RATINGS (JANUARY 2012)
SAPPHIRE ELECTRIC COMPANY LIMITED (SECL)

	CURRENT (JAN-12)	PREVIOUS (MAY-11)
ENTITY		
Long Term	AA-	AA-
Short Term	A1+	A1+

ANALYSTS

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PKR mln

	FY11	FY10
Actual Project Debt	12,593	
Debt allowed by NEPRA	11,485	
Total Installment paid	2,250	-
Total Outstanding Debt	14,556	11,843
Debt to Total Capital	77%	75%
Remaining installments	37	40

	FY11
Efficiency (%)- Required (Gas/HSD)	51.20/47.70
Efficiency (%)- Actual (Gas/HSD)	50.73/48.23
Available Capacity (Avg. %)	92.60

PROFILE

- SECL, was established in January 2005. The company's sponsors are; Sapphire Group with a 61% stake, via its group company Sapphire Fibres Limited (SFL), DEG Germany (19%) and Xenel Saudi Arabia (20%).
- SECL's seven member board comprises five representatives of the Sapphire Group, while Xenel and DEG are represented by one member each. The BoD meets almost every month to provide strategic guidance to management. Mr. Shahid Abdullah, the CEO, also heads the parent company SFL.

RATING RATIONALE AND KEY RATING DRIVERS

- The ratings of SECL reflect its low risk profile, emanating from a cashflow stream guaranteed by GoP under the Power Purchase Agreement (PPA), subject to adherence to agreed performance parameters. The appointment of General Electric (GE), as the Operations and Maintenance (O&M) contractor makes it liable for any operation failure related liabilities. Given relatively new exposure to Pakistani environment, it would be challenging for GE. Nevertheless, upholding a strong governance structure along with effective monitoring of the plant operations by the management is expected to ensure sustainability of operations on agreed parameters as per PPA. Meanwhile, the weak financial discipline of the sole customer, National Transmission and Despatch Company (NTDC), is the key challenge faced by the company, magnified in the wake of ongoing circular debt crisis in energy chain of the country. However, association of the company with Sapphire Group, wherein support is expected in case the need arises, provides comfort to the ratings.

- The ratings are dependent upon the company's ability to adhere to agreed upon performance parameters, as set by the power purchaser. Moreover, availability of gas remains important for efficient utilization of the gas-based power plant. Meanwhile, managing liquidity requirements in the midst of the circular debt crisis and external factors such as any changes in the regulatory framework of IPPs are critical to the ratings.

ASSESSMENT

- The total available capacity of electricity generation in Pakistan stands around 21,000MW. However, consistent growth in population and gradual electrification along with industrialization have increased the demand of electricity. In the absence of any noteworthy development in hydel, the government's reliance on thermal generation has increased – particularly IPPs. Given its financial constraints, the government incentivized the private sector to setup IPPs. As of now, there are 27 IPPs with installed capacity of ~ 7,500MW. With ~ 36% of the country's total capacity, IPPs are playing a critical role to manage the shortfall at acceptable level. However, the power sector has been plagued by the circular debt crisis which has resulted in accumulation of receivables for the IPPs. In order to ensure smooth and uninterrupted running of the plants, IPPs have resorted to enhance their working capital lines due to late payment by the single buyer (WAPDA/ NTDC). Going forward, GoP's failure to resolve circular debt and consistent pilling up of receivable could have a negative implication for the IPPs' sector.
- SECL is operating a combined cycle thermal power plant with gross capacity of 225 MW. The plant, is located on Muridke Road, District Sheikhupura. The company achieved its COD on 4th October 2010 (RCOD: 21st October 2009).
- General Electric Energy Parts Inc. (GEEPI) is the plant's O&M operator. The corresponding O&M contract's tenor is 18 years with the option to extend it further. Although General Electric has a significant presence globally, and possesses adequate experience in carrying out O&M activities, this is one of the few times that it has worked in Pakistan.
- The power plant is fueled by Pipeline Quality Gas supplied by Sui Northern Pipelines Limited (SNGPL). High Speed Diesel (HSD), the backup fuel, is sourced from Shell Pakistan. SECL has entered into a backup fuel supply agreement for twelve years. Due to acute shortage of gas in the country (especially during winter months), the company has been facing supply disruptions in its primary fuel; as a result, it runs its plant on HSD, the alternative fuel. However, SECL, while negotiating better gas supply is exploring multiple avenues for importing LNG, which can also be used as a primary fuel. Meanwhile, the company has installed an evaporative cooler, which will be beneficial during summer and would increase the plant's efficiency.
- Since the CoD, the availability of the plant has been maintained (92.6%) as per PPA defined parameters. Moreover, having been restricted to an acceptable level, forced outages were lower than the permitted amount. The company maintains its efficiency parameters as per the requirements set within the PPA. However, as a result of prevailing gas supply deficit and the ensuing increase in frequency of switching between two fuels, the plant achieved efficiency of 51.32% on gas and 49.27% on HSD, slightly lower than the required level. From the CoD to June 30, 2011, the company dispatched 808,153,088KWH of electricity.
- SECL's key source of earnings is the generation tariff from the power purchaser. The plant, at 51% average efficiency, has a generation tariff (levelized tariff for 25 years) of PKR 4.3200/Kilowatt hour (Kwh) on gas and PKR 12.2311/Kilowatt hour (Kwh) on HSD. The post COD tariff has been approved by NEPRA, however, management has filed a petition with NEPRA against certain disputed costs. The outcome of the petition is uncertain.
- In order to manage its fuel payments, SECL requires working capital lines equivalent to at least 55 days to cover credit period allowed to NTDC according to the terms of the PPA. Currently, the company's total short term WC lines are PKR 5.25bln, out of which PKR 3.25bln have been utilized as of end-Sept 2011. As outstanding receivables stood at PKR 3.70bln, balance of working capital lines provide SECL sufficient cushion in case of need. However, due to acute shortages of gas (especially in winter months), the plant is running on HSD, and thus, working capital requirements are expected to witness an increasing trend.
- The project's original proposed debt equity structure was 75:25. However, the structure as per the final project cost and debt financing assessed by NEPRA, was 72.34:27.66. Principal is to be repaid in 40 consecutive quarterly installments that have commenced from November 2010. Given, the company's precarious cash flow position, it has not paid out any dividends since coming online.