

Upper Lohore Khola Hydropower Company Limited (Revised)

Ratings

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

**The issuer rating is subject to the company maintaining overall gearing not exceeding 2.25x at the end of FY23.*

CRNL has assigned 'CARE-NP BB- (Is)' rating to Upper Lohore Khola Hydropower Company Limited (ULKH). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations in Nepal.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ULKH takes into account the project implementation risk and funding risk associated with its under construction Upper Lohore Hydropower Project (ULHP) amid cost overrun. The rating is also constrained by the possibility of delay in commercial operations extending beyond the Required Commercial Operation Date (RCOD) leading to a possible penalty for late COD and loss of escalation tariffs, if the COD is delayed by more than six months from RCOD. The rating also factors in operation stabilization risk associated with the greenfield hydropower project post commencement of commercial operation, hydrology risk associated with run-of-the-river power generation and exposure to volatile interest rate and regulatory risk.

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 favorable 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 Weaknesses

Residual project implementation and funding risk

ULKH is setting up 4MW Upper Lohore Hydropower Project (ULHP) in Dailekh district of Nepal. The expected project cost of Rs. 820.72 Mn (i.e. Rs. 205 Mn per MW) is proposed to be funded through debt to equity in the ratio of 69:31. As on mid-July 2022, the company has incurred a total expenditure of Rs. 807.13 Mn (~98% of project cost) with around 92% physical progress, leading to a possibility of further cost overrun. Till mid-July 2022 the funding mix has been through term loan of Rs. 567.60 Mn and balance through the promoters' contribution. ULKH further expects cost escalation by 8.5% in the revised budgeted cost, which will consequently increase the total project cost. The funding for the escalated cost is likely to be met from equity through the proceeds of an Initial Public Offering (IPO). Hence, timely infusion of the proposed equity remains crucial from credit standpoint.

The Required Commercial Operation Date (RCOD) of the project was July 25, 2021 (extended from July 26, 2020). However, the construction timeline of the project was delayed amid COVID imposed restrictions. Although the company has applied to the Ministry of Water Resources, Energy and Irrigation for the extension of RCOD, requisite approvals and commencement of operations within the extended timelines is crucial for the company. The management estimates the expected COD of the project to around January 2023. The project is likely to pay penalties for late COD. Furthermore, the project is also at risk of loss in tariff escalations to be availed by the company, which will be applicable if the project COD is delayed by more than 6 months from RCOD. The company's financial profile may be impacted adversely on further delay in commissioning the project

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

on account of increased interest cost, exposure to penalty for late COD and possible loss of escalation tariffs. Thus, timely approval of RCOD from regulatory bodies and actual COD without further delay would be key monitorable aspect.

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. As on Mid-July 2022, ~95% work related to transmission line has been completed. Timely completion of the transmission lines will be crucial for the company for generating revenue.

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 hydropower companies in Nepal. ERC will regulate generation, transmission and distribution of electricity in Nepal among others. Policies and directives issued by ERC such as approval process for IPO issuance and 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 Strength

Strong promoters and experienced management team

ULKH's board comprises of three 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

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.

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.

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.

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