

## Arun Valley Hydropower Development Company Limited

### Ratings

Facilities	Amount (Rs. Million)	Rating <sup>1</sup>	Rating Action
<b>Issuer Rating</b>	<b>NA</b>	<b>CARE-NP BBB- (Is) [Triple B Minus (Issuer)] (Credit watch with negative implications)</b>	<b>Reaffirmed and placed on credit watch with negative implications</b>

*\* The issuer rating is subject to overall gearing ratio of the company not exceeding 1.00x at the end of FY24 (FY refers to the twelve-month period ending mid-July).*

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BBB- (Is) [Triple B Minus (Issuer)]' assigned to Arun Valley Hydropower Development Company Limited (AHPC) and placed the rating on credit watch with negative implications. Issuers with this rating are considered to offer moderate degree of safety regarding timely servicing of financial obligations, in Nepal.

### Detailed Rationale & Key Rating Drivers

The issuer rating assigned to AHPC has been placed on credit watch with negative implications factoring in significant downtime of its 9.94 MW Kabeli B-1 Cascade Hydroelectric Project (KBHEP) due to flood that occurred on June 17, 2023. AHPC's operating performance for FY24 is expected to be significantly impacted by the same as the project is yet to resume operations. However, insurance coverage for damage of property and loss of profit (LOP) coverage for three months coupled with adequate cash reserve including liquid investments provides liquidity cushion to AHPC over the near-term. Nevertheless, longer than expected downtime of the project could lead to substantial loss of income for the company limiting its ability to service scheduled debt repayments in a timely manner going forward. CRNL will resolve the credit watch once clarity emerges on the extent and scope of the impact of the damages by flood and its impact on AHPC's financial risk profile coupled with the stabilization of operations of the company.

The rating continues to derive strength from experienced promoter/directors and management team and AHPC being part of a group with multiple hydropower projects being developed through associate companies, presence of power purchase agreement (PPA) with sufficient period coverage and moderate financial profile during FY23. The rating also factors in moderate counter party risk and government support for the power sector.

The rating, however, continues to be constrained by AHPC's exposure to its group companies, capital commitments and long gestation period related to investments in under construction hydropower project, hydrology risk associated with run-of-the-river power generation, exposure of the company to volatile interest rate risk and risk of natural calamities.

*Going forward, the ability the company to successfully resume operations of its hydropower project with satisfactory Plant Load Factor (PLF) will be the key rating sensitivities. Furthermore, any substantial increase in exposure to group associates or any substantial capital commitment that could lead to material deterioration in the company's capital structure from current levels will also be key rating sensitivities.*

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

## Detailed Description of the Key Rating Drivers

### Key Rating Strengths

#### **Experienced promoter/directors and management team with multiple hydropower projects being developed through associate companies**

AHPC has been involved in operation and construction of hydropower projects by itself and through associate companies. Currently, AHPC and its associate companies have 140.74 MW operational power projects which include 3MW PKHEP and 9.94 MW KBHEP developed by AHPC itself and remaining through associate companies. This provides a comfort to the company in terms of construction, operation and technical assistance. AHPC is managed under the overall guidance of the company's Board of Directors (BoD), who possesses wide experience in the Power sector. Mr. Jeevan Raj, Chairman has around a decade of experience in hydro power sector. Mr. Ramesh Prasad Neupane, Managing Director, has more than two decades of experience in hydropower sector and he is supported by other experienced management team members.

### Moderate financial profile

AHPC generates revenue by the selling of power generated through its 3 MW PKHEP at Sankhuwasabha District and 9.94 MW KBHEP at Taplejung district. KBHEP came in commercial operation in March 2022. The company reported increase in total operating income (TOI) by around 89% y-o-y to Rs. 263 Mn during FY23 (FY22: Rs. 139 Mn) on account of full year of operation of 9.94 MW KBHEP which operated only for 3.5 months during FY22, although operational performance of the plant remained subdued on account of flood at plant site as on Mid-June, 2023.

PBILDT in absolute amount increased to Rs. 202 Mn during FY23 (FY22: Rs. 103 Mn). As a result of subdued operational performance along with full year depreciation and interest cost related to 9.94 MW KBHEP post commercial operation during FY23, there was operational loss of Rs. 69 Mn during FY23 as compared to operational profit of Rs. 27 Mn. However, the company had gain on sale of shares amounting to Rs. 137 Mn during FY23 which resulted into Profit after Tax (PAT) of Rs. 51 Mn (FY22: Rs. 85 Mn) despite operational losses.

Capital structure remains comfortable with overall gearing ratio which stood at 0.77x at the end of FY23. Overall gearing ratio however deteriorated from 0.64x at the end of FY22 on account of additional loan undertaken by the company during FY23 for investment purposes. The total repayment of the debt incurred for construction of 3 MW PKHEP has already been made by the company. The free cash generation from the PKHEP thus provide cushion for the debt repayment of KBHEP. Apart from overall gearing, other coverage indicators including total debt to GCA and Interest coverage ratios stood at 10.48x and 1.11x for FY23 respectively (PY: 9.99x and 2.55x respectively).

The company has insurance coverage for both property and loss of profit (LOP) coverage of 3 months. Lower coverage regarding LOP is likely to result into material revenue loss for the company during FY24. However, the company's liquid investments in listed shares amounting to Rs. 494 Mn as on November end, 2023 provides some liquidity cushion for meeting cash outflow for repair and maintenances and debt service obligations over the near-term.

### Power purchase agreement with sufficient period coverage

Developed under the BOOT (Built, Own, Operate and Transfer) mechanism, Puluwa Khola Small Hydroelectric Project (PKHEP) and Kabeli B-1 Cascade Hydroelectric Project (KBHEP) are owned by AHPC, holding a 35-year Generation License from Ministry of Energy, Government of Nepal. The projects operate under Power Purchase Agreements (PPAs) with the Nepal Electricity Authority (NEA). Additionally, the counterparty payment risk associated with NEA is deemed moderate, given its full ownership by the Government of Nepal. AHPC entered into a PPA with NEA for a period of 25 years for PKHEP and 30 years for KBHEP from the Commercial Operation Date (COD) or until the validity of the Generation License, whichever occurs earlier. The projects feature differential tariff rate ranging from Rs. 3.90 to Rs. 8.40 per kWh, providing financial stability and sustainable revenue generation subject to dependence on the flow of river water for power generation. Power evacuation of PKHEP is done through NEA 220 kv transmission line along Koshi corridor and KBHEP is done through 132 kv transmission line to Amarapur Subststaion.

**Favorable Government policies and industry outlook**

The Government of Nepal (GoN) has featured the significance of power generation as a priority sector and encouraging private sector involvement by providing various exemptions within the power generation sector. GoN has also announced a comprehensive tax incentive package, offering full tax exemption for the initial 10 years and a 50% tax exemption for the subsequent 5 years to individuals or entities engaged in the commercial operation, transmission, and distribution of electricity until mid-April 2027. This approach is aimed at promoting investment and growth in the energy sector. Furthermore, directives from the Nepal Rastra Bank (NRB) mandate financial institutions regulated by NRB to allocate a minimum share of their total advances to the energy sector. This strategic initiative is expected to contribute to the financial support and development of projects within the energy sector which argues well for the sector.

The increasing trend of cross-border energy trade, coupled with the growing prospects stemming from new bilateral agreements between Nepal and India for additional power export from Nepal to India, further boosts the long-term demand outlook for the power sector in Nepal.

**Key Rating Weaknesses****Exposure to group companies, capital commitments and long gestation period related to investments in under construction hydropower project**

As on July 16, 2023, the company has investments in group companies (mainly hydro power generation companies) to the tune of Rs. 487 Mn (FY22: Rs. 253 Mn). The company also has certain contingent liabilities pertaining to group companies in the form of corporate guarantees provided on their behalf to the tune of Rs. 1,277 Mn as on mid-July 2023. Total exposure to group (including corporate guarantees) aggregated is Rs. 1,764 Mn equivalent to ~92% of its net worth. The adjusted overall gearing (net of investments, loans & advances to subsidiaries from net worth and addition of corporate guarantee) remained high at 1.91x as on mid-July 2023. Furthermore, AHPC has capital commitments to the tune of 1,000 Mn for 30 MW Likhu Khola Hydropower Project (LKHP).

Pike Hydropower Limited (PHL) is setting up 30 MW LKHP, the total estimated cost of construction for which is Rs. 6,582 Mn (i.e Rs. 219 Mn per MW) proposed to be financed in debt equity mix of 70: 30 (Debt amount of Rs. 4,608 Mn and equity of Rs. 1,974 Mn). AHPC has invested Rs. 275 Mn as on Mid-July, 2023 and rest of the equity commitments is to be financed through proposed right issue. Any substantial cost overrun in under-construction projects could require additional investments from AHPC, which is not uncommon for hydro projects in Nepal given the challenging geology. It could have adverse impact on future liquidity prospects and financial risk profile of the company. Thus, any additional commitments to the group or associates would also be key monitorable. Furthermore, any major regulatory changes related to investment companies which may impact the financial risk profile of the company will remain concern from analytical perspective.

**Subdued operational performance likely in FY24 owing to flood at plant sites**

During FY23, the operating performance of PKHEP remain subdued. The energy generation of PKHEP decreased to 79% of contracted capacity (92% of contracted capacity during FY22) on account of plant shut down as a result of flood at site dated June 17, 2023 resulting slight damage of project assets. The plant remained shut down for almost 1.5 months and resumed operations from August 30, 2023. For 9.94 MW KBHEP, flood at site dated June 15, 2023 resulted into plant shut down, which has limited the power generation to 67% of contracted energy during FY23 (78% during FY22). The power generation for KBHEP have been below 80% of contracted energy since commencing operations owing to low project head, thus subjecting project to short supply penalty. The plant is expected to resume operations by mid-January 2024. Timely resumption of the project leading to sustained cash generation from operations as envisaged will remain critical from analytical and revenue generation perspective.

### Hydrology risk associated with run-of-the-river power generation

Run-of-the-river power is considered to be 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 times when seasonal river flows are high and much less during the drier months. AHPC is generating electricity from discharge of Piluwa River at PKHEP and proposed to utilize water discharge from tailrace of Kabeli B-1 HEP from Kabeli River at KBHEP, which are snow fed streams, comprising of mountainous terrain. Hence, any variation in discharge of water and lower generation of HEP might impact the energy generation of projects which is of key importance for the company from the revenue generation perspective.

### 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.

### 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. AHPC is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project. One of the plants (KBHEP) is not in operation currently on account of flood at plant side. Revenue loss from shut down of plant coupled with low insurance coverage of LOP of only 3 months is likely to result into material revenue loss during FY24.

### About the Company

Arun Valley Hydropower Development Company Limited (AHPC) is a public limited company established in March 12, 1998 as a private limited company and later converted to public limited company as on August, 2005. It is promoted by business persons having long experience in the hydropower and other sectors for setting up Hydroelectric Project (HEP) in the territory of Nepal. AHPC has two run of the river hydropower projects namely 3.00 MW operational Piluwa Khola Small Hydroelectric Project (PKHEP) and 9.94 MW Kabeli B-1 Cascade Hydroelectric Project (KBHEP). The projects are constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Brief financial performance of AHPC during last 3 years is given below:

(Rs. In Million)

Particulars	FY21 (A)	FY22 (A)	FY23 (A)
Income from power sales	53	139	263
PBILDT Margin (%)	62.07	74.23	76.83
Overall Gearing (times)	0.31	0.64	0.77
Interest coverage (times)	43.11	2.55	1.11
Total Debt / Gross Cash Accruals (times)	6.56	9.99	10.48

A: Audited

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