



RATINGS (MAY 2011)

**SAPPHIRE ELECTRIC
COMPANY LIMITED
(SECL)**

INITIAL	
ENTITY	
Long Term	AA-
Short Term	A1+

ANALYSTS

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RATING RATIONALE AND KEY RATING DRIVERS

- The ratings of SECL reflect low financial risk owing to stable future cash flows, also guaranteed by the Government of Pakistan (GoP) under the Power Purchase Agreement (PPA), subject to adherence to performance parameters. The ratings incorporate low operational risk emanating from established operating track record of the O&M operator - General Electric. Meanwhile, weak financial discipline of the sole customer, National Transmission and Despatch Company (NTDC) would remain a key concern, natural-gas-based plant's relatively low-tariff structure is expected to place SECL in a better position to get priority payments from NTDC.
- The ratings are dependent upon the company's ability to adhere to agreed performance parameters as set by the power purchaser. The company is currently facing shortage in supply of its primary fuel, prolonged delay of which may cause the plant to run on High Speed Diesel, thereby hampering effective utilization of gas based plant. Furthermore, external factors such as any adverse changes in the regulatory framework may impact the ratings.

ASSESSMENT

- SECL is operating a combined cycle thermal power plant with gross capacity of 225 MW. The plant, is located on Muridke Road, District Shaikhupura. The company achieved its COD on 4th October 2010 (RCOD: 21st October 2009).
- General Electric Energy Parts Inc. (GEEPI) is the O&M operator of the plant. The O&M contract for the plant is for 18 years with an option of extending the contract further. Although General Electric has a significant presence globally, and possesses requisite experience to carry out O&M activities effectively, this is one of their very few instances of working 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. Lately, the company faced shortage in supply of gas-its primary fuel-as a result it runs its plant on a very low capacity as demand from power purchaser declined owing to high cost of electricity produced through HSD. However, the company, while negotiating with government departments to restore gas supply to the plant, is in the process of exploring different avenue for import of LNG, which can also be used as primary fuel.
- SECL's key source of earnings is the generation tariff from the power purchaser. The plant is working on average at 51% efficiency and has a generation tariff (levelized tariff for years 1-25) of 4.32 PKR/Kilowatt hour (Kwh) on gas and 12.2311 PKR/ Kilowatt hour (Kwh) on HSD. However, Post COD, tariff is yet to be determined by NEPRA. The cost overruns in the construction of the plant amounted to USD 32mln.
- The stability and sustainability of cash flows is ensured through the minimum guaranteed capacity charge component of the tariff that SECL would receive even if it produces no electricity (in case of zero demand from the power purchaser). However, if SECL is unable to supply electricity as per demand due to its own inefficiencies or fails to notify NTDC of the available capacity 12 hours prior to the dispatch date, it would be liable to pay liquidated damages as per provisions of the PPA.
- In order to avoid default on its fuel payments, SECL would require working capital lines equivalent to 55 days at least to cover credit period allowed to NTDC according to the terms of the PPA. SECL has arranged working capital lines of PKR 3.25bln to cover its working capital requirements. The company has already utilized credit lines worth PKR 1.5bln as on 31st December 2010. Underutilized working capital lines provide SECL sufficient cover in case the need arises. However, if the company requires to run on HSD, working capital requirement may increase.
- The project has a debt:equity structure of 75:25. Till COD, the company has obtained project financing to the tune of PKR 12,593mln. Principal is to be repaid in 40 consecutive quarterly installments that have started from November 2010.
- The tariff structure of the plant is relatively low as it runs on Natural Gas. Meanwhile, its prime location near major consumption center places it in a relatively better position to receive priority payments from the power purchaser.

PROFILE

- SECL, a public limited unlisted company, is established in January 2005. The sponsors of the company are Sapphire Group with a 61% stake, via its group company Sapphire Fibres Limited (SFL), DEG Germany (19%) and Xenel Saudi Arabia (20%). SFL, incorporated in 1979, is in the business of manufacturing and selling yarn and fabrics. The company has a total spinning capacity of around 91,200 spindles. DEG, a member of KfW Banken gruppe of Germany is one of the largest European development finance institutions for long-term project and company financing. Xenel, based in Saudi Arabia was founded in 1973. Over the years, Xenel has built expertise in various industries including energy sector through its multinational operations.
- SECL's seven members board comprises five representing the Sapphire Group, while Xenel and DEG are represented by one member each in the BoD. Though the BoD members have limited power sector experience, their overall diverse business exposure helps in providing strategic guidance to the management. Mr. Shahid Abdullah, the CEO, also heads the parent company if SECL, SFL.

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