North Eastern Electric Power Corporation Limited

August 02, 2018

North Eastern Electric Power Corporation Limited: [ICRA]AA/Stable assigned

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Proposed Non-Convertible Debenture	-	300.00	[ICRA]AA/Stable assigned
Non-Convertible Debenture – XIth issue	40.00	40.00	[ICRA]AA/Stable outstanding
Non-Convertible Debenture – XIIth issue	120.00	120.00	[ICRA]AA/Stable outstanding
Non-Convertible Debenture – XIIIth issue	72.50	72.50	[ICRA]AA/Stable outstanding
Non-Convertible Debenture – XIVth issue	2500.00	2500.00	[ICRA]AA/Stable outstanding
Non-Convertible Debenture – XVIth issue	900.00	900.00	[ICRA]AA/Stable outstanding
Non-Convertible Debenture – XVIIth issue	300.00	300.00	[ICRA]AA/Stable outstanding
Non-Convertible Debenture – XVIIIth issue	500.00	500.00	[ICRA]AA/Stable outstanding
Non-Convertible Debenture – XIXth issue	300.00	300.00	[ICRA]AA/Stable outstanding
Non-Convertible Debenture – Unplaced	200.00	200.00	[ICRA]AA/Stable outstanding
Issuer Rating	-	-	[ICRA]AA/Stable outstanding
Fund Based Limit – Short Term/Long Term Loan	500.00	500.00	[ICRA]AA/Stable outstanding [ICRA]A1+ outstanding
Total	**5432.50**	**5732.50**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned a long-term rating of [ICRA]AA (pronounced ICRA double A)[1] with Stable outlook to the Rs. 300-crore[2] proposed non-convertible debenture programme of North Eastern Electric Power Corporation Limited (NEEPCO).

ICRA has an outstanding long-term rating of [ICRA]AA with Stable outlook on the existing non-convertible debenture programme of NEEPCO aggregating to Rs. 4932.50 crore. ICRA also has an outstanding issuer rating of [ICRA]AA with Stable outlook on NEEPCO. An issuer rating is an opinion on the general creditworthiness of the rated entity and not specific to any particular debt instrument. On the Rs. 500-crore bank facilities of NEEPCO, ICRA has an outstanding long-term rating of [ICRA]AA with Stable outlook and a short-term rating of [ICRA]A1+ (pronounced ICRA A one plus).

Rationale

The rating assignment takes into account NEEPCO's sovereign ownership and demonstrated support from the Government of India (GoI), its strategic importance to the power scenario in North-East India, with the company meeting around 37% of the regional power requirement in FY2018, and the company's limited demand risks from existing projects arising from its competitive cost of power, and the location of its plants in the North-Eastern region, where competitive intensity is low due to

[1] For complete rating scale and definitions, please refer to ICRA's Website www.icra.in or other ICRA Rating Publications
[2] 100 lakh = 1 crore = 10 million

the existence of only a few players. The rating also derives comfort from the cost-plus nature of the company's operations, leading to steady business returns.

NEEPCO's financial performance in FY2018 has been better than expected due to multiple factors which include a) higher generation and plant availability from hydropower plants, b) higher generation and better quality of gas received (having higher calorific value) at the 101-MW gas-based project in Monarchak, and c) one-off income recognized during the period cumulating to Rs. 107.05 crore on account of compensation for capacity charge under-recovery for the 405-MW Ranganadi hydroelectric station, as well as booking of arrear income for the 135-MW Agartala gas-based power plant following the release of its tariff order. NEEPCO's standalone operating and net profits sequentially registered year-on-year (YoY) increases of 22.7% and 30.6% respectively in FY2018.

NEEPCO has commissioned the first and second units of the 60-MW Tuirial hydroelectric project in August and November of 2017. Additionally, NEEPCO has commissioned both the units of the 110-MW Pare hydroelectric project in May 2018. However, there has been a further delay in commissioning of the 600-MW Kameng hydroelectric project from the earlier deadline of March 2018, and the project is now expected to be operational from January 2019. ICRA notes that notwithstanding the significant cost escalations at Kameng, its first-year tariff remain competitive at around Rs. 4.4/kwh[3], supported by a favourable hydrology. However, given the high capital costs for Tuirial (Rs. 24.2 crore/MW) and Pare (Rs. 15.1 crore/MW), possibility for cost-disallowances by the regulator remain likely. This apart, ICRA understands that to keep the tariff at a reasonable level, a combination of lower operation and maintenance (O&M) expense, lower depreciation rates, and additional grants from Government of India are being considered for these two smaller stations. As per ICRA's revised estimates, factoring in these concessions, the first-year tariff (excluding free power) comes to around Rs. 5.7/kwh[4] for Pare and around Rs. 6.0/kwh[5] for Tuirial. Despite high tariffs at Pare and Tuiral, the generation of which will be mainly drawn by NEEPCO's existing customer base of seven power distribution utilities in North-East India, NEEPCO's average pooled tariff would continue to remain competitive, supported by low tariffs from its existing generation stations (which remained at Rs. 2.68/kwh in FY2018, excluding arrear/one-off bills), largely mitigating offtake risks for these two smaller projects. However, ICRA understands that despite Kameng's competitive levelised tariff, some of the beneficiary states earlier identified by the Government[6] have indicated their unwillingness to off-take power from Kameng. At present, around 50% of Kameng's capacity has been tied-up under long-term power purchase agreement (PPA), and the company is under active discussions to tie-up the balance capacity. Going forward, firming-up of Kameng's untied capacity, any large unexpected project cost disallowances by CEA/CERC which has not been factored in, and timely release of tariff orders for Tuirial, Pare and Kameng[7] would remain important rating drivers.

Gas supply at NEEPCO's 101-MW gas-based station at Monarchak has gradually improved from an average of 0.33 million metric standard cubic meter per day (mmscmd) between November – March of FY2017 to 0.40 mmscmd in FY2018 and Q1 FY2019, helping the plant operate at a plant load factor (PLF) of 76% in FY2018 and 74% in Q1 FY2019 from 49% in November to March of FY2017. However, gas supplies to the 135-MW Agartala gas station has steadily deteriorated from 0.74 mmscmd between November – March of FY2017 to 0.52 mmscmd in FY2018 and 0.47 mmscmd in Q1 FY2019, against a contracted quantity of 0.75 mmscmd. Additionally, gas supply to the 291-MW gas-based station at Assam has also remained suppressed at 1.19 mmscmd in FY2018 and 1.08 mmscmd in Q1 FY2019 against a contracted quantity of 1.4 mmscmd. ICRA notes that a lower gas availability is

[3] Calculated assuming Kameng's completion cost of Rs. 6,662 crore and CEA/CERC approved cost of Rs. 6,496 crore

[4] Calculated assuming Pare's completion cost of Rs. 1,658 crore, CEA/CERC approved cost of Rs. 1,575 crore (including Rs. 200 crore fresh grant), O&M expenses of 3.0% against 4.0%, and additional grant of Rs. 200 crore from the Government of India; Pare's earlier first year tariff estimate of Rs. 6.14/kwh had assumed an approved cost of Rs. 1,581 crore, and a haircut in RoE from 16.5% to 10%

[5] Calculated assuming Tuirial's completion cost of Rs. 1,450 crore, CEA/CERC approved cost of Rs. 1,251 crore (including Rs. 134 crore fresh grant), O&M expenses of 2.5% against 4.0%, additional grant of Rs. 134 crore from the Government of India, and depreciation rate of 2.0% for the first fifteen years against an allowed 5.28%; Tuirial's earlier first year tariff estimate of Rs. 8.01/kwh had assumed an approved cost of Rs. 1,442 crore, a haircut in RoE from 16.5% to 10% and a knockdown in O&M expenses to 2.5% from 4.0%

[6] Vide allocation order dated July 30, 2009, the Government of India allocated 85% of Kameng's capacity with beneficiary discoms in the North-Eastern, Western and Northern India

[7] NEEPCO has already filed the tariff petitions for Pare and Tuirial

suppressing the plant availability at the Assam and Agartala stations, and in turn leading to a substantial capacity charge under-recovery, which is estimated at around Rs. 136 crore for FY2019[8].

Given the absence of the Government's approval for the revised cost estimates for all the three ongoing hydroelectric projects, there has been a prolonged delay in equity infusion by GoI for funding the equity component of the cost escalation. This led to increased dependence on debt funding, in turn leading to increasing leveraging. However, ICRA observes that the approval process for the revised cost estimate for the Kameng, Pare and Tuirial projects is at an advanced stage, and after receiving the approval, GoI is expected to bring in 30% of the equity contribution for the project's cost escalation, which as per ICRA's estimates, would amount to around Rs. 1,408 crore. Out of this quantum, the Government has budgeted to release only Rs. 267 crore in FY2019, given the absence of approval for the revised cost estimates. Nonetheless, despite a delay in equity infusion, NEEPCO's capital structure remain at comfortable levels, supported by healthy cash accruals.

NEEPCO's healthy profit margins, steady cash accruals, and conservative capital structure strengthen its financial profile. The ratings also derive comfort from NEEPCO's favourable financial flexibility, as indicated by its ability to raise funds at competitive interest rates. Moreover, given the long tenure of project loans, NEEPCO has limited principal repayment pressure in FY2019 and FY2020, which is expected to be beneficial to the company as it would provide the necessary headroom to stabilise operations for the new projects before debt servicing picks up. The ratings also reflect NEEPCO's exposure to State Electricity Boards (SEB) having weak financial profile, thereby resulting in significant counter party credit risks, and the company's less diversified customer base, with Assam Power Distribution Company Limited alone accounting for around 45% of revenues, exposing the company to customer-concentration risks as well. However, ICRA notes that in the previous financial year, NEEPCO has been able to significantly bring down its receivable position from Rs. 1,026 crore as on March 31, 2016 to Rs. 441 crore as on March 31, 2017, which has supported its liquidity profile, and reduced its dependence on external borrowings to fund the ongoing capex. NEEPCO's collection efficiency have continued to remain high in FY2018 and Q1 FY2019, with the company maintaining a comfortable receivable position of Rs. 433 crore as on March 31, 2018 and Rs. 375 crore as on June 30, 2018. Given the weak financial health of distribution utilities, the company's ability to sustain a high collection efficiency would remain crucial from the liquidity perspective. Moreover, GoI's timely support to ensure tariff competitiveness for these projects will be important rating drivers.

Outlook: Stable

ICRA believes that NEEPCO's operating profits in FY2019 is expected to increase by around 25.6% YoY, driven by incremental revenue streams from the Tuirial, Pare and Kameng projects[9]. Notwithstanding an expected lower net profit in FY2019 over FY2018 due to an increase in capital charges, net cash accruals are expected to increase by 27.8% YoY in the current year. NEEPCO's financial position is likely to significantly improve in FY2020 following the first full year operations of Kameng, which would generate an EBITDA of around Rs. 978 crore during the period against Rs. 134 crore in FY2019[10]. NEEPCO has already reached the peak gearing level of 1.03 time as on March 31, 2018, and ICRA expects the company's capital structure to improve from FY2019 onwards, supported by rising accruals, and equity infusion from GoI. NEEPCO's outlook may be revised to 'Negative' under the following scenarios: a) further time and cost over-runs in commissioning Kameng, b) Unforeseen large cost disallowances for the Kameng, Pare and Tuirial projects leading to inadequate tariffs, c) gas availability at the operational gas stations deteriorating sharply, d) failure to tie-up the balance capacity at Kameng under long-term PPA. The outlook may be revised to 'Positive' if the company is able to commission the Kameng project within FY2019 and firms up long term PPA for bulk of its untied capacity, as well as CERC approves a remunerative cost-plus tariff for the Kameng, Pare, and Tuirial projects.

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[8] In the base case estimate, gas availability for Assam and Agartala is assumed to deteriorate further in FY2019 over FY2018. Plant availability assumed at 55% for Agartala and 54% for Assam in FY2019

[9] Kameng is assumed to operate for only one quarter (Q4 FY2019)

[10] Assuming 25% and 17% of Kameng's generation in Q4 FY2019 and FY2020 being sold in the merchant power market at a tariff of Rs. 3.0-3.25/unit, much lower than the cost-plus tariff

Key rating drivers

Credit strengths

NEEPCO's sovereign ownership and demonstrated support from GoI – NEEPCO is a 100% GoI owned undertaking. Over the years, the company has received demonstrated support from the parent in funding its sizeable ongoing projects, both in the form of equity infusion and soft loans at favourable repayment terms.

Strategic importance of NEEPCO to the power scenario in the North-East - NEEPCO has an installed power generation capacity of 1,457-MW (925-MW hydro, 527-MW gas, and 5-MW solar), which are located in the North Eastern region of India, and supplies power to all the seven states in the North East, meeting around 37% of the regional power requirement in FY2018.

Cost-plus nature of the company's operations, leading to steady business returns - The tariffs for NEEPCO's plants are determined as per the tariff regulation notified by CERC. NEEPCO's operational performance of the ongoing projects remains satisfactory. Moreover, supported by the low capital cost of its existing hydropower generation stations and the benefit of being able to procure gas at 60% of the domestic notified price, NEEPCO's tariff from operational plants remained competitive at Rs. 2.68/kwh in FY2018.

Healthy growth in overall generation in FY2017 and FY2018 - Supported by the stabilisation of operations from the newly-commissioned 101-MW Tripura gas projects, as well as higher generation from the operational hydroelectric projects, NEEPCO has been able to register healthy YoY generation growths of ~4.8% and ~12.7% in FY2017 and FY2018 respectively.

Comfortable financial profile as reflected by healthy profit margins, steady cash accruals, and conservative capital structure - NEEPCO's healthy profit margins, steady cash accruals, and conservative capital structure strengthen its financial profile. Between FY2013 and FY2018, the company has generated annual cash accruals ranging from Rs 280 crore – 450 crore. Moreover, despite large ongoing debt-funded capex, healthy accruals have led to a conservative capital structure, as indicated by a gearing of 1.03 times as on March 31, 2018.

Favourable financial flexibility as indicated by its ability to raise funds at competitive rates – NEEPCO has exhibited a high degree of financial flexibility, as indicated by its ability to raise funds at competitive rates, as well as refinance high-cost debt.

Long tenure of project loans leads to limited principal repayment pressure in the next 2 years - Given the long tenure of project loans, NEEPCO has limited principal repayment pressure in the next 2 years, which is expected to be beneficial to the company as it would provide the necessary headroom to stabilise operations for the under-construction projects before debt servicing kicks in.

Significant reduction in receivable position – Between FY2017 to Q1 FY2019, NEEPCO has been able to significantly improve its collection efficiency, as reflected by its receivable position declining from Rs. 1,026 crore as on March 31, 2016 to Rs. 441 crore as on March 31, 2017, and remaining at a comfortable level of Rs. 432 crore as on March 31, 2018 and Rs. 374 crore as on June 30, 2018. This has supported the company's liquidity profile, and reduced its dependence on external debt to fund the ongoing capex.

Credit challenges

Exposure to execution risks arising out of the ongoing Kameng project - NEEPCO is yet to commission the 600-MW Kameng hydroelectric project, exposing the company to project execution risks. Such risks get accentuated owing to its location in Arunachal Pradesh, where operational hurdles remain high.

Regulatory risks associated with the approval of tariffs for Tuirial, Pare, and Monarchak power projects - The tariff orders for NEEPCO's existing operational generation stations have been released by CERC for the period FY2015 to FY2019. This leads to regulatory clarity. However, CERC is yet to release the tariffs for the newly commissioned projects at Tuirial, Pare, and Monarchak, and any large cost-disallowances can adversely impact the company's business returns. Moreover, CEA is yet to approve the revised cost estimate for Kameng, which increases regulatory uncertainty.

Offtake risks associated with Kameng - At present, around 50% of Kameng's capacity has been tied-up under long-term power purchase agreement (PPA), and the company is under active discussions to tie-up the balance capacity. Going forward, firming-up of Kameng's untied capacity under a cost-plus regime would remain an important rating driver.

Delay in equity infusion by GoI – As the revised cost estimate for the ongoing hydroelectric projects is yet to be approved by the Government, there has been a delay in equity infusion by GoI to fund the equity contribution for the cost escalation at Kameng, Pare and Tuirial. This has resulted in increased dependence on debt funding, in turn leading to increasing leveraging.

Exposure to customer concentration and counterparty credit risks from financially weak state discoms – NEEPCO's customer profile includes the seven state-owned power distribution companies of North-East India. Given the weak financial profile of such discoms, NEEPCO remains exposed to significant counter-party credit risks. Moreover, the company's customer base is less diversified compared to other Central Public Sector Undertakings (CPSUs), exposing it to customer-concentration risks as well

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)
[Rating Methodology for Thermal Power Producers](#)

About the company:

NEEPCO, which was incorporated as a 100% GoI-owned power generating company in April 1976, has been mandated to harness the power generation potential, both through the hydro and thermal power routes in North-eastern region of India. NEEPCO assumes strategic importance to the power scenario in North East India, with the company meeting around 32% of the overall regional power demand. NEEPCO has been conferred the "Mini Ratna – Category I" status by the GoI. The company has 1,457-MW generation capacity in operation, of which 925-MW is hydro based, 527-MW is gas based, and the balance 5-MW is solar power based. NEEPCO is also at an advanced stage of commissioning the 600-MW Kameng hydroelectric project in Arunachal Pradesh.

In FY2018, on a provisional basis, the company reported a net profit of Rs. 295.17 crore on an operating income of Rs. 1700.92 crore, as compared to a net profit of Rs. 225.98 crore on an operating income of Rs. 1415.03 crore in the previous year.

Key financial indicators

	FY2017	FY2018 (Prov)
Operating Income (Rs. crore)	1415.03	1700.92
PAT (Rs. crore)	542.36	665.41
OPBDIT/OI (%)	38.33%	39.12%
RoCE (%)	9.63%	13.40%
Total Debt/TNW (times)	0.98	1.03
Total Debt/OPBDIT (times)	11.12	10.00
Interest coverage (times)	18.13	9.64