

**Grading Rationale**  
**Singati Hydro Energy Limited**

**Grading**

Particulars	Amount (Rs. in Million)	Grading	Grading Action
Initial Public Offer	435.00	CARE-NP IPO Grade 4 [IPO Grade Four]	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 4’ to the proposed Initial Public Offer (IPO) of Singati Hydro Energy Limited (SHEL). ‘CARE-NP IPO Grade 4’ indicates Below Average 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. SHEL proposes to issue 4.35 Mn shares of face value of Rs. 100 each at par aggregating Rs. 435 Mn.

**Detailed Rationale & Key Grading Drivers**

The grading assigned to SHEL is constrained by significant time and cost overrun leading to high cost of project and exposure to volatile interest rates, foreign exchange fluctuation risk and power evacuation risk. The grading also factors in hydrology risk associated with run of the river power projects and geological risk. The grading, however, derives strength from experienced board members and management team in hydropower sector, power purchase agreement (PPA) with sufficient period coverage, low project implementation risk and financial closure achieved for the project cost. Further, grading is supported by moderate counter party risk, shortage of power in the country and government support for the power sector.

**Detailed Description of the Key Grading Drivers**

**Key Grading Weaknesses**

***Significant time and cost overrun leading to high cost of project and exposure to volatile interest rates***

Total estimated cost of the project for initial 16 MW capacity was Rs. 2,893 Mn (i.e. Rs 181 Mn per MW). However, after the project capacity was upgraded to 25 MW, the estimated project cost was increased to Rs 4,752 Mn (i.e. Rs 190 Mn per MW). Per MW cost of the project increased due to change in headwork and powerhouse location; change in mode of flow of water from pipe scheme to tunnel system and loss from fluctuation in forex exchange rate. Also, the project cost was increased on account of poor geological condition requiring change in penstock design and change in location of surge shaft resulting in additional works. Furthermore, increased social mitigation costs and increased interest during construction (IDC) due to increased term debt followed by time overrun resulted in increased project cost. Further, due to tight liquidity position in

the market, the interest rate has been high and volatile during the last 1-2 years. Therefore, funding from Bank and Financial Institutions is exposed to volatile interest rate.

***Foreign exchange fluctuation risk***

The company imports many equipment and machineries for hydropower projects from outside the country especially from India and China. The payments regarding such imports have to be made in foreign currency i.e. USD and INR. The amount payable in foreign currency is based on the spot rate and the company has not taken any measures to hedge itself from foreign currency payment. This exposes the company to foreign exchange fluctuation risk. Further, SHEL incurred Rs. 70 Mn foreign exchange loss towards the project till date.

***Power evacuation risk***

The power generated from the project is proposed to be evacuated via 250 m long 132 KV transmission line to NEA Singati substation and from there 132KV transmission line from Singati to Lamosangu should be constructed to evacuate energy. SHEL is responsible for construction and maintenance of transmission line up to Singati Substation. Construction of Singati Substation and Singati-Lamosangu transmission line lies within scope of NEA. Till mid-April, 2019, ~70% of transmission line work within the scope of company has been completed. Singati Substation and Singati- Lamosangu transmission line work within the scope of NEA is ongoing and delay in the Singati- Lamosangu transmission line from the RCOD date will lead to high revenue losses for the company.

***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 summer season when seasonal river flows are high (Mid-April to Mid-December) and less during the winter season (Mid-Dec to Mid-April). SHEL is proposed to utilize discharge from Singati Khola which is a perennial river having catchment area of 195 sq. kms. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

***Geological Risk***

The project area is supposed to pose significant geological risks since it is generally located in rough terrain and is likely to face adverse climatic condition during construction period resulting in delay in the construction and project cost overrun. Project being in hilly region of Sindhupalchowk district was heavily affected by 2015 earthquake. The access road is prone to landslides and maintenance is required after each monsoon every year.

**Key Grading Strengths*****Experienced board members and management team in hydropower sector***

SHEL has 7 members in its board. The board is chaired by Mr. Batu Lamichhane, who is involved in hydropower sector and construction business for more than 20 years. Mr. Ganesh Karki, executive chairperson, is involved in hydropower sector for more than 20 years holding directorship in many operational and under-construction hydro power companies. They are also supported by experienced management team.

***Power purchase agreement with sufficient period coverage***

Initially, SHEL had signed PPA with NEA on November 13, 2013 for sale of power generated from 16MW capacity. Later, the project capacity was increased to 25MW (PPA amended on December 14, 2017 for additional capacity). The contracted energy for 16MW is 92.57 MU annually and for additional 9 MW capacity is 40.04 MU annually. The contracted Plant Load Factor (PLF) for 25 MW capacity is ~61%. PPA has been entered for the period of 30 years from the COD or till validity of generation license (obtained on January 14, 2016 for 35 years) whichever is earlier. PPA period may be extended with mutual consensus during the last six month of validity. Tariff as per PPA for initial 16 MW is Rs 4.80 per kWh for wet season (Mid-April to Mid-December) and Rs 8.40 per kWh for dry season (Mid-December to Mid-April) with 3% annual escalation on base tariff for 5 years and for additional 9 MW similar tariff and annual escalation on base tariff for 8 years.

***Low project implementation risk***

Till April 3, 2019, the company has achieved financial progress of ~77% on the basis of cost incurred. Till mid-April, 2019, works related to access road, camp facility and construction power has been completed; majority of civil work and hydro-mechanical works are completed, while electromechanical work and transmission line works are ongoing. As major part of the project work has been completed, the project implementation risk is reduced significantly. However, the project is still exposed to the residual risks associated with project implementation and satisfactory operations thereafter given the uncertain geology and adverse climatic conditions of the project area.

***Financial closure achieved for estimated project cost***

Total estimated cost of the project for initial 16 MW capacity was Rs. 2,893 Mn and the project was revised to Rs 4,752 Mn for 25 MW capacity. The estimated project cost is proposed to be financed through debt equity ratio of 70:30. Financial closure for Rs 3,326 Mn debt was achieved on July 15, 2018. The cost incurred till April 3, 2019, is Rs. 3,650 Mn and the same is funded through debt of Rs. 2,652 Mn and equity (including capital in advance) of Rs. 998 Mn.

***Moderate counter party risk***

SHEL is exposed to counter party payment risk pertaining to NEA, which has been making consecutive losses in past till FY16 and carry huge accumulated loss in its book. However, as per the annual report published by NEA,

during FY18 (provisional), NEA earned profit of Rs 1,010.21 Mn (Rs 1,502.28 Mn during FY17). The counter party payment risk is moderated by the fact that, NEA is fully owned by government of Nepal, net loss is declining over the period and NEA is generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producer (IPPs) in past.

### ***Shortage of power in the country***

As per the statistics presented in report published by Ministry of Energy Nepal on May 2018, the current peak electricity demand is about 1300 MW. 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 India beside domestic generation.

### ***Government support for the power sector***

Government of Nepal (GoN) considers hydropower generation as priority sector and intends to maximize private sector participation by offering different incentives. GoN has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years to those who generate electricity within Mid-April 2024. Income tax will be levied only 20% despite the normal tax rate for entity in Nepal is 25%. Also, GoN has declared to provide grant of amount equivalent to Rs. 5 Mn per MW installed capacity after receiving evidence of formal COD of complete power plant.

### ***About the Company***

SHEL was initially incorporated as a private limited company named Singati Hydro Energy Private Limited on May 19, 2010. Later on, it converted to a public limited company named Singati Hydro Energy Limited on June 20, 2018. It is promoted by various institutional and individual promoters from different background for setting up of a 25 MW run-of-river, Singati Khola Hydropower Project (SKHP) in Dolakha district of Nepal. The project is one of the 'super six' hydro power projects of Nepal. This project is constructed under BOOT (Build, own, Operate and Transfer) mechanism. Mr. Batu Lamichhane (15.58%), Mr. Ganesh Karki (9.01%), RC Hydro Investment Pvt. Ltd. (7.54%), Bask Hydel Investment Company Pvt. Ltd. (6.44%) and Baidik Hydro Investment Company Pvt. Ltd (6.30%) are the major promoter shareholders of the company. Promoters and public holding is expected to be in the ratio of 70:30 after issue of proposed IPO.

Initial RCOD of the project for 16 MW capacity was September 17, 2017 and for additional 9 MW capacity is July 16, 2020. The project was not completed within expected RCOD due to capacity enhancement. Therefore, RCOD for 16 MW capacity was extended to June 30, 2019 while RCOD for additional 9 MW capacity remained same. Commercial operation of the project is expected from Mid-July 2019.

**Analyst Contact**

Mr. Sakar Khadka  
[sakar.khadka@careratingsnepal.com](mailto:sakar.khadka@careratingsnepal.com)  
Tel No.: +977-01-4445473

**Relationship Contact**

Mr. Sajan Goyal  
[sajan.goyal@careratingsnepal.com](mailto:sajan.goyal@careratingsnepal.com)  
Tel No.: 9818832909/+977-01-4445472/3/4

**Disclaimer**

CRNL's IPO grading is a onetime assessment and the analysis draws heavily from the information provided by the issuer as well as information obtained from sources believed by CRNL to be accurate and reliable. However, CRNL does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. CRNL's IPO grading does not take cognizance of the price of the security and it is not a recommendation to buy, sell or hold shares/securities. It is also not a comment on the offer price or the listed price of the scrip. It does not imply that CRNL performs an audit function or forensic exercise to detect fraud. It is also not a forecast of the future market performance and the earnings prospects of the issuer; also it does not indicate compliance/violation of various statutory requirements. CRNL shall not be liable for any losses incurred by users from any use of the IPO grading.

**ANNEXURE I**

**CARE Ratings Nepal – IPO Grading Scale**

<b>CARE IPO grade</b>	<b>Definition</b>
<b>CARE-NP IPO Grade 1</b>	Strong fundamentals
<b>CARE-NP IPO Grade 2</b>	Above average fundamentals
<b>CARE-NP IPO Grade 3</b>	Average fundamentals
<b>CARE-NP IPO Grade 4</b>	Below average fundamentals
<b>CARE-NP IPO Grade 5</b>	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.