

Arun Valley Hydropower Development Company Limited

Ratings

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

**The issuer rating is subject to overall gearing of the company not exceeding 1.50x at the end of FY22.*

CARE Ratings Nepal Limited (CRNL) has reaffirmed Issuer rating of 'CARE-NP BB+ (Is) [Double B Plus (Issuer)]' to Arun Valley Hydropower Development Company Limited (AHPC). Issuers with this rating is considered to have moderate degree of safety regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to AHPC continues to be constrained by exposure to its group companies, project stabilization risk of Kabeli B-1 Cascade Hydroelectric Project (KBHEP), hydrology risk associated with run-of-the-river power generation and exposure to regulatory risk.

The rating, however, derives strength from multiple hydropower projects being developed through associate companies and experienced promoter/directors and management team, moderate operating performance of the company, presence of power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The rating also factors in current demand & supply gap and government support for the power sector.

Going forward, the ability of the company to reduce the gap between operational and contracted plant load factor (PLF) along with the timely receipt of payments from Nepal Electricity Authority (NEA) are the key rating sensitivities. Also, the ability of the company to timely execute the upcoming hydropower project without cost and time overrun is crucial from rating perspective.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Project stabilization risk of Kabeli B-1 Cascade Hydroelectric Project (KBHEP)

The estimated cost of KBHEP is Rs. Rs 1,979 Mn (i.e., Rs 199 Mn per MW) which is proposed to be financed in the debt equity ratio of 70:30 (i.e., Rs 1,385 Mn debt and Rs 594 Mn equity and internal accruals). The total debt amount has already been tied up. As on November 18, 2021, ~90% of the total project cost has been incurred and the physical progress is ~98%. The power generated from KBHEP along with other two projects will be pooled at Kabeli B-1 pooling station and further evacuated to Amarpur Substation. Even though, the plant is in the final stages of completion and is expected to commence operation in December 2021, the stabilization and streamlining of generation of power remains to be seen.

Exposure to group companies

As on July 15, 2021, the company has investments in associate companies (mainly hydro power generation companies) to the tune of Rs. 213 Mn. The total exposure to group aggregated is Rs. 213 Mn equivalent to ~12% of its net worth. AHPC has also provided corporate guarantee to the loan availed by its associate companies amounting to Rs. 1,843.50 Mn. The adjusted overall gearing (net of investments, loans & advances to subsidiaries from net worth and addition of corporate guarantee) remained high at 1.51x as on mid-July 2021. Any impact on the financial risk profile of AHPC on

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

account of the exposure to the group companies would be critical from credit perspective. Furthermore, any additional investment to the group or associates would also be key monitorable.

Exposure to volatile interest rates

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 will be change by change in liquidity position which lead to change in interest rate. Interest rate has been changing frequently in Nepal market in the last couple of years. Therefore, funding from Bank and Financial Institutions are exposed to volatile interest rate.

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 Kabeli B-1 HEP might impact the energy generation of projects which is of key importance for the company from the revenue generation perspective.

Exposure to regulatory risk

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) for regulating generation, transmission and distribution of electricity in Nepal. ERC will be the regulator under the GoN which will be responsible for regulating hydropower companies in Nepal. Policies and directives issued by ERC like approval process for IPO issuance, PPA approval through ERC poses a new challenge to hydropower companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strengths

Multiple hydropower projects being developed through associate companies and experienced promoter/directors and management team

AHPC has been involved in operation and construction of hydropower projects by itself and through associate companies. Currently, AHPC and its associate companies has 57.30 MW operational and 68.94 MW under construction hydropower projects along with 8.5 MW operational solar project. Also, 18.5 MW solar power projects are under pipeline developed by AHPC and its 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 20 years of experience in hydropower sector and he is supported by other experienced management team members.

Power purchase agreement with sufficient period coverage

AHPC had entered into PPA with Nepal Electricity Authority (NEA) as on January 23, 2000 and November 25, 2018 for sale of entire power generated by the plant of Piluwa Khola Small Hydroelectric Project (PKHEP) and Kabeli B-1 Cascade Hydroelectric Project (KBHEP) respectively. The PPA is signed for a period of 25 years for PKHEP and 30 years for KBHEP from the date of COD or till validity of Generation License whichever is earlier. The projects have differential tariff rate ranging from Rs. 3.90 and Rs. 8.40 per kWh. Required Commercial Operation Date (RCOD) for KBHEP was September 17, 2021 as per PPA. However, the company has applied for the extension of RCOD of the project with NEA.

Moderate operating performance of the company

AHPC is generating revenue by the selling of power generated through its 3 MW Piluwa Khola Small Hydroelectric Project (PKHEP) at Sankhuwasabha District. The company reported decrease in total operating income by around 23% to Rs. 53 Mn in FY21 (Audited; FY21 refer to 12 months ending on Mid-July 2021) from Rs. 69 Mn in FY20. The decrease in revenue during FY21 was on account of plant operated at lower capacity due to issues related to transmission of power. During FY20, the plant was operated at 64.71% which decreased to 50.03% during FY21 ending on Mid-July 2021. The annual contracted PLF for PKHEP is 74.38% of the installed capacity of the plant. For the year ended FY21, the energy generated was 67.26% against contracted PLF.

PBILDT margin declined to 62% during FY21 from 68% in FY20 on account of lower revenue generation. Despite the decline in PBILDT, PAT margin of the company improved on account of increase in non-operational income. Other Non-operational income increased to Rs 80 Mn during FY21 from Rs. 61 Mn during FY20 mainly due to income from sale of investment.

Overall gearing ratio deteriorated to 0.31x at the end of FY21 (FY20: 0.07x) on account of debt funded capex undertaken by the company for the development of the 9.94 MW Kabeli B-1 Cascade Hydroelectric Project (KBHEP). However, the total repayment of the debt incurred for construction of 3 MW PKHEP has already been made by the company. Apart from overall gearing, other coverage indicators including total debt to GCA and Interest coverage ratios stood moderate at 6.56x and 43.11x for FY21 respectively (PY: 0.93x and 4.93x respectively).

Current demand & Supply gap however possible oversupply in future along with moderate counter party risk

As per the NEA's Annual Report for FY21, the current peak electricity demand is 1,482MW. The total domestic installed capacity stands at 1,447 MW which includes 632 MW owned by NEA and 815 MW by private sector IPPs. Overall, during FY21, total energy demand was 8,960 GWh which was met by import of 2,806 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, requiring demand side management.

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 perspective also. During FY21, the company received payment from NEA for supply of power generated by AHPC within a month.

Favourable Government policies towards 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) have to allocate minimum share of their total advances to energy sector which argues well for the sector.

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 under construction Kabeli B-1 Cascade Hydroelectric Project (KBHEP). The projects are constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Financial Performance

(Rs. In Mn)

Particulars	FY19	FY20	FY21
	Audited	Audited	Unaudited
Income from Operations	55	69	53
PBILD Margin (%)	73.45	67.64	62.07
Overall Gearing (times)	0.05	0.07	0.31
Interest coverage (times)	5.60	4.93	43.11
Current Ratio (times)	2.12	2.34	0.53
Total Debt/Gross Cash Accruals (times)	0.79	0.93	6.56

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