

Salmani Devi Hydropower Limited

Ratings

Facility/Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	517.80	CARE-NP B+ [Single B Plus]	Revised from CARE-NP BB+
Short Term Bank Facilities	25.00	CARE-NP A4 [A Four]	Revised from CARE-NP A4+
Total Facilities	542.80 (Five Hundred Forty Two Million and Eight Hundred Thousand Only)		

* Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has revised the rating to 'CARE-NP B+' from 'CARE-NP BB+' for the long-term bank facilities of Salmani Devi Hydropower Limited (SDHL) and to 'CARE-NP A4' from 'CARE-NP A4+' for the short-term bank facilities of SDHL.

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to SDHL primarily takes into consideration instances of delays in servicing of debt obligations by the company owing to stressed liquidity position of the company. The ratings also factor in its below average financial risk profile marked by net losses, albeit on an improving trend year on year, modest debt service coverage indicators coupled with leveraged capital structure. The ratings continue to factor in hydrology risk associated with run-of-the river power generation, risk of natural calamities, exposure to regulatory risk and volatile interest rates.

The ratings, however, continue to derive strengths from experienced directors and management in various sectors and moderate operating performance of the company. The ratings also factor in presence of Power Purchase Agreement (PPA) with sufficient period coverage and government support for the power sector.

Going forward, the ability the company to successfully reduce the gap between operational PLF and contracted PLF and availability of sufficient hydrology with timely receipt of payments from Nepal Electricity Authority (NEA) will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Instances of delays in the repayment of bank loan obligations

There have been instances of delays in the repayment of bank loan obligations owing to cash flow mismatches amid moderate operating performance. Relatively high cost of project (~Rs. 226 Mn/MW) with higher debt levels has led to higher debt servicing requirement in the initial years of operations, exacerbated further by the spike in interest rates seen across banking sector in FY23. Though company's PLF levels have been improving year-on-year (y-o-y), cash accruals from operations have sometimes been not sufficient to cover the debt servicing on a timely basis. The ability of MEL to generate sufficient cash flow from operations, improve liquidity position leading to timely servicing of the debt obligations will be key monitorable aspect.

Below average financial risk profile

SDHL has been operating a 3.33 MW run-of-the-river Kapadigad Khola Hydropower Project (KKHP) in Doti District, Nepal since June 2019. The annual contracted PLF of the project is 65.01% of the installed capacity of the plant. During FY22 (Audited; FY refers to the twelve-month period ending mid-July), the PLF of the project improved to 88.87% of total

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

contracted capacity (FY21: 78.59%) amid improved hydrology coupled with efficient power evacuation. Furthermore, PLF stood at 88.58% of contracted capacity during 9MFY23 (Unaudited; refers to nine months period ended mid-April). SDHL reported increase in total operating income by ~19% to Rs. 100 Mn through sale of electricity during FY22 aided by improved hydrology. However, PBILDT margin of the company declined to 82.39% during FY22 from 91.49% on account of increase in administrative expenses. Despite increase in revenue, the company reported net loss of Rs. 11 Mn from operation during FY22 due to high depreciation base and interest outgo.

Furthermore, the capital structure of the company stood relatively leveraged with total gearing ratio of 2.58x at the end of FY22 (FY21: 2.53x) on account of decline in tangible net worth amid reported net loss. The interest coverage ratio stood modest at 1.45x during FY22 (FY21: 1.26x). Attributed to high project cost, the debt service coverage indicators expected to remain modest over the near-term.

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. SDHL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

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). KKHP utilizes discharge from Kapadigad Khola having catchment area of 125.33 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 volatile interest rate risk

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.

Key Rating Strengths

Experienced directors and management in various sector

SDHL is managed under overall guidance of the company's Board of Directors (BoD), who possesses wide experience in power sector as well as other industries. SDHL has three Board of directors, chaired by Ms. Uma Dahal, who has more than 25 years of experience in hydropower, health, education and finance sector. The company's management team is led by Mr. Peras Dahal, who has more than a decade of experience in different sectors. The BOD is further supported by other experienced management team members.

Power purchase agreement with sufficient period coverage and moderate counter party risk

SDHL entered into PPA with NEA on March 25, 2013 for sale of 3.33 MW power generated by the plant. The period of the PPA is 30 years from commercial operation date (COD) or till validity of Generation License (obtained on December 30, 2013 for 35 years), whichever is earlier. The tariff for wet season (Mid-April to Mid-December) is Rs. 4.80 per kWh and for dry season (Mid- December to Mid-April) is Rs 8.40 per kWh with 3% escalation on base tariff for 5 times in every year after completion of 12 months from COD date. NEA is owned by Government of Nepal and hence counter party default risk is low; however, timely realization of receivables is critical for the company and remains a key monitorable.

Favourable 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.

About the Company

Salmani Devi Hydropower Limited (SDHL) is a public limited company, incorporated in August 2, 2009 as private limited company and converted into public limited company on July 13, 2022. The company was promoted with an objective to setup a run-of-river Hydroelectric Project (HEP) of 3.33 MW in Doti district of Nepal. The commercial operation of the same started in June 2019. The project has been constructed under "BOOT" (Build, Own, Operate and transfer) model.

Financial Performance

(Rs. Million)

For the Period	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	67	84	100
PBILDT Margin (%)	75.66	91.49	82.39
Overall Gearing (times)	2.34	2.53	2.58
Interest Coverage (times)	0.84	1.26	1.45
Current Ratio (times)	0.99	1.00	1.01
Total Debt/Gross Cash Accruals (times)	(53.28)	33.20	21.89

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	517.80	CARE-NP B+ [Single B Plus]
Short Term Bank Facilities	Fund Based Limits	25.00	CARE-NP A4 [A Four]
Total		542.80	

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