time or cost overruns in under-construction projects, resulting in deterioration in cost competitiveness of these projects or ability to earn regulated returns, subject to disallowances by CERC; or higher dividend payouts/development of new projects, resulting in lowering of cushion available for debt servicing.

¹ For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

Key rating drivers

Credit strengths

Corporate guarantee extended by parent for full bank lines – The credit profile of SAPDC is strengthened by the unconditional and irrevocable corporate guarantee to be extended by SJVN for SAPDC’s bank lines.

Undertaking ensures timely servicing of dues – While the draft corporate guarantee given by SJVN does not have a structured payment mechanism, the guarantor has provided an assurance, over and above the corporate guarantee to be given to the bankers, that it would ensure timely servicing of SJVN’s bank debt-related obligations.

Strategically important GoI-owned company – SJVN is promoted by the GoI (a 61.93% stake) and the GoHP (a 26.85% stake). It has developed two hydro projects with aggregate capacity of 1,912 MW on Sutlej river in Himachal Pradesh besides its flagship project, 1,500-MW Nathpa Jhakri hydro power project (HPP), which has completed 15 years of operations. The GoI and GoHP have demonstrated their support for SJVN through equity contributions in the past. In addition, SJVN was able to secure project debt funding from World Bank at a cheap rate on account of it being a GoI entity. The World Bank loan is guaranteed by the GoI.

Cost-plus tariff to result in regulated returns – All commissioned hydro projects, and under-construction projects (except 60-MW Naitwar Mori and 900-MW Arun 3) have cost-plus tariff. For the under-construction projects as well, the company expects to sign PPAs at CERC/Uttarakhand Electricity Regulatory Commission (UERC)-approved tariff rates (CERC for Arun 3 HPP and UERC for Naitwar Mori HPP being developed in Uttarakhand). This ensures adequate recovery of fixed charges, resulting in comfortable debt servicing and earning regulated return, subject to meeting normative operating requirements.

Operational plants running efficiently – Generation from both operating hydro plants (1,500-MW Nathpa Jhakri HPP and 412-MW Rampur HPP) have consistently remained close to or above their respective design energy. This has aided the company in not only earning regulated returns but also incentives attached to higher-than-normative plant availability and higher-than-designed energy generation.

Regulatory clarity in place – Tariff for both the operational hydro projects is 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 45 days from 60 days, escalation 4.77% instead of 6.64%). The tariff order for 2014-19 was issued in July 2019 for Nathpa Jhakri HPP and June 2019 for Rampur HPP.

Credit challenges

Significant project capacity under construction – SJVN is undertaking construction of three projects with aggregate 2,280 MW capacity (two hydro and one thermal). This exposes the company to significant project execution risks (completion within budgeted time and cost estimates). These risks are exacerbated by its lack of experience in developing HPPs in Nepal, lack of experience in developing thermal power projects, very early stage of construction in both 900-MW Arun 3 project in Nepal and 1,320-MW coal-based Buxar project in Bihar (investment approval received in March 2019) in addition to the weak profile of contractors in Arun 3 HPP. These risks, however, are mitigated by the

support from the GoN for development of the project (the GoN benefits from 21.9% free power from the project and has already assisted in acquisition of land for the same), experience of SJVN in developing larger sized project in India, appointment of NTPC Ltd. as the project management consultant for end-to-end commissioning of the Buxar project.

Exposure to counterparty risks – Even though SJVN has a distributed PPA profile, it is still exposed to the risk of delayed payments from utilities with weak financials (more than a third of allocated capacity). The debtor days for SJVN have remained less than 60 days (adjusted for advance against depreciation and unbilled revenues). The cost of power being supplied by SJVN is very competitive (Rs. 2.31/unit for Nathpa Jhakri HPP and Rs. 4.25/unit for Rampur HPP in FY2019). This affords the company considerable bargaining power and it regularly regulates power for Delhi, Uttar Pradesh, and Jammu & Kashmir discoms to recover past dues.

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/UERC. While in case of Arun 3 HPP, since the PPA is yet to be signed, there is significant uncertainty with respect to offtake tariff of the project. To the extent the costs are disallowed, the cushion available for debt servicing for the respective project loans will be lower.

Capital structure to deteriorate going forward; although debt servicing remains comfortable – SJVN, for its under-construction projects, is expected to incur cumulative expenditure of ~Rs. 17,500 crore over the next five years. The company will therefore avail a sizeable quantum of debt with planned funding mix of 70:30 (debt:equity). This is expected to result in a substantial increase in debt. The total debt/OPBITDA is expected to increase to 9.1 times in FY2024 from 1.1 times in FY2019. While the capital structure will be substantially leveraged, the debt servicing on these project loans will commence post commissioning of the respective projects. In addition, the company will continue to generate surplus cash from the existing projects (entire debt paid off for 1,500-MW Nathpa Jhakri HPP and the remaining debt of Rampur HPP to be paid off by FY2028). Further, SJVN is expected to continue to hold sizeable cash and liquid investments, which add cushion for debt servicing.

Higher dividend payouts and/or higher incremental capital expenditure may put strain on internal accruals – SJVN is expected to fund the equity portion of its under-construction projects from internal accruals. While the amount of dividends/buyback was high in the past (the company was not actively undertaking construction of new projects), ICRA expects that the same to moderate with the company undertaking sizeable capital expenditure going forward. The available cushion in debt servicing will be severely impacted though if the dividend payout remains high or the company commences construction of new projects (several projects in SJVN portfolio are currently under survey/feasibility stage).

Liquidity position

The liquidity profile of SJVN is very strong, supported by the regulated nature of operations, financial flexibility reflected in its ability to raise funds from the market as a GoI entity, and cash and liquid investments of Rs. 2,906.1 crore as on March 31, 2019. The net debt of the company is negative Rs 750.9 crore as on March 31, 2019. Given the cost-plus nature of operations, the debt servicing is expected to remain comfortable at the current level of planned capital expenditure (equity portion of capital expenditure to be funded through internal accruals).

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Approach for rating debt instruments backed by third-party explicit support
Parent/Group Support	Parent: SJVN Limited The ratings are based on explicit support in the form of a draft corporate guarantee to extended by the parent (SJVN) for the bank lines of SAPDC
Consolidation / Standalone	For arriving at the ratings, ICRA has consolidated the financials of the various entities of SJVN (as mentioned in Annexure-2) given the close business, financial and managerial linkages among the same

About the guarantor

SJVN is a mini ratna company promoted by GoI (61.93%) and GoHP (26.85%); the balance 11.22% stake in the entity is held by the public. It currently has an installed capacity of 2,014.5 MW, which includes two hydro projects of Nathpa Jhakri (1500 MW) and Rampur (412 MW) in Himachal Pradesh, one wind project Khirvire (47.6 MW) in Maharashtra and one wind project Sadla (50 MW) and solar project Charanka (5 MW) in Gujarat. In addition, SJVN is currently developing projects of capacity 2,280 MW, which include the 900-MW Arun 3 hydro power project in Nepal, 60-MW Naitwar Mori hydro project in Uttarakhand and 1,320-MW Buxar project in Bihar. The CCEA approval for investment in the thermal project has been received in March 2019. Apart from these, there are other hydro projects in SJVN's portfolio which are under survey and investigation, DPR preparation, feasibility study stages.

In FY2019, the company reported an operating income (OI) of Rs. 2,654.7 crore and a net profit of Rs. 1,362.6 crore against an OI of Rs. 2,229.0 crore and net profit of Rs. 1,221.6 crore in FY2018.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	2,229.0	2,654.7
PAT (Rs. crore)	1,221.6	1,362.6
OPBDIT/OI (%)	75.8%	76.6%
RoCE (%)	13.9%	16.1%
Total Debt/TNW (times)	0.2	0.2
Total Debt/OPBDITA (times)	1.3	1.1
Interest Coverage (times)	20.1	17.6

About the company

SAPDC, a 100% subsidiary of SJVN Ltd., is located in Nepal and is currently developing the 900-MW Arun 3 hydro project on BOOT basis. The project will have a construction period of five years from the date of financial closure of the project and operation period of 25 years, after which it will be transferred to the GoN. The project, located on river Arun in the Sankhuwasabha district of Nepal, 657 km from Kathmandu via Birat Nagar, is a run-of-the-river scheme and will generate 3,924 MU. About 21.9% free power will be supplied to the GoN. The project is expected to commence commercial operations by end of FY2024. Financial closure is yet to happen, and PPAs are yet to be signed. The project is being developed at a cost of Rs. 6,959 crore to be funded in debt:equity of 70:30. The entire equity is to be brought up front.

The project development agreement (PDA) was signed with Investment Board of Nepal, GoN on 25.11.14. CCEA accorded investment approval in February 2017.

Key financial indicators (audited)

	FY2017*	FY2018*
Operating Income (Rs. crore)	0.0	0.0
PAT (Rs. crore)	0.0	-0.1
OPBDIT/OI (%)	-	-
RoCE (%)	0.0%	0.0%
Total Debt/TNW (times)	2.2	3.3
Total Debt/OPBDITA (times)	NM^	NM
Interest Coverage (times)	NM	NM

*July ending financial year

^NM – Not meaningful

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Instrument	Current Rating (FY2020)			Chronology of Rating History for the past 3 years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. Crore)	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017
1 Term Loan	Long Term	6333.48	Nil	Aug 2019 Provisional [ICRA]AA+ (SO) (Stable)	-	-	-

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	April 24, 2019	8.8%	January 15, 2039	2320.00	Provisional [ICRA]AA+ (SO) (Stable)
NA	Term Loan	July 15, 2019	8.8%	January 15, 2039	305.00	Provisional [ICRA]AA+ (SO) (Stable)
NA	Term Loan	July 16, 2019	8.8%	January 15, 2039	654.80	Provisional [ICRA]AA+ (SO) (Stable)
NA	Term Loan Proposed	-	-	-	3053.68	Provisional [ICRA]AA+ (SO) (Stable)

Source: SAPDC

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
SJVN Arun-3 Power Development Company Pvt. Ltd.	100%	Full Consolidation
SJVN Thermal Private Limited	100%	Full Consolidation
Cross Border Power Transmission Company Limited	26%	Equity Method
Kholongchu Hydro Energy Limited	50%	Equity Method

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