

Seti Khola Hydropower Private Limited

Ratings

Facilities	Amount (Rs. Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	3,800.00	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	150.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	3,950.00 (Three Thousand Nine Hundred and Fifty Million Only)		

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 Seti Khola Hydropower Private Limited (SKHPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SKHPL continue to remain constrained by project implementation risk associated with its under-construction hydropower project. The ratings also factor in hydrology risk associated with run-of-the-river power generation, risk of natural calamities, power evacuation risk and the company's exposure to regulatory risk and volatile interest rate risk.

The ratings, however, derive strengths from the company's experienced promoters and management team in the hydropower sector, presence of power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and government's 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

Project implementation risk

SKHPL is setting up a 22 MW run-of-river Seti Khola Hydropower Project (SKHP) in Kaski district of Nepal. The total cost of the project is estimated at Rs. 5,052.34 Mn (Rs. 229.65 per MW), which is proposed to be funded in the debt equity ratio of 75:25 (i.e., bank debt of Rs. 3,789.00 Mn and equity of Rs. 1,263.34 Mn). The debt of the project has been fully tied up. Till November 30, 2022, the company has incurred expenditure of Rs 1,551.80 Mn (financial progress of around 30.71%) funded through debt of Rs. 883.73 Mn and equity (including advance for share capital) of Rs. 600.11 Mn while the balance remains payable. Till November 30, 2022, promoters' contribution amounting to Rs. 600.11 Mn has been infused as against the projected requirement of Rs. 1,263.34. The company has already awarded contracts for civil works, hydro-mechanical, and electro-mechanical works and is in process of acquiring land for erecting transmission poles.

Required Commercial Operation Date (RCOD) of the project is July 30, 2023. However, the company has applied for further extension till July 28, 2024. If the project is not completed within the RCOD, the company will be liable to pay delay penalty. Furthermore, if COD is delayed by 6 months to 18 months from RCOD, there are restriction clauses in escalation of tariff rate. It is, therefore, critical for the company to complete the project within the timeline to avail the accelerated clauses of tariff. Any delay in the same would impact the project's expected returns and debt servicing capabilities which is critical from credit perspective.

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE 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 wet season when river flows are high (June to November) and less during the dry season (December to May). The power project is proposed to utilize discharge from Seti Khola having catchment area of 876.92 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.

Risk of Natural Calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their construction and operations vulnerable to adversities of nature. Floods and landslides that tend to occur in these areas pose threat to these power projects damaging their infrastructures as well as impacting their timely completion. Moreover, disruption in their construction in turn could lead to time and/or cost overrun, negatively impacting the project's financial aspects. Moving forward also, these natural calamities can adversely affect the smooth flow of power generation and distribution, which can further impact financial returns of the projects. SKHPL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Power evacuation risk

The power generated from the project is expected to be connected to Lekhnath-Damauli transmission line of NEA located near Kotre Bazar in Suklagandaki Municipality Ward no. 2. The company is required to construct a 2-km long double circuit Loop-in loop-out 132 kV transmission line from the project's powerhouse to NEA's Lekhnath-Damauli transmission line. The transmission line is operational and power will directly be connected to the national grid. The project is in process of acquiring land for erection of poles to connect to the transmission towers. Timely completion of transmission lines will be key rating sensitivity.

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, the sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strengths**Experienced promoters and management team**

SKHPL has three board of directors having long experience in various sectors including both operational and under construction hydropower projects in Nepal. The board is chaired by Mr. Anup Acharya who has more than two decades of work experience in construction business. He is also the chairman in Sanvi Energy Limited, which has one operational hydropower project and another in project stage. Furthermore, he is also the chairman of M.A. Construction Private Limited, which is a Class-A construction company having long experience in civil works related to the development of hydropower projects in Nepal. The other directors also have more than a decade's experience in various domains and the company is further supported by an experienced team to manage the day-to-day operations.

Power purchase agreement with sufficient period coverage

SKHPL has entered into a long-term Power Purchase Agreement (PPA) with NEA for the sale of 22 MW power to be generated from the project on take or pay basis. The contracted Plant Load Factor (PLF) is 69.24% of its total generation capacity. The PPA

has been entered for a period of 30 years from COD or till the validity of generation license, whichever is earlier. PPA period may be extended with mutual consensus during the last six months of validity.

The project's PPA has been executed under the six-months dry season (December to May) and six-months wet season (June to November) modality. Tariff rate as per PPA is Rs. 4.80 per Kwh for wet season and Rs. 8.4 per Kwh for dry season with 3% annual escalation on base tariff for eight years. It is critical for the company to start the commercial production within the RCOD to have the benefits of all the eight tariff escalations in the base tariff. The escalations would support the project's incremental revenue, return and debt service coverage indicators.

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 2027. Also, with government focus more toward reservoir-based hydropower projects; Monetary Policy FY23 has provided full tax exemption for first 15 years and 50% tax exemption for next 6 years to reservoir and semi-reservoir projects completing financial closure within mid-April 2029 with a capacity higher than 40 MW. As per various directives from NRB, 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

Seti Khola Hydropower Private Limited (SKHPL) is a private limited company, incorporated on July 4, 2016 by a group of individual promoters having long experience in various sectors including hydropower for setting up Hydroelectric Project (HEP) in Nepal for setting up of a 22 MW, run-of-river, Seti Khola Hydropower Project in Pokhara, Kaski district of Nepal. 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. Million)	Ratings
Long Term Bank Facilities	Term Loan	3,789.00	CARE-NP BB
Long Term Bank Facilities (Proposed)	Term Loan	11.00	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	150.00	CARE-NP A4
Total		3,950.00	

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