

Sikles Hydropower Limited

Ratings

Instrument / Facilities	Amount (Rs. In Million)	Rating ^[1]	Rating Action
Issuer Rating	NA	CARE-NP BB+ (Is) [Double B Plus Issuer]	Assigned
Long Term Bank Facilities	1,500.00	CARE-NP BB+ [Double B Plus]	Assigned
Total Bank Facilities	1,500.00 [One Thousand Five Hundred Million only]		

*The issuer rating is subject to overall gearing of the company not exceeding 2.00x at the end of FY22.

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

Also, CRNL has assigned the rating of 'CARE-NP BB+' for the long-term bank facilities of Sikles Hydropower Limited (SHL).

Detailed Rationale & Key Rating Drivers

The rating assigned to Sikles Hydropower Limited (SHL) is constrained by subdued operating performance of the power project during FY21, leveraged capital structure, 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, moderate financial performance of the company, 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 reduce the gap between operational and contracted plant load factor (PLF) along with the timely receipt of payments from Nepal Electricity Authority (NEA), significant reduction in debt levels are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Subdued operating performance of power project during FY21

SHL has commissioned run-of-the-river 13MW Madkyu Khola Hydroelectric Project (MKHP) at Kaski District of Nepal. The commercial operations commenced in April 2018. During FY20, the plant was operated at plant load factor (PLF) of 61.47% which decreased to 49.77% during FY21. The operating performance in terms of power generation was low during FY21 on account of hydrology related issues throughout the period. Also, the plant was not operational for around a month due to landslide at the project site. The annual contracted PLF for MKHP is 64.79% of the installed capacity of the plant. For the year ended FY20, the energy generated was 94.83% and 80.50% in FY21 against contracted PLF. This is crucial from analytical perspective for the company to reduce the gap between operational PLF and contracted PLF.

Leveraged capital structure

The capital structure of the company is leveraged with high overall gearing ratio of 2.16x at the end of FY21 (FY20: 2.37x). The capital structure is leveraged on account of debt funded capex undertaken by the company for the

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

development of the project. However, the overall gearing ratio is expected to improve in future on account of the prepayment of the term loan from the IPO proceeds. Apart from overall gearing, other coverage indicators including total debt to GCA stood high at 11.77x for FY21 respectively (PY: 10.41x). The gross cash accruals of the company declined to Rs. 131 Mn during FY21 from Rs. 153 Mn in FY20. Interest coverage ratios declined to 1.72x during FY21 (PY: 1.95x). The deterioration in coverage indicators was on account of lower revenue generation which led to decline in profitability and thereby impacted coverage indicators.

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 wet season when river flows are high (Mid-April to Mid-December) and less during the dry season (Mid-December to Mid-April). The project utilizes discharge from Madkyu Khola having catchment area of 71.3sq. kms based on Perennial River. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola.

Exposure to volatile interest rate

Nepalese banking sectors are fixing floating interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions (BFIs) remains volatile to change in liquidity position which lead to change in interest rate. Interest rate has been changing frequently in Nepal market since last 2-3 years. Therefore, funding from BFIs is subject to volatile interest rate.

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

SHL has 6 Board of Directors, chaired by Ms. Prem Kumari KC, who holds 53.43% of the total share capital, has more than three decades of experience in different sectors. She is also director at Gandaki Hydropower Pvt Ltd (4.8 MW operational Mardi Khola Hydropower Project), and Civil Hydropower Pvt Ltd. The other directors of the company have also long experience in different sectors including hydropower sector. SHL is part of KC Group of companies which is one of the leading organizational groups in Nepal. In addition to the hydropower projects, the promoters of KC group of Companies have made their investments in different other sectors like construction, Hospitality and Housing, Manufacturing, educational institutions, Banking and Insurance.

Power purchase agreement with sufficient period coverage

The company had entered into PPA with Nepal Electricity Authority (NEA) as on November, 2009 for 9.968 MW (amended to 13 MW as on March 23, 2016) for sale of entire power generated by the plant. The PPA is signed for a

period of 30 years from the date of COD. Tariff rate as per PPA is Rs 4 and 7 per Kwh for wet season (Mid-April to Mid-December) and the tariff rate for dry season (Mid-December- Mid April) is Rs. 4.80 and 8.40 per Kwh, with 3% annual escalation on base tariff for 9 and 5 years for 9.968 MW and 3.032 MW respectively.

Moderate financial performance of the company, however impacted in FY21

SHL is generating revenue by the selling of power generated through its 13 MW Madkyu Khola Hydroelectric Project since April 2018. The company reported decrease in total operating income by around 24% to Rs. 255 Mn in FY21 (Unaudited; FY21 refer to 12 months ending on Mid-July 2021) from Rs. 334 Mn in FY20. The decrease in revenue during FY21 was due to lower sale of units which was attributed to lower energy generation.

PBILDT in absolute amount was decreased to Rs. 218 Mn in FY21 (FY19: Rs. 315Mn). Also, PBILDT margin declined to 85% during FY21 from 94%in FY20 due to the decrease in total income which resulted in increase in cost due to proportion of fixed cost which deprived it of its scale benefits. With decline in PBILDT, PAT of the company declined to Rs. 60 Mn in FY21 from 77Mn during FY20. However, the PAT margin remained stable around 23% during FY20 and FY21.

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. The company received payment from NEA for supply of power generated by SHP within 43 to 54 days during FY21.

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

Sikles Hydropower Limited (SHL) is a public limited company, incorporated in July 28, 2004 as a private limited company and later converted to public limited company in May 17, 2019. The company is setting up 13MW run-of-the-river Madkyu Khola Hydroelectric Project (MKHP) at Kaski District of Nepal. The project came into a commercial operation since April 2, 2018. The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Financial Performance

Particulars	FY18	FY19	FY20
	Audited		
Income from Operations	271	334	255
PBILDT Margin (%)	76.86	94.33	85.36
Overall Gearing (times)	2.77	2.37	2.16
Interest coverage (times)	1.20	1.95	1.72
Current Ratio (times)	NA	1.01	1.04
Total Debt/Gross Cash Accruals (times)	44.95	10.41	11.77

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	1,500.00	CARE-NP BB+
Total		1,500.00	

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