

United Idi Mardi & R.B. Hydropower Limited

Ratings

| Facilities | Amount (Rs. Million) | Rating ¹ | Rating Action |
|-----------------------------------|--|---|-------------------|
| Issuer Rating | NA | CARE NP BB+ (Is) [Double B Plus (Issuer Rating)] | Reaffirmed |
| Long Term Bank Facilities | 989.96 (Decreased from Rs. 1,025.78 Mn) | CARE NP BB+ [Double B Plus] | Reaffirmed |
| Short Term Bank Facilities | 150.82 (Increased Rs. 115.00 Mn) | CARE-NP A4+ [A Four Plus] | Reaffirmed |
| Total Facilities | 1,140.78 (One Thousand One Hundred Forty Million and Seventy-Eight Thousand Only) | | |

**The issuer rating is subject to overall gearing ratio of the company not exceeding 2.50x at the end of FY22.*

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of 'CARE-NP BB+' to long term bank facilities and 'CARE-NP A4+' to the short-term bank facilities of United Idi Mardi & R.B. Hydropower Limited (UMHL).

Also, CRNL has reaffirmed Issuer rating of 'CARE-NP BB+ (Is) [Double B Plus (Issuer Rating)]' to UMHL. Issuers with this rating is considered to have moderate degree of safety regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the UMHL continues to be constrained by hydrology risk associated with run-of-the-river power generation and exposure to regulatory risk and volatile interest risk. Further, the ratings also factor in subdued operating performance during FY21 (FY refer 12 months ending on July15, 2021).

The ratings, however, derive strength from experienced board members/ management team and associated with the group having multiple hydropower projects, moderate financial risk profile, presence of power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The ratings also factor in current demand & supply gap however possible oversupply in future and government support for the power sector.

Going forward, the ability of the company to reduce the gap between operational and contracted plant load factor (PLF) along with the timely receipt of payments from Nepal Electricity Authority (NEA) are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Subdued operating performance

UMHL has commissioned run-of-the-river 7MW Upper Mardi Hydropower Project (UMHP) and the commercial operation date of the project was in October 2019. During the 9 months operations in FY20, the plant was operated at Plant Load Factor (PLF) of 41.25% which decreased to 39.65% during FY21. The operating performance in terms of power generation was low due to less hydrology throughout the period. Also, during Mid-July to Mid-August 2020, the plant was not operating due to flood thereby, affecting the operational efficiency.

The annual contracted PLF for UMHP is 58.51% of the installed capacity of the plant. For the year ended, the energy generated was 85.84% during 9MFY20 and 67.93% in FY21 against contracted PLF. It is critical for the company to reduce the gap between operational PLF and contracted PLF for having the stable revenue profile.

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

Exposure to volatile interest rate

Nepalese banking sectors are fixing floating interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions will be change by change in liquidity position which lead to change in interest rate. Interest rate has been changing frequently in Nepal market in the last couple of years. Therefore, funding from Bank and Financial Institutions are exposed to volatile interest rate.

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-Dec to Mid-April). UIMHL is proposed to utilize discharge from Mardi Khola having catchment area of 40 sq kms with the design discharge of 2.60 M3/S at Q40 exceedance flow and available gross head of 335m. Mardi Khola is a perennial river and is one of the tributaries of Seti river which is one of the major tributaries of Sapta Gandaki River. Also, the project has faced challenges in having sufficient hydrology which led to lower energy generation during FY21 and thus, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

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.

Key Rating Strength**Associated with the group having multiple hydropower projects and experienced board members/ management team**

UIMHL is part of KC Group of companies which is one of the leading organizational groups in Nepal. The promoters of KC group of companies have made their investments in diversified sectors like hydropower projects, construction, hospitality and housing, manufacturing, educational institutions, banking and insurance. This provides comfort to the company in terms of technical and operational assistance. UIMHL has total 6 board members. Mr. Prakash K.C, executive chairperson, has more than 38 years of experience in Hydropower, Banking and Construction industries. Mr. Roshan K.C, managing director, is director at Machhapuchchhre Bank Ltd., and other operational and under-construction hydropower companies. He is supported by other experienced management team.

Moderate financial risk profile of the company

UIMHL is generating revenue by selling power generated through its 7MW run-of-river, Upper Mardi Khola Hydropower Project. The company reported increase in total operating income by around 28% to Rs. 135 Mn in FY21 (Unaudited; FY21 refer to 12 months ending on Mid-July 2021) from Rs. 105 Mn in FY20. The increase in revenue during FY21 was on account of full year operation of the plant.

PBILDT margin declined to 79% during FY21 from 83% in FY20 due to increase in administration expenses on account of full year of operation of the plant. The company had non-operational income amounting to Rs. 36.12 Mn in FY21 on account of insurance claim for the loss of revenue due to floods. On account of better management of borrowings and decline in interest rate coupled with reduction in debt levels has favorably supported the interest expenses which reduced by Rs. 14 Mn in FY21 over last year.

Overall gearing ratio stood at 2.38x at the end of FY21 (FY20: 4.19x) on the back of increase in networth of the company due to issue of Initial Public Offering (IPO). Also, the prepayment of the term loan and working capital loan of Rs. 105 Mn from the IPO proceeds led to improvement in overall gearing ratio. Apart from overall gearing, other coverage indicators including total debt to GCA and Interest coverage ratios also improved and stood at 16.16x and 1.32x for FY21 respectively (PY: -ve and 0.92x respectively).

Power purchase agreement with sufficient period coverage

UIMHL had entered into PPA with Nepal Electricity Authority (NEA) for 7MW as on June 7, 2016 for sale of entire power generated from the project. The PPA is signed for a period of 30 years from the COD or till validity of generation license whichever is earlier. RCOD of the project was mid-July 2020, however the project was completed 9 months before RCOD and hence, the company will be eligible for all the five escalations of 3% on base tariff. The tariff rate 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 years.

Current demand & Supply gap however possible oversupply in future along with moderate counter party risk

As per the NEA's Annual Report for FY21, the current peak electricity demand is 1,482MW. The total domestic installed capacity stands at 1,447 MW which includes 632 MW owned by NEA and 815 MW by private sector IPPs. Overall, during FY21, total energy demand was 8,960 GWh which was met by import of 2,806 GWh from India whereas balance was met by domestic generation. However, considering under construction projects which are expected to generate electricity in next 2-3 years and electricity demand which has not increased substantially in past few years could create a situation of oversupply in near future in wet season, requiring demand side management.

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 critical for the company and from analytical perspective also.

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 2024. 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

United Idi- Mardi and R.B Hydropower Ltd (UIMHL) was initially incorporated as a private limited company as on March 1, 2010 and later on, it was converted to a public limited company as on April 17, 2018. It is promoted for setting up of a 7MW run-of-river, UMHP in Kaski district of Nepal. The projects is constructed under BOOT model (Build, Own, Operate and Transfer).

Financial Performance

(Rs. in Mn)

| Particulars | FY20 | FY21 |
|--|---------|---------|
| | Audited | Audited |
| Income from Operations | 105 | 135 |
| PBILDT Margin (%) | 82.63 | 79.16 |
| Overall Gearing (times) | 4.19 | 2.38 |
| Interest coverage (times) | 0.92 | 1.32 |
| Current Ratio (times) | 0.94 | 1.02 |
| Total Debt/Gross Cash Accruals (times) | -ve | 16.16 |

Annexure-1: Details of Instruments/Facilities

| Name of the Instrument | Type of the Facility | Amount (Rs. Million) | Rating |
|----------------------------|----------------------|----------------------|-------------|
| Long Term Bank Facilities | Term Loan | 989.96 | CARE-NP BB+ |
| Short Term Bank Facilities | Overdraft | 25.00 | CARE-NP A4+ |
| Short Term Bank Facilities | Proposed | 125.82 | CARE-NP A4+ |
| Total Facilities | | 1,140.78 | |

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