

## Silk Power Private Limited

### Rating

Facilities	Amount (Rs. Million)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities	3,300.00	CARE-NP BB- [Double B Minus]	<b>Assigned</b>
<b>Total Facilities</b>	<b>3,300.00</b> <b>[Three Thousand and Three Hundred Million Only]</b>		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has assigned the rating of 'CARE-NP BB-' to the long-term bank facilities of Silk Power Private Limited (SPPL).

### Detailed Rationale & Key Rating Drivers

The rating assigned to SPPL is constrained by project implementation risk associated with its upcoming hydropower project which is at nascent stages of construction. The rating also factors in the hydrology risk associated with run-of-the-river power generation, exposure to regulatory risk and volatile interest rates.

The rating, however, derives strength from SPPL's experienced promoters and management team and presence of power purchase agreement (PPA) with sufficient period coverage. The rating also factors in financial closure for the entire debt funding estimated for the project and government support for the power sector.

*Going forward, the ability of the company to successfully execute the project within envisaged cost and time and early stabilization thereafter will be the key rating sensitivities.*

### Detailed description of the key rating drivers

#### Key Rating Weaknesses

##### Project implementation risk

SPPL is setting up a 23.55 MW Luja Khola Hydropower Project (LKHP) in Solukhumbu District of Nepal. The total cost of the project is envisaged at Rs. 4,400 Mn (Rs. 187 Mn per MW) to be funded in debt to equity ratio of 75:25. The total debt amounting to Rs. 3,300 Mn has been fully tied up. The financial progress of the project till November, 2022 was only 4% of the total project cost. As the project is in nascent stages of construction, this exposes the company towards project execution risk in terms of completion of the project within the envisaged time and cost. Furthermore, the company is in process of obtaining generation license for the project, which remains a key monitorable aspect.

The Power generated from the project is proposed to be evacuated through 35 km long 132 KV Transmission Line to NEA Lammanne (Tingla) substation at Khumbu-Pasang Lhamu Rural Municipality, Solukhumbu district which is operational. SPPL is responsible for construction of transmission line up to Lammanne (Tingla) Substation and timely completion of the same before the commencement of commercial operations would impact the revenue generation. Furthermore, the project is in initial stages of construction and any delay beyond the Required Commercial Operation Date could lead to impact on project returns and debt servicing capabilities.

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and other CARE publications

**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 (June to November) and less during the dry season (December to May). The power project is proposed to utilize available head and flow from Luja Khola (river). The project utilizes discharge from Luja Khola (river) having catchment area of 86 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.

Since there is no minimum commitment on revenue in PPA in case of adverse river flows scenario, the company is exposed to hydrology risk of the power project for the generation of revenue. The project is also subjected to dry-energy short-supply penalty in case the project fails to supply a minimum of 30% of the annual energy generation in the dry months.

**Exposure to volatile interest rate**

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy, with substantial upward pressure on interest rates in the last 2-3 quarters. Increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates, which is also evident in the recent rate hikes taken by BFIs. Any further significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

**Exposure to regulatory risk**

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) for regulating generation, transmission and distribution of electricity in Nepal. ERC will be the regulator under the GoN which will be responsible for regulating hydropower companies in Nepal. Policies and directives issued by ERC like approval process for IPO issuance, PPA approval through ERC poses a new challenge to hydropower companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

**Key Rating Strengths****Experienced promoter/directors and management team**

SPPL has four members in its Board of Directors, chaired by Mr. Kumar Kharel, who has more than fifteen years of experience in hydropower. He is also the chairman of Three Star Hydropower Limited Company, Gaun Ghar Ujalyo Sana Hydropower Private Limited Company and the director of Kutheli Bukhari Small Hydropower Private Limited. Other directors of the company also have long experience in myriad fields ranging from insurance, real estate, trading, pharmaceutical, financial sector, etc. Furthermore, the board is supported by an experienced team across various functions.

**Power purchase agreement with sufficient period coverage**

The estimated total installed capacity of the plant is 23.55 MW which is in the process of amendment to 24.88 MW. SPPL had entered into a long term PPA with NEA as on January 30, 2019 for sale of 23.55 MW power to be generated from the project on take or pay basis. The contracted Plant Load Factor (PLF) for total 23.55 MW is 67% with total contracted energy of 138.22 MU. PPA has been entered for the period of 30 years from the COD or till validity of generation license whichever is earlier. The company has all the necessary approvals for the projects except, Generation license, which is in the process

of approval. Tariff rate as per PPA is Rs 4.80 per Kwh for wet season and the tariff rate for dry season is 8.4 per Kwh with 3% annual escalation on base tariff for 8 years.

Required Commercial Operation Date (RCOD) of the project is February 25, 2025. Barring extensions, if the project is not completed within the mentioned RCOD, then the company is required to pay delay penalty. Furthermore, if COD is delayed by 6 months to 18 months from RCOD, there are restriction clauses in escalation of tariff rate. It is crucial for the company to complete the project within the timelines to have the accelerated clauses of tariff. Any delay in the same could lead to impact on project returns and debt servicing capabilities which is critical from analytical perspective.

### **Favorable Government policies towards power sector**

Favorable Government policies towards power sector Government of Nepal (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 has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years for such person/entity who starts commercial operation, transmission and distribution of electricity up to mid-April 2024. As per various directives from NRB whereby all the banks (type A, B C, D) have to allocate minimum share of their total advances to energy sector which argues well for the sector.

### **About the Company**

Silk Power Private Limited (SPPL) is a private limited company, incorporated on September 08, 2019 involved in setting up of a run-of-river, Luja Khola Hydropower Project (LKHP) in Khumbu-Pasang Lhamu Rural Municipality of Solukhumbhu District. The project will be constructed under BOOT (Build, own, Operate and Transfer) mechanism.

### **Annexure-1: Details of Instruments/Facilities**

<b>Name of the Instrument</b>	<b>Type of the Facility</b>	<b>Amount (Rs. Million)</b>	<b>Rating</b>
<b>Long Term Bank Facilities</b>	<b>Term Loan</b>	<b>3,300.00</b>	<b>CARE-NP BB-</b>
<b>Total Facilities</b>		<b>3,300.00</b>	

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