

## 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 BB- (Is) [Double B Minus Issuer] (Credit watch with negative implications)</b>	<b>Revised from CARE-NP BBB- (Is) and continues to remain 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 revised the issuer rating of Arun Valley Hydropower Development Company Limited (AHPC) to 'CARE-NP BB- (Is)' from 'CARE-NP BBB- (Is)'. The rating continues to be on credit watch with negative implications. 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 revision in issuer rating of AHPC factors in an instance of delay in debt servicing by AHPC<sup>2</sup> since the rating was last reviewed by CRNL. The overdue amount for the quarter ended mid-January 2024 has already been serviced and there are no ongoing delays in debt servicing by the company as on January end 2024 as confirmed by AHPC's lenders to CRNL. The rating continues to be placed on credit watch with negative implications factoring in continued 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 (although only for three months) coupled with adequate liquidity backup (majorly from investments in listed shares) are expected to provide 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 post resumption of operations.

The rating 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. The rating, however, 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. The rating also factors in moderate counter party risk and government support for the power sector. The rating also takes cognizance of approval by Securities Board of Nepal for 1:1 right share issuance by AHPC, which is expected to support AHPC's financial risk profile as half of the proceeds is likely to be used for reduction of debt.

*Going forward, the ability of 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

<sup>2</sup> There were less than 30 days delays with respect to interest and installment due for the quarter ended mid-January, 2024.

## Detailed Description of the Key Rating Drivers

### Key Rating Weaknesses

#### Prolonged plant downtime to continue to impact AHPC's near-term risk profile

AHPC's near-term financial profile remains impacted by the continued shutdown of its 9.94 MW KBHEP. Although 3.00 MW Piluwa Khola Small Hydroelectric Project (PKHEP) has resumed operations from August 30, 2023, operational cash accruals are not adequate to meet scheduled debt servicing. Following the resumption of operation of upstream 25 MW Kabeli Hydropower Project from January 24, 2024 onwards, The management expects that the plant to commence operations in the next quarter.

The company had applied for the restructuring of its existing loans (that had to be completed within mid-January, 2024) as per the relaxations allowed by the Nepal Rastra Bank for projects impacted by natural calamities. However, the same was not approved by its lenders on account of adequate liquidity available with the company related to its investment in listed shares and available free cash and bank balances, which were sufficient for servicing debt obligations over the near term. Since the management expected approval of restructuring of loans as they were eligible for the same as per NRB guidelines, however late minute rejection of loan restructuring in the quarter end led to delays of less than 30 days in debt servicing by the company for the quarter ended mid-January 2024. The overdue amount for the quarter ended mid-January 2024 has already been serviced and there are no ongoing delays in debt servicing by the company as on January end 2024.

AHPC's investment in listed shares amounting to Rs. 650 Mn fair value as on January 30, 2024, do provide some liquidity cushion over the near term. Nevertheless, AHPC's ability to complete the rehabilitation of KBHEP (expected to resume operations by mid-April 2024) and swift stabilization of operations thereafter remain critical from a credit perspective. Furthermore, AHPC has received approval from SEBON, on January 04, 2024, for 1:1 right share issuance worth Rs. 1,867.96 Mn. Book closure date was January 29, 2024. About half of the proceeds is expected to be used for reduction of debt, which is expected to lighten AHPC's financial burden going forward. Timely completion of the issuance and use of proceeds as envisaged will remain key monitorable.

#### 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.

#### 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 the 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 rates. Interest coverage ratio declined to 1.11x in FY23 (FY22: 2.5x) on account of subdued operational performance of power plant coupled with increased interest cost with respect to full year operation of 9.94 MW KBHEP in FY23 (KBHEP came into operation in March 2022 and operated for only 3.5 months during FY22). The interest coverage ratio was below unity in Q1FY24,

### **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 the plant side. Revenue loss from shut down of the plant coupled with low insurance coverage of LOP of only 3 months is likely to result into material revenue loss during FY24.

### **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.

#### **Power purchase agreement with sufficient period coverage**

Developed under the BOOT (Built, Own, Operate and Transfer) mechanism, Piluwa 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 Amarpur Substation.

### 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.

### 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)	Q1FY24
Income from power sales	53	139	263	13
PBILDT Margin (%)	62.07	74.23	76.83	24.37
Overall Gearing (times)	0.31	0.64	0.77	0.77
Interest coverage (times)	43.11	2.55	1.11	0.08
Total Debt / GCA (times)	6.56	9.99	10.48	41.75

A: Audited

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