

Grading Rationale
Sayapatri Hydropower Limited

Grading

Facility	Amount (Rs. In Million)	Grading	Rating Action
Initial Public Offer	90.00	CARE-NP IPO Grade 5 [IPO Grade Five]	Assigned

The explanatory notes regarding the Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure 1

CRNL has assigned grading of ‘CARE-NP IPO Grade 5’ to the proposed Initial Public Offer (IPO) of Sayapatri Hydropower Ltd (SHL). ‘CARE-NP IPO Grade 5’ indicates Poor Fundamentals. CRNL assigns IPO grades on a scale of Grade 1 to Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. CRNL’s IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the ‘fundamentals’ of the issuer. SHL proposes to issue 900,000 shares of face value of Rs.100 each at par aggregating Rs. 90 million.

Detailed Rationale & Key Grading Drivers

The grading assigned to Sayapatri Hydropower Limited (SHL) is constrained by short track record of operations, weak operational performance with low Plant Load Factor (PLF), operating losses and cash losses over the period leading to stressed liquidity and delays in repayment of the loans. The grading also factors in SHL’s leveraged capital structure with high project cost, high accumulated losses and weak debt service coverage indicators, power evacuation risk and hydrology risk associated with run-of-the-river power generation. The grading, however, derives strength from experienced Board Members, management team and financial support from the promoter group over the period, power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and prompt bills realization from the NEA, shortage of power in the country and government support in power sector.

Sufficient hydrology to generate contracted energy, timely receipt of the payments from NEA and timely operation of Harichaur Substation to evacuate full power generated from the project are the key grading sensitivities.

Detailed Description of the Key Grading Drivers

Key Grading Weaknesses

Short track record of operations and weak operational performance with low PLF

The commercial operation of the project started from June 26, 2016. The annual contracted PLF of the project is 62.74%. During FY18, the PLF from the project was low at 35.23% which declined marginally from PLF of 36.11% during FY17 due to hydrology issues, problem in transmission line and hydropower machines being under maintenance. However, SHL has PLF of 70.81% and 89.84% during the month ended Mid-August and Mid-September, 2018 respectively (69.15% and 77.49% respectively during the same period in FY17). The operated PLF was lower than contracted energy PLF on annual basis because SHL was not able to evacuate full power generated from the project due to delay in completion/operation of Harichaur substation by NEA.

Operating losses and cash losses over the period leading to stressed liquidity and delays in repayment of the loans

The project was in operation for 19 days in FY16 and full year of operation thereafter. It has operating losses of Rs. 26.92 Mn and cash losses of Rs 6.75Mn with Rs 41.74 Mn revenue from sales of power during FY18 (Rs 33.99 Mn and Rs 11.84 Mn respectively during FY17) because project was not able to generate sufficient revenue due to power evacuation issues and lower hydrology leading to lower power generation. It has accumulated loss of Rs 82.38 Mn as on July 16, 2018. Operating losses and cash losses decreased in FY18 as compared to FY17, despite slight decline in revenue, mainly due to lower operating expenses during FY18 as compared to FY17. The cash losses over the period along with inadequate cashflows from the project led to stressed liquidity and delays in the repayment of the term loans by the company. During Oct 2018, the lender banks sanctioned additional term loan of Rs 27 Mn for the settlement of overdue loan principle amount and interest.

Leveraged capital structure with high project cost and weak debt coverage indicators

The project was completed with high project cost of Rs 231.09 Mn per MW and debt equity ratio and overall gearing ratio was high at 2.69x and 2.91x as on July 16, 2018 (2.32x and 2.45x as on July 15, 2017), which is expected to improve after issue of proposed IPO. The company is

having leveraged capital structure which was also impacted by high accumulated losses over the period. Total Debt/GCA is negative by 55.09x at the end of FY18.

The interest coverage ratio of the company was low at 0.79x in FY18 (0.63x in FY17). SHL is unable to generate sufficient cash flows to fully service its interests and principal repayments therefore frequently rely on the advance from directors and shareholders to service debt obligations. At the end of FY18, SHL has Rs 21.22 Mn in interest payable.

Power evacuation risk

The power generated from the project is proposed to be evacuated to NEA grid by 4Km long 33KV Transmission Line to NEA Harichaur Substation. The 33kV transmission line (in the scope of project) has been completed and the power has been evacuated to NEA grid through this 33kV transmission line by converting power down to 11kV, since its operation. Timely completion/operation of Harichaur Substation to evacuate full power generated from the project is critical for the project cashflows.

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

Run-of-the-river (ROR) power is considered an uneven source of power, as a ROR project has little or no capacity for water storage and therefore is dependent on the flow of river water for power generation. ROR, therefore, generates much more power during times when seasonal river flows are high (Mid-April to Mid-December) and much less during the drier months (Mid-Dec to Mid-April). SHL utilizes discharge from Daram Khola (tributary of Badi Gad river, which is a major tributary of the Kali Gandaki River), a perennial river, having catchment area of 84 sq kms based on water source from forest. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

Key Grading Strengths

Experienced Board members, management team and financial support from the promoter group.

SHL has 6 Board of Directors, led and chaired by Mr. Badri KC, a reputed Non Resident Nepali (NRN) and current general secretary of Non Resident Nepali Association (NRNA) holding 9.78% shares of the company. Other board members includes Mr. Sapila Raj Bhandari, also a NRN and current vice chairperson of NRNA, Mr. Bikash Kumar Shrestha, Mr. Pawon Dhakal,

Mr. Gopal Prasad Niure and Mr. Nar Bahadur Thapa each having decades of experience in the different industries.

SHL has been obtaining financial support in the form of short term loans and additional equity from directors and promoters. Share capital of the company increased to Rs 210 Mn in FY18 from Rs 192.03 Mn in FY16 by infusion of additional share capital by existing shareholders as well as through entry of new shareholders. Similarly, the short term loan of Rs 13.62 Mn in FY18 and Rs 3.88 Mn in FY17 was received from directors and shareholders.

Power purchase agreement with sufficient period coverage

SHL had signed PPA with NEA on April 1, 2012 for sale of 2.5MW power. The period of PPA is 30 years from the commercial operation date (COD) or till validity of Generation License (received on May 16, 2013 for 35 years), whichever is earlier. PPA period may be extended with mutual consensus during the last six month of validity. The tariff for wet season (Mid-April to Mid-December) is Rs 4.80 per kWh and for dry season (Mid-December to Mid-April) is Rs 8.40 per kWh with 3% escalation on base tariff for 5 years from the COD (i.e. from June 26, 2016). The contracted energy for wet season is 11.18 Million units and for dry season 2.56 million units.

Moderate counter party risk and prompt bills realization from the NEA

SHL is exposed to counter party payment risk pertaining to NEA, which has made losses in past till FY 2016 and carry huge accumulated loss in its book. The counter party payment risk is moderated by the fact that, NEA is fully owned by government of Nepal, generating profit and positive gross cash accruals in recent years and further NEA has history of making timely payment to independent power producer (IPPs) till date. SHL is receiving payment from NEA as per the payment provisions of PPA.

Shortage of power in the country

As per the statistics presented in report published by Ministry of Energy Nepal on July 2018, the current peak electricity demand is about 1300. The total domestic installed capacity stands 1073 MW which includes 562 MW generated by NEA and 511 MW generated and supplied by private sector IPPs. To meet the current demand, NEA is importing upto 450 MW power from beside domestic generation.

Government support for the power sector

GoN considers hydropower generation as priority sectors and tries to involve private sector participation in power generation by offering different incentives. The sector is exempted from income tax for first 10 years and 50 percent for additional 5 years to those which generate electricity within Mid-April 2024; and further lump sum capital subsidy Rs. 5 Mn per MW will be granted to those producers who generate and connect the generated electricity to national grid. Income tax will be levied only 20% despite that normal tax rate for entity in Nepal is 25%.

About the Company

SHL is Public Company, incorporated on July 30, 2007, promoted by institutional as well as individual promoters from different background. It is currently operating 2.5 MW Daram Khola 'A' hydro power project in run –of –river scheme located at Baglung district, Nepal. The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism. The commercial production and sale of power started from June 26, 2016.

Initially, the total cost of the project as per the Bank's loan agreement was estimated at Rs. 463.34 Mn which was proposed to be funded through Debt: Equity ratio of 70:30. However, the project was completed with total cost of Rs 577.74 Mn (cost per Mw Rs. 231.09 Mn) funded through debt of Rs 364.5 Mn and rest by equity of Rs 213.24 Mn.

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Annexure 1**CARE Ratings Nepal – IPO Grading Scale**

CARE IPO grade	Definition
CARE-NP IPO Grade 1	Strong fundamentals
CARE-NP IPO Grade 2	Above average fundamentals
CARE-NP IPO Grade 3	Average fundamentals
CARE-NP IPO Grade 4	Below average fundamentals
CARE-NP IPO Grade 5	Poor fundamentals

Note:

Modifiers {"+" (plus)} can be used with the grading symbols 2, 3 and 4. The modifiers reflect the comparative standing within the category.