

Kalanga Hydro Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Issuer Rating	NA	CARE-NP BB- (Is) [Double B Minus (Issuer)]	Assigned

* The issuer rating is subject to total debt not exceeding Rs. 3,500 Mn at the end of FY24 (FY refers to the twelve-month period ending mid-July).

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP BB- (Is)' to Kalanga Hydro Limited (KHL). 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 KHL is constrained by the significantly high cost of its hydropower project leading to highly leveraged capital structure and increased financial burden towards debt servicing in the initial years of commercial operations owing to high interest outgo considering the project is heavily debt funded. The revenue profile also remains impacted by loss of one (out of five) tariff escalation due to delays of more than six months in commencing commercial operations from the required commercial operations date (RCOD). In addition, the rating also factors in inherent hydrology risk associated with run-of-the-river power generation, risk of natural calamities and exposure to volatile interest rate risk.

The rating, however, derives strengths from KHL's experienced promoters and management team in the hydropower sector, low offtake risk and moderate counter party risk, and favorable government policy towards power sector. The ratings also take comfort from KHL's satisfactory operational performance with stable power evacuation in the first year of commercial operations, sustenance of which remains imperative from credit perspective in coming years.

Going forward, the ability of the company to successfully reduce the gap between operational Plant Load Factor (PLF) and contracted PLF and availability of sufficient hydrology with timely receipt of payments from Nepal Electricity Authority (NEA) leading to improved solvency and coverage indicators will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

High project cost leading to increased financial strain in initial years of operations

KHL has set up a 15.33 MW run-of-river Kalanga Gad Hydroelectric Project in Bajhang District of Nepal. The final cost of the project was Rs. 4,355 Mn (Rs. 284.08 per MW), which was funded in the debt equity ratio of ~69:31. The project faced multiple hiccups during construction including disruptions amid the covid-19 pandemic, challenges in land acquisition and damages by floods during construction. As a result, the commercial operation of the project was substantially delayed. Against the RCOD of December 1, 2021, actual COD was February 10, 2023. The company was liable for late COD penalty of Rs. 35.52 Mn and was eligible for only 4 out of 5 possible tariff escalations attributed to delay in commencement of operations, limiting its revenue profile over the long run. Additionally, the project cost had increased multiple times due to delay in execution of project leading to substantial increase in interest during construction (IDC) coupled with increase in cost of machineries. The project was also impacted by damages due to floods during construction, which also led to higher cost. Consequently, the relatively high project cost of around Rs. 284 Mn per Megawatt (MW) is likely to lead to a longer payback period coupled with elevated debt servicing requirements in the initial years of operations owing to higher interest outgo. The company's ability to adequately service its debt obligations will therefore hinge on its ability to generate sufficient cash flow from operations, which will be crucial from analytical perspective.

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

Furthermore, the company has partly funded its project cost by additional loans (Rs. 377.57 Mn) against initial public offering. This has led to added financial burden on the company in the interim. Timely completion of the proposed public issuance and debt repayment as envisaged will also remain a key monitorable as the company's current capital structure remains highly leveraged with gearing of over 5.07x at the end of FY23.

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

A Run-of-the-river (ROR) power project is recognized as a variable energy source of generation of power due to its reliance on natural river flow without significant water storage capacity. The dependency on river flow makes the power generation from the project highly responsive to seasonal variations. The project extracts discharge from Kalanga Gad, covering a catchment area of 446.71 sq. kms, characterized as a perennial river. KHL tends to produce higher electricity output during the wet season, from mid-April to mid-December, when river flows are abundant. Conversely, during the dry season, from mid-December to mid-April, power generation may be reduced due to lower river flows. Consequently, the project's performance will be exposed to the inherent risk associated to the natural hydrological patterns, variability in water discharge and optimized power generation efficiency throughout the year.

Risk of Natural Calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their construction and 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 as well as impacting their timely completion. Moving forward, these natural calamities can adversely affect the smooth flow of power generation and distribution, which can further impact financial returns of the projects. KHL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Exposure to volatile interest rate

KHL's interest rates are based on floating interest rate regime, where a certain premium is added to the monthly base rate and interest rate is changed accordingly on monthly 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 changes in interest rates. During FY23 (~5 months of operations) interest coverage was below unity. Although improved cash generation from operations has supported coverage indicators in H1FY24 (H1 refers to the six-month period ending mid-January), the company's interest outgo remains on the higher side given the company's relatively high debt levels. Higher interest rates than envisaged could result in squeezed margins of the company, impacting its liquidity profile.

Key Rating Strengths

Experienced promoters and management team

KHL has six board of directors having long experience in various sector including both operational and under construction hydropower projects in Nepal. The board is chaired by Mr. Khageshwar Bohara who has more than a decade of experience in various business domains including hydropower sector. He is also an executive committee member of Independent Power Producers' Association of Nepal (IPAN), which is an umbrella organization of independent power producers in Nepal. Mr. Birendra Bahadur Malla, Managing Director, also has experience of more than a decade in hydropower sector. The directors are also supported by the experienced management team to run the day-to-day activities.

Low offtake risk with moderate counter party risk

KHL had entered into a long term PPA with Nepal Electricity Authority (NEA) as on June 30, 2015 for sale of 15.33 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 (June to November) is Rs 4.80 per kWh and for dry season (December to May) is Rs 8.40 per kWh with 3% escalation on base tariff for continuous 5 years. The contracted energy for the project is 97.962 million units at PLF of 72.94%. Offtake risk remains low as the company has signed PPA on 'take or pay' basis with NEA which is owned by Government of Nepal and hence counter party default risk is deemed moderate; however, timely realization is critical for the company and from analytical perspective also.

Satisfactory operating performance so far in FY24

FY24 will be the first full year of operations and so far, the power generation from the plant has been satisfactory with PLF of ~98% of contracted energy during H1FY24. During FY23, when the plant was operational for 5 months, total energy generated against the contracted PLF was 79.93%. The ability of the company to sustain its operational Plant Load Factor (PLF) close to the contracted levels is critical from revenue generation perspective and will remain critical from analytical perspective particularly given its relatively debt servicing burden.

Favorable Government policies towards power sector

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.

About the Company

Kalanga Hydro Limited (KHL) was initially incorporated as a private limited company as on 20 December, 2007 (converted to a public limited company as on July 14, 2021) by a group of individual and institutional promoters for setting up of a 15.33 MW, run-of-river, Kalanga Gad Hydroelectric Project in Bajhang district of Nepal. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

Contact us**Analyst Contact**

Mr. Alish Rai
+977-9802358504
alish.ra@careratingsnepal.com

Mr. Santosh Pudasaini
+977-9802312855
pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani
+977-9818832909
achin.nirwani@careratingsnepal.com

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