Sanjen Jalavidhyut Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed IPO of Sanjen Jalavidhyut Company Limited

Instrument/Facility	Issue Size	Grading Action (December 2018)
IPO (equity) Grading	NPR 547.50 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 an 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 relatively better position within the grading categories concerned. SJCL is proposing to come out with an IPO of 5,475,000 equity shares with a face value NPR 100 each, at par.

The assigned grading is constrained by the time and cost overrun seen in the two hydro-electric projects (HEPs) aggregating 57.3 MW being developed by SJCL. The projects are expected to be delayed compared to their commissioning schedule and have already seen ~11% cost increment over the initial estimates. Any unexpected timeline delays in completion of the balance project components could further increase the costs through hard cost escalations and incremental interest capitalisation, among others. In addition, the project is exposed to foreign exchange fluctuation risks on account of the unhedged USD denominated contractual liabilities (~27% of project cost). These would impact the return metrics of the projects, given the fixed tariff structure. The grading also considers the evacuation risks for the projects as the Chilime hub for power evacuation is behind its earlier commissioning schedule. This could potentially delay the project commissioning and increase the cost estimates further. The hydrology risk for the projects is also high, given the lack of deemed generation clause in power purchase agreement (PPA). The grading is also constrained by the interest rate volatility in the market and the counterparty credit risks arising out of its exposure to the loss-making Nepal Electricity Authority (NEA) for the energy supplied. However, this is partly offset by the sovereign support to the NEA, being fully owned by the Government of Nepal and its past track record of timely payment to private HEP developers.

Nonetheless, the grading factors in the strength of promoter companies (NEA and Chilime Hydropower Company Limited which are both direct/indirect Government undertakings) and their significant experience in development and operations of hydropower projects. With a firm PPA in place and positive demand outlook 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 the Employees Provident Fund (EPF, one of the largest state-owned retirement fund operators) and the promoters have infused their share of equity; with the remaining equity being raised through a series of IPOs. The current physical progress (~65-70%) also minimises the project implementation risks to an extent. Going forward, SJCL’s ability to commission the projects within the budgeted time and cost estimates and also the availability of sufficient hydrology and evacuation infrastructure will be the key parameters driving the project returns.

SJCL is developing two run-of-the-river (ROR) HEPs in the Sanjen river–Sanjen Upper Hydroelectric Project (SUHEP) with 14.8 MW[1] capacity and its cascade project Sanjen Hydroelectric Project (SHEP) with a capacity of 42.5 MW in the Rasuwa district. The generation licences for these projects were obtained from the Ministry of Energy on August 2012 and November 2011 respectively, valid for 35 years, including the period of construction. The projects have faced substantial time overrun compared

[1] PPA capacity is 14.6 MW

to the earlier commissioning targets. Overall ~65-70% physical progress has been achieved in project execution as of mid-October 2018, with plans to complete construction by mid-January 2020[2] against the required commercial operation date (RCOD) of July 2017 and January 2019 respectively. Though the RCOD as per the PPA might be further extended, given the delays in the evacuation structure of the NEA, the validity of the generation licence could limit the overall life of these projects.

The PPA for SUHEP was signed on October 2011 with the NEA and the agreed tariff for wet season (mid-April to mid-December) is NPR 4.8 per kWhr and for dry season is NPR 8.4 per kWhr with 3% escalation on base tariff for five years. Similarly, the PPA for SHEP was signed on December 2011 with a similar base tariff but with 3% escalation on the successive tariff for 10 years. The electricity generated from the projects is to be evacuated to the Chilime hub substation through a 5km long 132kV transmission line. However, the NEA is still to build the said substation and a 26.5 km long 220 kV double circuit transmission line from the Chilime Hub to the Trishuli 3B hub. This corridor project was started in FY2011 and is currently targeted for completion by mid-July 2019. Though further delays in completion of the evacuation structure is likely, the presence of the NEA as a promoter mitigates this risk of delays to some extent. In the event of delay in transmission line completion, the power generated from the project will have to be evacuated through the existing 66kVA line, which can result in higher losses and also limit the quantum of power evacuated.

The project cost as per the latest estimates is NPR 8,912 million (i.e. ~11% over the earlier estimate of NPR 8,034 million). The cost escalation is primarily on account of the incremental interest during construction (IDC) due to the delayed execution and the actual/expected forex losses. The EPC contracts for project execution have a sizeable USD component at ~USD 27.84 million, ~50% of which remains to be paid over the remaining contract period. Significant currency devaluation (NPR has depreciated by ~34% since execution of these contracts) exposes the project to further project escalation costs, apart from the ~NPR 200 million forex losses already sustained so far. Hard cost escalations so far have been absorbed by the 15% budget for contingencies considered in the earlier estimates, leaving minimal room for further escalations (~3%). The projects would also be entitled to a capital subsidy of NPR 5 million per MW from the Government upon connection to the national grid. This could be utilised to cover any sudden contingencies.

The debt component has been initially tied up with the EPF at a debt-to-equity ratio of 50:50 excluding interest during construction (IDC), which is to be capitalised separately. The agreement to finance the forex losses remains to be completed. Including these, the debt-to-equity ratio for the project would be ~59:41. The project loan is now to be repaid over a period of seven years following its operations, as against an earlier 10-year repayment tenure. This significantly reduces the equity cash flow at the initial years and hence also remains a concern. As of now, 75% of the equity requirements (~NPR 2,738 million) has been brought in with the plans to raise the balance equity through a series of IPOs[3]. Of the NPR 4,950 million costs incurred till mid-October 2018, NPR 2,603 million has been funded through debt, and the rest from equity.

Typically, hydro-power projects entail significant project execution risks, being located in difficult terrain and are likely to face adverse climatic conditions during the construction period. Sudden geological surprises can also disrupt the construction schedule of any project. Post the commissioning, any loss of generation due to shortage of water or silting can negatively impact the project earnings and return indicators. Thus, timely completion within the budgeted time and cost estimates and the availability of requisite hydrology and evacuation infrastructure (to be developed by NEA) would be the key factors driving the returns for these projects.

2 *Earlier plan was to start operations by mid-January 2019.*

3 *First tranche of IPO (NPR 876 million) to contributories of EPF and staffs of promoter companies already completed*.

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

Links to applicable criteria:
IPO Grading Methodology

About the company
Sanjen Jalavidhyut Company Limited (SJCL), a subsidiary of Chilime Hydropower Company Limited (Chilime; ~53% stake at present) was incorporated in 2010 as a public limited company. Chilime, promoted by the NEA, owns and operates the 22.1-MW Chilime HEP and is also involved in the construction of hydropower projects with 270 MW capacity, through various subsidiaries, including SJCL. Around 14% stake as of now is held by the NEA, a Government of Nepal-owned company. SJCL plans to float 49% of its total issued capital to the public through a series of IPOs in various tranches (all at par) after which the promoter holding will dilute to 51%. As a part of the IPO process, the company has already issued 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 the promoter companies. After this proposed issue to the general public (15% of issued capital), SJCL will finally issue 10% of the issued capital to the local inhabitants of the project location[4].

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[4] *This contrasts with regulations that requires issues to be made to affected locals first. Pre-approval for this contradiction has been received from SEBON.*

For more information, visit www.icranepal.com

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