Sagarmatha Jalabidhyut Company Private Limited: [ICRANP] LBB- (Assigned)

April 11, 2019

Summary of rated instruments:

Instrument*	Rated Amount (NPR Million)	Rating Action
Fund-based - Long-term loans	1,340.00	[ICRANP] LBB- (Assigned)
Total	**1,340.00**	

**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 1,340-million long-term loans of Sagarmatha Jalabidhyut Company Private Limited (SJCPL).

Rationale

The assigned ratings factor in the early stage of project development and consequently higher execution risk associated with the proposed 9.6-MW Super Mai-A hydroelectric project (HEP) being developed by SJCPL in the Illam district of Eastern Nepal. The rating also factors in the relatively high project capital cost on a fixed tariff regime and high gearing level (given the 75:25 debt equity ratio) which results in moderate return and debt coverage indicators for the company. The rating also remains constrained by the hydrological risk due to the absence of the deemed generation clause in the power purchase agreement. The interest rate volatility in the banking sector also remains a rating concern, given the high debt burden of the company.

Nonetheless, the assigned rating draws comfort from the experience of the promoters in hydro power development and operation. The rating also factors in 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) and a positive demand outlook for renewable energy in Nepal. 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 agreements with fixed tariff structure results in low off-take risk - SJCPL has executed a PPA with the 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 3% annual escalation on base tariff for 8 years. A firm PPA with pre-defined tariff mitigates off-take and tariff risk. At the same time, the PPA provides for healthy contract energy level corresponding to 67% plant load factor (PLF), which is likely to result in higher revenue generation. Moreover, the counterparty credit risk also remains low, given the sovereign support of the Government of Nepal (GoN) to the NEA, and the NEA's past track record of timely payment of energy bills to private hydropower developers. Moreover, higher number of escalations in the energy tariff (previously 3/5 years) also augurs well for the company's return profile.

Supply-demand gap to result in healthy offtake - Nepal is a net importer of electricity, even with limited electrification across the country and current suppressed demand (per capita power consumption of <150 KW as per 2015 study, among the lowest in Asia). In the fiscal year (FY) 2017/2018, the peak power demand in the Integrated Nepal Power System (INPS) surged to 1,508 MW, while the installed operational capacity was only 1,074 MW. The shortfall was met through import. As per the NEA, the power demand is expected to grow at the rate of ~15% over the next 22 years (driven by increase in electrification, per capita consumption and higher industrial demand) and hence the supply-demand gap is expected to persist.

Evacuation risk remains low because of NEAs already operational substation at the connection point - The generated power will be evacuated through the Godak substation (s/s) of the NEA, which is ~12 km from the project powerhouse. The Godak substation, a part of the Kabeli corridor transmission line (TL) project of the NEA, has been operational since October 2015. The project's powerhouse and the NEA's/s will be connected through a 132KV 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 9.6-MW Super Mai-A HEP.

Low funding risk - The proposed 9.6-MW project is likely to be developed at an estimated cost of NPR 1,790 million. Nearly 75% of the project cost is to be debt-funded for which the developer has tied up the limits with a consortium of banks. Similarly, the developer has already infused ~70% of the project equity till the first week of April 2019. Accordingly, the funding risk for this project remains low.

Lower likelihood of time and cost overrun - The promoters have recently developed a 7.8-MW project in the vicinity of the current project, within the estimated cost and time parameters. This provides comfort about the execution capacity of the promoters. Similarly, upfront equity injection by the promoters and the developer's plan to complete the project ahead of the required COD is likely to result in savings in interest during construction (IDC). All the contracts between SJCPL and the project's contractors are denominated either in the Nepalese currency (NPR) or the Indian currency (INR) (fixed peg with NRP), eliminating the forex risk. All these result in lower likelihood of time and cost overrun.

Credit challenges

Execution risk remains high due to early stage of project development - Although the low evacuation risk for the 9.6-MW project remains a comfort, the nascent stage of the project development creates significant execution risk. Project execution remains in the early stages (~15% of the project cost incurred till mid-March 2019). Given the high gearing levels 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, there is an adequate time buffer before the required commercial operation date (RCOD) for the project.

High project cost and gearing result in modest return and weak debt coverage indicators - SJCPL's management estimated project cost is ~NPR 1,790 million, which is ~75% debt-funded. This results in relatively higher commissioning cost for the 9.6-MW project (~NPR 186 million per MW) and sizeable debt burden on the project, resulting in modest debt coverage indicators, post commissioning. The return and debt coverage indicators could further come under pressure in case the project is unable to achieve the designed operating parameters.

Hydrological risk and absence of deemed generation clause in the PPA – The Mai river basin (where the project is being developed) is predominantly rain-fed and, therefore, the project hydrology remains dependent on the annual precipitation in the region. 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.

Annexure-1: Instrument details

Instrument	Rated Amount (NPR Million)	Rating Assigned
Fund-based - Long-term project loans	1,340.00	[ICRANP] LBB-
Total	**1,340.00**	

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

Sagarmatha Jalbidyut Company Private Limited (SJCPL) was incorporated in November 2015 as a private limited company. As of mid-March 2019, the company has seven promoters with major holding from the Chairman Mr. Rajendra Prasad Gautam (~46%), other major shareholders being Mr. Mohan Bikram Karki (16%), Mr. Madhav Prasad Mainali (15%) & Mr. Rajendra BC (14%). The company is developing a 9.6-MW Super Mai-A HPP (Required Commercial Operation Date-RCOD: January 13, 2021) in Illam District of Eastern Nepal. Till mid-March 2019, the project had achieved ~15% financial progress.

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About ICRA Nepal Limited:

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