Singati Hydro Energy Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) (Double B [Issuer Rating])	Reaffirmed
Long Term Bank Facilities	4,414.76	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	250.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	4,664.76 (Four Billion Six Hundred Sixty-Four Million and Seven Hundred Sixty Thousand Only)		

**The issuer rating is subject to total debt of the company not exceeding Rs. 4,665 Mn at the end of FY24.*
Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB (Is)' assigned to Singati Hydro Energy Limited (SHEL). Issuers with this rating are considered to offer 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 bank facilities and 'CARE-NP A4' assigned to the short term bank facilities of SHEL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to SHEL remain constrained by the relatively high cost of its majorly debt funded project leading to leveraged capital structure and suppressed debt service coverage indicators in the initial years of commercial operations owing to high interest expense. The ratings also factor in hydrology risk associated with run-of-the-river power generation, exposure to regulatory risk, volatile interest rate risk and risk of natural calamities.

The ratings, however, derive strength from experienced promoters/directors and management team, presence of power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk, and favorable government policy towards power sector. The ratings factor in SHEL's satisfactory operational performance in the early years of operations, sustenance of which remains imperative from credit perspective in coming years. The ratings also take cognizance of proposed rights share issuance by the company, expected to completed by FY24 end (FY refers to the twelve-month period ending mid-July), and likely improvement in the financial risk profile of the company post partial prepayment of the term loans from the proceeds.

Going forward, the ability of the company to profitably operate at contracted Plant Load Factor (PLF) levels leading to cash accruals as envisaged, timely issuance of the rights shares as envisaged, availability of sufficient hydrology during both dry and wet seasons and 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

Elevated debt service burden in initial years of operations owing to high project cost

During the development of Singati Khola Hydropower Project (SKHP), SHEL had undergone multiple revisions in the project cost resulting in the final cost of Rs. 6,131 Mn which was financed by debt to equity mix of 76.35:23.65. The project cost had increased multiple times due to delay in execution of project leading to increase in interest during construction (IDC) coupled with increase in other management expenses on account of the delay. Considering the project is highly debt funded, the project cost of around Rs. 245 Mn per Megawatt (MW) is relatively high compared to similar projects, which has resulted in elevated debt servicing requirements in the initial years of operations owing to higher interest outgo, exacerbated further by the relatively higher interest

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

rates currently prevailed in the market. The company's ability to adequately service its debt obligations will therefore hinge on its ability to generate sufficient cash flow from operations.

As on mid-July 2023, SHEL's overall gearing stood high at 3.73 times, majorly due to net losses transferred to reserves which eroded the company's tangible net worth. Despite satisfactory operational performance, the company incurred net loss of Rs. 155 Mn in FY23 on account of high interest outgo. Interest coverage ratio decreased from 1.40 times in FY22 to 1.10 times in FY23 and total debt to gross cash accruals increased substantially from 30.12 times in FY22 to 99.06 times in FY23. The ability of the company to improve its net profitability with better debt service coverage indicators is critical from credit perspective. Furthermore, the company is in process of issuing 1:1 rights share amounting Rs. 1,450 Mn, expected to be concluded by FY24 end. Part of the proceeds are proposed to be used for term loan prepayment. Timely completion of the issuance and prepayment leading to improvement in SHEL's capital structure as envisaged will also remain key monitorable.

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 summer season when seasonal river flows are high (Mid-April to Mid-December) and less during the winter season (Mid-December to Mid-April). SHEL is proposed to utilize discharge from Singati Khola which is a perennial river having catchment area of 195 sq km with the design discharge of 10.88 m^3/s at Q_{40} exceedance flow and available gross head of 268m. Hence, any variation in discharge of water might impact the energy generation of project which is of key importance for the company from the revenue generation perspective.

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

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. 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.

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.

Key Rating Strengths

Experienced promoter/directors and management team

SHEL is managed under the overall guidance of its seven-member Board of Directors (BoD) which includes experienced businessmen with long experience in various sectors. Mr. Batu Lamichhane, an experienced promoter of SHEL has been involved in hydropower and construction sector for more than 20 years. Other promoters and directors also have long experience in various sectors ranging from hydropower, construction, tourism, etc. Furthermore, the board is supported by an experienced team in the related field.

Satisfactory operational performance

SHEL started commercial production in July 31, 2021 and has operated at an average PLF of around 95% of contracted capacity. During FY23, the plant was operated at 55.93% of its generation capacity with total energy generated against contracted PLF of 89.06%. The slightly lower PLF during FY23 was mainly on account of lesser hydrology with FY23 being a relatively dry year compared to FY22. Total Operating Income of the company remained steady at ~646 Mn over FY22-FY23 with positive cash accruals despite high interest burden. The company's ability to sustain its operational PLF close to the contracted levels is critical from revenue generation perspective and consequently on its ability to service financial obligations on a timely manner.

Power purchase agreement with sufficient period coverage

Initially, SHEL had signed PPA with NEA on November 13, 2013 for sale of power generated from 16MW capacity. Later, the project capacity was increased to 25MW and PPA has been amended on December 14, 2017 for additional capacity. The contracted Plant Load Factor (PLF) for 25 MW is 60.55% with the contracted energy of 132.61 Million Units (MU) annually. PPA has been entered for the period of 30 years from the COD or till validity of generation license whichever is earlier. The differential tariff rate ranges from Rs 4.80 per to Rs 8.40 per kWh with 3% annual escalation on base tariff for 5 years in case of 16MW and 8 years in additional 9MW. The company has signed PPA with NEA is owned by Government of Nepal and hence counter party default risk is low; however, timely realization of the same is critical for the company and from analytical perspective also.

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 the 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 2026. 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 augurs well for the sector.

About the Company

SHEL was initially incorporated as a private limited company on May 19, 2010, and later converted to a public limited company on June 20, 2018. It is promoted by various institutional and individual promoters from different backgrounds for setting up of a 25 MW run-of-river, Singati Khola Hydropower Project (SKHP) in Dolakha district of Nepal. The project is one of the 'super six' hydro power projects of Nepal. This project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

Brief financial performance of SHEL is shown as follows:

Particulars	FY 22 (Audited)	FY23 (Unaudited)
Income from Operations	647	646
PBILDT Margin (%)	87.58	86.19
Overall Gearing (times)	3.35	3.73
Interest coverage (times)	1.38	1.09
Total Debt/Gross Cash Accruals (times)	30.12	99.06

Annexure-1: Details of Instruments/Facilities

Name of the instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	4,414.76	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	250.00	CARE-NP A4
Total Facilities		**4,664.76**	

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About CARE Ratings:

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