

Peoples Power Limited

Ratings

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

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has revised the issuer rating assigned to Peoples Power Limited (PPL) to 'CARE-NP BB+ (Is)' from 'CARE-NP BB (Is)'. Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The revision in rating assigned to PPL takes into account the successful commencement of commercial operations of the 4.96 MW run-of-the-river Upper Puwa-II hydropower project (UPHP) from November 27, 2022. The rating also takes cognizance of the completion of the Initial Public Offering (IPO) by the company in August 2022 and subsequent prepayment of long term loans from the proceeds of the IPO. This has substantially reduced the debt servicing burden of the company going forward. The rating continues to derive strength from PPL's experienced promoters and management team, presence of power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and government support for the power sector.

The rating, however, is constrained by operations stabilization risk associated with the hydropower plant as power generation have remained below par in the initial months of operations. The rating also continues to factor in hydrology risk associated with run-of-the river power generation, moderate power evacuation risk, risk of natural calamities, exposure to regulatory risk and volatile interest rates.

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 Weaknesses

Project stabilization risk

The company commenced its commercial operations from November 27, 2022. During the first 6 month of operations, the plant operated at 21.67% of its generation capacity. The total energy generated against the contracted PLF was modest at 58.38%. Apart from operational bottlenecks in the initial years of operations, lower power generation in the initial months of operations was also on account of lower hydrology amid a relatively dry year in recent times coupled with intermittent tripping issues with the NEA transmission line. The project is on nascent stage of operations. Thus, stabilization and streamlining of the production in coming years remains to be seen. The company's ability to achieve operational PLF as envisaged will remain a key monitorable aspect.

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

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 river flows are high (June to November) and less during the winter season (December to May). PPL is

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

proposed to utilize discharge from Puwa Khola having catchment area of 63.90 sq. kms based on semi snow-fed river. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola.

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their 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. These natural calamities can adversely affect the smooth flow of power generation and distribution, which can impact financial returns of the projects. The company is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Moderate power evacuation risk

Currently, the power is evacuated through ~6km 33 kV transmission line to the NEA's operational Upper Puwa I substation, which is then connected to the NEA's Power grid line passing through Puwa Khola Bazar. There have been instances of tripping issues in the initial year of operations, partly impacting its operational PLF. Smooth evacuation of power generated from the project on a sustained basis will remain a key monitorable aspect.

Exposure to volatile interest rate risk

The company's interest rates are based on 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. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed 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 Strengths

Experienced promoters and management team in hydropower sector

PPL has four board of directors, 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. Santosh Raj Nepal, Director, has been associated with hydro power companies for more than a decade and has extensive experience of handling the administrative operations of under construction and operational hydro power plants. Mr. Tanka Raj Aryal is an Advocate by profession and associated with the company as Director. He is looking after the legal affairs of the company. The promoters have been involved in various under construction hydropower project such as KBNR Isuwa Power Limited (97.2MW) [CARE-NP BB/A4] and Moonlight hydropower Development Limited (22.14MW) [CARE-NP BB-].

Moderate debt servicing requirement post completion of IPO

The company completed IPO of Rs. 310 Mn in August 2022. The entire proceed was used to repay debt. Long-term loans reduced from Rs. 640 Mn at the end of FY22 to Rs. 360 Mn at the end of 9MFY23. Consequently, the company's scheduled debt servicing in the initial years of operations has reduced significantly. This is likely to put less burden on operational cash accruals for debt servicing, leading to likely increase in distributable profits.

Power purchase agreement with sufficient period coverage

PPL had entered into a long term PPA with NEA in 2017 for sale of power generated from 4.96 MW hydro power and the basis of arrangement is take or pay. The contracted Plant Load Factor (PLF) is 64.40% with total contracted energy of 27.98 MU (dry season: 8.41 MU and wet season: 19.57 MU). PPA is for the period of 30 years from the COD or till validity of generation license (obtained on September 17, 2018 for 35 years) whichever is earlier. PPA period may be extended with mutual consensus during the last six months of validity. Tariff rate as per PPA is Rs 4.80 per kWh for wet season (June to November) and Rs 8.40 per kWh for dry season (December to May) with 3% annual escalation on base tariff for 8 years.

Favorable Government policies towards power sector

Government of Nepal (GoN) considers power generation as priority sector and intends to maximize private sector participation in generation of electricity by offering different exemptions and facilities on power sector. 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 towards 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 whose capacity is higher than 40 MW, completing financial closure within mid -April 2029. 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. Also, increasing trend of cross-border energy trade and its prospect in upcoming days with bilateral agreements with the neighboring nations shows positive outlook on long- term demand for the power sector.

About the company

Peoples Power Limited (PPL) was incorporated on January 26, 2017. It is promoted by individual promoters for setting up of a 4.96MW run-of-river Upper Puwa-II hydropower project. The project is being constructed under "BOOT" (Build, Own, Operate and transfer) model and is located in Sakhejung and Maipokhari VDC of Ilam district of Nepal.

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