

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]	Reaffirmed
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 FY24 (FY refers to the twelve-month period ending mid-July).

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 offer 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 'CARE-NP A4+' assigned to the short-term bank facilities of SHL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to Sikles Hydropower Limited (SHL) remains constrained by moderate operating performance of its 13 MW hydropower project, albeit with improving Plant Load Factor (PLF) levels during FY23 (Unaudited; FY refers to the twelve-month period ending mid-July) as compared to previous two fiscal years. The rating also factors in hydrology risk associated with run-of-the-river power generation, exposure to volatile interest rate and risk of natural calamities.

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

Moderate operating performance of power project

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 annual contracted PLF for MKHP is 64.79% of the installed capacity of the plant. The operating performance of the power plant rebounded during FY23 with Plant Load Factor (PLF) of 82% of contracted capacity which were subdued during previous two fiscal years. Plant remained shut down for total 85 days during FY22 on account of floods in site resulting into low PLF of 49% of contracted energy. Despite improved PLF levels during FY23, the operating performance of the project remains moderate owing to hydrology issues particularly during dry season. The company's ability to

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

operate the plant without substantial interruptions leading to revenue generation as envisaged remains crucial from credit perspective.

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

The company's interest rates are based on 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. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed to volatile interest rate.

Risk of Natural Calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their construction and operations vulnerable to adversities of nature. Floods and landslides that tend to occur in these areas pose threat to these power projects damaging their infrastructures as well as impacting their timely completion. Moreover, disruption in their construction in turn could lead to time and/or cost overrun, negatively impacting the project's financial aspects. Moving forward also, these natural calamities can adversely affect the smooth flow of power generation and distribution, which can further impact financial returns of the projects. MKHP is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

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 Ltd (CARE-NP BB/A4). 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.

Moderate financial performance of the company

The company reported increase in Total Operating Income (TOI) by ~56% y-o-y to Rs. 312 Mn during FY23 (FY22: Rs. 200 Mn) attributable to rebound in operational performance. PBILDT thus improved to Rs. 262 Mn in FY23 (FY22: Rs. 152 Mn). PAT of the company was Rs. 41 Mn during FY23 (FY22: Rs. 70 Mn). Despite operational loss of Rs. 36 Mn, profitability of SHL during FY22 was supported by receipt of property damage and loss on pay insurance claims amounting to Rs. 107 Mn. Although the company has benefitted from reasonable insurance income in previous 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.

The capital structure of the company stood moderate with total gearing ratio which improved to 1.50x at the end of FY23 (FY22: 1.92x) on account of infusion of equity through Initial Public Offer (IPO) amounting to Rs. 200 Mn as on September, 2022 coupled with scheduled repayment of loans. Interest coverage ratios improved to 1.78x in FY23 (FY22: 1.42x) on account of substantial increase in PBILDT as compared to previous year despite slight increase in interest expenses. Total debt to GCA stood high at ~11.84x for FY23 (PY: 9.66x).

Favorable Government policies towards power sector

Government of Nepal (GoN) considers power generation as priority sector and intends to maximize private sector participation in generation of electricity by offering different exemptions and facilities on power sector. 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 2027. As per various directives from NRB, all the financial institutions regulated by NRB (type A, B, C, D) have to allocate minimum share of their total advances to energy sector which argues well for the sector. Also, increasing trend of cross-border energy trade and its growing prospect in upcoming days supported by new bilateral agreements between Nepal and India for additional export of power to India from Nepal augurs well for the long-term demand prospect for the power sector in Nepal.

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.

Brief financial performance of MKHP during last 3 years is given below:

(Rs. in Million)			
Particulars	FY21 (A)	FY22 (A)	FY23 (UA)
Income from Operations	255	200	312
PBILDT Margin (%)	84.26	76.14	83.98
Overall Gearing (times)	2.02	1.92	1.50
Interest coverage (times)	1.68	1.42	1.78
Total Debt/Gross Cash Accruals (times)	8.28	9.66	11.84

A: Audited, UA: Unaudited

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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