

Solar Farm Limited

Ratings

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB+ (Is) [Double B Plus]	Assigned

**The issuer rating is subject to the company maintaining overall gearing not exceeding 0.50x at the end of FY24 (FY refers to the twelve-month period ending mid-July)*

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

Detailed Rationale & Key Rating Drivers

The rating assigned to SFL is constrained by the relatively small scale of operations of solar power project and single project concentration risk. The rating also factors in equity commitment to under-construction solar power project, the mode and timelines of investment for which is not yet finalized and project implementation and execution risks associated with the same. Also, the rating takes note of company's capex plans for setting up new solar power project, the funding pattern of which is not yet finalized which could have impact on financial risk profile and capital structures of the company. Furthermore, the rating also factors in exposure of solar projects to climatic conditions and technological risks and exposure to regulatory risk.

The rating, however, derives strength from strong promoters and experienced management team and presence of power purchase agreement (PPA) with sufficient period coverage. The rating also factors in debt free nature of the company as on mid-July 2023 moderate operating performance of the project during FY22-23 and positive outlook for the renewable power industry over the medium term.

Going forward, the ability of the company to successfully reduce the gap between operational Plant Load Factor (PLF) and contracted PLF will be the key rating sensitivities. Furthermore, any substantial capital commitment or debt funded investments that could lead to material deterioration in the company's capital structure and debt coverage indicators will also be key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Small scale of operations and single project concentration risk

SFL has been operating 5 MW Belchautara Solar Power Project (BSPP) at Tanahaun District since October 18, 2021. The scale of operations has remained low marked by a total operating income and gross cash accruals of Rs. 41 Mn and Rs. 30 Mn, respectively, during FY22. The small scale limits the company's financial flexibility in times of stress particularly related to fixed commitments including lease rentals. Furthermore, SFL derives its income from a single project. This exposes the company to concentration risk as its fortunes are linked to the operational and financial performance of a single power project, which are highly subject to the climatic and technological condition of PV modules.

Equity commitment to under-construction solar power project and associated project implementation and execution risk

The company has plans to add new 5 MW solar power project in its portfolio. The funding pattern for same has not been finalized yet. Also, timelines for construction and operation of the project are yet to be finalized. The estimated cost of the project is Rs. 450 Mn proposed to be financed with equity of Rs. 200 Mn and remaining through debt. The equity infusion is to be made through

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

a proposed public issuance. Substantial fund flow to under construction solar power project as a result of current commitments and any potential cost overrun could have adverse impact on future liquidity prospects and financial risk profile of the company given its small scale of operations, low revenue base and cash accruals.

Exposure to regulatory risk

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) as a regulatory body to regulate generation, transmission and distribution of electricity in Nepal among others. The right granted to ERC for PPA approval, prior approval of IPO issuance, approval of mergers, prescribe condition for maintaining standards of electricity placed outside transmission line and examine the standard, prescribe maintenance of proper internal control system, account systems and auditing method along with perform surprise check, inspect and investigate the licensed persons and imposing fine for noncompliance of applicable act, regulations and directives poses a new challenge to power sector companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Operations exposed to climatic conditions and technological risks

The company has used mono-crystalline technology in solar projects although expensive than poly-crystalline technology suffers relatively lower degradation, requires lesser land and draws maximum sunlight in the areas of lower sunlight with high heat tolerance thus are more efficient than poly panels. However, achievement of desired Capacity Utilization Factor (CUF) going forward would be subject to change in climatic conditions, amount of degradation of modules as well as technological risks.

Key Rating Strengths**Strong promoters and experienced management team**

Dolma Impact Fund holds majority shares of SFL (44.94% equity shares as on Mid-July 2023). Dolma Impact Fund is the first commercial impact fund setup in Nepal for providing growth capital to Small and Medium Enterprises (SMEs) with strong entrepreneurial and management capacities whose target sectors include investment in technology, healthcare and renewable energy sectors.

SFL has seven board members including two representatives from Dolma Impact Fund and one from Kumari Bank Limited. The board is chaired by Mr. Ash Bahadur Gurung. Mr. Lekhnath Pandey, Managing Director has experience in other hydropower companies of Butwal Power Company Limited including operational 5.1 MW Andhikhola Hydropower plant and operational 12 MW Jhimruk Hydropower Project. Mr. Kushal Gurung, Director, MSc in Carbon Management from University of Edinburg, is a clean tech professional with more than 15 years of work experience in renewal sector spanning across Asia and Europe. The day-to-day operations of company is entrusted to EPC contractor, REnergy Developer Pvt Ltd, which has extensive experience in the engineering, procurement, construction, installation, start-up, operation and maintenance of solar power facilities.

Moderate operating performance of power plant

The annual contracted PLF for BSPP is 19.54% of the installed capacity of plant. The operating performance of the company has been moderate so far in FY22 and FY23 as reflected by PLF of 17.65% and 17.70% during FY22 (9 months) and FY23 respectively. The PLF remains steady at 90% of contracted energy during FY22 and FY23 respectively.

Debt free nature of company

SFL has not availed any credit facilities from banks. All the funding for its operational power project was funded through equity or preference shares from institutional and individual investors. Consequently, SFL's gearing ratio was 'nil' as on mid-July 2023 as it did not have any debt on in its books. However, in case the company were to go through the plans of acquisition of another partially debt funded 5 MW solar power project which is under preliminary stage of construction, it is likely to result into addition of fresh debt in its books in coming years.

Power purchase agreement with sufficient period coverage

SFL has entered into PPA with Nepal Electricity Authority (NEA) on August 08, 2018 for sale of 5 MW power to be generated from the project on take or pay basis. 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 July 03, 2019 the project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 25 years. PPA is signed for a period of 25 years from the date of COD or till validity of Generation License, whichever is earlier. PPA is entered at fixed tariff rate of Rs. 7.30 per kWh.

Positive Outlook of renewable power industry

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 solar power through Alternative Energy Promotion Centre. 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 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. Hence, the major drivers for the growth in solar capacity addition including government initiation on encouragement of solar power for both residential and commercial purpose, fixed tariff rates throughout the year, technological advancement, shorter implementation schedules and lower fuel availability risks as compared to conventional sources of energy, shows positive outlook on long- term demand for the renewable power sector.

About the company

Solar Farm Limited (SFL) is a public limited company, incorporated on September 16, 2016 as private limited company and converted into public limited company on January 05, 2023. SFL is involved in operation of 5 MW Belchaur solar power project (BSPP) in Belchaur, Suklagandaki Municipality 05, Tanahun. The power from solar power project is evacuated from 0.5 km 33 kv transmission line to Khairanitar substation which is further connected to national grid.

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