

Upper Lohore Khola Hydropower Company Private Limited

Rating

Instrument / Facilities*	Amount (Rs. in Mn)	Rating ¹	Rating Action
Long-term Bank Facilities	570.00	CARE-NP BB [Double B]	Assigned
Total Facilities	570.00 (Five Hundred Seventy Million)		

*Details of instrument / facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has assigned the rating of 'CARE-NP BB' to the long-term bank facilities of Upper Lohore Khola Hydropower Company Private Limited (ULKH).

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of ULKH is constrained by residual project implementation and stabilization risk associated with greenfield hydropower project, hydrology risk associated with run-of-the-river power generation and exposure to volatile interest rate and foreign currency fluctuation risk. The rating also factors in increase in projected cost coupled with delay in its commencement of commercial operations.

The rating, however, derives strength from the experienced directors and management team, presence of power purchase agreement (PPA) with sufficient period coverage, low power evacuation risk, government favourable policies for the sector and moderate counter party risk.

Going forward, the ability of the company to successfully execute the project without further cost and time overrun and early stabilization thereafter will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Constraints

Time and Cost overrun in the project

ULKH is setting up a new hydro project of 4 MW in Dailekh district of Nepal. The initial project cost was estimated at Rs. 717.45 Mn and scheduled commercial operation date was July 26, 2020. However, the total cost of project has revised to Rs. 817.72 Mn. The cost overrun is mainly attributable to increase in construction cost due to price rise, change in project scope (penstock alignment) and purchase of additional land. The project is expected to commence commercial operations in December 2021. The company is in process of taking the necessary approvals from regulatory bodies to change the RCOD. Any delays in the implementation may impact the company's financial risk profile adversely and is also crucial from credit prospective. During initial phases of operations, the capital structure of the company is expected to remain leveraged.

Residual project implementation and stabilization risk

The revised project cost of Rs. 817.72 Mn (i.e. Rs. 204 Mn per MW) is proposed to be funded in debt-equity ratio of 70:30. As on April 2021, the company has incurred a total expenditure of Rs. 717.42 Mn which was funded through term loan of Rs. 432.18 Mn and balance through the promoters' contribution. As per the progress report dated June 16, 2021, the overall physical progress of the project is ~82%. This exposes the company towards project execution with-in the envisaged time and cost. Furthermore, stabilization and streamlining of revenue shall remain a concern.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

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

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). The project is exposed to risk associated with variation in discharge of water from the aforesaid river/khola.

The power generated from the project will be evacuated by ~17 km long 33kV Transmission line to NEA's Dailekh Bazar Substation. The Dailekh Bazar substation is operational; however, the construction of the transmission lines from powerhouse to the substation is within the scope of ULKH. Timely completion of the transmission lines will be crucial for the company for generating revenue.

Exposure to volatile interest rate and fluctuating currency risk

Nepalese banking sectors are fixing floating interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions (BFIs) remains volatile to change in liquidity position which lead to change in interest rate. Interest rate has been changing frequently in Nepal market since last 2-3 years. Therefore, funding from BFIs is subject to volatile interest rate.

ULKH had entered into contract with a foreign based contractor for delivery of the electro-mechanical equipment and its management thereafter until commissioning. The contract price is termed in Euro currency and the company has made ~55% payment to the contractor till mid-July 2021 and the balance is payable in foreign currency which is not hedged by the company yet. This exposes the company towards fluctuating currency fluctuation risk for its foreign currency payments.

Key Rating Strengths***Experienced promoters, directors and management in various sector***

ULKH's board comprises of 3 directors. The board is chaired by Mr. Kedar Nath Poudel, who has more than 30 years of experience in education, trading and hydropower sectors. He is also a director at Gaurishankar Power Development Limited and Shikhar Power Development Private Limited. Other directors of the company also have experience in various sector. Furthermore, the board is supported by an experienced team across various functions.

Power purchase agreement with sufficient period coverage and moderate counter party risk

ULKH had entered into a PPA with NEA as on March 22, 2018 for sale of power to be generated from 4MW hydro power project. The tenure of the PPA is 30 years from commercial operation date (COD) or till validity of Generation License (obtained on January 4, 2019 for 35 years), whichever is earlier. The contracted energy Plant load factor (PLF) for the project is 60.56% with total contracted energy of 21.22 million units (MU). 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 8 years after completion of 12 months from COD date. If COD doesn't fall within RCOD, the company is bound to pay penalty to NEA as per the 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.

The company has signed PPA with NEA is owned by Government of Nepal and hence counter party default risk is low; however, timely realization of critical for the company and from analytical prospective also.

Current demand & supply gap however possible oversupply in future

As per the NEA's Annual Report for FY20, the current peak electricity demand is 1,408MW. The total domestic installed capacity stands at 1,328 MW which includes 632 MW owned by NEA and 696 MW by private sector IPPs. Overall, during FY20, total energy demand was 7,894 GWh which was met by import of 1,721 GWh from India whereas balance was met by domestic generation.

However, considering under construction projects which are expected to generate electricity in next 2-3 years and electricity demand which has not increased substantially in past few years could create a situation of oversupply in near future in wet season.

Government support for the 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) has to allocate minimum share of their total advances to energy sector which argues well for the sector.

About the Company

Upper Lohore Khola Hydropower Company (ULKH) is a Private company, incorporated on November 01, 2017. The company has been promoted by a group of individual promoters having long experience in various sectors. It is setting up 4 MW run-of-river, Upper Lohore Hydropower Project (ULHP) in Dailekh district of Nepal. The project is being constructed under "BOOT" (Build, Own, Operate and transfer) model having 49.80 km² catchment area and 2.50 m³/sec design discharge at 40% exceedance flow.

Annexure 1: Details of Instrument / Facilities

Name of the Instrument / Bank Facilities	Type of the Facility	Amount (Rs. In Million)	Ratings assigned
Long Term Bank Facilities	Term Loan	497.60	CARE-NP BB
Long Term Bank Facilities- Proposed	-	72.40	CARE-NP BB
Total		570.00	

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