

## Arun Kabeli Power Limited (Revised)

### Ratings

Facilities	Amount (Rs. Million)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities	2,444.56	CARE-NP BBB- [Triple B Minus]	Assigned
Short Term Bank Facilities	150.00	CARE-NP A3 [A Three]	Assigned
Total Facilities	2,594.56 (Two Billion Five Hundred Ninety-Four Million and Five Hundred Sixty Thousand Only)		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has assigned the rating of 'CARE-NP BBB-' to the long-term bank facilities and 'CARE-NP A3' to the short-term bank facilities of Arun Kabeli Power Limited (AKPL).

### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of AKPL derive strength from satisfactory operational and financial performance of the project marked by sustained power generation since its commissioning till 11MFY23 (Unaudited, refers to the eleven-month period ending mid-June 2023) leading to net profitability with adequate gross cash accruals over the past three consecutive years during FY21-FY23. The ratings also factor in successful completion of its right issue over Oct-Nov 2023, the partial proceeds of which has been utilized for deleveraging the balance sheet in H1FY24. Reduced debt levels are likely to improve its capital structure in FY24 (FY, refers to twelve-month period ending mid-July) and ultimately the interest burden of the company. The ratings take into account experienced directors in power sector, association with group having multiple hydropower projects, presence of power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and government support for the power sector.

The ratings, however, is constrained by material revenue loss expected in FY24 on account of shut down of plant for the better half of FY24 and inadequate coverage for Loss of Profit (LOP) insurance (indemnity period of only 3 months in excess of revenue loss for first 30 days from plant shut down date) which is likely to offset the tangible net worth base to certain extent. The flood occurred dated June 15, 2023 led to plant shut down which resumed its full-fledged operations from January 24, 2024 onwards. The ratings also factor in equity commitments to an under-construction hydropower project and related project implementation and stabilization risk, risk of natural calamities inherent in operational hydropower project, hydrology risk associated with run-of-the-river power generation and exposure to volatile interest rate risk.

*Going forward, the ability of the company to reduce the gap between operational PLF and contracted PLF on sustained basis and availability of sufficient hydrology with timely receipt of payments from Nepal Electricity Authority (NEA) will be the key rating sensitivities. Furthermore, 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.*

### Detailed description of the key rating drivers

#### Key Rating Strengths

#### Experienced directors/management team in power sector and part of Arun Valley Hydropower Group of Companies

AKPL is managed under the overall guidance of the company's Board of Directors (BoD) with significant experience in the power sector. The board is chaired by Mr. Ramesh Prasad Neupane, who has more than two decades of experience in hydropower

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

sector. He is also Managing Director of Arun Valley Hydropower Development Company Limited (AHPC) (CARE-NP BB- (Is)) and director of Ridi Power Company Limited (RIDI) (CARE-NP BB+(Is)). Mr. Jeevan Raj, Managing Director has more than one decade of experience in hydro power sector. He is supported by other experienced management team members. Currently, Arun Valley group of companies have around 140 MW operational power projects which include 25MW Kabeli B1 Hydropower Project (KBHP) operated by AKPL. Experienced background of BOD's and AKPL being a part of Arun Valley group could provide technical support and operational synergy to AKPL.

### **Satisfactory operating performance of power project over FY20-11MFY23**

AKPL operates the 25 MW run-of-the-river Kabeli B1 Hydropower Project (KBHP) in the Panchthar and Taplejung Districts. The project has been operational since November 9, 2019. KBHP harnesses the discharge from the snow-fed Kabeli River, which benefits from a substantial catchment area and gross head. This favorable catchment area has enabled the project to consistently generate satisfactory energy levels during both dry and wet seasons since its commissioning. The energy generation was ~92% of the contracted capacity on an average for the period FY22-11MFY23.

However, due to a flood at the plant site on June 15, 2023; thereby impacting the operations for a period of around 7 months. The flood caused damage to the penstock pipes, impacting both operational and financial performance. The plant resumed operations on January 24, 2024. Going forward, the company's ability to reduce the gap between operational PLF (Plant Load Factor) and contracted PLF on a sustained basis and will remain a key monitorable aspect.

### **Moderate capital structure and debt coverage indicators, with deleveraging in H1FY24 after successful completion of right issue**

The capital structure of the company stood moderate with overall gearing ratio of Rs. 1.64x at the end of FY23 (FY22: Rs. 1.66x). The overall gearing ratio improved marginally on account of scheduled repayments of term loan and increase in tangible net worth (TNW) due to accretion of profit. Interest coverage ratio stood moderate at 1.61x during FY23 (FY22: 2.67x). Although total debt / GCA stood high at 15.16x at the end of FY23 (FY22: 9.29x), the overall capital structure and gearing levels is expected to improve in FY24 post prepayment of term loan to the tune of Rs. 655 Mn and increase in of its overall tangible net worth (TNW) base after right issue in H1FY24 although losses expected for FY24 may offset TNW to certain extent. The company had successfully completed its right issue amounting Rs. 1,955 Mn over Oct-Nov 2023. The ability of the company to sustain its net profitability over next couple of years while maintaining debt service coverage indicators at envisaged level is critical from credit perspective.

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

AKPL entered a long-term Power Purchase Agreement (PPA) with the Nepal Electricity Authority (NEA) on July 13, 2012, for the sale of 25 MW of electricity generated by the Kabeli B1 Hydropower Project (KBHP). The duration of this PPA extends for 30 years from the Commercial Operation Date (COD) or until the expiration of the Generation License, obtained on July 12, 2013, valid for 35 years, whichever occurs first with a provision for potential extension of the PPA period through mutual agreement within the final six months of its validity.

The agreed tariff structure differentiates between the wet season (Mid-April to Mid-December) and the dry season (Mid-December to Mid-April). During the wet season, the tariff stands at Rs 4.80 per kilowatt-hour (kWh), while during the dry season, it is Rs 8.40 per kWh. Additionally, the tariff incorporates a 3% escalation on the base tariff, applicable five times annually. The annual contracted energy allocation for the project amounts to 141.74 million units (MU), with 22.89 MU allocated for the dry season and 118.86 MU for the wet season, at a contracted Plant Load Factor (PLF) of 64.72%.

AKPL commenced its commercial operations on November 09, 2019, making it eligible for all five tariff escalations based on the agreed tariff rate. Given that AKPL is entitled to all escalations in the tariff, this benefits the company by enhancing return indicators and ultimately reducing the payback period for the project.

**Favorable policies towards power sector**

The Government of Nepal (GoN) has prioritized hydropower generation as a crucial sector for economic development and aims to enhance private sector involvement by offering a range of incentives and facilities. In line with this objective, GoN has introduced a comprehensive tax incentive package, providing full tax exemption for the initial 10 years and a 50% tax exemption for the subsequent five years to individuals or entities engaged in the commercial operation, transmission, and distribution of electricity until mid-April 2027. These incentives are designed to encourage investment and promote growth in the hydropower sector. Additionally, directives from the Nepal Rastra Bank (NRB) mandate that all banks to allocate a minimum share of their total advances to the energy sector. This directive further reinforces the government's commitment to supporting and facilitating investment in the energy sector, including hydropower projects.

Furthermore, the long-term demand outlook for the Nepalese power sector is promising, with new bilateral agreements facilitating additional exports of power to India. These agreements underscore the potential for Nepal to capitalize on its hydropower resources and leverage them for economic growth and argues well for the sector.

**Key Rating Weaknesses****Material revenue loss expected in FY24 amid plant shut down for extended period**

The company's insurance for loss of profit (LOP) was covered for a duration of 3 months. This relatively shorter coverage period is likely to result into material revenue loss for the company throughout FY24. In FY23, the total operating income (TOI) of the company declined to Rs. 653 Mn as compared to Rs. 721 Mn in FY22. This decline was attributed to lower energy generation. Additionally with higher interest expenses, mainly due to the transition from a fixed-rate regime to a floating-rate regime during FY23 led to decrease in PBILDT margin to 84% in FY23, from 92% in FY21 and FY22. This decline also impacted on the Gross Cash Accruals (GCA), which decreased to Rs. 224 Mn in FY23 from Rs. 369 Mn in FY22.

However, the company's financial outlook is anticipated to improve, supported by the prepayment of a partial portion of term loans using proceeds from rights issues, along with the resumption of plant operations from January 24, 2024 onwards. Moreover, considering the historically better sustained operational performance of the power project prior to the occurrence of the flood, the financial performance of the company is expected to remain satisfactory moving forward.

**Associated project implementation and stabilization risk related to investment in under construction hydropower project**

Kabeli Energy Limited (KEL) is in the process of developing the 37.60 MW Kabeli A Hydropower Project, situated in Pachthar and Taplejung districts. The projected total cost of the project is estimated to be Rs. 7,520 Mn, with financing intended in a debt-equity mix of 60:40. AKPL has committed to contribute 40% of the equity amount, equivalent to Rs. 1,200 Mn, towards KEL. As of February 06, 2024, AKPL has already invested Rs. 640 Mn, with the remaining equity to be infused gradually in accordance with the project's requirements. Substantial fund flow requirement for such investments as a result of current commitments and any potential cost overrun, which is not uncommon for hydro projects in Nepal given the challenging geology, could have adverse impact on future liquidity prospects and financial risk profile of the company. Thus, additional required investments will continue to 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 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 river flows are high (Mid-April to Mid-December) and less during the winter season (Mid-Dec to Mid-April). Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

### 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. The company operations were impacted for around 6 months in FY24 due to flood at plant site and there was no revenue generation during the impacted period.

### 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.

### About the Company

Arun Kabeli Power Limited (AKPL) is a public limited company incorporated in January 07, 2011, promoted by business persons having long experience in the hydropower and other sectors for setting up Hydroelectric Project (HEP) in the territory of Nepal. It is part of Arun Valley Hydropower group. AKPL has one operational 25 MW run of the river Kabeli B1 Hydropower Project (KBHP) at Panchthar & Taplejung District which has been in commercial operation since November 09, 2019. The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Brief financial performance of AKPL during FY21, FY22 and FY23 is given below:

Particulars	(Rs. In Million)		
	FY21 (A)	FY22 (A)	FY23 (UA)
Income from operations	707	721	653
PBILDT Margin (%)	92.47	91.36	83.61
Overall Gearing (times)	1.89	1.66	1.64
Interest Coverage (times)	2.35	2.67	1.61
Total Debt/ Gross Cash Accruals (times)	9.41	9.29	15.16

A: Audited, UA: Unaudited

### Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	2,444.56	CARE-NP BBB-
Short Term Bank Facilities	Working Capital Loan	150.00	CARE-NP A3
<b>Total Facilities</b>		<b>2,594.56</b>	

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