

Sanjen Jalavidhyut Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed Initial Public Offering (IPO) of Sanjen Jalavidhyut Company Limited

Instrument/Facility	Issue Size	Grading Action (June 2017)
IPO (equity) Grading	NPR 876 Million	[ICRANP] IPO Grade 4+ (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4+”, indicating below-average fundamentals to the proposed Initial Public Offering (IPO) of Sanjen Jalavidhyut Company Limited (SJCL). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative better position within the grading categories concerned. SJCL is proposing to come out with an IPO of 8,760,000 numbers of equity shares of face value NPR 100/- each at par. Current offerings size is 24% of the total capital and is reserved to contributories and employees of the lender of the institution (Employees Provident Fund - EPF) and to employees of promoter companies; company will later issue IPO to affected locals (10%) and general public (15%).

The grading assigned takes into account the significant project implementation risks involved in the under-construction hydroelectric projects (HEPs) of aggregate 57.3 MW being developed by SJCL. The projects are currently behind their initial commissioning schedule and delay in completion of balance activities can impact the project costs and returns given the fixed tariff structure. While the current progress (~45%) minimises the risk of geological surprises to an extent, delay in project works especially commissioning of transmission line are critical for achieving commissioning within the budgeted time and cost estimates and also limit the projects from operating at design parameters. In addition, the project is exposed to foreign exchange fluctuation risks on account of unhedged USD denominated contractual liabilities (~30% of project cost). Hydrology risk for the projects is high, since the revenues are directly linked to unit sales, hence any loss of generation due to shortage of water or silting can negatively impact the project earnings and return indicators. The grading is also constrained by interest rate volatility in the market and the counterparty credit risks arising out of exposure to loss making NEA (Nepal Electricity Authority) for the energy supplied, although the same is partly mitigated by the fact that NEA is fully owned by the Government and has been making payments to IPPs (Independent Power Producers) in a timely manner in the past.

Nonetheless, the grading factors in the strengths of promoter companies (NEA and Chilime Hydropower Company Limited which are both direct/indirect Government undertakings) which have significant experience in development and operations of hydropower projects. In addition, with a firm Power Purchase Agreement (PPA) in place and positive demand outlook owing to supply-demand gap in the power sector, the tariff and off-take risks are also minimal. Funding risks for the projects are also minimal as debt requirements of the projects have been tied up with Employees Provident Fund (EPF, one of the largest state-owned retirement fund operator) and promoters have infused their share of equity; remaining equity being raised through series of IPOs. The projects would also be entitled to a capital subsidy of NPR 5 million per MW from Government upon connection to national grid. Presence of NEA as a promoter mitigates the risk of delay in commissioning of transmission line to some extent. Going forward, ability of the company to commission the projects within the budgeted time and cost estimates and also availability of sufficient hydrology and evacuation infrastructure will be key parameters driving returns of the project.

SJCL is developing two run of the river (ROR) hydropower projects in Sanjen river– Sanjen Upper Hydroelectric Project (SUHEP) of capacity 14.8 MW and cascade project Sanjen Hydroelectric Project (SHEP) having capacity of 42.5 MW in Rasuwa district of Central Development Region of Nepal. The

Generation License for these projects was obtained from Ministry of Energy on August 2012 and November 2011 respectively valid for 35 years including the period of construction on Build Own Operate Transfer (BOOT) basis. The projects have faced substantial time overrun mainly owing to Apr-2015 earthquake and its aftershocks and subsequent blockades. Though the Required Commercial Operation Date (RCOD) as per PPA has been extended, generation license validity of 35 years could limit overall life of the projects. Expected COD for the projects are November 2018 and January 2019 respectively against revised RCOD of July 2017 and January 2019 (earlier the RCOD was July 2015 and December 2015). The electricity generated from the projects shall be evacuated from switchyard of the project to Chilime hub substation through a 5km long 132kV single circuit transmission line. However, NEA has just completed land acquisition and is yet to start construction works for the said substation. In addition, 26.5 km long 220 kV double circuit transmission line from Chilime Hub to Trishuli 3B hub is to be developed by NEA. In the event of delays in transmission line completion, the power generated from the project will have to be evacuated through existing 66kVA line which can result in higher losses and also limit the quantum of power evacuated. PPA for SUHEP was signed on October 2011 with NEA and the agreed tariff for wet season is NPR 4.8 per kWhr and for dry season is NPR 8.4 per kWhr with 3% escalation on base tariff for 5 years. PPA for SHEP was signed on December 2011 with agreed tariff for wet season at NPR 4.8 per kWhr and for dry season at NPR 8.4 per kWhr with 3% escalation on successive tariff for 10 years.

The contract for civil works of the upper project has been awarded to Joint Venture (JV) of ECI Engineering and Construction Company Ltd, India and Bajra Guru Construction of Nepal and the civil contract for cascade project has been awarded to JV of SEW Infrastructures Limited, India and Tundi Construction, Nepal. Hydro-mechanical contract for both the projects has been awarded to Nepal Hydro and Electric Ltd. and Electro-mechanical contract has been awarded to Dongfang Electric Corporation Limited, China. Overall ~45% progress has been achieved in project execution as of mid-April 2017 with plans to complete construction by end of November 2018 and January 2019 respectively. SMEC International Pty Ltd. Australia is the consultant for the projects. These EPC contracts have significant USD component (~USD 27.84 million of which ~USD 17.68 million remains to be paid over the contract period). Significant currency devaluation (NPR has depreciated by ~20% since execution of these contracts) exposes the project to escalations in project costs. As regards physical progress, ~50% and ~30% of civil works has been completed in these projects, excavation of headrace tunnel for upper project has been completed while for lower project, significant portion of tunnel remains to be excavated (~21% complete as of mid-April 2017 out of total length of 3,635 metres). Foundation work for power house structure are in progress while 45% of fabrication works have been completed. Transmission line contracts are yet to be awarded.

The project cost as per latest management estimates is NPR 8,034 million to be funded in debt to equity ratio of ~55:45¹. The debt component has been tied up with EPF and promoters have already brought in their share of equity (~NPR 1,862 million) with plans to raise remaining equity requirements of project (~NPR 1,789 million) through series of IPO. Of the NPR 2,504 million costs incurred till mid-April 2017, ~NPR 1,502 million has been funded through debt and balance from promoters' equity. Capital subsidy to be received from Government is expected to be utilized towards covering contingencies. Typically, hydro-power projects entail significant project execution risks as they are located in difficult terrain and hence adverse climatic conditions during the construction period and also geological surprises can disrupt construction schedule of any project. Thus, timely completion within the budgeted time and cost estimates and the availability of requisite evacuation infrastructure (to be developed by NEA) would be the key factors driving the returns for these projects.

¹ Financial closure was done at debt: equity of 50:50 excluding interest during construction (IDC); IDC to be capitalized separately and including the same, debt to equity ratio is ~55:45.



Company Profile

Sanjen Jalavidhyut Company Limited (SJCL), a subsidiary of Chilime Hydropower Company Limited (Chilime; ~77% stake) was incorporated in 2010 as a public limited company. Chilime, promoted by NEA, owns and operates 22.1 MW Chilime HEP and is also involved in construction of hydropower projects totaling ~270 MW capacity through various subsidiaries, including SJCL. 20% stake is held by NEA, a Government of Nepal owned company. SJCL plans to float 49% of total issued capital to public through a series of IPO in various tranches (all at par) after which current promoter holding will dilute to 51%. As part of the IPO process, the company would issue 24% of its post IPO paid-up capital amounting to NPR 876 million to contributories and employees of the sole lender EPF and employees of promoter companies. Thereafter, the company would issue 10% of its issued capital to the local inhabitants of project location in the second tranche and finally 15% of the post issue paid up capital to general public.

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