

Arun Valley Hydropower Development Company Limited

Ratings

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BBB- (Is) [Triple B Minus (Issuer)]	Revised from CARE-NP BB+ (Is)

** The issuer rating is subject to overall gearing ratio of the company not exceeding 1.00x at the end of FY23.*

CARE Ratings Nepal Limited (CRNL) has revised issuer rating assigned to Arun Valley Hydropower Development Company Limited (AHPC) to 'CARE-NP BBB- (Is) [Triple B Minus (Issuer)]' from 'CARE-NP BB+ (Is) [Double B Plus (Issuer)]'. Issuers with this rating are considered to offer moderate degree of safety regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The revision in rating assigned to the issuer ratings of AHPC takes into account successful commencement of commercial operations of the 9.94 MW Kabeli B-1 Cascade Hydroelectric Project (KBHEP) coupled with improving operating performance of the 3MW Piluwa Khola Small Hydroelectric Project (PKHEP) aided by upgradation in power evacuation setup of the project wherein power generated from the project is now evacuated through a 220 kv transmission line compared to the earlier 33 kv. The rating continues to derive strength from multiple hydropower projects being developed through associate companies and experienced promoter/directors and management team, presence of power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. Additionally, the rating also factors in government support for the power sector.

The rating, however, continues to be constrained by exposure to its group companies, project stabilization risk associated with KBHEP and hydrology risk associated with run-of-the-river power generation. The rating also factors in exposure of the company to volatile interest rate risk and regulatory risk.

Going forward, the ability 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) will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

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 have 79.74 MW operational power projects which include 3MW PKHEP and 9.94 MW KBHEP developed by AHPC itself and remaining 66.80 MW through associate companies. Furthermore, 59 MW hydropower projects and 9 MW solar power projects are under construction to be 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.

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

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.

Improving financial profile of the company backed by increased revenue base

AHPC generates revenue by the selling of power generated through its 3 MW Piluwa Khola Small Hydroelectric Project (PKHEP) at Sankhuwasabha District and 9.94 MW Kabeli B-1 Cascade Hydroelectric Project (KBHEP) at Taplejung district. KBHEP came in operation in March 26, 2022. The company reported increase in total operating income by around 163% to Rs. 141 Mn in FY22 (Unaudited, refers to twelve-month period ended mid-July 2022) from Rs. 53 Mn in FY21. The increase in revenue during FY22 was on account of increase in PLF as a percentage of contracted capacity of PKHEP to 92.89% in FY22 as compared to 67.26% in FY21 aided by upgradation of evacuation infrastructures along Koshi corridor by NEA from 33 kv to 220 kv in August 2021 thus resolving the tripping issues in transmission line. Higher TOI in FY22 was also on account of commissioning of KBHEP and its operation for around 3.5 months in FY22. The energy generated by KBHEP was 77.84% against contracted PLF in FY22.

PBILDT margin increased to 75% during FY22 from 62% in FY21. PAT of the company increased to Rs. 91 Mn in FY22 from 78 Mn during FY21 amid increase in revenue from power generation however offset to some extent by the interest payments on 9.94 MW KBHEP which started from Mid-July 2022 along with depreciation charge in KBHEP.

Overall gearing ratio stood at 0.62x at the end of FY22 (FY21: 0.31x) 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). The debt undertaken for 3 MW PKHEP has already been repaid. Apart from overall gearing, other coverage indicators including total debt to GCA and Interest coverage ratios stood moderate at 9.08x and 2.69 for FY22 respectively (PY: 6.56x and 43.11x respectively).

Favorable 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.

Key Rating Weaknesses**Exposure to group companies**

As on July 16, 2022, the company has investments in group companies (mainly hydro power generation companies) to the tune of 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 2022 (PY: Rs. 2,094 Mn). Total exposure to group (including corporate guarantees) aggregated is Rs. 1.530 Mn equivalent to ~81% 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 1.51x as on mid-July 2022. Any impact on the financial risk profile of AHPC on account of the exposure to the group companies would be critical from credit perspective. Furthermore, any additional investments to the group or associates would also be key monitorable.

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

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and 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. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

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.

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	FY20 (A)	FY21 (A)	FY22 (UA)
Income from power sales	69	53	141
PBILDT Margin (%)	67.64	62.07	74.51
Overall Gearing (times)	0.07	0.31	0.62
Interest coverage (times)	4.93	43.11	2.69
Total Debt / Gross Cash Accruals (times)	0.93	6.56	9.08

A: Audited; UA: Unaudited

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