ICRA Lanka assigns issuer rating of SL[A-] with Stable Outlook to Panasian Power PLC

June 26, 2019

Instrument*	Current Rated Amount (LKR Mn)	Rating Action
Issuer Rating	-	SL[A]- with Stable Outlook assigned

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a Group Company of Moody's Investors Service, has assigned the Issuer rating of [SL] A- (pronounced SL A minus) with Stable outlook for Panasian Power PLC ("PAP"/ "the Company").

Rationale

The assigned rating considers positively the experience of the management team and the Company's satisfactory operational track record in the power sector, which has permitted the Company to record healthy growth in revenues and profits over the past few years. PAP currently operates three Mini Hydro Power Plants (MHPPs), two rooftop solar power plants (directly owned) as well as a newly commissioned ground solar power plant in Sri Lanka, accounting for a total power generation capacity of 11.4MW. Despite its small scale of operations, the Company has been efficiently managing its operations through prudent selection of energy sources, locations and strong control over operations & maintenance. While the Company's oldest Power Purchase Agreement (PPA) pertaining to Rathganga-MHPP (3MW) is expiring in June 2019, the Company's balance PPAs are in place for the next 15-20 years with the Ceylon Electricity Board (CEB), which provides strong revenue visibility over the long term. Given the government backing for CEB, the counterparty credit risk is expected to be limited as also demonstrated by the payment track record so far, providing further comfort.

The rating also draws comfort from PAP's healthy financial profile, which is characterized by robust profitability (average return on capital employed (RocE) in excess of 20%), comfortable capital structure (gearing of 0.67x as on March 31, 2019) and adequate coverage metrics. PAP's liquidity profile is also strong with adequate cash balances and liquid investments, besides access to bank funding given its strong relationship with financial institutions.

The assigned rating factors in the Company's large reliance on run-of-the-river MHPPs which are exposed to vagaries of the Monsoons. Notwithstanding the Company's diversification efforts into solar power energy sector, the risk is accentuated by PAP's current modest scale of operations which exposes cash flows to volatility. Moreover, one of PAP's major plants – Rathganga's (contributing currently about 30% of consolidated revenues in FY2019) PPA is expected to expire in June 2019. While the Company is negotiating a new PPA with the authorities, the tariff rate is expected to be considerably lower as compared to the tariff enjoyed by the Company under the current PPA. Therefore, the ability of the Company to negotiate favourable terms for this plant and achieve further revenue diversification would be key rating sensitivities.

Given the government's favourable policy framework on the solar power sector (especially for roof top solar segment), and relatively shorter gestation period for development of solar power plants compared with mini hydropower projects, ICRA Lanka views favourably the Company's plans to scale up its capacity by 15-20 MW in the solar power segment over the next two/three years. The Company also intends to raise new capital infusion of LKR 400 Mn in the short term to support its new capacity expansion plan, which provides adequate comfort on the Company's ability to successfully carry out its scaling up operations as envisaged and fund raising ability. Given the industry outlook and Government of Sri Lanka's (GoSL) focus on Non-Conventional Renewable Energy Sources (NCRE), the demand prospects also augur well for the Company.

The rating also considers the Company's various large capex projects, which are currently under review, and therefore, this would have an impact on the long term capital structure of the Company going forward. The Company intends to construct new MHPPs both in Sri Lanka and overseas, accounting for~10MW. These projects are currently in the early stages, and therefore, implementation of such projects will take place only after the necessary approvals are granted. Therefore, the ability of the management to efficiently manage the implementation of its capacity expansions (including the pipelines of solar power projects) remains to be reviewed going forward.

Key Rating Drivers

Credit strengths

Strong execution track record, capable management and efficient organizational structure: The rating considers favourably the experience of the management team and PAP's strong operational track record which have enabled the Company to record healthy growth in revenues and profits over the past several years. The current investor-consortium, as well as the new equity investor-Emerald Fund, have a keen interest in the renewable energy sector in Sri Lanka and therefore, over the next two years, the Company intends to scale up its operations significantly in the solar power sector. At the operational level, the Company is also supported by a strong engineering team, complemented by a sizeable maintenance /operations team. Further, the Company's current group structure has helped to expand the business operation without significantly leveraging the balance sheet through prudent use of JV structures, also taking advantages of concessionary finances, which are available for solar power projects/investments.

Diversification strategy: although, the Company's current power generation capacity is largely concentrated in the hydropower sector (with 8.9 MW), over the next two years, the Company intends to scale up its installed energy capacity up to 25-30 MW in the solar power segment. This will help the Company to mitigate the risks of vagaries of Monsoons. Moreover, given the less volatility in Plant Load Factor (PLF) of solar power segment in Sri Lanka, the expansion into solar will also provide further stabilization in the Company's overall PLF levels going forwards. PAP also acts as an EPC contractor for its group solar power investments and this has further helped the Company to benefit from the lower global PVC prices (compared to the market conditions). Moreover, the Company's MHPPs are also located in the Central and Southern parts of the country, which has also helped the hydropower segment to geographically diversify from the North East and South West Monsoons. Further, the Company is currently reviewing to set up new MHPPs in Sri Lanka and abroad. Although, these projects are currently at the initial stages of approvals, these projects in the long run, would help the Company to further diversify its operations geographically.

Comfortable Financial Profile: PAP's financial profile is characterized by relatively robust profitability (ROCE in excess of 15-20%, except in FY16/17), relatively comfortable capital structure (moderate gearing of 0.67x as at FY2019) and adequate coverage metrics. PAP's liquidity profile has also traditionally been strong with adequate cash balances and liquid investments, besides access to bank funding, given its strong relationship with financial institutions. ICRA Lanka also views positively the planned new equity infusion of LKR 400 Mn and the same will help the Company to scale up its operations going forward without highly leveraging its capital structure. Moreover, the Company has recently restructured some its debts (at standalone levels), which has helped the Company to align its debts along with the cash flow generating assets/entities.

Credit challenges

Fluctuations in rainfall leading to volatile cash flows: the Company's power generation is still highly reliant on run-of-the-river MHPPs, which are exposed to vagaries of the Monsoons (although this is mitigated to an extent by the geographical diversification). The risk is accentuated by PAP's current modest scale of operations which exposes cash flows to volatility; during FY2016/17, the severe drought conditions that prevailed in Sri Lanka had adversely affected the overall PLF levels of most MHPPs in Sri Lanka and consequently the profitability. However, this risk is largely being mitigated by the recent diversification efforts into solar power segment. Therefore, the ability of the management to successfully carry out the capacity expansions as envisaged remains to be reviewed going forward and hence, this is a key rating sensitivity to the assigned rating.

Increased capital expenditure programme: given the Company's capacity expansion plan in the solar power segment, PAP intends to invest ~LKR 2.4 Bn in FY2020/21. This is expected to be largely funded by debt facilities. Moreover, the Company is also faced with execution risk since there is a larger pipeline of solar power projects. However, shorter gestation period of development of solar power plants and the Company's expertise of this segment mitigate this risk to an extent. Therefore, the ability of the management to efficiently manage the implementation of its capacity expansions and negotiate favourable terms with the Banks to fund the expansion plans, remain as a key factor in the assigned rating.

Regulatory environment and other macroeconomic volatility: One of PAP's major plants – Rathganga's PPA is expected to expire in June 2019. Although, according to the recent regulations, the new tariff levels are expected to be negotiated at favourable terms than that of the previous regulatory guidelines, the ability of the management to negotiate a favourable tariff structure (as envisaged) remains to be reviewed going forward. Moreover, since, PAP intends to scale up its capacity significantly in the solar power segment over the next two/three years, the changes in the current regulations of this sector would likely have an impact on the overall performance of the group. The macro economic conditions such as increasing interest rate, depreciation of Sri Lankan rupee and other economic policy directives of Sri Lanka would also have an impact on the Company's new capacity expansion plans (as most raw materials for the construction of solar power plants are largely imported).

Analytical approach: For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below**.**
Links to applicable criteria: http:*www.icralanka.com/images/pdf/Corporate%20Rating%20Methology.pdf*

About the Company:

Incorporated in 2002 as a Board of Investment (BOI) venture, Panasian Power PLC (PAP) constructs, operates and maintains MHPPs as well as rooftop and ground solar power plants. At present, PAP operates three mini hydro power projects with an installed capacity of 9.1MW along with a combination of rooftop and ground solar power plants amounting to~ 3.0 MW. The Company directly owns the Rathganga MHPP, whilst Manelwala MHPP and Padiyapellela MHPP are operated as fully owned subsidiaries. The Company also intends to expand its MHPP portfolio with the addition of Padiyapellela Phase II (2.4MW) and the proposed Medakumbura MHPP (2.5MW). Moreover, recently, PAP has commissioned rooftop solar power plants through Panasian Investments Pvt Ltd, with the installed capacity of 2.0 MW(of which 1.2 MW capacity is under JV levels) and another on ground solar power plant with total installed capacity of 1MW (to be commissioned in June CY2019). Moreover, PAP has a pipeline of~10MW of ground solar projects which would be commissioned during FY2020/21. Due to the extensive in-house technical knowledge, PAP takes on a dual role as EPC and investment partner. With these power plants, the Company has 4 subsidiaries, 4 sub-subsidiaries and 2 JVs. The Company's diversification aims to achieve installed capacity of~30MW by FY2022 while continuing to diversify its NCRE energy generation mix. During FY2019, PAP's total installed power generation capacity stood at 10.1 MW with an estimated energy potential of 37.45 GWh power supplied to the National Grid.

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