FitchRatings

Fitch Assigns Sri Lanka's Vidullanka PLC First-Time 'A+(lka)' National Rating; Outlook Stable

Fitch Ratings - Jakarta - 15 Jun 2023: Fitch Ratings has assigned a National Long-Term Rating of 'A+(Ika)' with a Stable Outlook to Sri Lanka based renewable power producer Vidullanka PLC. At the same time, the agency has assigned a National Short-Term Rating of 'F1(lka)' to Vidullanka's two issuances of unlisted commercial paper of LKR100 million each.

The ratings reflect Vidullanka's weak counterparty, Ceylon Electricity Board (CEB, B(lka)/Stable), which is offset by the power producer's relatively strong cash flows from overseas operations, small operating scale, long-term power purchase agreements (PPAs) with fixed tariffs, and modest financial profile amid a significant increase in domestic funding costs.

KEY RATING DRIVERS

Weak Counterparty Profile: Vidullanka's ratings are constrained by its exposure to CEB, the sole electricity transmitter and distributor in Sri Lanka, that has a weak credit profile. As of December 2022, payments from CEB have delayed for more than 600 days. We expect the CEB payment delay to ease gradually, supported by a likely improvement in CEB's cashflows following the total increase in the power tariff of nearly 190% over the last year (75% in August 2022; 65% in February 2023).

Fitch forecasts receivable days for Vidullanka's power plants in Sri Lanka to improve but remain at around 600 days for the financial year ending March 2024 (FY24) and improve further thereafter. However, growing contribution from overseas operations and the engineering, procurement and construction (EPC) segment should keep Vidullanka's consolidated receivables manageable at below 200 days.

Overseas Projects Support Cash Flows: We believe Vidullanka's diversification overseas mitigates the risks from its exposure to CEB. We expect the strong cash flows from the company's Ugandan projects to support positive cash flow from operations. We estimate the Ugandan projects to account for about 90% of Vidullanka's EBIT in FY23 (FY22: 80%) given their US dollar-denominated cashflows and depreciation of Sri Lankan rupee during the year. According to the company, it has full access to the cash at the Ugandan operations after servicing debt obligations.

Small Operating Scale: The company currently operates 49 megawatt (MW) of capacity at its power plants, including joint-venture assets. Vidullanka's scale is likely to remain stable in the next 12-24 months, with the company's cautious approach to investments following the challenging domestic economic and industrial environment.

Price Certainty, Volume Risk: We believe the long-term PPAs for the group's operating assets in Sri Lanka provide price certainty and long-term cash flow visibility. The PPAs have tenors of 15-20 years, with the average remaining life of 11 years. We believe the risk of non-renewal is minimal, given the power shortage in the country. Moreover, Vidullanka has renewed the PPA for its longest operating asset and is in the midst of renewing the another PPA. However, production volume can vary under the PPAs, as it is based on resource availability, which is affected by seasonal and climatic patterns.

Low Capex: We expect Vidullanka's capex to remain low with the expected completion of its Horana Solar power plant in June 2023 and absence of any new projects under development in the near future. The company is focusing on EPC contracts during FY24-FY25. We estimate capex (excluding any investments in JVs) to range between LKR400 million and LKR 500 million annually over FY24 and FY25. We consequently expect Vidullanka's free cash flows to remain positive during FY24-FY26.

Vidullanka is planning to invest in a JV to develop a 50MW solar power plant in Malawi. The company has already secured funding for its share of investment (USD 10 million) for the first phase of development.

Stable Leverage, Lower Coverage: We forecast Vidullanka's EBITDA net leverage to remain at around 2.5x over the next three years (FY22: 2.7x). However, we expect EBITDA interest cover to weaken to below 4.0x during FY23 and FY24 and further to around 3.0x beyond FY25 (FY22: 5.8x), due to rising interest rates. However, the coverage remains adequate for its current ratings. As of end-March 2023, around 30% of its corporate loans carried variable rates.

Growth from Lower-Margin Business: The company has a USD13 million EPC contract to set up a 2.2MW hydro plant for the Guyana Energy Agency. The project is funded by the Islamic Development Bank and the payments are guaranteed. We include this in our revenue forecasts for FY24 and FY25, as the project will take about 18 months to complete, which will translate into about 60% revenue growth in FY24. However, the project generates lower margin than Vidullanka's main business. As such, we expect EBITDA margin to be reduce to 46%-53% in FY24-FY25, from 65% in FY22.

DERIVATION SUMMARY

The rating for Vidullanka is the same as the rating on the third-largest cable manufacturer in Sri Lanka, Sierra Cables PLC (A+(lka)/Stable). Vidullanka has a bigger operational scale with EBITDA of around LKR2.5 billion, compared with around LKR1 billion for Sierra. This offset by the lower counterparty risk for Sierra, whose revenue is better diversified between private (retail) and government (CEB and National Water Supply and Draining Board) customers. The leverage and coverage profiles of the two companies are comparable.

Vidullanka is rated higher than Sri Lankan power producer Resus Energy PLC (BBB(Ika)/Negative) given the former's stronger business and financial profiles. The Negative Outlook on Resus's rating reflects the risk that payment delays from CEB may persist and further erode its liquidity. Resus's operations are concentrated in Sri Lanka and it generates 100% of its cashflow from CEB, resulting in higher counterparty and liquidity risk than Vidullanka, which derived 90% of FY23 EBIT from overseas, based on Fitch estimates. Resus had 17MW of installed capacity at FYE22, and this will increase to 29MW with completion of projects in the pipeline. However, it will remain smaller than the 49MW capacity of Vidullanka.

We see that Vidullanka has a similar liquidity profile and funding access as peers rated 'A+(lka)'. Unlike the other local power producers, which have been granted debt moratoriums from banks to cope with liquidity pressure arising from the CEB's delayed payments, Vidullanka's cash flow remains adequate to fulfill its debt obligations.

KEY ASSUMPTIONS

- Revenue to increase by more than 40% in FY23 with higher contribution from overseas projects. Revenue to increase by around 60% in FY24, supported by the USD13 million EPC contract.

- EBITDA margin to be stable in FY23, and reduce to around 45% in FY24 with higher contribution from lower-margin business (EPC).

- Blended receivable days of around 230 days in FY23.

- Capex of around LKR400 million per year, with no major investment in the pipeline.

- Additional JV investment of USD10 million over FY24 and FY25 for the 50MW Malawi project.

- Dividend payout at around 40%.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

We do not anticipate positive rating action in the near to medium term given the weak counterparty profile of CEB. That said, material improvement in CEB's credit profile can lead to positive rating action provided Vidullanka's maintains an adequate financial profile.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Sustained increase in leverage with EBITDA net leverage exceeding 4.0x;

- Sustained decrease in EBITDA/interest coverage below 1.8x (FY22: 5.8x);

- Weakening liquidity position, including decline in access to bank funding and/ or commercial paper issuance.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: Vidullanka had around LKR600 million in cash and cash equivalents at FYE23, and Fitch estimates it had more than LKR500 million in unused but uncommitted credit lines. This compared with LKR1.4 billion of debt maturing in the next 12 months, comprising around LKR1 billion that is related to overdraft facilities and around LKR400 million that is the current portion of long-term debt for its power plant projects.

We expect the banks to roll over the company's working capital debt. Around 70% of Vidullanka's corporate debt are in form of Wakala facilities and commercial paper (CP) subscription, which have been rolled over in the last three years. The company has good relationships with some local banks and other international financial institutions.

ISSUER PROFILE

Vidullanka is a renewable power producer in Sri Lanka with a total installed power generation capacity of 48.3MW (including associates and JVs) at December 2022. The installed capacity consists of hydro (32.4MW), solar (12.7MW), and dendro, or wood fueled capacity (3.3MW). The operation is based in Sri Lanka (35.3MW) and Uganda (13MW).

DATE OF RELEVANT COMMITTEE

31 May 2023

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING		
Vidullanka PLC	Natl LT	A+(lka)	New Rating
senior unsecured	Natl ST	F1(lka)	New Rating

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VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

- National Scale Rating Criteria (pub. 22 Dec 2020)
- Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)
- Corporate Rating Criteria (pub. 29 Oct 2022) (including rating assumption sensitivity)
- Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 13 May 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

- Solicitation Status
- Endorsement Policy
- Potential Conflicts Resulting from Revenue Concentrations

ENDORSEMENT STATUS

Vidullanka PLC -

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