

Setikhola Hydropower Limited

Ratings

Facilities	Amount (Rs. Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	3,800.00	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	150.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	3,950.00 (Three Thousand Nine Hundred and Fifty Million Only)		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (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 Setkhola Hydropower Limited (SKHL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SKHL continues to remain constrained by project implementation risk and operations stabilization risk thereafter associated with its under-construction hydropower project. The rating also factors in hydrology risk associated with run-of-the-river power generation, risk of natural calamities, power evacuation risk and the company's exposure to regulatory risk and volatile interest rate risk.

The rating, however, derives strengths from the company's experienced promoters and management team in the hydropower sector, low offtake risk and moderate counter party risk. The ratings also factor in the government's support for the power sector.

Going forward, the ability of the company to successfully execute the project within the 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 and stabilization risk

SKHL is setting up a 22 MW, run-of-river, Seti Khola Hydropower Project (SKHP) in Pokhara, Kaski district of Nepal. The total cost of the project is estimated at Rs. 5,052 Mn (~Rs. 229.65 per MW), which is proposed to be funded in the debt equity ratio of 75:25 (i.e., bank debt of Rs. 3,789 Mn and equity of Rs. 1,263 Mn). The debt of the project has been fully tied up. Till February 18, 2024, the company has incurred expenditure of Rs 3,389 Mn (financial progress of around 67 %) funded through debt of Rs. 2,467 Mn and equity (including advance for share capital) of Rs. 884 Mn while the balance remains payable. Promoters' contribution amounting to Rs. 884 Mn has already been infused as against the projected requirement of Rs. 1,263.

The power evacuation risk is moderate as the power generated from the project is expected to be connected to operational 220 kV Lekhnath-Damauli transmission line of NEA for which the company is required to construct a ~2.7-km long double circuit Loop In Loop Out 132 kV transmission line from the project's powerhouse to aforementioned transmission line.

Required Commercial Operation Date (RCOD) of the project is currently July 28, 2024. If the project is not completed within the RCOD, the company will be liable 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, therefore, critical for the company to complete the project within the timeline to avail the accelerated clauses of tariff or get necessary extension approvals, if required. Any delay in the same would impact the project's expected returns and debt servicing capabilities which is critical from credit 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 Seti Khola, covering a catchment area of ~876 sq. kms and dominated by snow and glacier in its upper part, characterized as a perennial snow-fed river. SKHL tends to produce higher electricity output during the wet season, from mid-June to mid-December, when river flows are abundant. Conversely, during the dry season, from mid-December to mid-May, power generation may be reduced due to lower river flows. However, hydrology risk is partially mitigated by presence of glacial lakes in its catchment, which generally melts during February and March, providing Seti Khola with steady source of discharge during dry seasons. 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. SKHL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Exposure to volatile interest rate

SKHL's interest rates are based on floating interest rate regime, where a certain premium is added to the monthly base rate and interest rate is changed accordingly on monthly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remains quite volatile as they are impacted by available liquidity in the system, which leads to changes in interest rates. Being high debt funded project, higher interest rates than envisaged could result in squeezed margins of the company, impacting its liquidity profile.

Key Rating Strengths**Experienced promoters and management team**

Dolma Impact Fund holds majority shares of SKHL (48.98% equity shares as on April 17, 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.

SKHL has seven board of directors having long experience in various sectors including both operational and under construction hydropower projects in Nepal. The board is chaired by Mr. Anup Acharya who has more than two decades of work experience in construction business. He is also the chairman in Sanvi Energy Limited [CARE-NP BB+/A4+], having one operational hydropower project and another in project stage. Furthermore, he is also the chairman of M.A. Construction Private Limited [CARE-NP BB/A4], which is a Class-A construction company having long experience in civil works related to the development of hydropower projects in Nepal. The other directors also have more than a decade's experience in various domains and the company is further supported by an experienced team to manage the day-to-day operations.

Low offtake risk and moderate counterparty risk

SKHL has entered into a long-term Power Purchase Agreement (PPA) with NEA for the sale of 22 MW power to be generated from the project on take or pay basis. The contracted Plant Load Factor (PLF) is 69.24% of its total generation capacity. The PPA has been entered for a period of 30 years from COD or till the validity of generation license, whichever is earlier. PPA period may be extended with mutual consensus during the last six months of validity.

The project's PPA has been executed under the six-months dry season (December to May) and six-months wet season (June to November) modality. Tariff rate as per PPA is Rs. 4.80 per Kwh for wet season and Rs. 8.4 per Kwh for dry season with 3% annual escalation on base tariff for eight years. It is critical for the company to start the commercial production within the RCOD to have the benefits of all the eight tariff escalations in the base tariff. The escalations would support the project's incremental revenue, return and debt service coverage indicators.

Industry Outlook

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 2027. Also, with government focus more toward reservoir-based hydropower projects; Monetary Policy FY23 has provided full tax exemption for first 15 years and 50% tax exemption for next 6 years to reservoir and semi-reservoir projects completing financial closure within mid-April 2029 with a capacity higher than 40 MW. As per various directives from NRB, 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

Setikhola Hydropower Limited (SKHL) is a private limited company, incorporated on July 04, 2016 and converted to public limited on July 14, 2023. It is promoted by a group of individual promoters having long experience in various sectors including hydropower for setting up Hydroelectric Project (HEP) in Nepal for setting up of a 22 MW, run-of-river, Seti Khola Hydropower Project in Pokhara, Kaski district of Nepal. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

Annexure-1: Details of Instruments/Facilities

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Ratings
Long Term Bank Facilities	Term Loan	3,789.00	CARE-NP BB
Long Term Bank Facilities (Proposed)	Term Loan	11.00	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	150.00	CARE-NP A4
Total		3,950.00	

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