

Rating Rationale
Suri Khola Hydropower Limited

Rating

Facility	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	760.00	CARE-NP BB [Double B]	Assigned
Total Facilities	760.00		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP BB’ to the long-term bank facilities of Suri Khola Hydropower Limited (SKHPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SKHPL is constrained by project implementation and stabilization risk including the power evacuation risk and significant time overrun of the project. The rating is also constrained by SKHPL’s exposure to volatile interest rates, exposure to regulatory risk, hydrology risk associated with run of the river power generation and negative impact of Covid-19 Pandemic on the project. The rating, however, derives strength from board members and management having experience in hydro power sector, strong institutional promoter and moderate counter party risk. The ratings also factor in achievement of financial closure for full project cost, presence of power purchase agreement (PPA) with sufficient period coverage, demand supply gap in Nepal coupled with increasing demand of power in the country and government support for the power sector. The ability of SKHPL to timely complete the project without any time or cost overrun and timely completion of transmission infrastructure are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Project implementation risk and stabilisation risk

On the basis of cost incurred till February 17, 2020, the company has achieved financial progress of ~46% of the total project cost. As per the progress report of April 2020, ~72% of the civil works is completed, ~71% of the hydro mechanical works has been completed including 1500 m (out of 3330m) headrace pipe has been laid. The overall physical progress of the project achieved is ~68% till April 2020. Additionally, COVID-19 pandemic which has led to imposition of countrywide lockdown since March 24, 2020, has disrupted the Nepalese economy and has impacted under construction projects like Suri Khola Hydropower Project (SKHP). Further, with India as well impacted by COVID-19, the supply schedule of electromechanical equipment is likely to be impacted. Considering, COVID-19 situation which has slowed the progress of the project and likely delay in transmission line, SKHPL expects to start the commercial operation by end of February 2021. Though, there is major progress, the project is still

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

exposed to the residual risks associated with project implementation and satisfactory operations thereafter.

Power evacuation risk

The power generated from the project is proposed to be evacuated through 6.9 km long 33KV Transmission Line to Nepal Electricity Authority's (NEA) Singati Substation in Dolakha District. Further, the power will be evacuated through NEA's under construction 132KV Transmission line from Singati to Lamosangu. Construction of transmission line from powerhouse to Singati substation is within the scope of SKHPL. Foundation work and the erection of 126 towers (out of 134 towers) has been completed till March, 2020. Timely completion of the transmission lines and substations by both SKHPL and NEA will be key rating sensitivity.

Significant time overrun of the project

Required Commercial operation date (RCOD) of the project as per PPA was April 13, 2018 which was extended to August 29, 2018 due to the delay in construction of the transmission line from Singati to Lamosangu by NEA on account of which the project was delayed to prevent the revenue loss. The project is planned to be completed simultaneously with the completion of transmission line from Singati to Lamosangu. Subsequent amendments of RCOD has been made to the PPA due to the delay in the construction of the transmission line. The RCOD of the project was further extended to October 17, 2019 which was subsequently extended to April 30, 2020. Further, SKHPL has applied for the extension of RCOD and expects project to be completed by end of February 2021. Further delay in the construction of the transmission line from Singati to Lamosasngu may result delay in the project which may also lead to increase in project cost and revenue loss to the company.

Exposure to volatile interest rate

Nepalese banking sector fix interest rates on lending, based on quarterly published base rate by the banks. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, funding from Banks and Financial Institutions are exposed to volatile interest rate.

Hydrology risk associated with run-of-the-river power generation

Run-of-the-river power is considered an unsteady source of power, as a run-of-the-river project has little or no capacity for water storage and therefore is dependent on the flow of river water for power generation. It, thus, generates much more power during wet season when river flows are high (Mid-March to Mid-December) and less during the dry season (Mid-Dec to Mid-March). SKHP is proposed to utilize discharge from Suri Khola having catchment area of 36.40 sq. kms based on perennial river. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola.

Exposure to regulatory risk

Nepalese banking sector fix interest rates on lending, based on quarterly published base rate by the banks. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months.

Therefore, funding from Banks and Financial Institutions are exposed to volatile interest rate. Government of Nepal (GON) has recently established Electricity Regulatory Commission (ERC) for regulating generation, transmission and distribution of electricity in Nepal. ERC has issued a directive to take approval before public issuance of share capital. It poses a new challenge to hydropower companies which has to go through an additional approval process before it can issue shares to public. Hence, the hydropower companies planning for public issuance of share capital is exposed to risk associated with delay in approval process which may delay project funding and eventually delay the project.

Impact of Corona Virus on the Project

Due to the pandemic of Corona Virus there are several impacts on the under-construction projects like unavailability of contract labor and unavailability of construction material due to partial operations of manufacturing units across Nepal. Also, there is expected delay in supply of Electromechanical (EM) and Hydromechanical (HM) equipment due to effect of pandemic in Nepal and India. Delay in execution of project due to various reasons may lead to increase in cost. The project is also likely to attract penalty as per the PPA entered with NEA if the RCOD is not extended further.

Key Rating Strengths

Board members and management having experience in hydro power sector

SKHP has 5 Board of Directors, chaired by Mr. Himal Gurung, who has more than 16 years of experience in hydropower and construction sector. He is associated with different hydropower companies having total capacity 51.4 MW. Mr. Chandra Bahadur Karki, Director, has more than 9 years of experience in hydropower sector. Management Team of SKHPL is led by Mr. Gurung and he is supported by other experienced team members.

Strong Institutional Promoter

Dolma Impact Fund (DIF) which has invested Rs. 113.37 Mn equity (holds 48% as on February 23, 2020) in SKHPL is an institutional investor setup in Nepal for investments in Small and Medium Enterprises with strong entrepreneurial and management capacities. Major Investors in Dolma Impact Fund includes FMO a Dutch Development Bank, FINNFUND a Finnish sovereign Development Finance Institution, OeEB an Austrian Development Bank and Dutch Good Growth Fund (DGGF), a growth fund commissioned by the Dutch Ministry of Foreign Affairs. DIF has invested in 8 companies across the Renewables, Healthcare and Technology sector. The investment in renewable companies has a cumulative capacity of ~34 MW in hydropower and 5 MW in solar power.

Financial closure achieved for the full project cost

The estimated cost of the project is Rs 1,086 Mn (i.e. Rs. ~170 Mn per MW) which is proposed to be funded in Debt equity ratio of 70:30 (i.e. Rs 760 Mn term loan and Rs 326 Mn equity). SKHPL has entered into consortium loan agreement on June 01, 2016 for Rs 760 Mn term loan. Out of Rs 326 Mn of

equity, till February 23, 2020, Rs. 235 Mn has been infused by shareholders. Out of the total project cost; SKHPL has incurred Rs. 496 Mn till February 17, 2020.

Power purchase agreement with sufficient period coverage

SKHPL had entered into a long term PPA with NEA as on June 03, 2015 for sale of 6.4 MW power to be generated from the project. The contracted Plant Load Factor (PLF) for total 6.4MW is 58.59%. Tariff rate as per PPA for 6.4 MW is Rs 4.80 per kWh for wet season (Mid-March to Mid-December) and Rs 8.40 per kWh for dry season (Mid-December to Mid-March) with 3% annual escalation on base tariff for 5 years. Required Commercial Operation Date (RCOD) of the project was April 30, 2020. The company has requested to NEA for further extension of RCOD.

Moderate counter party risk

SKHPL is exposed to counter party payment risk pertaining to Nepal Electricity Authority (NEA), which has been making consecutive losses in past till FY16 and carry huge accumulated loss in its book. However, as per the annual report published by NEA, during FY19 (provisional), NEA earned profit of Rs 7,205 Mn (Rs 2,897 Mn during FY18). Further, during FY19, NEA achieved gross cash accrual of Rs 11,915 Mn (Rs 7,107 Mn in FY18). The counter party payment risk is moderated by the fact that, NEA is fully owned by government of Nepal, net loss is declining over the period and NEA is generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producer (IPPs) in past.

Power demand & supply gap coupled with increasing demand of power in the country

As per the NEA's Annual Report for FY19, the current peak electricity demand is 1,320 MW. The total domestic installed capacity stands at 1,178 MW which includes 617 MW owned by NEA and 561 MW by private sector IPPs. Overall, during FY19, total energy demand was 7,584 GWh which was met by import of 2,813 GWh from India whereas balance was met by domestic generation. As per NEA, electricity demand is in increasing trend and is expected to increase in future with increase in electricity consumption through the promotion of electric vehicles by building charging station and replacing cooking gas with electricity, increase in access of population using electricity (78% in FY19) etc.

Government support for the power sector

GoN considers hydropower generation as priority sector and intends to maximize private sector participation in generation of hydroelectricity by offering different exemptions and facilities. GoN on 5 December 2019 has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years to those who generate electricity within mid-April 2024. Also, GoN has declared to provide grant of amount equivalent to Rs. 5 Mn per MW installed capacity after receiving evidence of formal COD of power plant.

About the Company

Suri Khola Hydropower Limited (SKHPL) is a Public Limited company, incorporated on December 02, 2008 as a Suri Khola Hydropower Private Limited and changed to public limited on July 02, 2018. It is promoted by individual promoters from different background and institutional investors for setting up of a 6.4 MW run-of-river, Suri Khola Hydropower Project (SKHP) in Dolakha district of Nepal. The major shareholder of the company as on February 23, 2020 are Dolma Impact Fund-I (48.19%) and Mr. Himal Gurung (42.50%). The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism. As per the Generation License, from Government of Nepal – Ministry of Energy, obtained as on June 07, 2015 the project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 35 years.

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Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	760.00	CARE-NP BB
Total		760.00	