

Sikles Hydropower Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Issuer Rating	NA	CARE-NP BB+ (Is) [Double B Plus Issuer]	Reaffirmed
Long Term Bank Facilities	1,470.00 (Decreased from 1,500.00)	CARE-NP BB+ [Double B Plus]	Reaffirmed
Short Term Bank Facilities	30.00	CARE-NP A4+ [A Four Plus]	Assigned
Total Facilities	1,500.00 (One Billion and Five Hundred Million Only)		

*The issuer rating is subject to overall gearing ratio of the company not exceeding 2.00x at the end of FY23.

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB+ (Is)' assigned to Sikles Hydropower Limited (SHL). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Also, CRNL has reaffirmed the rating of 'CARE-NP BB+' assigned to the long-term bank facilities and assigned 'CARE-NP A4+' to the short term bank facilities of SHL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to Sikles Hydropower Limited (SHL) continue to be constrained by subdued operating performance of the power project during FY22 (Unaudited; FY refers to twelve-months period ending on Mid-July 2022) and FY21, moderately leveraged capital structure, hydrology risk associated with run-of-the-river power generation and exposure to regulatory risk.

The ratings, however, continue to derive strengths from strong parentage and experienced management team, moderate financial performance of the company, presence of power purchase agreement (PPA) with sufficient period coverage and government support for the power sector.

Going forward, the ability of the company to reduce the gap between operational and contracted plant load factor (PLF) along with the timely receipt of payments from Nepal Electricity Authority (NEA), significant reduction in debt levels are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Subdued operating performance of power project during FY22 and FY21

SHL has commissioned run-of-the-river 13MW Madkyu Khola Hydroelectric Project (MKHP) at Kaski District of Nepal. The commercial operations commenced in April 2018. The operating performance of the hydropower project is on declining trend since FY20 as the power generation is frequently hampered due to incidences of recurrent natural calamities and less hydrology at the project site. The annual contracted PLF for MKHP is 64.79% of the installed capacity of the plant. During FY22, the plant operated at plant load factor (PLF) of 49.38% against contracted capacity which decreased from 70.45% during FY21. The operating performance in terms of power generation was low due to landslide and floods at the project

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications.

site for around a month in FY21 and for three months in FY22. During the first four months of FY23, there has been steady improvement in company's PLF level and the company reported PLF of 91.33% against contracted capacity, mainly on account of improved hydrology during wet season. The company's ability to operate the plant without substantial interruptions leading to revenue generation as envisaged remains crucial from credit perspective.

Moderately leveraged capital structure

The capital structure of the company stood moderately leveraged with total gearing ratio of 1.94x as on FY22 which improved from 2.02x as on FY21 due to decline in term liabilities with scheduled repayment of loans coupled with increased network. Furthermore, the overall gearing ratio is expected to improve in FY23 on account of the downsizing of term loan from the IPO proceeds (Rs. 200 Mn completed on September 2022). Apart from overall gearing, other coverage indicators including total debt to GCA stood high at 10.67x for FY22 respectively (PY: 8.28x). The gross cash accruals of the company declined to Rs. 137 Mn during FY22 (FY21:Rs. 186 Mn). Interest coverage ratios declined to 1.43x during FY22 (PY: 1.68x). The deterioration in coverage indicators was on account of lower revenue generation which led to decline in profitability and thereby impacted coverage indicators.

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-April to Mid-December) and less during the dry season (Mid-December to Mid-April). The project utilizes discharge from Madkyu Khola having catchment area of 71.3sq. 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 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 few quarters. A contractionary monetary policy for FY23 coupled with increasing inflation has only added to the upward pressure on interest rates, resulting in the rate hikes taken by BFIs in the first half of FY23. 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 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

Strong parentage and experienced management team

SHL has 6 Board of Directors, chaired by Ms. Prem Kumari KC, who holds 40.09% of the total share capital, has more than three decades of experience in different sectors. She is also director at Gandaki Hydropower Pvt Ltd (4.8 MW operational Mardi Khola Hydropower Project), and Civil Hydropower Pvt Ltd. The other directors of the company have also long experience in different sectors including hydropower sector. SHL is part of KC Group of companies which is one of the leading organizational groups in Nepal. In addition to the hydropower projects, the promoters of KC group of Companies have made their investments in different other sectors like construction, Hospitality and Housing, Manufacturing, educational institutions, Banking and Insurance.

Power purchase agreement with sufficient period coverage

The company had entered into PPA with Nepal Electricity Authority (NEA) as on November, 2009 for 9.968 MW (amended to 13 MW as on March 23, 2016) for sale of entire power generated by the plant. The PPA is signed for a period of 30 years from the date of COD. Tariff rate as per PPA is Rs 4 and Rs. 7 per Kwh for wet season (Mid-April to Mid-December) and the tariff rate for dry season (Mid-December- Mid-April) is Rs. 4.80 and Rs. 8.40 per Kwh, with 3% annual escalation on base tariff for 9 and 5 years for 9.968 MW and 3.032 MW respectively. Currently, generated power is evacuated through NEA's 12km long double circuit 33/132KV Lekhnath Substation in Kaski district. However, the plant is exposed to power evacuation risk from this route as the same has been impacted due to natural calamities such as floods and landslides leading to shutdown of the project for a material period, as seen in the past.

Moderate financial performance of the company

SHL is generating revenue by the selling of power generated through its 13 MW Madkyu Khola Hydroelectric Project since April 2018. The company reported decrease in total operating income by around ~22% to Rs. 200 Mn in FY22 from Rs. 255 Mn in FY21. The decrease in revenue during FY22 was due to lower sale of units which was attributed to lower energy generation.

Profitability of the company has been impacted by lower operating income leading to PBILDT declining to Rs. 154 Mn in FY22 (PY: Rs. 215 Mn). Consequently, PBILDT margin declined to ~77% during FY22 from ~84% in FY21. During FY22, the company had non-operational income amounting to Rs. 91.89 Mn on account of insurance claim for the loss of revenue and the company further expects to receive Rs. 71.83 Mn in FY23 offsetting the respective years' average cash flow generation to some extent. Nonetheless, PAT of the company declined to Rs. 65 Mn in FY22 from Rs.109 Mn during FY21, impact of lower operating income is being offset by income from insurance claim, to some extent. Although the company has benefitted from reasonable insurance income in periods of project downtime, improvement in power generation leading to adequate cash flow generation from the projects for a sustained period will be critical from credit perspective.

Favorable Government policies towards power sector

GoN considers hydropower generation as a 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 2026. 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 augurs well for the sector.

About the Company

Sikles Hydropower Limited (SHL) is a public limited company, incorporated in July 28, 2004 as a private limited company and later converted to public limited company in May 17, 2019. The company is setting up 13MW run-of-the-river Madkyu Khola Hydroelectric Project (MKHP) at Kaski District of Nepal. The project came into a commercial operation since April 2, 2018. The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Annexure 1: Details of Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	1,470.00	CARE-NP BB+
Short Term Bank Facilities	Overdraft	30.00	CARE-NP A4+
Total		1,500.00	

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