

Suryakunda Hydro Electric Limited

Rating

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

**The issuer rating is subject to overall gearing not exceeding 3.0x 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 assigned issuer rating of 'CARE-NP B+(Is)' to Suryakunda Hydro Electric Limited (SKHEL). Issuers with this rating are considered to offer high risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to SKHEL is constrained by project implementation risk associated with its under-construction hydropower project, which is in initial stages of construction. With partial debt for project yet to be tied up, it also remains exposed to funding risk. With physical progress of ~30% till February 12, 2024, the project is well behind schedule apropos of required commercial operations date (RCOD) of March 2022 and the company could be liable for delay penalty and loss of some tariff escalations (depending on actual COD and further extensions of RCOD by Nepal Electricity Authority, if any), which could adversely impact its income prospects. The rating also factors in hydrology risk associated with run-of-the-river power generation, risk of natural calamities and moderate power evacuation risk. The rating, however, derives strength from SKHEL's experienced promoters and management team and low offtake risk. The rating also factors in moderate counter party risk and government support for the power sector.

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

Detailed description of the key rating drivers

Key Rating Weaknesses

Project implementation risk

SKHEL is setting up of a 11 MW run-of-river Upper Tadi Khola Hydropower Project (UTKHP) in Nuwakot district of Nepal. Total cost of the project has been estimated at Rs. 2,200 Mn (Rs. 200 Mn per MW) which is proposed to be financed in debt equity ratio of 73:27 (i.e., Rs. 1,608 Mn debt and Rs. 592 Mn equity). Debt for the project has been partially tied up. Out of Rs. 592 Mn equity, ~70% (Rs. 411.5 Mn) has been infused as on October 18, 2023. Contract for civil, hydromechanical, and electromechanical works have been awarded and as on February 12, 2024, SKHEL has achieved physical progress of ~30%. As the project is in initial stages of construction, this exposes the company towards project execution risk in terms of completion of the project within the envisaged time and cost.

RCOD of the project was March 24, 2022 and is well behind schedule apropos of RCOD. Even after factoring RCOD extension by two years, which the company has applied for, the project is still expected to be commissioned behind RCOD. Thus, it will likely be liable for late COD penalty (5% of revenue that could have been generated in the period between RCOD and COD) and restriction in tariff escalations (loss of at least two escalations if COD is delayed by more than 18 months), which could adversely impact income prospects of SKHEL. Any further delays in construction than envisaged could further impact project returns and debt servicing capabilities which is critical from analytical perspective.

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

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

A Run-of-the-river (ROR) power project is recognized as a variable energy source of generation of power due to its reliance on natural river flow without significant water storage capacity. The dependency on river flow makes the power generation from the project highly responsive to seasonal variations. The project extracts discharge from Tadi Khola, covering a catchment area of 96 sq. kms, characterized as a perennial river. SKHEL tends to produce higher electricity output during the wet season, from mid-April to mid-December, when river flows are abundant. Conversely, during the dry season, from mid-December to mid-April, power generation may be reduced due to lower river flows. Consequently, the project's performance will be exposed to the inherent risk associated to the natural hydrological patterns, and variability in water discharge throughout the year.

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. SKHEL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Moderate Power Evacuation Risk

The power generated from the project is proposed to be evacuated through ~6 km 33 kV double circuit transmission line from powerhouse to NEA's operational 33 kV Samundratar substation located at Nuwakot district. Construction of transmission line up to Samundratar substation falls under the scope of SKHEL. As the project is well behind its schedule, timely completion of the transmission lines without any further delays will be a key monitorable aspect.

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

SKHEL is majorly promoted by API Power Company Limited (API) [CARE-NP BB+(Is)/BB+/A4+], having 51% stake as on October 18, 2023. API is part of Arun Valley group of companies that has total operational hydropower projects of 62.5 MW and multiple under-construction projects with extensive experience in the sector. SKHEL is managed under the overall guidance of the company's Board of Directors (BoD), who possesses wide experience in the Power sector. Mr. Satish Neupane is the Chairperson of the company, he is also founding director of Arun Valley Hydropower Development Company Limited [AHPC, CARE-NP BBB- (Is)], and managing director of API Hydro Mechanical Pvt. Ltd. Mr. Neupane has more than a decade of experience in hydro power sector. Mr. Sanjeev Neupane is the Managing Director who looks after day-to-day operation of APC since 2012. He was also director of Arun Kabeli Power Limited and People Investment Company Limited. Currently, he is also chairman of Ridi Power Company Limited [CARE-NP BB+(Is)].

Low offtake risk and moderate counterparty risk

SKHEL had entered into a PPA with Nepal Electricity Authority (NEA) as on March 16, 2012 for sale of 11.00 MW power on to be generated from the UTKHP on a take or pay modality. The contracted energy for 11.00 MW is 61.32 million units (MU) annually with contracted Plant Load Factor (PLF) of 63.64%. PPA has been entered for a period of 30 years from COD or till validity of generation license, whichever is earlier. Tariff rate as per PPA is Rs 4.80 per kWh for wet season (Mid-April to Mid-

December) and Rs. 8.40 kWh for dry season (Mid- December to Mid-April) with 3% annual escalation on the base tariff for a duration of 5 years. However, as RCOD of March 2022 has passed with pending approval for extension, the company is susceptible to reduction in number of tariff escalations dependent on COD of UTKHP. These contractual terms outline the framework governing the sale of power generated by the UTKHP, delineating the revenue structure and operational parameters for SKHEL within the energy market. Additionally, the counterparty payment risk associated with NEA is deemed moderate, given its full ownership by the Government of Nepal. Such arrangements provide revenue stability and sustainability to the company.

Favorable policies towards power sector

The Government of Nepal (GoN) has prioritized hydropower generation as a crucial sector for economic development and aims to enhance private sector involvement by offering a range of incentives and facilities. In line with this objective, GoN has introduced a comprehensive tax incentive package, providing full tax exemption for the initial 10 years and a 50% tax exemption for the subsequent five years to individuals or entities engaged in the commercial operation, transmission, and distribution of electricity until mid-April 2027. These incentives are designed to encourage investment and promote growth in the hydropower sector. Additionally, directives from the Nepal Rastra Bank (NRB) mandate that all banks are to allocate a minimum share of their total advances to the energy sector. This strategic initiative is expected to contribute to the financial support and development of projects within the energy sector which augers well for the sector.

The industry outlook of Nepalese power sector is likely to remain stable over the long-term with increasing domestic demand for generation backed by growing national demand with an average growth rate of around 11% p.a. over the last five years (2018-2023). Additionally, increasing cross-border energy trades coupled with fresh bilateral treaty signed between Nepal and India for export of 10,000 MW electricity to India over a period of 10 years has further boosted the demand outlook for the power sector in Nepal.

About the Company

Suryakunda Hydro Electric Ltd. (SKHEL) is a public limited company, initially incorporated as a private limited company and later converted to public limited on July 06, 2023. SKHEL is setting up a 11.00 MW run-of-river, Upper Tadi Khola Hydropower Project (UTKHP) in Dupcheswor Rural Municipality, Nuwakot district, Bagmati Province. The project will be constructed under BOOT (Build, own, Operate and Transfer) mechanism.

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