RATING REPORT

Neelum Jhelum Hydropower Company (Private) Limited

REPORT DATE:
January 12, 2022

RATING ANALYSTS:
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RATING DETAILS		
	Instrument Rating	
Rating Category	**Latest Rating**	**Previous Rating**
Sukuk	AAA	AAA
Rating Date	*Jan 12, 2022*	*Dec 24, 2021*
Rating Outlook	Stable	Stable
Rating Action	Reaffirmed	Reaffirmed

COMPANY INFORMATION	
Incorporated in 2004	External auditors: Ernst & Young Ford Rhodes Sidat Hyder
Private Limited Company	**Chairman:** Lt. Gen (Retd) Muzammil Hussain **CEO:** Engr. Muhammad Zareen
Key Shareholders (with stake 5% or more):	
Water & Power Development Authority (WAPDA) – 100%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (August 2021)
Rating the Issue (November 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf
https://docs.vis.com.pk/docs/Notchingtheissue202007nov.pdf

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.

RATING RATIONALE

The rating assigned to the Sukuk issue take into account unconditional and irrevocable first-demand guarantee issued by the President of 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 dated 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 did not opt for extension of interim PPA, as a petition was filed regarding final tariff with CPPA-G in November'2020. CPPA-G forwarded Company's request to NEPRA in February 2021. The public hearing was held on June 21, 2021 at NEPRA Head office; however, the tariff petition could not procced on its merits due to the prevailing of third-party validation of project costs. Resultantly, the interim tariff of Rs. 9.1184 per kWh has been extended on take and pay basis with must run condition until the company gets waiver of third-party validation requirement or conducts the validation. After complying with either of the two condition, the company will file a final tariff petition through CPPA-G. The Planning Commission of Pakistan has invited Request for Proposals (RFP) for cost validations through third-party in August 2021. The award of contract for validation engagement is still awaited.

Physical progress stands at 99.89% while taking over of whole project has been delayed

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. Since commissioning, the project has generated energy of 15,743.6 million kWh up to November 30, 2021.

As per the latest progress report dated December 07, 2021, physical progress stood at 99.89%. Main works remaining include submission of construction drawings/shop drawings, punch list items, O&M manuals, and some remaining Civil & EMH works. Taking over certificate of the whole the whole of project could not be issued to the contractors due to non-completion of some pending works on the project site; however, the same is expected to be completed by end-March'2022. Financial progress (with Interest During Construction (IDC) etc.) stood at 82.41%; as per the management, the lag in financial and physical progress is due to completion of project well below 4th revision and settlement of payments. Operating fixed assets stood at Rs. 381.8b (FY20: Rs. 390.7b) with no capital-work-in-progress at end-FY21. Right-of-use assets amounted to Rs. 4.9m (FY20: Rs. 10.0m).

As per the 4th revision in PC-1 2017, the approved contract cost was Rs. 506.8b; however, as per management, the project is completed within Rs. 428b. Accounting for IDCs and other costs, total expenditure amounted to Rs. 417.7b as per the latest progress report. 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 expects final tariff to vary from the 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. 9.1184/kWh, announced on August 19, 2019, included components of debt repayment and Operations & Maintenance (O&M) is still applicable; 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 that would be implemented upon the issuance of TOC to the contractors, waiver or completion of third-party validation, and signing of financial PPA.

The power complex remained operational as per availability of water and generated 4,789.7 million kWh units of electricity during FY21, well above the target of 4,600 million kWh. However, since the provisional tariff expired on October 16, 2020 and the company filed to final tariff instead of taking extension, no invoices were raised for the sale of power to CPPA-G between Oct'2020 and June'2021. Resultantly, based on the provisional tariff of Rs. 9.1184/kWh, the company injected power into National Grid of Rs. 43.7b during FY21, out of which Rs. 16.5b was recorded as sale of power and remaining Rs. 27.2b (FY20: Rs. 932m) was recorded as contract assets. Since the company is entitled to claim delayed payment surcharge at 3-month KIBOR plus 2% per annum, total delayed payment surcharge turned out to be Rs. 1.2b (FY20: Rs. 1.1b) during FY21. The CPPA-G released funds of Rs. 33.2b during FY21 against the invoices; however, total receivables increased to Rs. 79.0b by end-FY21 including contract assets of Rs. 27.2b.

Bottom-line supported by reduction in finance cost burden despite largely stable revenue
Revenue from sale of electricity to CPPA-G amounted to Rs. 43.7b (FY20: Rs. 44.2b) while late payment surcharge was Rs. 1.2b (FY20: Rs. 1.1b) during FY21. 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. The company reported slightly lower gross profit of Rs. 33.2b (FY20: Rs. 35.1b), which translated into gross margin of 74.1% (FY20: 77.6%), mainly on account of incremental cost of imported energy amounting to Rs. 221.7m (FY20: nil), increase in employees' benefits to Rs. 156.5m (FY20: Rs. 22.9m), and surge in insurance cost to Rs. 1.5b (FY20: Rs. 470.3m) during FY21. Administrative expenses declined to Rs. 88.6m (FY20: Rs. 1.1b) in the absence of delayed payment charges to contractors during FY21. Meanwhile, the company also recorded a provision of Rs. 2.2b (FY20: nil) during FY21 against delayed payment charges due from CPPA-G. Finance cost declined to Rs. 25.6b (FY20: Rs. 33.2b) mainly due to lower markup on musharaka instrument as well as slight decline in finance cost on commercial financing during the year. Other income declined to Rs. 1.9b (FY20: Rs. 3.3b) due to lower interest rates and mainly comprised interest income of bank accounts during FY20. Resultantly, the company reported higher net profit of Rs. 3.5b (FY20: Rs. 662m) which translated into improved net margin of 7.7% (FY20: 1.5%) during FY21.

Funds from Operations (FFO) decreased to Rs. 27.4b (FY20: 31.8b) mainly on account of increase in interest payment to Rs. 16.7b (FY20: Rs. 15.2b) and decrease in interest income during FY21. The debt service coverage ratio was recorded at 1.48x (FY20: 1.64x) as the company made long-term principal repayments of Rs. 13.1b (FY20: Rs. 13.5b), including diminishing musharaka repayment of Rs. 12.5b (FY20: Rs. 12.5b) and related party loans repayment of Rs. 566m (FY20: Rs. 1.0b) during FY21.

Manageable capitalization indicators
Paid up capital of the company amounted to Rs. 41.7b (FY20: Rs. 41.7b) while share deposit money amounted to Rs. 5.3b (FY20: Rs. 5.3b) at end-FY21. Overall equity base increased to Rs. 105.9b (FY20: Rs. 102.3b) as the retention of profits led to decrease in accumulation losses to Rs. 10.3b (FY20: Rs. 13.8b) by end-FY21. Equity contribution by GoP in the form of NJS amounted to Rs. 69.3b (FY20: Rs. 69.3b), which was collected from electricity consumers of distribution companies (DISCOs) operating in Pakistan.

Long-term financing from financial institutions through GoP (including current maturity) stood 170.5b (FY20: Rs. 171.1b) on account of foreign relent loans (FRL) repayment of Rs. 131m and cash development loans (CDL) repayment of Rs. 435m during FY21. Unutilized foreign relent loans balance remained unchanged at US$ 285.5m (FY20: US$ 285.5m) as no new funds were mobilized during the year. Short-term borrowings from WAPDA decreased to Rs. 11.0b (FY20: Rs. 15.0b) on account of payment settlement during the year; these borrowings represent amount payable to WAPDA on account of principal and interest payments made by WAPDA of various foreign relent and local loans on behalf of the company. Increase in accrued markup payable to Rs. 104.3b (FY20: Rs. 95.5b) was due to delay repayment of FRL and CDL loans. The external auditors have reclassified long-term financing and diminishing musharaka as current liabilities owing to default in payments of principal and interest amounts to the GoP. As per the management, diminishing musharaka repayments are on time while delay in long-term financing repayments is due to non-finalization of tariff and delays in payments from CPPA-G against the sale of electricity. The company is negotiating a revised repayment schedule for its long-term (excluding diminishing musharaka) and short-term loans that would be aligned with the company's revenue stream under its final tariff and PPA.

Outstanding balance of diminishing musharaka, inclusive of current maturity, amounted to Rs. 62.5b (FY20: Rs. 75.0b) as the company made principal repayment of Rs. 12.5b (FY20: Rs. 12.5b) during FY21. The instrument 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. 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 6-month 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. 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. Amount and date of installment paid till date as tabulated below:

Principal Outstanding	Installment	Due Date	Payment Date	Amount Paid
100.00	1st Installment	28.12.2018	28.12.2018	10.34
93.75	2nd Installment	28.06.2019	28.06.2019	11.82
87.50	3rd Installment	28.12.2019	28.12.2019	12.50
81.25	4th Installment	28.06.2020	28.06.2020	12.19
75.00	5th Installment	28.12.2020	28.12.2020	9.38
68.75	6th Installment	28.06.2021	28.06.2021	9.16
62.50	7th Installment	28.12.2021	28.12.2021	9.01

Neelum Jhelum Hydropower Company (Private) Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY19**	**FY20**	**FY21**
Operating Fixed Assets	404,317	390,761	381,786
Long-term Advances	336	301	301
Trade Debts	-	68,645	52,152
Contract Assets	36,147	932	27,173
Other Assets	552	388	492
Bank Balances	38,231	23,992	23,656
Total Assets	**479,583**	**485,019**	**485,560**
Long-Term Financing *(Inc. current maturity)*	169,034	171,088	170,522
NBP Sukuk (*Inc. current maturity)*	87,500	75,000	62,500
Trade and Other Payables	21,073	17,068	22,060
Short-term Borrowings	16,048	15,048	11,000
Accrued Markup	80,068	95,439	104,373
Total Liabilities	**381,448**	**382,532**	**379,616**
Issued Capital	41,664	41,664	41,664
Accumulated (Loss)/Profit	(14,445)	(13,783)	(10,325)
Share Deposit Money	5,300	5,300	5,300
Government Grant	65,616	69,307	69,307
Total Equity	**98,135**	**102,487**	**105,945**
INCOME STATEMENT	**FY19**	**FY20**	**FY21**
Net Revenue	27,798	45,262	44,826
Gross Profit	18,764	35,111	33,206
Finance Cost	30,355	33,178	25,588
Other Income	3,596	3,296	1,944
Profit/(Loss) Before Tax	(9,562)	1,615	4,010
Profit/(Loss) After Tax	(8,200)	662	3,458
FFO	-	31,815	27,432
RATIO ANALYSIS	**FY19**	**FY20**	**FY21**
Gross Margin (%)	67.5	77.6	74.1
Net Margin (%)	-	1.5	7.7
FFO to Long-Term Debt (x)	-	0.13	0.12
FFO to Total Debt (x)	-	0.12	0.11
Debt Servicing Coverage Ratio (x)	-	1.64	1.48
Gearing (x)	2.78	2.55	2.33
Debt Leverage (x)	3.89	3.73	3.58
Current Ratio (x)	0.20	0.25	0.28

**FY20 accounts were restated.*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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 — Annexure III

Name of Rated Entity	Neelum Jhelum Hydropower Company (Private) Limited
Sector	Power
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
12.01.2022	AAA	-	Stable	Reaffirmed
30.12.2020	AAA	-	Stable	Reaffirmed
24.12.2019	AAA	-	Stable	Reaffirmed
02.01.2019	AAA	-	Stable	Reaffirmed
13.09.2017	AAA	-	Stable	Reaffirmed
12.04.2016	AAA	-	Stable	Reaffirmed

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 Meetings Conducted

Name	Designation	Date
Mr. Saqlain Manzoor	CFO	December 30, 2021