

Sabha Pokhari Hydropower Private Limited

Rating

Facilities	Amount (Rs. Million)	Rating 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 (Six Hundred Twenty 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 Sabha Pokhari Hydropower Private Limited (SPHPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SPHPL continue to remain constrained by the project implementation risk associated with its under-construction hydropower project. The ratings also factor in the hydrology risk associated with run-of-the river power generation, risk of natural calamities, power evacuation risk and company's exposure to regulatory risk and volatile interest rates. The ratings, however, derive strength from the company's experienced board members and management team, 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

SPHPL is setting up a 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. 882 Mn (Rs. 176 Mn per MW) to be funded in debt-to-equity ratio of 70:30. The total debt amounting to Rs. 617 Mn has been fully tied up. As on April 19, 2023, the company has incurred expenditure of Rs. 704 Mn (financial progress of ~80%). As the project is under construction, the company is exposed to project execution risk in terms of completion of project within the envisaged cost and time. Furthermore, the company also remains exposed to the risks associated with post project implementation and satisfactory operations thereafter to achieve the envisaged revenue.

Required Commercial Operation Date (RCOD) of the project was June 30, 2022 which was extended to December 29, 2022 and the company has applied for further extension to June 30, 2023 citing delays in construction amid the covid19 led disruptions. If approved, the extended RCOD is likely to provide cushion in terms of completing the project within the additional timeframe. If the project is not completed within the RCOD, the company will be liable 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, therefore, critical for the company to complete the project within the timeline to avail the accelerated clauses of tariff. Any delay in the same could impact the project's expected returns and debt servicing capabilities which is critical from credit perspective.

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

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

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 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 and risk of natural calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their 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. These natural calamities can adversely affect the smooth flow of power generation and distribution, which can impact financial returns of the projects. SPHPL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

The Power generated from the project is proposed to be evacuated through 18 kms long 33KV long transmission line from powerhouse to Khandbari Substation at Tumlintar. The transmission line to Khandbari substation is under construction. Earlier, the company had entered into an agreement with Dibyashwari Hydropower Limited (DHL) to evacuate the power generated through its transmission line. However, as the Khandbari substation is operational now, company will be evacuating to Khandbari substation directly. Timely completion of the transmission lines is crucial for the company from revenue generation prospective.

Exposure to volatile interest rate

The company's interest rates are based on 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. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed 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, the 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, Managing Director, 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

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 contracted Plant Load Factor (PLF) is 66.61% of total generation capacity. The PPA has been entered into for a period of 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 tariff escalations in the base tariff are expected to support the project's incremental revenue and return and coverage indicators, provided the project is commissioned within the RCOD.

Favorable government policies towards power sector

Government of Nepal (GoN) considers hydropower generation as a 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 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. Also, increasing trend of cross-border energy trade and its prospect in upcoming days with bilateral agreements with the neighboring nations shows positive outlook on long- term demand for the power 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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