RATING REPORT

Neelum Jhelum Hydropower Company (Private) Limited

REPORT DATE:
December 30, 2020

RATING ANALYSTS:

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RATING DETAILS

	Instrument Rating	
Rating Category	**Long-term**	**Long-term**
Sukuk	AAA	AAA
Rating Date	*Dec 30, 2020*	*Dec 24, 2019*
Rating Outlook	Stable	Stable

COMPANY INFORMATION

Incorporated in 2004	**External auditors**: Ernst & Young Ford Rhodes Sidat Hyder
Private Limited Company	**Chairman of the Board**: Lt. Gen (Retd) Muzammil Hussain
Key Shareholders (with stake 5% or more):	**Chief Executive Officer**: Brig (Retd) Muhammad Zareen
WAPDA (Water & Power Development Authority) – 100%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporate (May 2019)
Notching The Issue (June 2016)
https://www.vis.com.pk/kc-meth.aspx

Neelum Jhelum Hydropower Company (Private) Limited

OVERVIEW OF THE INSTITUTION

Neelum Jhelum Hydropower Company (Private) Limited (NJHPC) was incorporated on November 18, 2004. The company is a Special Purpose Vehicle (SPV) constituted as a subsidiary of WAPDA (Water and Power Development Authority) for the generation and sale of electricity via the development of Neelum Jhelum Hydropower Power project (NJHPP).

Profile of Chairman

Lt. Gen. (Retd.) Muzammil Hussain, HI (Mil) assumed charge as Chairman of WAPDA on August 24, 2016. He carries over 38 years of experience in Armed forces and is a graduate from Pakistan Military Academy (PMA) with distinction.

Profile of CEO

Brig (Retd.) Muhammad Zareen has been appointed as CEO of NJHPC in September, 2016. Previously, he has served as Advisor Northern Area Projects and General Manager Projects (Northern Areas) for WAPDA.

Financial Snapshot

Net Equity: end-FY20: Rs. 104.5b; end-FY19: Rs. 99.2b; end-FY18: Rs. 100.4b

Total Assets: end-FY20: Rs. 485.0b; end-FY19: Rs. 479.6b; end-FY18: Rs. 463.5b

RATING RATIONALE

The rating assigned to the Sukuk issue take into account unconditional and irrevocable first demand guarantee issued by the President Islamic Republic of Pakistan (on behalf of the Government of the Islamic Republic of Pakistan) (GoP) covering issue amount of the Sukuk along with profit payments. GoP would immediately pay the entire called amount once the demand notice from the trustee is received. Ratings also incorporate strong financial muscle and implicit support from the parent entity, Water and Power Development Authority (WAPDA), in the form of equity injection and funding support.

The company signed an interim PPA with CPPA-G on January 8, 2020, which was valid for one year effective from revised tariff notification date (October 17, 2019) and was extendable with mutual consent of all parties. Subsequent to the lapse of one year ended on October 16, 2020, the management has not opted for extension of interim PPA given that the company has filed a petition regarding final tariff with CPPA-G for onward submission to NEPRA. NJHPC expects that NEPRA would determine the final tariff by end-March'21. The levelized final tariff for 30 years is expected to be Rs. 10.65/kWh which would be implemented after the company signs final PPA (end-March'21) and will be effective from the CoD.

Physical progress stands at 99.76%; delays mainly occurred due to COVID-19 resulting in foreign staff leaving the project site: NJHPC was setup to design, construct, own, operate and maintain Neelum Jhelum Hydropower Power Project (NJHPP) which is a state-of-the-art, world class underground facility with installed capacity of 969 MW (4 Turbines of 242.25 MW each). The main purpose is the development of NJHPP for generation and sale of electricity to CPPA-G. It is a Composite Dam (Gravity + Rock fill) having height of 60 meters, with a tunnel system comprising Twin Tunnels (19.60 km each), Single Tunnel (8.94 km) and Tailrace Tunnel (3.55 km). All four units remained operational during FY20; however, given generation capacity of the power plant is directly linked to the availability of water there is sizeable seasonal variation in energy generation. The project has generated 10,892.6 million kWh up to September 30, 2020 since CoD.

As per the latest progress report, physical progress stood at 99.76%. The delays were experienced due to COVID-19 lockdown and flare-ups on Line of Control (LOC) leading to foreign staff leaving the site for safety reasons. Financial progress (with Interest During Construction (IDC) etc.) stood at 82.28%; the lag in financial and physical progress is due to settlement of payments. Operating fixed assets stood at Rs. 390.7b (FY19: Rs. 404.3b) at end-FY20 while capital work in progress including direct costs and exchange loss on foreign capitalized payments amounted to Rs. 55.3b (FY19: Nil). The company has also recorded right-of-use asset of Rs. 10m (FY19: Nil) in line with initial recognition under IFRS 16.

As per the 4th revision in PC-1 2017, the approved contract cost was Rs. 506.8 billion; however, as per management the project is expected to be completed within Rs. 430 billion; accounting for IDCs and other costs total expenditure amounting Rs. 417b was recorded at end-Sep'20. The project cost is being funded through a debt: equity: grant ratio of 74:10:16, with grant component covered by the Neelum Jhelum Surcharge (NJS).

The company and WAPDA signed interim PPA with CPPA-G; the company expects final tariff to vary from the revised provisional tariff notified by NEPRA: Under the interim PPA, the company is obligated to sell and deliver all output of the plant on 'take and pay' basis at the tariff notified by NEPRA. The revised provisional tariff of Rs. 9.12 kWh, announced on August 19, 2019, included components of debt repayment and Operations & Maintenance (O&M) is still applicable (i.e. after expiration of interim PPA); meanwhile, the components of insurance, water use surcharge and profitability will be added once the final tariff is decided. The levelized final tariff for 30 years is expected to be Rs. 10.65/kWh which would be implemented after the company achieves official operations after issuing Taking Over Certificate (TOC) to the contractors and sign final PPA, expected by end-March'21.

The company has raised invoices of Rs. 69.7b against payments against sale of electricity till June 30, 2020, which were agreed to be received in six equal semi-annual installments. Invoices have been raised on monthly basis in the ongoing year. Outstanding trade debts of Rs. 68.6b (FY19: Nil) included billed revenue against sale of electricity at end-FY20. Delayed payment surcharge of Rs. 143.3m (FY19: Nil) that is eligible to be billed was also shown as trade receivables. Contract assets at end-FY20 included only delayed payment surcharge of Rs. 932.4m accrued on invoices which have not been fully repaid on or before the due date; the same amounted to Rs. 36.1b at end-FY19 on account of unearned revenue of Rs. 27.8b coupled with revenue from trial production adjusted from capital work in progress.

Revenue against sale of electricity stood higher: Revenue from sale of electricity to CPPA-G recognized at the point in time amounted to Rs. 44.2b for FY20 (FY19: 27.8b) while late payment surcharge was Rs. 1.1b (FY19: Nil). Revenue of the company is exempt from sales tax for a period of five years from the date of commencement of commercial production under notification issued by Azad Jammu and Kashmir Central Board of Revenue.

Gross margins increased to 77.6% (FY19: 67.5%) on account of rationalized operating costs; the company recorded gross profit of Rs. 35.1b (FY19: Rs. 18.8b) during FY20. Meanwhile, administrative expenses increased to Rs. 1.1b (FY19: Rs. 63.9m) due to delayed payment charges to contractors amounting Rs. 1.1b (FY19: Nil). These charges pertained to adjustment of an amount related to 2013, that was initially a part of project cost; the same has been incorporated in administrative expenses during the review period. Finance cost was recorded higher at Rs. 33.2b (FY19: Rs. 30.4b) partly in line with higher average markup rates on musharaka financing and partly due to higher foreign relent loans during FY20. Other income largely comprising interest income on bank accounts amounted to Rs. 3.3b (FY19: Rs. 3.6b) during FY20. Net profits was recorded at Rs. 1.6b (FY19: Rs. (8.2b)) during FY20.

Funds from Operations (FFO) amounted to Rs. 34.8b (FY19: NA) mainly on account of improved profitability and higher non-cash adjustments. FFO to total debt and FFO to long-term debt was 0.14x and 0.13x at end-FY20. Long-term repayments during FY20 amounting Rs. 13.5b included Rs. 12.5b paid against long-term diminishing musharaka and Rs. 1.0b against related party loans. Debt service coverage ratio was 1.74x in FY20.

Capitalization supported by internal cash generation along with Neelum Jhelum Surcharge: Equity base of the company increased to Rs. 104.5b (FY19: Rs. 99.2b) on account of decrease in accumulated losses and equity contribution by GoP in the form of NJS. The surcharge amounting to Rs. 69.3b (FY19: Rs. 65.6b) at end-FY20 pertained to NJS billed by DISCOs to consumers up till the date of CoD. Paid-up capital amounted to Rs. 41.7b (FY19: Rs. 41.7b) while share deposit money from WAPDA amounted to Rs. 5.3b (FY19: Rs. 5.3b) at end-FY20.

Long-term financing from financial institutions through GoP (including current maturity) stood higher at Rs. 171.1b (FY19: Rs. 169.0b) at end-FY20 on account of additional borrowing mobilized from Saudi Fund for Development to the tune of Rs. 741.6m and from Exim Bank China to the tune of Rs. 1.3b. Unutilized foreign relent loans balance amounted to US$ 285.5m (FY19: US$ 298.4m) at end-FY20. Lease liabilities including current portion recognized under IFRS 16 amounted to Rs. 10.7m (FY19: Nil). Short-term borrowings of Rs. 15.0b (FY19: Rs. 16.0b) represented loan payable to WAPDA on account of principal and interest payments made by WAPDA on behalf of NJHPC of various foreign relent and local loans. The loan amount is considered payable on demand with no interest being charged until the finalization of terms and conditions. Trade and other payables stood lower at Rs. 17.1b (FY19: Rs. 21.1b) mainly on account of decrease in payables to contractors to Rs. 7.3b (FY19: 17.7b). Meanwhile, late payment surcharge increased to Rs. 5.7b (FY19: Rs. 3.2b); this represented the late fee charges on due installments of foreign relent loans. Additionally, the company has received Rs. 72.8b till end-FY20 as NJS, the excess amount received by the company has been recorded as a liability under Neelum Jhelum Surcharge payable of Rs. 3.5b (FY19: Nil) at end-FY20. The company expects to make a net settlement to the Ministry of Energy or its departments when instructed.

Outstanding balance of Diminishing Musharaka Sukuk (including current maturity) amounted to Rs. 75.0b (FY19: Rs. 87.5b) at end-FY20. The Sukuk is an unlisted, privately placed and non-SLR eligible. It has a tenor of 10 years inclusive of a grace period of 2 years beginning from first drawdown of the Sukuk. First drawdown of Rs. 30b occurred in June'16; second drawdown of Rs. 35b at end-Oct'16 and the third drawdown of Rs. 35b was completed by end-June'18. The Sukuk certificates carry profit at a rate of 6M KIBOR *Plus* 1.75% with semiannual rental payments. NJHPP is entitled to a rebate (Hiba) of up to 0.62% in case the installments (rental + principal) are made within 30 days of the due date. Amount and date of installments paid till date are given below:

	Payment Date	**Amount Paid**
1st Installment	Dec 29' 2018	Rs. 10.3b
2nd Installment	Jun 29' 2019	Rs. 11.8b
3rd Installment	Dec 18' 2019	Rs. 12.5b
4th Installment	Jun 29' 2020	Rs. 12.2b
5th Installment	Dec 21' 2020	Rs. 9.4b

Given payments during review period were made within 30 days a rebate of equivalent to 0.62% was given to the company. As per the waterfall mechanism, an amount equivalent to one-sixth of the installment amount is being deposited each month so that debt payment account (DPA) on the installment date is equivalent to the installment amount. In case of any shortfall in DPA by NJHPC, WAPDA will inject the required funds. In the absence of any income stream, DPA would be recharged with the borrowed amount. As per the management, DPA has been filled with the required amount to be paid on the due date with monthly payments received against invoices averaging around Rs. 3b from CPPA-G.

Corporate Governance: The board comprises nine directors and all are ex-officio directors from WAPDA and senior officials of GoP. Two new directors were appointed during the review period following the retirement of previous ones. Present composition of board is given below:

1.	Lt. Gen Muhammad Muzzamil (Retd), Chairman WAPDA	Chairman NJHPC	BoD
2.	Mr. Zulfiqar Haider Addl. Secretary EAD GoP	Member NJHPC	BoD
3	Mr. Tanvir Butt Addl. Secretary MoF GoP	Member NJHPC	BoD
4.	Syed Muhammad Mehar Ali Shah JS MoWR GoP	Member NJHPC	BoD
5.	Dr. Shazad Bangush Chief Secretary GoAJ&K	Member NJHPC	BoD
6.	Mr. Javed Akhter M(P) WAPDA	Member NJHPC	BoD
7.	Mr. Naveed Asghar Ch M(F) WAPDA	Member NJHPC	BoD
8.	Mr. Jawaid Akhter Latif M(W) WAPDA	Member NJHPC	BoD
9.	Brig ® Muhammad Zareen CEO NJHPC	Member NJHPC	BoD

At senior management level, Mr. Saqlain Manzoor was appointed as Chief Financial Officer in place of Mr. Hamid Mahmood upon expiry of his contract on July 20, 2020.

Neelum-Jhelum Hydropower Company (NJHPC) Appendix I

BALANCE SHEET (in PKR millions)	FY18	FY19	FY20
Operating Fixed Assets	1,128	404,317	390,695
Capital Work in Progress	402,024	-	55
Trade Debts	-	-	68,645
Contract Asset	-	36,147	932
Other Assets	2,097	889	699
Bank Balances	58,262	38,231	23,992
Total assets	**463,511**	**479,583**	**485,019**
Long-Term Financing (Including current maturity)	156,052	169,034	171,088
NBP Sukuk (Including current maturity)	100,000	87,500	75,000
Trade and Other Payables	24,032	21,073	17,068
Short-Term Borrowings	16,048	16,048	15,048
Mark-Up Accrued on Long-Term Borrowings	55,163	79,999	95,405
Other Liabilities	11,862	6,752	6,927
Total Liabilities	**363,156**	**380,406**	**380,536**
Issued, subscribed and paid up capital	41,664	41,664	41,664
Accumulated Profit/(Loss)	(5,203)	(13,402)	(11,788)
Share Deposit Money	5,300	5,300	5,300
Government Grant (NJS)	58,593	65,616	69,307
Total Equity	**100,354**	**99,178**	**104,482**
INCOME STATEMENT	**FY18**	**FY19**	**FY20**
Revenue	-	27,798	45,262
Gross Profit	-	18,764	35,111
Administration Expenses	43	64	1,149
Finance Cost	-	30,355	33,178
Other Income	-	3,595.6	3,296.0
Profit/ (Loss) Before Tax	(1,748)	(9,562)	1,615
Profit/(Loss) After Tax	(3,110)	(8,200)	1,615
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**
Gross Margin (%)	-	67.5	77.6
Net Margin (%)	-	-	3.6
Funds from Operations (FFO)	-	-	34,826
FFO to Long-Term Debt (x)	-	-	0.14
FFO to Total Debt (x)	-	-	0.13
Debt Service Coverage Ratio (x)	-	-	1.74
Gearing (x)	2.71	2.75	2.50
Debt Leverage (x)	3.60	3.84	3.64
Current Ratio (x)	0.45	0.49	0.53

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Neelum Jhelum Hydropower Company (Private) Limited
Sector	Power
Type of Relationship	Solicited
Purpose of Rating	Sukuk rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30/12/2020	AAA	N/a	Stable	Reaffirmed
24/12/2019	AAA	N/a	Stable	Reaffirmed
2/01/2019	AAA	N/a	Stable	Reaffirmed
13/09/2017	AAA	N/a	Stable	Reaffirmed
12/04/2016	AAA	N/a	Stable	Preliminary

Instrument Structure	Apart from GoP guarantee, security structure of the Sukuk entails charge on all unencumbered present and future assets of the company and exclusive lien over debt payment account (DPA). As per the waterfall mechanism, an amount equivalent to one-sixth of the installment amount will be deposited each month so that DPA on the installment date is equivalent to the installment amount. In case of any shortfall in DPA Account by NJHPC, WAPDA will inject the required funds.
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meeting/s Conducted		Name	Designation	Date
	1	Mr. Shakeel Ahmad	Deputy General Manager Finance	25-Nov-2020