

Barun Hydropower Company Limited

Ratings

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

* The issuer rating is subject to overall gearing ratio of the company not exceeding 0.5x at the end of FY23 (FY refers to the twelve-month period ending mid-July).

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB+ (Is)' assigned to Barun Hydropower Company Limited (BHCL). 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 rating assigned to BHCL continues to remain constrained by moderate historical power generation track record of the company, albeit with improving trend in 9MFY23 (Unaudited, refers to the nine-month period ended mid-April 2023), hydrology risk associated with run-of-the river power generation, risk of natural calamities, exposure to regulatory risk and volatile interest rates. The rating, however, derives strengths from the experienced promoters and management team, presence of Power Purchase Agreement (PPA) with sufficient period coverage, and moderate financial risk profile with comfortable gearing levels. The rating also factors in moderate counter party risk and government support for the power sector. The rating also takes cognizance of successful completion of the right share issued of Rs. 268 Mn by the company in October 2022.

Going forward, the ability the company to successfully reduce the gap between operational PLF and contracted PLF with timely receipt of payments from Nepal Electricity Authority (NEA) will be the key rating sensitivities. Furthermore, any substantial increase in exposure to group associates/other projects or any other substantial capital commitment that could lead to material deterioration in the company's capital structure from current levels will also be critical from analytical perspective.

Detailed description of the key rating drivers

Key Rating Weaknesses

Moderate historical power generation track record, albeit with improving trend in 9MFY23

BHCL has been operating a run-of-the-river 4.5 MW hydropower project in Shankhuwasava district of Nepal since August 2011. The plant operated at ~54% of generation capacity in FY22 (Audited, FY refers to twelve-month period ended on July 2022). The annual contracted PLF of the projects is 66.06% of the generation capacity. During FY22, the project's Plant Load Factor (PLF) was at 83% of contracted capacity. The electricity generated during FY22 was 21.48 MU as compared to 14.19 MU in FY21 on account of switching to new 220 kV transmission line in mid- August 2022 coupled with improvement in hydrology. The project's operational performance further improved to ~88% of contracted capacity in 9MFY23. The company's ability to continue to reduce the gap between operational PLF and contracted PLF, on a sustained basis, remains to be seen and 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).

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

Hewa Khola Small Hydropower Project (HKHP) utilizes discharge from Hewa Khola having catchment area of 81.03 sq.km based on perennial river. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

Risk of Natural Calamities

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. Furthermore, BHCL's operations are currently impacted by the recent flood on Hewa Khola. Assessment of the damages is in progress. Nonetheless, in case of a prolonged plant downtime, the company's returns are likely to be supported, to some extent, by the insurance coverage taken by the company.

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

BHCL is managed under the overall guidance of the company's Board of Directors (BoD) with members having wide experience in the power sector. BHCL has seven Board of directors, chaired by Dr. Bhushan Guragain, MSc in public health from Harvard School of Public Health, with more than 10 years of experience in hydropower and health sector. Company management team is led by Mr. Sandeep Adhikari, MBS, acting CEO of the company and has more than 10 years of experience in banking sectors and 2 years in hydropower sector. He is supported by other experienced management team members.

Power purchase agreement with sufficient period coverage and moderate counter-party risk

BHCL had entered into PPA with Nepal Electricity Authority (NEA) for 2.4 MW as on September 19, 2007 which was amended on August 26, 2009 for additional 2.1 MW for sale of entire power generated by the plant. The PPA is valid till August 2041 and may be extended with mutual consensus through discussion from last six month of validity. Tariff rate as per PPA for HKHP is Rs. 3.90 and Rs. 4.80 per Kwh for wet season (Mid-April to Mid-December) and the tariff rate for dry season (Mid-December to Mid-April) is Rs. 5.52 and Rs. 8.40 per Kwh for 2.4 MW and 2.1 MW, respectively, with escalations on base tariff for 9 years available only for 2.1 MW. Furthermore, NEA is owned by Government of Nepal and hence counter party default risk is moderate; however, timely realization of receivables is critical for the company and remains a key monitorable.

Moderate financial risk profile with comfortable gearing ratio

During FY22, BHCL reported the total income of Rs. 94 Mn through the sale of electricity as compared to Rs. 60 Mn in FY21 on account of resolution of tripping issue in transmission line coupled with improvement in hydrology. Consequently, PBILDT margin rangebound around ~70% in FY22.

Overall gearing ratio, however, improved to 0.68x at the end of FY22 from 0.82x at the end of FY21 on the back of repayment of term loan and increase in net worth due to accretion of profit to net worth. Total debt to Gross Cash Accrual ratio remained moderate at 7.86x during FY22. Amid improving financial performance, the company's capital structure and debt service coverage indicators are likely to improve going forward.

Improvement in Power Evacuation Risk

The company's power evacuation risk has improved substantially after switching to the double circuit 220 kV Koshi Corridor transmission line in August 2021. Prior to this, the power generated from the project was being evacuated through the 33 kv Dharan Dhankuta transmission line, which had tripping issues leading to a high power evacuation risk for the company, particularly in the peak season. However, since switching to the 220kV transmission line, the issues related to tripping has been reduced significantly and company's billing units has correspondingly increased since the switch. Thus, power evacuation risk of the hydropower project is likely to remain on the lower side going forward.

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

BHCL is a public limited company, incorporated in January 20, 2004 as a private limited company and later converted to public limited company in July 15, 2009. It is promoted by individual promoters having long experience in the hydropower and other sectors for setting up Hydroelectric Project (HEP) in Nepal. The company was listed with Nepal Stock Exchange (NEPSE) in October 2015. BHCL is involved in the operation of 4.5 MW run-of-the-river Hewa Khola Small Hydropower Project (HKHP) in Shankwasava District, Nepal which has been in commercial operation since August 6, 2011. The power project utilizes available head and flow from Hewa Khola (river) with catchment area of 81.03 km² and 4.5 m³/s design discharge at 41% exceedance flow.

Brief financial performance of BHCL during last 3 years is given below:

(Rs. In Million)

Particulars	FY20 (A)	FY21 (A)	FY22 (A)
Income from power sales	85	59.76	94
PBILDT Margin (%)	65.21	71.82	68.91
Overall Gearing (times)	0.9	0.82	0.68
Interest coverage (times)	1.84	2.02	3.63
Current Ratio (times)	2.81	3	1.92
Total Debt / Gross Cash Accruals (times)	9.69	10.45	7.86

A: Audited

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