

## Makar Jitumaya Suri Hydropower Limited

### Ratings

Facility/Instrument#	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
<b>Issuer Rating*</b>	<b>NA</b>	<b>CARE-NP BB+ (Is) [Double B Plus Issuer Rating]</b>	<b>Revised from CARE-NP BB (Is)</b>
<b>Long Term Bank Facilities</b>	<b>1,685.00</b>	<b>CARE-NP BB+ [Double B Plus]</b>	<b>Revised from CARE-NP BB</b>
<b>Total Facilities</b>	<b>1,685.00 (One Billion Six Hundred Eighty-Five Million only)</b>		

\*The issuer rating is subject to overall gearing ratio of the company not exceeding 2.25x at the end of FY24 (FY refers to the twelve-month period ending mid-July).

# Details of instruments/facilities in Annexure 1

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

Also, CRNL has revised the rating assigned to long term bank facilities of MAKAR to 'CARE-NP BB+' from 'CARE-NP BB'.

### Detailed Rationale & Key Rating Drivers

The revision of ratings assigned to MAKAR factors in the satisfactory operational performance of Suri Khola Hydropower Project (SKHP) marked by sustained power generation since its commissioning on May 1, 2022 coupled with satisfactory construction progress of its under-construction Upper Suri Khola Hydropower Project (USKHP) during the review period. The ratings also factor in successful completion of IPO of Rs. 228 Mn by MAKAR in April 2023, the proceeds of which were utilized for construction of USKHP as earlier envisaged. Also, the ratings continue to derive strength from MAKAR's strong parentage and experienced management team, presence of power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and government support for the power sector. The ratings also take cognizance of lower power evacuation risk for both the projects, however, stabilization of power evacuation after USKHP comes into operations for an extended timeframe remains to be seen as the present evacuation route is relatively cramped. The ratings, however, remains constrained by project implementation risk and stabilization risk associated with USKHP, hydrology risk associated with run-of-the-river power generation, risk of natural calamities, exposure to volatile interest rate risk and regulatory risk.

*Going forward, the ability of the company to successfully execute USKHP within envisaged cost and time and early stabilization thereafter will be the key rating sensitivities. Also, the ability of the company to reduce the gap between operational PLF and contracted PLF on sustained basis and availability of sufficient hydrology with timely receipt of payments from Nepal Electricity Authority (NEA) will also be the key rating sensitivities.*

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

## Detailed description of the key rating drivers

### Key Rating Weaknesses

#### Project implementation risk of Upper Suri Khola Hydropower Project

The company is setting up a 7 MW USKHP. The RCOD of USKHP is April 11, 2024 with estimated cost of Rs. 1,295 Mn (i.e., Rs. 185 Mn per MW) which is proposed to be financed in the debt equity ratio of 70: 30. Total debt component of the proposed funding amounting to Rs. 906 Mn is fully tied up. As on May 08, 2023, ~89% of the total project cost had been incurred. As per the management, USKHP has already achieved ~95% physical progress till mid-August 2023 and expects USKHP to come into operations before RCOD (Required Commercial Operation Date) by December end 2023. This augurs favorably for MAKAR's revenue profile and support debt coverage indicators going forward.

#### 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). 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.

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

#### Exposure to regulatory risk

Government of Nepal (GoN) has 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

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

### Strong parentage and experienced management team

MAKAR has four members in its Board of Directors, chaired by Mr. Himal Gurung, who has more than 17 years of experience in hydropower and construction sector. He is associated with a number of hydropower companies. The board is supported by experienced professionals. Dolma Impact Fund (DIF), which has invested Rs. 261 Mn equity (34.29% shareholding) in MAKAR, is an institutional investor and is the first commercial impact fund setup in Nepal for providing growth capital to Small and Medium Enterprises (SMEs) with strong entrepreneurial and management capacities.

### Satisfactory operating performance of Suri Khola Hydropower Project

SKHP commenced commercial operations from May 1, 2022. During the first fifteen months of its operations (May 01, 2022 to mid-July 2023), the project's Plant Load Factor (PLF) was satisfactory at around 92% of contracted energy. The power generation was moderated slightly during four months (wet season) on account of maintenance activities. Nonetheless, the financial performance of the company has been satisfactory with operating income through sale of electricity of Rs. 164 Mn during FY23 (FY22: Rs. 25 Mn). However, the company reported net loss of Rs. 6 Mn with gross cash accruals of Rs. 38 Mn in FY23 (FY22: Rs. 32 Mn and Rs 124 Mn, respectively) on account of high interest expenses. The energy generation in dry months has been relatively better during FY23, which bodes well for the revenue profile of the company as tariff rates during dry season are higher than wet season. Sustained power generation coupled with annual escalations on tariff rate is likely to improve operational cash flows from the project in upcoming years.

### 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 and 7 MW power to be generated from SKHP and USKHP. The contracted PLF for 6.4 MW and 7 MW is 58.59% and 66.92% with total contracted energy of 32.85 MU and 41.03 MU. 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. It is crucial for the company to complete USKHP within the timelines to have the accelerated clauses of tariff. Any delay in the same would lead to impact on project returns and debt servicing capabilities which is critical from analytical perspective.

Following eight-months of wet and four-month of dry season, the total contracted energy of the project is 32.85 MU (SKHP) and 41.03 MU (USKHP) with relatively lower dry energy mix of ~24% of the total contracted energy for both the projects which remains a constraint for company's income profile.

### Lower 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 33 KV Transmission Line to the Singati Substation. Furthermore, power is evacuated through 132 KV Transmission line from Singati to Lamosangu. However, there are expectations of overload in the existing power route which might lead to tripping issues and the company is in the process of installation of new transformer for USKHP. However, smooth power evacuation for a reasonable period after USKHP comes into operations remains to be seen and will remain crucial for the company from revenue generation prospective.

### Favorable Government policies towards power sector

Government of Nepal (GoN) considers power generation as priority sector and intends to maximize private sector participation in generation of electricity by offering different exemptions and facilities on power sector. 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. 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. Also, increasing trend of cross-border energy trade and its growing prospect in upcoming days supported by new bilateral agreements between Nepal and India for additional export of power to India from Nepal augurs well for the long-term demand prospect for the power sector in Nepal.

### About the Company

Makar Jitumaya Suri Hydropower Limited" (MAKAR) 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.

### Financial Performance

For the year ended Mid-July	FY22	FY23
	(Audited)	(Provisional)
Income from Operations	25	164
PBILD Margin (%)	49.59	89.36
Overall Gearing (times)	2.53	2.48
Interest Coverage (times)	0.60	1.35
Current Ratio (times)	0.51	2.69

### 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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