

## Makar Jitumaya Suri Hydropower Limited

### Ratings

Instrument / Facilities	Amount (Rs. In Million)	Rating <sup>[1]</sup>	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B Issuer]	Assigned

\* The issuer rating is subject to the overall gearing ratio of the company not exceeding 2.50x at the end of FY22.

CARE Ratings Nepal Limited (CRNL) has assigned Issuer rating of 'CARE-NP BB (Is) [Double B (Issuer Rating)]' to Makar Jitumaya Suri Hydropower Limited (MJSHL). Issuers with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations, in Nepal.

### Detailed Rationale & Key Rating Drivers

The rating assigned to Makar Jitumaya Suri Hydropower Limited (MJSHL) is constrained by project implementation risk and stabilization risk, significant time overrun of the Suri Khola Hydropower project along-with cost overrun, 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 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 Suri Khola Hydropower project along-with cost overrun**

The total cost of the Suri Khola Hydropower Project (SKHP) 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 which is proposed to be financed in the debt equity ratio of 70:30 with the debt amount of Rs. 865.50 Mn and remaining amount through equity. Required Commercial operation date (RCOD) of the project as per PPA was April 13, 2018 which has been extended multiple times due to delay in construction of the transmission line from Singati to Lamosangu by NEA. With a view to prevent the revenue loss, the management has delayed the project construction and as per plans of management, the project is planned to be completed simultaneously with the completion of transmission line from Sinagati to Lamosangu. SKHPL has applied for further extension of RCOD on account of delay in the construction of NEA transmission line.

##### **Project stabilisation risk in case of Suri Khola Hydropower Project**

The company is setting up a 6.4 MW Suri Khola Hydropower Project (SKHP). 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 2021. Out of the total capex planned, as on July 15, 2021, the company has incurred total expenditure of Rs. 1,186.88 Mn and funded from term debt of Rs. 770.36 Mn and remaining from promoter's contribution. As on July 2021, around 96% of the total project cost has been incurred and the overall physical progress of the project is about 99%. The plant is in the final stages of installation and is expected to commence production in October 2021. However, there has been delay in

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com)

the construction of Singati to Lamosangu transmission line which is critical for the company from revenue generation prospective Also, being a new unit, the stabilization and streamlining of production remains to be seen.

***Project implementation risk in case of Upper Suri Khola Hydropower Project***

The company is also setting up a 7 MW Upper Suri Khola Hydropower Project (USKHP). The total cost of the green-field project is estimated at Rs. 1,295 Mn, which will be funded by term loan of Rs. 906.10 Mn and remaining amount from the promoter's fund. The project is at very initial stage of construction. The total debt of the same is yet to be tied up and the required commercial operation is April 13, 2023. Out of the total capex planned, as on July 15, 2021, the company has incurred total expenditure of Rs. 64.20 Mn funded through promoter's contribution. As on July 15, 2021, ~4.96% of the total project cost has been incurred and the physical progress is ~32%. This exposes the company towards project execution risks in terms of partial debt and equity yet to be tied up along with completion of the project within the envisaged time and cost.

***Power evacuation risk***

The power generated from Upper Suri Khola Hydropower Project (USKHP) is proposed to be evacuated through 4km long 33KV Transmission Line to switchyard of Suri Khola Hydroelectric Project (SKHP) and then the power from USKHP & SKHP is to be evacuated through 6.9 km long 33KV Transmission Line to NEA under construction Singati Substation. Furthermore, 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 completion of the transmission line and substation is critical for the company from revenue perspective and any further delay of the same would result to loss in revenue.

***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***

MJSHL has 4 directors on its board, chaired by Mr. Himel 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 Bidhya Baridhi Sigdel, Director, has more than 12 years of experience in different sectors including banking and finance sector. He is also an investment Director at Dolma Advisors and represents Dolma Impact Fund in the board of MJSHL who is supported by other experienced team members. Dolma Impact Fund (DIF) which has invested Rs. 260.59 Mn equity in MJSHL 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, FINNFUND a Finnish

sovereign Development Finance Institution, OeEB an Austrian Development Bank and DGGF, a growth fund commissioned by the Dutch Ministry of Foreign Affairs.

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

The company had entered into a long term PPA with NEA as on June 3, 2015 and July 26, 2018 for sale of 6.4 MW & 7 MW power to be generated from SKHP and USKHP respectively. PPA has been entered for the period of 30 years from the 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 the tariff rate for dry season (Mid-December- Mid April) is 8.40 per Kwh, with 3% annual escalation on base tariff for 5 and 8 years for SKHP and USKHP. In case of SKHP, required Commercial Operation (RCOD) of the project 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, the company 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 decrease to 4 years from 5 years. Similarly, the RCOD of USKHP is April 13, 2023.

***Current demand & Supply gap however possible oversupply in future along with moderate counter party risk***

As per the NEA's Annual Report for FY21, the current peak electricity demand is 1,482MW. The total domestic installed capacity stands at 1,447 MW which includes 632 MW owned by NEA and 815 MW by private sector IPPs. Overall, during FY21, total energy demand was 8,960 GWh which was met by import of 2,806 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, requiring demand side management.

The company has signed PPA with NEA is owned by Government of Nepal and hence counter party default risk is low; however, timely realization of critical for the company and from analytical perspective also.

***Favourable Government policies towards 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. As per various directives from NRB whereby 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***

Makar Jitumaya Suri Hydropower Limited (MJSHL) was incorporated on July 15, 2021, after the merger of Makar Jitumaya Hydropower Private Limited (MJHPL) with Suri Khola Hydropower Limited (SKHL). The merged entity is currently developing two under-construction hydropower projects namely, 6.4 MW run-of-river, Suri Khola Hydropower Project (SKHP) and 7MW Upper Suri Hydropower Project (USKHP) in Dolakha district of Nepal.

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