

Sabha Pokhari Hydropower Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	617.00	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	3.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	620.00		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB' assigned to the long term bank facilities and 'CARE-NP A4' assigned to the short term bank facilities of Sabha Pokhari Hydropower Private Limited (SPHPL).

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of SPHPL factor in the residual project implementation risk and operation stabilization risk associated with its under-construction hydropower project. The rating is also constrained by hydrology risk associated with run-of-the river power generation, power evacuation risk and partial offtake risk, exposure to regulatory risk and volatile interest rates. The ratings, however, continue to derive strength from experienced board members and management team, presence of power purchase agreement (PPA) with sufficient period coverage and government support for the power sector.

Going forward, the ability of the company to successfully execute the project within envisaged cost and time and early stabilization thereafter will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Residual Project implementation and stabilization risk

SPHPL is setting up 5 MW run-of-river Lankhuwa Khola Hydroelectric Project (LKHP) in Sabhapokhari Rural Municipality of Sankhuwasabha District. The total cost of the project is envisaged at Rs. 881.60 Mn (Rs. 176 Mn per MW) and is to be funded in debt to equity ratio of 70:30. The total debt component of Rs.617 Mn has been tied up. Out of total equity of 264 Mn, promoters have infused Rs. 196.78 Mn (including Rs. 167.61 Mn advance for share capital) till May 27, 2022. As on May 27, 2022, the company had achieved physical progress of 65%. This exposes the company towards residual project execution risk in terms of completion of the project within the envisaged time and cost.

Required Commercial Operation Date (RCOD) of the project was June 30, 2022. The project is running behind schedules due to recurring lockdowns in the last 2 years which had disrupted the availability of work force and required construction materials at the site. The company expects to complete the work by December 2022 and is also in process for taking the extension of RCOD for the same period. If the project is not completed within six months of the mentioned RCOD, the company is required to pay delay penalty. Furthermore, if COD is delayed by more than six months from RCOD, there are restriction clauses in escalation of tariff rate as well. It is crucial of the company to take the necessary approvals for extension of RCOD and to complete the project within the timelines to have the accelerated clauses of tariff. Any delay in the same would led to impact on project returns and debt servicing capabilities which is critical from analytical perspective.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications

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 river flows are high (Mid-April to Mid-December) and less during the winter season (Mid-Dec to Mid-April). SPHPL is proposed to utilize discharge from Lankhuwa Khola/river and Orang Khola/river, the tributaries of Sabha Khola/river in the Koshi Basin having catchment area of 57.80 sq kms. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

Power Evacuation Risk

The Power generated from the project is proposed to be evacuated through 16.4 kms long 33KV long transmission line from powerhouse to Khandbari Substation at Tumlintar. The company has entered into an agreement with Dibyashwari Hydropower Limited (DHL) to use its transmission line. SPHPL has to construct 4 km 33kv transmission line from its powerhouse to the DHL's power house which will be then connected in loop-in loop-out arrangement. The transmission line to Khandbari substation is under construction. Timely completion of the transmission lines and substation is crucial for the company from revenue generation prospective.

Exposure to volatile interest rate risk

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company 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 hydropower companies in Nepal. ERC will regulate generation, transmission and distribution of electricity in Nepal among others. Policies and directives issued by ERC such as approval process for IPO issuance and 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 Strengths**Experienced Board Members and management team**

SPHPL is promoted by Dr. Laxmi Prasad Devkota, Chairman, PhD in Water Resource Engineering, with more than two decades of experience in the field of water resources engineering and management as well as country level planning and development. He was former member of National Planning Commission and was associated with research and development institutes of Nepal, hydro power companies in different capacities. Mr. Shree Ram Devkota, has done his Master's degree in Renewable Energy and also associated with power generation companies for more than a decade. The BOD is further supported by other experienced management team members.

Power purchase agreement with sufficient period coverage providing low offtake risk

SPHPL had entered into a long term PPA with Nepal Electricity Authority (NEA) as on June 04, 2017 for sale of 5 MW power to be generated from the project. The period of the PPA is 30 years from COD or till validity of Generation License, whichever is earlier. The tariff for wet season (June to November) is Rs 4.80 per kWh and for dry season (December to May) is Rs 8.40 per kWh with 3% escalation on base tariff for 8 times on annual basis. The PPA with NEA at the specified rates and for long duration reduces the offtake risks significantly. However, the company exposed to restrictions in the number of escalations in tariff, if there is delay in COD of the project than RCOD by more than 6 months.

Favorable 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

Sabha Pokhari Hydropower Private Limited (SPHPL) is a private limited company, incorporated on May 23, 2007. It is promoted by individual promoters to develop Hydropower in Nepal under "BOOT" (Build, Own, Operate and Transfer) model. SPHPL is setting up Lankhuwa Khola Hydroelectric Project (LKHP) in Sabhapokhari Rural Municipality, Sankhuwasabha District of Nepal having installed capacity of 5MW, run-of-river project. The project is proposed to utilize available head and flow from Lankhuwa Khola (River), which is a tributary of Sabhapokhari Khola and is designed to take water from Lankhuwa khola to generate 29.17 GWh of energy.

Annexure 1: Details of the Facilities Rated

Name of the Bank Facilities	Type of the Facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loan	617.00	CARE-NP BB [Double B]
Short Term Bank Facilities	Fund Based Limits	3.00	CARE-NP A4 [A Four]
Total		620.00	

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