

Suri Khola Hydropower Limited

Ratings

Instrument / Facilities	Amount (Rs. In Million)	Rating ^[1]	Rating Action
Long Term Bank Facilities	760.00	CARE-NP BB [Double B]	Reaffirmed
Total Facilities	760.00		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of 'CARE-NP BB' assigned to the long-term bank facilities of Suri Khola Hydropower Limited (SKHL).

Detailed Rationale & Key Rating Drivers

The rating assigned to Suri Khola Hydropower Limited (SKHL) is constrained by residual project implementation and stabilization risk associated with delayed and cost overrun greenfield project, power evacuation risk, hydrology risk associated with run-of-the-river power generation and exposure to regulatory risk.

The rating, however, derives strength from strong parentage and experienced management team, presence of power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The rating also factors in current demand & supply gap however possible oversupply in future and government support for the power sector.

Going forward, the ability of the company to successfully execute the project without further cost and time overrun and early stabilization thereafter are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Significant time overrun of the project along-with cost overrun

The total cost of the project was envisaged at Rs. 1,085.70 Mn to be funded in debt equity ratio of 70:30 (debt of Rs 760 Mn and equity of Rs. 325.70 Mn). However, the same has been revised to Rs. 1,236.53 Mn and proposed to be financed in the debt equity ratio of 70:30. As per PPA, required commercial operation date (RCOD) of the project was April 13, 2018 which has been extended multiple times due to delay in construction of the transmission line from Singati to Lamosangu by Nepal Electricity Authority (NEA). With a view to prevent the revenue loss, the management also delayed the implementation schedule of the project. Subsequent necessary amendments of RCOD have been made in the PPA.. The current RCOD of the project which has been approved is December 31, 2020. However, SKHPL has applied for further extension of RCOD on account of delay in the construction of NEA transmission line.

Residual project implementation risk and stabilisation risk

SKHL is setting up a new hydro project of 6.4 MW capacity. The total cost of the green-field project is estimated at Rs. 1,236.53 Mn, which will be funded by term loan of Rs. 865.50 Mn and remaining amount from the promoter's fund. The debt of the same has been tied up and the commercial operation is expected in October 18, 2021. Out of the total capex planned, as on June 25, 2021, the company has incurred total expenditure of Rs.1,115.78 Mn funded out of term debt of Rs. 674.08 Mn and remaining from promoter's contribution. As on June 2021, around 90% of the total project cost has been incurred; however; the overall physical progress of the project is about 97%. There has been delay in the construction of Singati to Lamosangu transmission line which is critical for the company from revenue generation prospective. Furthermore, post project implementation risk, the company remains exposed to risk in the form of

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

stabilization of the power generation facilities to achieve the envisaged plant load factor (PLF) which shall remain crucial for the company.

Power evacuation risk

The power generated from the project is proposed to be evacuated through 6.9 km long 33KV Transmission Line to NEA's under construction Singati Substation. Further, power will be evacuated through under construction 132KV Transmission line from Singati to Lamosangu. There are many hydropower projects within the corridor (nearing completion) which are dependent upon timely completion of NEA substation and transmission line for power evacuation. Construction of Singati-Lamosangu Transmission Line, is under implementation. The expected date of operation of transmission line is October 18, 2021. The completion of the transmission line and substation is critical from revenue perspective.

Exposure to regulatory risk

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) for regulating generation, transmission and distribution of electricity in Nepal. ERC will be the regulator under the GoN which will be responsible for regulating hydropower companies in Nepal. Policies and directives issued by ERC like approval process for IPO issuance, PPA approval through ERC poses a new challenge to hydropower companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strength

Strong parentage and experienced management team

Dolma Impact Fund (DIF) which has invested Rs. 260.11 Mn equity in SKHPL is an institutional investor and 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. Major Investors in Dolma Impact Fund includes FMO a Dutch Development Bank [S&P AAA/Stable/A-1+], FINNFUND a Finnish sovereign Development Finance Institution, OeEB an Austrian Development Bank [S&PAA+/ A1+] and DGGF, a growth fund commissioned by the Dutch Ministry of Foreign Affairs. SKHP has 5 Board of Directors, chaired by Mr. Himal Gurung, who has more than 16 years of experience in hydropower and construction sector. He is associated with different hydropower companies having total capacity 51.4 MW. Mr. Chandra Bahadur Karki, Director, has more than 9 years of experience in hydropower sector. Management Team of SKHL is led by Mr. Gurung and he is supported by other experienced team members.

Power purchase agreement with sufficient period coverage

SKHL had entered into a long term PPA with NEA as on June 3, 2015 for sale of 6.4 MW power to be generated from the project. The contracted Plant Load Factor (PLF) for total 6.4 MW is 53.57% with total contracted energy of 32.85 MU. PPA has been entered for the period of 30 years from the COD or till validity of generation license (obtained on June 7, 2015 for 35 years) whichever is earlier.

Tariff rate as per PPA is Rs 4.80 per Kwh for wet season (Mid-April to Mid-December) and the tariff rate for dry season (Mid-December- Mid April) is 8.40 per Kwh, with 3% annual escalation on base tariff for 5 years. Required Commercial Operation (RCOD) was December 31, 2020. The company has requested to NEA for further extension of RCOD on account of the delay in the completion of the NEA transmission line and if RCOD is not revised by NEA, SKHL is required

to pay late COD penalty. Further, if COD is delayed by 6 months to 18 months from RCOD, then the number of escalations in tariff rate will also be restricted.

Moderate counter party risk

SKHL is exposed to counter party payment risk pertaining to Nepal Electricity Authority (NEA), which has been making consecutive losses in past till FY16. However, as per the annual report published by NEA, during FY20 (provisional), NEA earned profit of Rs 11,056 Mn (Rs. 9,812 Mn during FY19) resulting the accumulated profit in its book. Further, during FY20, NEA achieved gross cash accrual of Rs 16,056 Mn (Rs 14,664 Mn in FY19). 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 generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producers (IPPs) in past.

Current demand & supply gap however possible oversupply in future

As per the NEA's Annual Report for FY20, the current peak electricity demand is 1,408MW. The total domestic installed capacity stands at 1,328 MW which includes 632 MW owned by NEA and 696 MW by private sector IPPs. Overall, during FY20, total energy demand was 7,894 GWh which was met by import of 1,721 GWh from India whereas balance was met by domestic generation.

However, considering under construction projects which are expected to generate electricity in next 2-3 years and electricity demand which has not increased substantially in past few years could create a situation of oversupply in near future in wet season.

Government support for the power sector

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 2024. Further, no income source will be asked for investment made within mid-April 2020 in hydro-electricity project. Also, Unified Directive of 2020/21, has directed "Class-A" to allocate minimum 10% of credit to energy sector and "Class-B" and "Class-C" banks to allocate minimum 20% and 15% of total credit respectively to agriculture, energy, SMEs and tourism sector within mid-July 2024.

About the Company

Suri Khola Hydropower Limited (SKHL) is a Public Limited company, incorporated on December 02, 2008 as a Suri Khola Hydropower Private Limited and changed to public limited on July 02, 2018. It is promoted by individual promoters from different background and institutional investors for setting up of a 6.4 MW run-of-river, Suri Khola Hydropower Project (SKHP) in Dolakha district of Nepal.

As per the Generation License, from Government of Nepal – Ministry of Energy, obtained as on June 07, 2015 the project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 35 years.

Annexure 1: Details of Instrument / Facilities

Name of the Instrument / Bank Facilities	Type of the Facility	Amount (Rs. in Million)	Rating assigned
Long Term Bank Facilities	Term Loan	760.00	CARE-NP BB
Total		760.00	

Contact Us

Analyst

Ms. Elisha Lamichhane
Contact No.: 977-01-4012628
Email: elisha.lamichhane@careratingsnepal.com

Senior Analyst

Ms. Shalini Sanghai
Contact No.: +977-01-4012629
Email: shalini.sanghai@careratingsnepal.com

Relationship Contact

Name: Achin Nirwani
Contact No.: +977 9818832909
Email: achin.nirwani@careratingsnepal.com

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