Samling Power Company Private Limited: [ICRANP] LBB-/ A4 (Assigned)

12 November 2018

Summary of rated instruments:

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

**Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP] LBB- (pronounced ICRA NP L Double B minus) to the NPR 1,398.75-million long-term loans (including proposed limits) of Samling Power Company Private Limited (SPCL). ICRA Nepal has also assigned the short-term rating of [ICRANP] A4 (pronounced ICRA NP A Four) to the NPR 530-million short-term loans[1] of SPCL.

Rationale

The assigned rating takes into account early stage of development and consequently higher execution risks associated with proposed 9.51-MW Mai Beni hydroelectric project (HEP), being developed by SPCL in Illam district of Eastern Nepal. The rating is also constrained by relatively high capital cost of the project on a fixed tariff regime (which does not compensate for high incurred capital cost); which could result in moderate return indicators. Given the higher estimated project cost, generational efficiency of the project will be the key driver for 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 fresh borrowings or equity injection by promoters. Nonetheless, the assigned rating draws comfort from the financial strength and experience of promoters in hydro power development. The rating also factors in low regulatory and off-take risks, given firm off-take arrangement through long term power purchase agreement (PPA) with Nepal Electricity Authority (NEA). The assigned rating also factors in the presence of operational NEA substation at the proposed connection point and resulting low evacuation risk for the project.

Key rating drivers

Credit strengths

Presence of long term Power Purchase Agreement (PPA) with fixed tariff structure results in low off-take risk:

SPCL has executed a PPA with 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[2]. Firm PPA with pre-defined tariff mitigates off-take and tariff risk. Moreover, counterparty credit risk also remains low, given the sovereign support of the Government of Nepal (GoN) to NEA, as well as NEA's past track record of timely payment of energy bills to private hydropower developers.

Supply demand gap to ensure healthy offtake:

Nepal is a net importer of electricity, even with limited electrification across the country and current supressed demand (per capita power consumption of <150 KW as per 2014 study, among the lowest in Asia). As per NEA, the power demand is expected to grow at the rate of ~15% over the foreseeable future, which could be higher in the event of increased

[1] *Letter of credit and bank guarantee, earmarking the long-term loan limit*

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

economic activities. Hence the supply-demand gap is expected to persist. At the same time, the GoN has introduced favourable regulations like compulsory floor of 5% of total BFIs loan towards the energy sector, and 10-year tax holiday for hydropower projects, among others. All this remains positive for the renewable energy sector players.

Evacuation risk remains low as NEA's already has operational substation at the connection point:
The generated power will be evacuated through the Godak substation (s/s) of NEA, which is ~4.0 km from the power house of the project. The Godak substation, a part of Kabeli corridor transmission line (TL) project of NEA, has been operational since October 2015. The project's power house and NEA s/s will be connected through a 33KV TL, to be built at the developer's cost. Most of the projects commissioned in the past 4-5 years have witnessed delays due to lack of evacuation infrastructure. This risk is absent for the 9.51-MW Mai Beni HEP.

Credit challenges

Execution risk remains high due to early stage of project development:
Although low evacuation risk for the 9.51-MW Mai Beni HEP remains a comfort, the nascent stage of the project development and geological surprises typical to civil works in the hydropower sector creates significant execution risk. Project execution remains in early stages (~13% of the project cost incurred/advances till mid-September 2018) and therefore, construction delays cannot be ruled out completely; especially on the ~2,400m tunnel front that is to start soon. Given high gearing level in the project (~75% debt funding), construction delays could most likely result in cost overrun, impacting the project's return and debt servicing capability. Nonetheless, the risk is partly mitigated by the promoter's financial strength and established track record in civil works[3] and hydropower development/operation[4]. Developer's ability to inject timely equity (~57% of project equity infused till mid-September 2018) will also have a bearing on project execution; which is partly comforted by the financial strength of the major promoters of SPCL.

High project cost and gearing level could strain debt coverage ratio:
The 9.51-MW Mai Beni HEP will be commissioned at a relatively higher estimated commissioning cost (~NPR 196 million per megawatt of installed capacity) and will be have a high gearing level (75% of the cost to be debt funded). Tariff structure for the project is fixed and does not take into account the cost of commissioning. This could result in moderate return and put pressure on debt service indicators for the project. 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.

Hydrological risk and absence of deemed generation clause in the PPA:
As with smaller rivers in the country, long term gauge record is not available for the Mai River[5]. 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 NEA does not contain the provision for deemed generation. Nonetheless, the Mai river basin has many operation projects with the earliest project being in operation since 1999[6]; which is a source of comfort.

Annexure-1: Instrument details

Instrument	Rated Amount (NPR Million)	Rating Assigned
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

3 CE construction (largest promoter) is involved in design and development of civil structures since 1992.
4 Including 7.6 MW Jogmai HEP in Illam district; The 7.6 MW project is in operation since April 2017
5 Flow derived through correlation with nearest downstream station (with >30 years of recorded flow).
6 6.2 MW Puwa Khola of NEA

Total	1,398.75

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 Private 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 other individuals associated with these companies. As of mid-September 2018, major shareholders of SPCL included CE Construction Private Limited (~17% stake), Urja Developers Private Limited (~9%), Mohan Bikram Karki (~4%), Bal Gopal Baidhya (~3%), and Grande Holding Private Limited (~3%), among others. SPCL is a special purpose vehicle (SPV) established for developing a 9.51-MW under-construction HEP, "Mai Beni", in the Illam district of Eastern Nepal. The required commercial operation date of the project is November 2021, as per the PPA signed with the Nepal Electricity Authority.

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About ICRA Nepal Limited:

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