CREDIT RATING REPORT

Saint Lucia Electricity Services Ltd (LUCELEC)

Caribbean Information & Credit Rating Services Limited

December 2016

INSTRUMENT RATED	RATING
USD 15 million Debt Issue (Notional)	*Cari*BBB (Foreign Currency)

RATING HISTORY			
Date	Foreign Currency	Local Currency	Instrument/Remarks
December 13, 2016	*Cari*BBB	*Cari*BBB	USD 15 million Debt Issue (Notional)
December 10, 2015	*Cari*BBB	*Cari*BBB	USD 15 million Debt Issue (Notional)
March 31, 2015	*Cari*BBB	*Cari*BBB	USD 15 million Debt Issue (Notional)
December 11, 2013	*Cari*BBB	*Cari*BBB	USD 15 million Debt Issue (Notional)
March 8, 2013	*Cari*BBB	*Cari*BBB	USD 15 million Debt Issue (Notional)
December 9, 2011	*Cari*BBB	*Cari*BBB	USD 15 million Debt Issue (Notional)
July 28, 2006*	*Cari*BBB	*Cari*BBB	USD 15 million Debt Issue (Notional)

**Initial Rating Assigned*

RATING DRIVERS

Strengths

- Monopoly position as the sole energy transmission and distribution company in Saint Lucia, with continued focus on renewable energy development
- Improved financial performance and debt servicing ability notwithstanding declining revenue
- Good operating efficiency supported by continued focus on system enhancement and network improvements

Weaknesses

- Persistently high receivables though improving ageing profile
- Significant risk retention via self-insurance of T&D assets

Rating Sensitivity Factors

- A change in the economic performance of the GOSL which leads to a downgrade or rating watch.
- Loss of more than 25% of its generation, transmission or distribution physical assets
- Improvement of the receivables aging profile with debtors over 90 days declining to 20% of total trade receivables

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COMPANY BACKGROUND

Saint Lucia Electricity Services Ltd (LUCELEC) was established on November 9, 1964, as a private limited liability company with the purpose of electricity generation and distribution for Saint Lucia. The company became public on August 22, 1994. The top five shareholders[1] account for 85.6% of total outstanding shares and are Emera (Caribbean) Incorporated (20%), First Citizens Bank Limited (20%), National Insurance Corporation of Saint Lucia (16.8%), Castries City Council (16.4%) and the Government of Saint Lucia (12.4%). The remaining 14.4% of outstanding shares are widely held.

The company presently operates one electricity generation facility at Cul de Sac and seven substations throughout the island linked by a 66kV transmission network. Originally commissioned with 2 generators in 1990, the generation facility now houses 10 generators and has a total installed capacity of 88.4 MW.

[1] *The shareholdings disclosed are of the voting shares*

RATIONALE

Caribbean Information and Credit Rating Services Limited (CariCRIS) reaffirmed the assigned ratings of *Cari***BBB** (Foreign and Local Currency) on the regional rating scale for the US $15 million notional debt issue of Saint Lucia Electricity Services Limited (LUCELEC), with a **stable** outlook. These ratings indicate that the level of creditworthiness of this obligation, adjudged in relation to other obligations in the Caribbean continues to be **adequate**. The stable outlook is based on CariCRIS' expectation that LUCELEC will continue to have a steady and predictable revenue stream over the next 12 months, consistent with its 3-year trend. We expect the company to continue to benefit from subdued energy prices over the next 12 months, thereby maintaining or improving its present PAT margin. Trade receivables should decline as a result of a forecasted marginal improvement in the country's economic performance, as well as LUCELEC's ongoing credit management initiatives.

The factors in support of the ratings are:

Monopoly position as the sole energy transmission and distribution company in Saint Lucia, with continued focus on renewable energy development

LUCELEC is the only full integrated electricity company in Saint Lucia with the exclusive right to transmit and distribute electricity. In 2016, the regulatory environment changed significantly following the passage of the National Utilities Regulatory Commission Bill[2]. Based on the new regulatory framework, independent power producers (IPPs) may be granted licenses by the National Utilities Regulatory Commission (NURC) to generate electricity from renewable sources. While this change allows new competitors in the generation space, we believe that LUCELEC will retain its monopoly position in transmission and distribution, since the new regulatory and legislative changes have not liberated this segment of its operations. Further, based on the Act, competition from the IPPs will be limited to electricity generation from renewable sources.

In keeping with its strategic plan and the Government of St. Lucia's (GOSL's) mandate to achieve 35% of electricity production from renewable energy by 2020, LUCELEC, guided by the

[2] *The water and electricity sectors will now be regulated by the National Utilities Regulatory Commission (NURC), a multi-sector, independent regulatory body. The regulation has not been fully implemented with approximately only 20% of the changes completed. Full implementation is expected by December 2017.*

National Energy Transition Strategy[3] (NETS) continues to pursue several renewable energy projects. To this end, discussions with the GOSL are ongoing to acquire land near the Bordelais Correctional Facility for construction of a 12 MW wind turbine farm, and this project is expected to start by the 3rd quarter of 2017. LUCELEC has also embarked on the construction of a 3 MW Solar PV Farm for completion by June 2017, and feasibility studies for its geothermal project are ongoing.

Improved financial performance and debt servicing ability notwithstanding declining revenue

Table 1
Summary of Financial Performance for the periods 2013 - 2015

	2015	% chg	2014	% chg	2013	% chg	3-Year Avg (%)**	3-Year Peer Sample Avg (%)
	EC $ 'million							
Operating Revenue	312.8	(5.0)	329.2	(1.2)	333.1	(2.1)	(2.8)	5.6
Cost of Sales	196.8	(8.4)	214.9	(2.5)	220.4	(6.1)	(5.7)	7.3
Profit After Tax (PAT)	28.9	7.8	26.8	5.9	25.3	(12.1)	0.5	5.7
Total Assets[a]	478.4	(5.2)	504.5	6.2	475.1	(3.6)	(0.9)	3.0
Net Worth	247.0	9.5	225.6	6.5	211.8	8.1	8.0	5.3
	%							
Gross Profit Margin	37.1		34.7		33.8		35.2	29.4
EBITDA Margin	26.8		24.6		24.2		25.2	18.8
PAT Margin	9.2		8.1		7.6		8.3	6.5
ROCE	13.6		13.2		12.7		13.1	12.5
Return on Equity (ROE)	12.2		12.3		12.4		12.3	11.7
Return on Assets (ROA)	5.9		5.5		5.2		5.5	5.1
Total Debt/Net Worth	55.8		67.9		79.3		67.7	68.7
	Times							
Interest Cover[b]	7.1		6.2		6.1		6.5	8.0
DSCR	2.8		2.7		2.4		2.6	2.5
Current Ratio	2.6		1.9		2.3		2.3	1.9

Source: LUCELEC and annual reports of regional electricity service companies
Financial year runs from January to December 2015
[a] *Excludes intangible assets*
[b] *EBITDA/interest expense*
*** 3-year averages run from 2013 - 2015*

[3] *Developed jointly by the GOSL and LUCELEC in consultation with the Rocky Mountain Institute. The transition strategy will ensure that the stability and reliability of the existing electrical grid is not compromised as the government works towards accomplishing its renewable energy mandate. It will also investigate ways in which a higher penetration of renewable energy is obtained at the least cost.*

In 2015, the company recorded its highest sales per kWh since 2011, which attributed to increased electricity consumption in nearly all sectors. Despite the higher unit sales - 1.7% sales per kWh increase over 2014 - revenue in 2015 of EC $312.8 million was 5% lower than the prior year mainly due to of a 6.1% decline in tariffs to EC $0.92 per kWh caused by reductions in fuel price hedges during the year (*Table 1*). Overall the company's profitability improved for the 2nd consecutive year with increases noted in all profitability margins and return ratios, and LUCELEC continued its outperformance of its regional peers[4].

For the 9-month period ended September 2016, LUCELEC's PAT improved by 18.9% over the corresponding 9-month period in 2015, leading to a marked increase in its profitability margins (*Table 2*). The company's higher profit outturn was largely driven by higher unit sales coupled lower administrative and finance costs during the period. Profitability was moderated by an 18.2% decline in revenue compared to the previous comparative period. This decline in revenue primarily reflected lower fuel surcharges[5] passed on to customers as a consequence of lower oil prices during the year.

CariCRIS is of the view that LUCELEC's declining revenue trend does not negatively impact the company's business or financial risk profiles, as the company's customer base remains stable, and electricity consumption has been increasing. We expect electricity consumption to further increase over the next 12 months leading to a further strengthening of the company's financial performance, barring the occurrence of any external shocks.

[4] *Compared to the weighted average of CariCRIS' sample of regional electricity companies*

[5] *The price of fuel is a pass through cost to customers. The fuel surcharge is based on the difference between the cost of fuel used to generate sales in the current month and the average fuel price for the 12-month period ending December of the prior year.*

Table 2

Summary of Financial Performance for the 9-month Periods Ended September 2014 - 2016

	9 mths to Sept 2016	% chg	9 mths to Sept 2015	% chg	9 mths to Sept 2014	% chg	3-yr Avg % Growth
	EC $'000						
Operating Revenue	195,675	(18.2)	239,204	(2.5)	245,316	(0.9)	(7.2)
Operating Costs	106,914	(31.2)	155,500	(3.8)	161,645	(2.3)	(12.5)
Profit After Tax (PAT)	24,765	18.9	20,820	2.3	20,361	5.7	9.0
Total Assets [a]	442,374	(9.7)	489,784	3.9	471,288	(6.0)	(3.9)
Net Worth	235,729	2.5	229,997	1.8	225,938	15.9	6.7
Total Debt	126,580	(12.0)	143,851	(9.6)	159,196	(8.6)	(10.1)
Operating Cashflow after Working Capital Changes	22,686	(69.6)	74,578	43.2	52,069	8.5	(6.0)
	%						**3-yr Avg**
GP Margin	45.4		35.0		34.1		38.2
EBITDA Margin	33.9		26.1		25.1		28.4
PAT Margin	12.6		8.7		8.3		9.8
ROCE	11.4		10.2		10.3		10.6
Total Debt/Net Worth	53.7		62.5		70.5		62.2
	Times						**3-yr Avg**
Interest Cover	10.1		7.0		6.4		7.8
DSCR	1.8		5.0		3.2		3.3
Current Ratio	2.5		2.1		3.5		2.7

Source: LUCELEC Management Accounts

Financial year ends on December 31

[a] *Excludes intangible assets*

LUCELEC's debt service coverage ratio (DSCR), though remaining adequate, declined to 1.8 from 5.0 times. The deterioration was driven by a sharp drop in the company's operating cash flow after working capital change following the cash transfer to its subsidiary, LUCELEC Caps-Ins. Inc.[6] in the 9-month period to September 2016; the cash transfer represents the accumulated funds due to the fund for the insurance of T&D assets. Interest cover however remained strong at 10.1 times compared to 7.0 times in the previous period. We expect LUCELEC to continue to show good debt protection ratios in the coming 12 months.

[6] *A wholly owned subsidiary of LUCELEC which is a vehicle for managing the self – insurance of the company's transmission and distribution assets*

Good operating efficiency supported by continued focus on system enhancement and network improvements

Consistent with its strategic objective of system improvement and enhancements, ongoing maintenance and capital investments continue to be a priority. In 2016, the company completed several projects which are expected to increase its operating reliability and data transmission capability. These projects include the upgrade of the Castries substation, the installation of a Fiber Optic Terminal[7] and the installation of a Travelling Wave Fault Locator[8] on the southern ring in the 66kV transmission system. Further, maintenance of its generation and T&D assets remain largely on schedule.

LUCELEC continues to meet its operating performance targets and the non-achievement of one metric the 9-month period to September 2016, is attributable to an event outside of the company's control. The System Average Interruption Duration index (SAIDI) metric as at September 2016 worsened to 25.2 hours from 7.0 hours one year earlier as a result of the loss of 1 substation for 20 hours during Tropical Storm Matthew, which affected Saint Lucia in September 2016. If this exceptional event is excluded, as is required by the official IEEE beta method[9], calculating reliability indices, the SAIDI would have been 5.01 hours which is within the target of 5.9 hours (*Table 3*).

Table 3
Key Operating Efficiency Metrics Relative to Target for the 9-month periods ended September 2014 - 2016

	Sept'16		Sept'15		Sept'14		Sept'13	
	Actual	Target	Actual	Target	Actual	Target	Actual	Target
SAIDI (hrs)	25.2	5.9	7.0	5.4	5.7	6.8	5.9	7.9
System Losses (%)	7.5	7.6	8.3	8.7	8.1	8.6	9.7	9.6
Fuel Efficiency (kwh/imp gallon)	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3

Source: LUCELEC

7 *Platform for the Smart grid, AMI meters and SCADA system. 1st upgrade since 1990, data throughput increased from 2mbs to 1gb per second.*

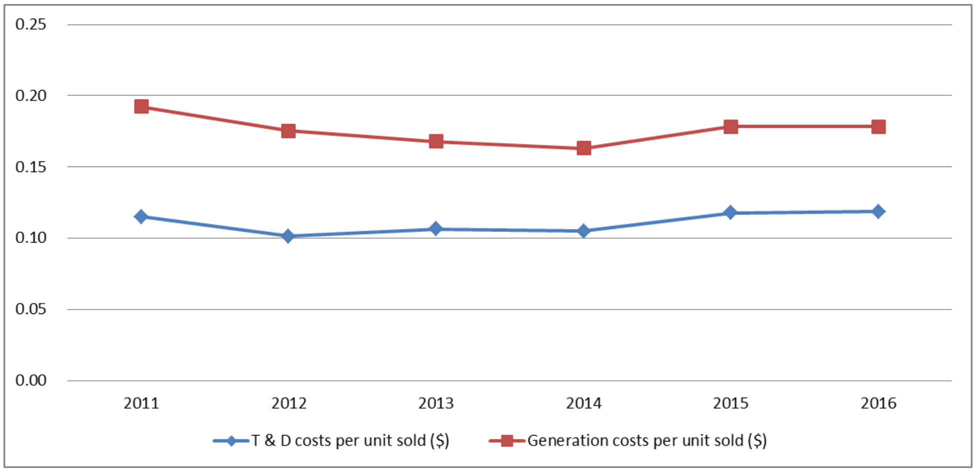
8 *Travelling-wave fault location is a method of estimating the location of a fault in a power grid transmission line based on measuring the difference in the arrival times or fault artifacts at the two ends of the line. It will improve the detection and response time of the LUCELEC maintenance team should a fault occur.*

9 *Methodology allows segmentation of reliability data into two distinct sets for review.*

LUCELEC's good operating efficiency supported by ongoing maintenance and upgrade investments has had positive knock-on effects on the company's ability to manage costs in line with its targets, evidenced by its relatively stable T&D and generation costs over the last 6 years as depicted in Chart 2.

Chart 2

Operational Costs Per Unit Sold for the 9-month periods ended September 2011 - 2016



Further improvements to the Castries Substation are planned for 2017 as well as the installation of the Travelling Wave Fault Locator on the northern ring of the 66kV transmission system that includes the company's substations at Castries, Union and Reduit. These initiatives, along with a business process review and cost optimization exercise, are expected to drive cost savings in 2017 and 2018.

These rating strengths are tempered by:

Persistently high receivables though improving aging profile

LUCELEC's average collection period of 56.5 days in 2015 remains significantly above its regional peers which averaged 43.8 days over the same period. Notwithstanding this, as at September 2016, trade receivables stood at EC $46.4 million, 23% below the outstanding balance recorded as at September 2015. All customer segments experienced double-digit declines with the exception of the Government and Castries City Council *(Table 4)*. The company's receivables aging profile also improved, most notably in the >120 days bucket, a historically troublesome area for LUCELEC. Despite the improvement, receivables as a percentage of total revenue declined by only 1.3% in 2016 compared to 1.8% for the corresponding period in 2015, indicating that revenue for the period declined faster than the rate of collections.

Table 4
Receivables year-on-year % Change by Customer Segment and Aging Bucket

Customer	% Chg	Aging Bucket	%Chg
Government	6.1	Current	-12.2
Castries City Council	12.6	> 30 days	-18.5
WASCO	-50.6	> 60 days	-15.9
Commercial & Industrial	-23.6	> 90 days	-19.5
Hotels	-33.4	>120 days	-39.0
Domestic	-19.7		

Source: LUCELEC

Over the coming 12 months, we expect the company's receivables to continue its downward trend in light of intensified efforts to tighten its credit management activities in the commercial & industrial, domestic and government customer segments, which represent its top 3 debtors.

Significant risk retention via self-insurance of T&D assets

Typical of some electricity companies in the region, LUCELEC currently maintains self-insurance for its T&D assets, increasing the level of risk retention by the company. This policy was adopted due to the high cost of insurance cover for these assets. However, LUCELEC is significantly under-insured with coverage of T&D assets below 30%. We believe that although periodic risk assessments are done, adequate insurance is critical in this hurricane-prone region.

December 13, 2016