Samling Power Company Limited: Ratings reaffirmed

August 10, 2020

Summary of rated instruments

Instrument *	Rated Amount (NPR Million)	Rating Action
Long-term loan; Fund based	1,398.75	[ICRANP] LBB-; reaffirmed
Short-term loans; Fund based	(530.00)	[ICRANP] A4; reaffirmed
Total	**1,398.75**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has reaffirmed the long-term rating of [ICRANP] LBB- (pronounced ICRA NP L double B minus) for Samling Power Company Limited's[1] (SPCL) long-term loan. ICRA Nepal has also reaffirmed the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) for the company's short-term loans.

Rationale

The ratings reaffirmation factors in the lowering of project execution risk, given the advanced stage of construction and the adequate headroom in the project's required commercial operation date (RCOD). The ratings draw comfort from the financial strength, technical expertise, and experience of the promoters in hydro power development. The rating also factors in the low regulatory and off-take risks, given the firm off-take arrangement through a long-term power purchase agreement (PPA) with the Nepal Electricity Authority (NEA). The assigned rating also factors in the presence of the operational NEA substation at the proposed connection point and the resulting low evacuation risk for the project. The changes made by the FY 2021 Monetary Policy, requiring banks to increase their exposure towards energy sector, could enable companies like SPCL with near operational projects to raise cheaper borrowings, which could improve project economics and provide comfort to the financial profile.

However, the ratings remain constrained by the expected moderate to weak debt coverage indicators of SPCL, given the high capital cost for project development and the fixed tariff regime (which does not compensate for high incurred capital cost). Further, the project cost is likely to increase because of the Covid-19 pandemic impact on the areas such as labour availability, logistics, etc. The funding gap on both the debt and the equity front, stemming from the probable escalation in project cost, also remains a rating concern. SPCL's ability to secure the additional fund in time will remain essential for the project execution without significant delay. Given the higher estimated project cost, the generational efficiency of the project will be the key driver for the overall financial profile of the project (and company). Lower generational efficiency, especially in the initial years when the cash build-up is low, could constrain the debt coverage indicators, necessitating further fresh borrowings or equity injection by promoters.

Going forward, the SPCL's ability to tie up any funding gaps and the ability of the project to achieve the design parameters in addition to the interest rate volatility in the market would be the key drivers for determining the project return metrics and coverage indicators.

Key rating drivers

Credit strengths

1 Erstwhile Samling Power Company Private Limited.

Advanced stage of project development and low evacuation risk reduces execution risk

As of mid-April 2020, the 9.51-MW Mai Beni HEP has registered ~70% progress. The project has almost completed the critical component such as breakthrough of the ~2,400-m tunnel, construction of the intake structure, etc; thereby lowering the project execution risk. The risk of the project being unable to meet the completion deadline is mitigated by the adequate headroom in the timeline for the project's commercial operation (required commercial operation date in November 2021). Moreover, the power evacuation risk for the project also remains low. The NEA's Godak Substation (a part of the Kabeli corridor transmission line and the connection point for the 9.51-MW Mai Beni HEP) is already operational since October 2015. The project's powerhouse and NEA s/s will be connected through a ~4 KM, 33KV transmission line, to be built at the developer's cost.

Low offtake risk, given current demand-supply gap and long-term power purchase agreement – Nepal is a net importer of electricity even with limited electrification across the country. For FY2019, Nepal imported ~37%[2] of its energy demand from India. As per the NEA, the power demand is expected to grow at a rate of ~15% over the foreseeable future, driven by an increase in electrification, per capita consumption, and industrial demand. Hence, the supply-demand gap is expected to persist, resulting in the healthy offtake of the energy to be generated by the project.

SPCL has executed a PPA with the Nepal Electricity Authority (NEA) for its entire capacity, at a pre-determined energy tariff. Tariff rates are standard at NPR 4.8 and NPR 8.4 per unit during the wet and dry seasons, respectively, with 5.0 times 3% annual escalation on base tariff[3]. Firm PPA with the pre-defined tariff mitigates the off-take and tariff risk. Moreover, the counterparty credit risk also remains low, given the sovereign support of the Government of Nepal (GoN) to the NEA, as well as the NEA's past track record of timely payment of energy bills to private hydropower developers.

Experienced promoter Group – SPCL is a joint venture between two Groups and its related individuals. CE construction Private Limited is a reputed contractor with a long track record in design and construction with prior experience on working as a contractor for hydropower projects. Similarly, Urja Developers Private Limited has been involved in hydropower project development and operation for a long time with prior experience in the field. The financial strength, technical expertise and prior hydropower experience of the major promoter groups remains a rating positive.

Credit challenges

High project cost and gearing level could strain debt coverage ratio

The 9.51-MW Mai Beni HEP was originally estimated to be commissioned at a relatively higher cost (~NPR 196 million per megawatt of installed capacity) with 75% debt financing. The cost is likely to witness a further increase, given the challenges in the areas of logistics and labour procurement and management, created by the pandemic. The tariff structure for the project is fixed and does not consider the cost of commissioning. This could result in moderate returns and put pressure on the debt service indicators for the project. The incremental financial profile of the company will depend on the generational performance of the 9.51-MW project. Lower project efficiency, especially in the early years when cash reserves are low, could put pressure on the debt servicing capacity of the project and could necessitate equity infusion or short-term borrowings to meet the debt-servicing requirement.

Funding risk

On the original cost of NPR 1,865 million, SPCL has tied up the entire loan of NPR 1,399 million and has infused 80% of the project equity (~NPR 373 million out of NPR ~466 million). Nearly 20% of the original project equity must be raised through an IPO, the timely arrangement of which will be essential for the project completion. Moreover, the probable cost escalation in the project cost could also give rise to a funding gap on both the equity and the debt front. As per the original loan

2 NEA's annual report for FY2019

3 For 9.008 MW capacity; for balance 500 KW capacity, 8-times 3% escalation is provided in the addendum PPA

agreement, the cost escalation must be borne through equity unless otherwise agreed by the financing bank. The ability of SPCL to arrange for the incremental fund to cover the probable cost overrun will remain essential for the project execution within the stipulated time.

Hydrological risk and absence of deemed generation clause in the PPA

As with smaller rivers in the country, the long-term gauge record is not available for the Mai River[4]. Hence the availability of water to sustain long-term energy generation remains a concern. This is a major risk for the project earnings, since the PPA with the NEA does not contain the provision for deemed generation. Nonetheless, the Mai river basin has many operational projects with the earliest project being in operation since 1999[5], which is a source of comfort.

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

Links to applicable criteria:
Corporate Credit Rating Methodology

About the company

Samling Power Company Limited (SPCL), is a hydropower development company incorporated in 2014. The company is promoted by CE Construction Private Limited, Urja Developers (associated company of CE) and individuals related to these companies. As of mid-July 2020, the major shareholders of SPCL are CE Construction Pvt Ltd (15%), Urja Developers Pvt Ltd (8%), Mohan Bikram Karki (3%), Grande Holdings Pvt Ltd (3%), among others.

SPCL is a special purpose vehicle that is developing a 9.51-MW run-of-the-river (ROR) hydroelectric project (HEP) Mai Beni in the Illam district of Eastern Nepal, under the 40% exceedance flow model. The project is estimated to be commissioned at the budgeted cost of NPR 1,865 million. The required commercial operation date of the project is in November 2021, as per the PPA signed with the NEA.

As of mid-April 2020, the project has achieved ~70% physical and financial progress.

Annexure-1: Instrument details

Instrument	Rated Amount (NPR Million)	Rating Reaffirmed
Fund-based - Long-term loans (I)	1,398.75	[ICRANP] LBB-
Non-fund based- Short-term loans- LC (Within I)	(500.00)	[ICRANP] A4
Non-fund based- Short-term loans- BG (Within I)	(30.00)	[ICRANP] A4
Total	**1,398.75**	

Analyst Contacts

Mr. Kishor Prasad Bimali (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Sailesh Subedi (Tel No. +977-1-4419910/20)
sailesh@icranepal.com

4 Flow derived through correlation with nearest downstream station (with >30 years of recorded flow).
5 6.2 MW Puwa Khola of NEA

Relationship Contacts

Ms. Barsha Shrestha (Tel No. +977-1-4419910/20)
barsha@icranepal.com

About ICRA Nepal Limited

ICRA Nepal Limited, the first Credit Rating Agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, technical and analytical skill augmentation.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

For more information, visit www.icranepal.com

ICRA Nepal Limited
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
Phone:+977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com