

Ingwa Hydropower Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B Issuer]	Reaffirmed

* The issuer rating is subject to overall gearing ratio of the company not exceeding 3.00x at the end of FY23.

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB (Is)' assigned to Ingwa Hydropower Limited (IHL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to IHL continues to be constrained by the project implementation risk and stabilization risk thereafter associated with its under construction hydro project, hydrology risk associated with run-of-the-river power generation, exposure to regulatory risk and volatile interest rates. The rating, however, continues to derive strengths from the experienced management team, presence of power purchase agreement (PPA) with sufficient period coverage, and low power evacuation risk. The rating also factors moderate counter party risk and government support for the power sector. *Going forward, the ability the company to successfully execute the project within its estimated 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 and stabilization risk

IHL is setting up a 9.70 MW Ingwa Khola Hydropower project in Panchthar district of Nepal. The total cost of the project is estimated at Rs. 1,950 Mn (Rs. 201.03 Mn per MW), which is proposed to be funded by debt to equity in the ratio of 75:25. The debt component of the project has been fully tied up.

As on mid-August 2022, the company had achieved physical progress of 71%. Required Commercial Operation Date (RCOD) of the project is May 15, 2023 (earlier May 15, 2022). This exposes the company towards project execution risk in terms of completion of the project within the envisaged time and cost. If the project is not completed within the mentioned RCOD, then the company is required to pay delay penalty. Furthermore, if COD is delayed by 6 months to 18 months from RCOD, there are restriction clauses in escalation of tariff rate. It is crucial for the company to complete the project 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.

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). IHL is proposed to utilize discharge from Ingwa Khola, a tributary of Kabela River,

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

having catchment area of 202 sq kms with 6.21 m³/s design discharge at 45.67% exceedance flow, based on Perennial River. Hence, 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.

Exposure to volatile interest rate risk

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. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy, with substantial upward pressure on interest rates in the last few quarters. A contractionary monetary policy for FY23 coupled with increasing inflation has only added to the upward pressure on interest rates, resulting in the rate hikes taken by BFIs in the first quarter of FY23. Any further significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Key Rating Strengths

Experienced management team in hydropower sector with strong institutional promoter group

IHL is managed under the overall guidance of the company's Board of Directors (BoD), who possesses wide experience in the various sector including hydropower projects. The board is chaired by Mr. Satish Neupane who has more than 15 years of experiences and he is also the currently Chairman at API Power Company Ltd. [CARE-NP B+ (Is)] and a director of Arun Valley Hydropower Development Company Ltd. [CARE-NP BBB- (Is)]. He is supported by other experienced directors namely Mr. Guru Prasad Neupane and Mr. Sanjeev Neupane along with a team of experienced management personnel.

IHL is promoted by institutional promoters mainly API (~27.09%), and Arun Kabeli Power Limited (~17.25%). The institutional promoters. Being backed by the institutional promoters, the company anticipates steady investment and knowhow for the construction and operation of hydropower project.

Power Purchase agreement with sufficient period of coverage

IHL had entered into a long term PPA with Nepal Electricity Authority (NEA) as on July 24, 2011 for sale of 9.70 MW power to be generated from the project. The period of the PPA is 30 years from the date of COD or till validity of Generation License, whichever is earlier. PPA period may be extended with mutual consensus during the last six months of validity. 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 years.

The contracted energy for the project is 65.73 million units at PLF of 77.36%. The required commercial operation (RCOD) of the project is mid-May 2022. The company is in the process of extension of RCOD. If COD doesn't fall within RCOD, the company is bound to pay penalty to NEA as per PPA. Further, number of escalations in tariff rate will be reduced if there is delay in COD of the project than RCOD by more than 6 months.

Lower Power evacuation risk

The power generated from the project is proposed to be evacuated through ~16 km double circuit 33 KVA distribution line to the NEA's Kabeli substation located in Kabeli, Taplejung district which is in operation. Therefore, there is no major power evacuation risk except the construction of transmission line from the powerhouse to the NEA substation, which is under the scope of the company.

Favorable Government policies towards power sector

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

Ingwa Hydropower Limited (IHL) was incorporated on June 23, 2009 as Private Limited Company, which was later converted in Public Limited Company on August 25, 2014. The company has been promoted by institutional promoters and individual businessmen of Nepal for setting up of a 9.70 MW run-of-river, Ingwa Khola hydroelectric project (IHL) in Panchthar district of Nepal. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

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