Sahas Urja Limited: [ICRANP-IR] BB+ and [ICRANP] LBB+/A4+ assigned

October 5, 2020

Summary of rated instruments

Instrument*/Facility	Rated Amount (NPR Million)	Rating Action
Issuer Rating	NA	[ICRANP-IR] BB+; assigned
Long-term loans	8,650	[ICRANP] LBB+; assigned
Short-term loans	50	[ICRANP] A4+; assigned
Total	**8,700**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned an issuer rating of [ICRANP-IR] BB+ (pronounced ICRA NP issuer rating double B plus) to Sahas Urja Limited (Sahas). ICRA Nepal has also assigned a rating of [ICRANP] LBB+ (pronounced ICRA NP L double B plus) to the company's long-term loans and a rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to its short-term loans.

Rationale

The assigned ratings consider the relatively low budgeted cost of NPR 138 million per MW for the 86-MW Solu Khola (Dudhkoshi) hydro-electric project (HEP) being developed by Sahas. Given the similar tariff structure for most HEPs, the lower project cost is likely to result in better debt coverage as well as return indicators. The ratings further remain supported by the project's low funding risks as the promoters' entire equity commitment has been injected and the required debt component has been fully tied-up. The ratings also take comfort from the prior experience of the promoters and directors in hydropower projects. Further, the ratings factor in the lower evacuation risks as the Tingla substation of the Nepal Electricity Authority (NEA) has already been charged and the associated transmission lines are approaching completion. The Solu river, along which the project is being built, is also gauged, given the presence of long-term gauge data. Additionally, its flow is partially snow supported, which augurs well for generation prospects. ICRA Nepal also takes comfort from the long-term power purchase agreement (PPA) at predetermined tariffs and escalations under the take-or-pay modality, which eliminates the risks related to tariff and offtake of the energy to be generated by the project.

Nonetheless, the assigned ratings are constrained by the high execution risk with the project in middle stages of construction (~50–55% physical progress till mid-September 2020). Any delays in project execution on account of geographical surprises in the ~4.5-km long tunnel work (~52% completed so far) would have a bearing on the project cost structure, impacting Sahas' financial metrics amid the fixed tariff structure. The project has also faced timeline delays due to the change in contractors, one event of tunnel collapse as well as other force majeure events (flood/landslides). Hence, it has already missed the required commercial operation date (RCOD) of September 26, 2020[1]. While the application for extension of the same is pending at the NEA, slowdown in construction activities due to the impact of Covid-19 pandemic could result in late COD penalties as well as tariff escalation loss. Similarly, rating concerns arise from the hydrological risks, given the absence of a deemed generation clause in the PPA. The ratings are also constrained by the counterparty credit exposure from the NEA, which has a moderate financial profile (albeit with recent improvements). These risks are partly mitigated by the sovereign support of the Government of Nepal to the NEA and its past track record of timely payments to independent power producers.

Going forward, Sahas' ability to timely raise the balance equity through the proposed IPO as well as commission the project within the estimated cost and revised timeline estimate of June 2022, would remain critical. Further, the project's ability to achieve its designed operating parameters as well as interest rate volatility in the market would be the key drivers for determining its return metrics and coverage indicators.

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[1] However, this is likely to be extended till December 30, 2020 at first tranche, as decided by the meeting of Coordination Committee (with participation from the company's as well as NEA officials) held on October 4, 2020. This extension mainly factored in the likely delays in completion of NEA's Tingla substation. Further, application for further RCOD extension to factor in impact of Covid-19 and other force majeure events still remain pending.

Key rating drivers

Credit strengths

Prior experience of promoters/directors in hydropower sector provides comfort – Most of the company's directors and major promoters were involved in the development of the operational 5-MW project of Ruru Jalbidyut Pariyojana Limited (rated BBB by ICRA Nepal). The promoters and directors also have experience in other hydropower projects, which provides comfort both during the constructional as well as operational period. However, Sahas has a very diverse shareholding with much lower stake from the key promoters (the largest promoter holding only ~2% stake), which remains an area of concern.

Return and coverage indicators expected to remain supported by lower project cost – The 86-MW project is planned to be developed at a much lower cost of NPR 138 million per MW. This along with the presence of eight annual tariff escalations on the base rate and slightly better dry energy mix of ~19% are expected to support the company's profitability as well as debt coverage indicators. The company's ability to complete the project within the estimated cost would remain a key monitorable. The project cost is, however, prone to escalations, mainly in the event of delays in project execution. Any unanticipated large cost escalations would have a bearing on the ratings assigned.

Low funding risk at current cost estimates – The project's budgeted cost of NPR 11,860 million is being funded at a rough debt-to-equity ratio of ~73:27. The loan financing has already been arranged through a consortium of 10 financial institutions for a total loan of NPR 8,650 million. The equity requirement for the project development is NPR 3,210 million and the promoters have already injected their entire commitment of NPR 2,450 million. Sahas plans to raise an additional NPR 1,050 million through the proposed IPO issue. The post IPO equity of Sahas would be in excess of the project's equity requirements by NPR 290 million. This could be used in case of contingencies. However, the company's ability to timely close the funding gaps, if any, in case of cost overruns, would remain crucial.

Lower evacuation risk – The power to be generated by the project is to be evacuated through the NEA's Tingla substation, which has already been charged. Similarly, the associated transmission lines to operational Mirchaiya substation is also in advanced construction phase with the NEA planning to complete the same in the next few months. With management targeting to complete the project by June 2022, evacuation structures are likely to complete earlier than project COD, thereby minimising the evacuation risks.

Low tariff and offtake risks with presence of long-term PPA at predetermined tariffs and escalations – The project's tariff and offtake risks remain low as the company has a 30-year PPA with the NEA (the sole purchaser and distributor of electricity in Nepal) for its entire project capacity. As per the PPA, the pre-defined tariffs are NPR 4.8 per kWh for the wet season (eight months) and NPR 8.4 per kWh for the dry season with 3% annual escalation on the base tariff for eight times.

Credit challenges

High project execution risks – Typically, hydro-power projects entail significant project execution risks (being in difficult terrain) and are likely to face adverse climatic conditions during the construction period. The 86-MW project is at the mid-stage of development with around ~50–55% progress achieved till mid-September-2020. Till the same date, the tunnel excavation work was ~52% complete (~2,337m excavated out of the total tunnel length of 4,469m), exposing the project to risk of geological surprises. The tunnel structure also includes two vertical drop shafts, which would remain the critical component. Though the rock quality within tunnels so far has been mostly within the expected range, weak structure at one section leading to collapse delayed the tunnel excavation by around six months. The project's completion within the revised timeline could also remain a challenge, particularly amid the ongoing Covid-19 pandemic, which has slowed the pace of construction.

Delay in project completion could result in cost escalation, tariff escalation loss and late COD penalty – The project has already crossed the current RCOD of September 26, 2020. The delays were mainly on account of change in contractors (owing to liquidation process being started for the parent company of the earlier contractor) and damages in the tunnel. Further, events of flood/landslides at the project site as well as on the highways to the project impacted the timeline. Any unanticipated delays in project completion could result in increased project cost through incremental interest capitalisation, monitoring costs as well as hard cost escalations. The current cost estimates do not include room for major contingencies, which could absorb initial cost escalations, if any.

The company has applied for extension of RCOD, mainly factoring in the impact of Covid-19 as well as some of the force majeure events; the outcome of the same remains to be seen. The achievement of the revised RCOD would remain critical in determining the number of escalations that the project would avail as well as implications of any late COD penalty.

High hydrology risks, given lack of deemed generation clause in PPA – The lack of a deemed generation clause in the PPA exposes the project to hydrology risk in case of adverse river flow scenarios as it will not receive any compensation for such losses from the NEA. While the Solu River being gauged as well as snow-fed provides comfort, periodic gauge measurements by Sahas, have reported lower river discharge, which remains an area of concern.

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

Links to applicable criteria:
Issuer Rating Methodology
Corporate Credit Rating Methodology

About the company

Incorporated in February 2014 as a private limited company, Sahas Urja Limited (Sahas) was converted to a public limited company in September 2014 to facilitate public participation. The paid-up capital of the company as of mid-July 2020 was NPR 2,450 million. The major promoters include Mr. Mahendra Kumar Giri (2.29% stake), Mr. Sushil Thapa (2.11%), Ms. Anupama Thapa (2.04%) and Mr. Him Prasad Pathak (1.94%), among others. The company plans to raise NPR 1,050 million, i.e. 30% of the total equity from general shareholders, through the proposed IPO issue. It is developing an 86-MW Solu Khola (Dudh Koshi) HEP in Solukhumbu District, Province 1 of Nepal. The project is a run-of-the-river (R-o-R) type and is being developed at 40.70% probability of exceedance (Q40.70).

Annexure-1: Instrument details

Instrument	Rated Amount (NPR Million)	Rating Action
Fund-based facilities; Long-term loan	8,650	[ICRANP] LBB+; assigned
Fund-based facilities; Short-term loan (Bridge gap loan; within term loan)	(1,250)	[ICRANP] A4+; assigned
Non-fund based facilities; short-term loan (Bank guarantee)	50	[ICRANP] A4+; assigned
Non-fund based facilities; short-term loan (Letter of credit; within term loan)	(3,500)	[ICRANP] A4+; assigned
Total	**8,700**	

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About ICRA Nepal Limited

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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.

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