

## Makar Jitumaya Suri Hydropower Limited

### Ratings

Facility/Instrument	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B Issuer]	Reaffirmed
Long Term Bank Facilities	1,685.00	CARE-NP BB [Double B]	Reaffirmed
<b>Total Facilities</b>	<b>1,685.00</b>		

\*The issuer rating is subject to overall gearing ratio of the company not exceeding 2.50x at the end of FY23.

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB (Is)' assigned to Makar Jitumaya Suri Hydropower Limited (MJSHL). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Also, CRNL has reaffirmed the rating of 'CARE-NP BB' assigned to the long-term facilities of MJSHL.

### Detailed Rationale & Key Rating Drivers

The ratings assigned to MJSHL continue to be constrained by project implementation risk associated with its under-construction Upper Suri Khola Hydropower Project (USKHP) and operations stabilization risk associated with its recently operational Suri Khola Hydropower Project (SKHP). The ratings also factor in the significant time overrun of SKHP along with cost overrun, hydrology risk associated with run-of-the-river power generation and exposure to volatile interest rate and regulatory risk.

The ratings, however, derive strengths from MJSHL's strong parentage and experienced management team, presence of power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The ratings also take cognizance of successful commencement of commercial operations of SKHP and the lower power evacuation risk for both the projects following completion of the sub-station and transmission line, however, stabilization of power evacuation for an extended timeframe remains to be seen.

*Going forward, the ability of the company to swiftly stabilize the operations of the newly commenced hydro power project, availability of sufficient hydrology to generate sufficient energy as contracted and successfully execute the under-construction project without further cost and time overrun and early stabilization thereafter will be the key rating sensitivities.*

### Detailed description of the key rating drivers

#### Key Rating Weaknesses

#### Significant time overrun of Suri Khola Hydropower Project (SKHP) along with cost overrun

The cost of the 6.4 MW SKHP underwent several revisions following a significant time overrun, majorly on account of delays in the construction of the transmission line, which was under National Electricity Authority's (NEA) purview. The final cost (pending final audit) of the project was Rs. 1,313.48 Mn (at Rs. 205 Mn per MW) financed by bank loan amounting to Rs. 909.39 Mn and equity amount of Rs. 355.50 Mn with rest as capital payables. The original Required Commercial Operation Date (RCOD) of the project as per PPA was April 13, 2018 was extended multiple times due to the delay in construction,

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

resulting in a higher project cost than earlier envisaged. During the initial years of operations, the capital structure of the company is expected to remain leveraged characterized by a relatively higher overall gearing.

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

SKHP commenced commercial operation from May 1, 2022. During the first two and a half months of its operations (May 2022 to mid-July 2022), the project's Plant Load Factor (PLF) was around 93% of contracted energy. Since the project is in initial year of operations, stabilization and streamlining of production in coming years remains to be seen and will remain a key monitorable aspect.

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

The company is also setting up a 7 MW hydro power project (USKHP). The estimated cost of the project is Rs. 1,295 Mn (i.e., Rs.185 Mn per MW) and the same is proposed to be financed in the debt equity ratio of 69.5: 30.5. Total debt component of the proposed funding amounting to Rs. 900 Mn is fully tied up. As on May 9, 2022, ~32.43% of the total project cost had been incurred while the physical progress was ~64%.

The project is in the middle stage of construction. The Required Commercial Operation Date (RCOD) of the projects is April 2023. The company has applied for extension of RCOD to NEA. If COD doesn't fall within RCOD, the company is bound to pay penalty to NEA as per the PPA. The number of escalations in tariff rate will also be reduced if COD of the project is delayed by more than six months. Being at middle stages of construction, the company is exposed to the project implementation risk within the envisaged time and cost. As most of the machineries for the projects is likely to be imported, the project cost is likely to be impacted by the appreciating USD.

#### **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-March to Mid-December) and less during the dry season (Mid-December to Mid- March). SKHP is proposed to utilize discharge from Suri Khola having catchment area of 36.40 sq. kms based on Perennial River. Similarly, USKHP is proposed to utilize discharge from Hulak Khola and Kolung Khola having catchment area of 23 sq. kms and 3.68 sq. 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 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.

#### **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.

### **Key Rating Strength**

#### **Strong parentage and experienced management team**

MJSHL has 4 Board of Directors, chaired by Mr. Himel Gurung, who has more than 16 years of experience in hydropower and construction sector. He is associated with a number of hydropower companies. Mr. Bidhya Baridhi Sigdel, Director, has more than 12 years of cross sector experience. He is also an investment Director at Dolma Advisors and represents Dolma Impact Fund in the board of MJSHL. The board is supported by experienced professionals. Dolma Impact Fund (DIF), which has invested Rs. 260.59 Mn equity in MJSHL, is an institutional investor. 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. 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 to Mid-April) is 8.40 per Kwh. Number of escalations in tariff rate for SKHP and USKHP are 5 times and 8 times, respectively.

#### **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 the Singati Substation. Further, power will be evacuated through 132KV Transmission line from Singati to Lamosangu. The construction of the Singati-Lamosanghu transmission has been completed (handover to NEA by the contractor is still pending) and power evacuation from various projects in the area from the Singati substation has started, along with for SKHP. Now that the transmission line is operational, power evacuation risk for both the projects has improved. However, smooth power evacuation for a reasonable period remains to be seen and will remain a key monitorable.

#### **Favorable Government policies towards power sector**

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**

Makar Jitumaya Suri Hydropower Limited" (MJSHL) came into existence after the merger between Makar Jitumaya Hydropower Private Limited (MJHPL) and Suri Khola Hydropower Limited in July 15, 2021. MJHPL has two hydropower projects, namely, 6.4 MW Suri Khola Hydropower Project (SKHP) and 7.0 MW Upper Suri Khola Hydropower Project (USKHP)

in Gaurishankar Rural Municipality, Dolakha district of Nepal. SKHP commenced operations from May 1, 2022 while USKHP is currently under-construction. The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism.

#### Annexure 1: Details of Instruments/Facilities

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	1,685.00	CARE-NP BB
<b>Total</b>		<b>1,685.00</b>	

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