

## Aarati Power Company Limited

### Rating

Facilities	Amount (Rs. Million)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities	2,061.00	CARE-NP BB- [Double B Minus]	Assigned
Short Term Bank Facilities	59.00	CARE-NP A4	Assigned
<b>Total</b>	<b>2,120.00</b> <b>(Two Billion Two Hundred Twenty Million Only)</b>		

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP BB-' to the long term bank facilities and 'CARE-NP A4' to the short term bank facilities of Aarati Power Company Limited (APCL).

### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ACPL are constrained by project implementation risk associated with its under-construction hydropower project. The ratings also factor in power evacuation risk, hydrology risk associated with run-of-the-river power generation, risk of natural calamities, and the company's exposure to regulatory risk and volatile interest rate risk.

The ratings, however, derive strength from the company's experienced promoters and management team in the hydropower sector, presence of power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and government's support for the power sector.

*Going forward, the ability of the company to successfully execute the project within envisaged cost and time and early stabilization thereafter will be the key rating sensitivities.*

### Detailed description of the key rating drivers

#### Key Rating Weaknesses

#### Project implementation risk and stabilization risk thereafter

ACPL is setting up a 14.5 MW, run-of-river, Upper Irkhuwa Khola Hydropower Project (UIKHP) in Bhojpur District of Nepal. The total cost of the project is estimated at Rs. 2,835 Mn (Rs. 196 Mn/MW). The proposed funding mix for the estimated cost is debt and equity in the ratio of 63:37 (i.e., debt of Rs. 1,859 Mn and equity of Rs. 1,035 Mn). The debt of the project has been fully tied up. The company has achieved physical progress of around 25% till end of May 2023. Out of the total capex planned, as on end of May 2023, the company has incurred a total expenditure of Rs. 412 Mn funded out of promoter's contribution of Rs. 215 Mn and remaining from payables. This exposes the company towards project execution in terms and completion of the project with-in the envisaged time and cost. During initial phases of operations, the capital structure of the company is expected to remain leveraged due to the debt funded project.

#### Hydrology risk associated with run-of-the-river power generation and 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 wet season when river flows are high (Mid-April to Mid-December) and less during the dry season (Mid-December to Mid-April). Since there is no minimum commitment on revenue in PPA in case of adverse river flows scenario, the company is exposed to hydrology risk of the power project for the generation of revenue.

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

The power generated by UIKHP is proposed to be evacuated to NEA's operational Shitalpati Substation located in Sankhuwasabha. The company is required to construct approximately 10.2 km long 132kV single circuit transmission line from the project's switchyard to NEA's substation. Timely completion of transmission line will be key sensitive from the credit perspective.

### **Risk of Natural Calamities**

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their construction and 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 as well as impacting their timely completion. Moreover, disruption in their construction in turn could lead to time and/or cost overrun, negatively impacting the project's financial aspects. Moving forward also, these natural calamities can adversely affect the smooth flow of power generation and distribution, which can further impact financial returns of the projects. APCL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

### **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, the sector is prone to regulatory risk and changes in other policies by GoN.

### **Key Rating Strengths**

#### **Experienced promoters and management team**

ACPL has three directors in its board, chaired by Mr. Bharat Bahadur Khatri who has more than two decades of experience in practicing lawyer and also been associated with hydro power company in the capacity of public director. Mr. Birendra Bahadur Neupane is also a director of the company who has more than three decades of experience in the construction as well as hydropower projects. Mr. Prakash Dulal, executive director also has experience in the hydropower sector of more a than decade. He has been involved as Director in various hydropower companies. The promoters have been involved in various operational and under construction hydropower project such as Peoples Power Limited (4.96MW) [CARE-NP BB+(Is) and KBNR Isuwa Power Limited (97.2MW) [CARE-NP BB/A4] and Moonlight hydropower Development Limited (22.14MW) [CARE-NP BB-].

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

ACPL has entered into PPA with Nepal Electricity Authority (NEA) as on July 17, 2018 for sale of 14.5 MW power to be generated from the project. The period of the PPA is 30 years from the date of COD or till validity of Generation License whichever is earlier. PPA period may be extended with mutual consensus during the last six months of validity. The tariff for wet season (June to November) is Rs 4.80 per kWh and for dry season (December to May) is Rs 8.40 per kWh with 3% escalation on base tariff for 8 years. The contracted energy of the project is 90.57 million units (MU). The Plant Load Factor (PLF) of the project is 71.31%. Timely completion of project within the RCOD is crucial for the company is eligible to avail the benefits of all the escalations. Required Commercial Operation Date (RCOD) of the project is currently November 16, 2023 and the company has applied for further one year extension. If the project is not completed within the RCOD, the company will be liable to pay delay penalty. Furthermore, if COD is delayed by more than 6 months from RCOD, there are restriction clauses in escalation of tariff rate. It is, therefore, critical for the company to complete the project within the timeline to avail the accelerated clauses of tariff. Any delay in the same would impact the project's expected returns and debt servicing capabilities which is critical from credit perspective.

### 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 2027. Also, with government focus more toward reservoir-based hydropower projects; Monetary Policy FY23 has provided full tax exemption for first 15 years and 50% tax exemption for next 6 years to reservoir and semi-reservoir projects completing financial closure within mid-April 2029 with a capacity higher than 40 MW. As per various directives from NRB, 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

Aarati Power Company Limited (APCL), incorporated on January 13, 2016. The company is involved in developing a 14.5 MW run-of-river Upper Irkhuwa Khola Hydropower Project in Bhojpur District of Nepal. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

Annexure-1: Details of Instruments/ Facilities.

Facilities	Type of Facilities	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	2,061.00	CARE-NP BB- [Double B Minus]
Short Term Bank Facilities	Working Capital	50.00	CARE-NP A4
Short Term Bank Facilities	Bank Guarantee	9.00	CARE-NP A4
<b>Total</b>		<b>2,120.00</b>	

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