



RATINGS (JUNE 2011)

FFC ENERGY LIMITED (FFCEL)

NEW	
ENTITTY	
Long Term	A
Short Term	A1

ANALYSTS

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PROFILE

- FFCEL is setting up a 49.5 MW power plant based on wind - a renewable energy source. The plant would be located in Gharo, keti Bandar, at Jhampir Sindh on 1,283 acres of leased land. The company is a wholly owned subsidiary of Fauji Fertilizer Company (FFC). The sponsor - FFC - is a leading fertilizer manufacturing company with robust business profile emanating from high-demand high-margin fertilizer segment, which is supplemented by low leveraged capital structure and strong cash flows and coverages. FFC is well placed to comfortably support the committed financial needs of FFCEL.
- FFCEL has seven members FFC nominated board. Lt. General Malik Arif Hayat (retd.), who is also CEO of FFC, is the CEO of the company. FFC's project team is assisting him in setting up this power plant.

RATING RATIONALE AND KEY RATING DRIVERS

- The ratings reflect robust financial profile of the sponsor - Fauji Fertilizer Company - and established credentials of lead EPC contractor - Nordex, Germany. At the same time, the ratings incorporate FFCEL's exposure to multiple risks in set-up stage including a) weak law and order situation and stressed infrastructure that may disrupt timely availability of requisite resources b) first venture of Nordex in Pakistan, though it is expected to be managed by selection of Descon Engineering as core partner that has sound domestic experience, and c) equipment malfunctioning wherein modular commissioning pattern would be offering swift learning curve, helping in minimizing overall delays.
- The management, cognizant of these risks, has built mitigants in arrangements with Nordex - fixed price contract and corporate guarantee. Nevertheless, the company would be exposed to financial risk (scheduled debt repayments) in case material delays occur in CoD. The comfort is drawn from Debt Service Reserve Account and commitment by FFC to make good any shortfall in it; offering cushion against delay upto one installment. This is supplemented by three months favorable gap between agreed and required CoD. Same EPC contractors are acting as O&M operators. Post commissioning, the nature of the projected cash flow stream is considered stable emanating from a long-term Energy Purchase Agreement, which allows for guaranteed returns subject to adherence to agreed performance benchmarks. Nevertheless, weak financial discipline of the sole power purchaser remains a concern.
- Management's ability to effectively manage the construction and operating risks while ensuring timely commissioning of the project would remain critical. Furthermore, external factors such as any adverse changes in the regulatory framework or material delay in achieving CoD may impact the ratings.

ASSESSMENT

- Given growing demand supply gap in electricity and increasing fuel supply risk of thermal IPPs, the government has lately offered various initiatives to investors to set up power plants based on renewable energy (RE). RE projects are governed under Renewable Energy Policy 2006 developed by Alternative Energy Development Board (AEDB).
- FFCEL, a special purpose company incorporated in November 2009, is in the process of setting up a 49.5 MW wind power plant on Build, Operate, and Own basis. The life of the power project, commensurate with the validity of generation license, is twenty years. The expected cost of the project is US\$ 134 mln.
- FFCEL has executed an EPC contract with Nordex - a renowned wind power solution provider with above 3% share in world's installed wind energy capacity (end-10). Any delays in the completion of the project deadlines as specified in the Energy purchase agreement may result in the company having to pay liquidated damages to power purchaser. However, risks related to the timely completion of the project, including design, construction, commissioning and testing of the power plant are transferred to the EPC contractor. In case of delays in COD due to EPC contractor, damages subject to a cap of 5% of EPC price are payable by the contractor. In addition, parent of the lead contractor - Nordex Germany - has provided a corporate guarantee against the performance agreed in EPC contract. The management is confident of achieving the same in advance of the required COD by three months, signifying cushion available against any contingency.
- Positive cost overruns are a pass through item for the company caused by currency and interest rate fluctuations. These can move the project cost upward or downward. FFCEL has agreed a cushion of 25% of total project cost as contingency against any cost overrun in Project Funds Agreement. At COD, the tariff is adjusted to reflect these cost overruns subject to the approval of NEPRA. Under the Project Funds Agreement (PFA), the sponsors and lenders have committed to fund all positive cost overruns in the ratio of 20:80 respectively. Furthermore negative cost overruns, which are not pass-through, are to be funded solely by the sponsors.
- The O&M contractor would be responsible for ensuring that the installation meets set performance targets including the availability of the plant. Wind risk, which is inability of the plant to produce electricity in case required wind is not available, is fully transferred to the power purchaser. Any changes in the O&M arrangement would require prior approval of the Lenders.
- FFCEL's key source of earnings would be the generation tariff from the power purchaser, National Transmission and Dispatch Company (NTDC). FFCEL has a generation tariff (levelized tariff for years 1-20) of US\$16.1090 (PKR 13.6927) per Kilowatt hour. Given plant contracted capacity of 49.5 MW, all tariff components will be adjusted at the time of COD based upon the initial dependable capacity tests to be carried out for determination of the contracted capacity.
- The stability of cash flows is ensured through the minimum guaranteed payment to FFCEL even if there is zero electricity demand from the power purchaser. However, if FFCEL fails to supply electricity, due to less than benchmark availability (95%), the payments from the power producer would be restricted to the extent of electricity production. Because of free availability of resource, working capital requirement for wind based IPP are negligible.
- The project is being financed through an 80:20 capital structure. In this regard, a project finance facility, denominated in PKR, has been arranged. The current size of the facility is ~PKR 10,773mln which includes contingency funding reserve of ~PKR 1,621mln. The repayment mechanism has been established such that the company, prior to commencement of each repayment, would create a reserve account equivalent to one upcoming installment in six equal monthly installments. The reserve would be maintained in the form of cash. This reserve would take care of any temporary disruption in the cash flows. In addition, the sponsor has established an irrevocable SBLC of PKR 768mln in favor of FFCEL, which is expected to take care of any disruption in repayment of first installment. However, the company would have to fill the DSRA from its own cash flows once the SBLC is expired.