

KBNR Isuwa Power Limited

Ratings

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Long Term Bank Facilities	9,069.00	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	100.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	9,169.00 (Nine Billion and One Hundred Sixty-Nine Million Only)		

Details of Facilities in Annexure 1

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

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of KBNR continue to remain constrained by the project implementation risk associated with its under-construction hydropower project. The ratings also factor in risk of natural calamities, exposure to power evacuation risk, hydrology risk associated with run-of-the-river power generation, however mitigated to an extent due to peaking reservoir and exposure to regulatory risk and volatile interest rate risk.

The ratings, however, continue to derive strength from the experienced promoters and management team in hydropower sector, presence of power purchase agreement (PPA) with sufficient period coverage, relatively high dry energy mix, moderate counter party risk and full financial closure achieved for the project. The ratings also factor in current government support for the power sector.

Going forward, the ability of the company to timely execute the project within Required Commercial Operation Date (RCOD) avoiding any time or cost overrun and early stabilization thereafter will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Project implementation risk

KBNR is setting up a 97.2 MW peaking run-of-river Isuwa Khola Hydropower Project in Sankhuwasabha district of Nepal. The estimated total cost of the project is Rs. 11,338.33 Mn (cost per MW of Rs. 116.64 Mn) to be funded in debt equity ratio of 80:20 (debt of Rs. 9,070.66 Mn and equity of Rs. 2,267.67 Mn). Till May 16, 2023, ~38.94% of the total project cost (i.e., Rs. 4,415 Mn) had been incurred. As on mid-May 2023, Rs. 1,916 Mn equity has already been infused. Furthermore, as per the progress report as on May 16, 2023, physical progress was around 46%. This exposes the company towards project execution risk in terms of completion of the project with-in the envisaged time and cost.

RCOD of the project was July 17, 2023. However, the company has applied for extension of RCOD for additional two years. The extension, if approved, is expected to provide some cushion to complete the project in revised timelines, barring any major setback. However, this exposes the company to the possibility of cost overrun vis-a-vis the initial budgeted cost of the project. If COD doesn't fall within RCOD, the company is bound to pay late COD penalty to Nepal Electricity Authority (NEA). Further, if COD is delayed by 6 months to 18 months from RCOD, then the number of escalations in tariff rate will decrease to 7 times from 8 times. It is crucial for the company to complete the project within the timelines to have the accelerated clauses of tariff. Any delay in the same would lead to impact on project returns and debt servicing capabilities which is critical from analytical perspective.

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

Power evacuation risk

The Power generated from the project is proposed to be evacuated through ~22km long Double circuit 230kV Transmission Line to NEA's under-construction Tumlingtar sub-station. The construction of transmission line from powerhouse to substation is within the scope of the company while that for the sub-station is under NEA's purview. Timely completion of the transmission lines and the substation will be crucial for the company from revenue generation prospective.

Hydrology risk associated with run-of-the-river power generation, however mitigated to some extent due to peaking reservoir

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-May to Mid-November) and less during the dry season (Mid-November to Mid-May). KBNR is proposed to utilize discharge from Ishuwa Khola having catchment area of 160.79 sq. kms based on snow fed Perennial River. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ khola. However, the risk is minimized to some extent in the project due to peaking reservoir of six hours for dry season which will be used during peak time of dry season.

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. KBNR is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Exposure to volatile interest rate

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 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**

KBNR is managed by three Board of Directors and board is chaired by Mr. Birendra Bahadur Neupane who has around four decades of experience in civil construction including experience in hydropower sector. He has been associated in various

operational hydropower projects under Himal Dolakha Hydropower Company Limited (HDHCL) and Joshi Hydropower Development Company Limited and under-constructed hydropower projects.

Power purchase agreement with sufficient period coverage

KBNR had entered into a long term PPA with NEA as on October 12, 2018 for sale of 97.2 MW power to be generated from the project. PPA has been entered for the period of 30 years from the COD or till validity of generation license (obtained on June 09, 2020 for 35 years) whichever is earlier. Tariff rate as per PPA is Rs 4.80 per KWh for wet season (Mid-May to Mid-November) and the tariff rate for peak dry season (Mid-November to Mid-May) is Rs 8.55 to 10.55 per KWh depending on the peak hours while the non-peak rate for the dry season is 8.40 per Kwh, with 3% annual escalation on base tariff for 8 years. The PPA is under the take or pay modality, which eliminates the risks related to tariff and offtake of the energy to be generated by the project.

Following six-month wet and six-month dry season, the contracted Plant Load Factor (PLF) for total 97.2 MW is 79.19% at probability of exceedance of 59% with total contracted energy of 674.30 MU (i.e., 262.54 MU for dry season and 411.76 MU for wet season) with relatively higher dry energy mix of ~39% of the total contracted energy, which augurs well for the company's income profile.

Favorable Government policies towards power sector

Government of Nepal (GoN) considers hydropower generation as a 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 the 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

KBNR Isuwa Power Limited (KBNR) is a public limited company, incorporated on December 18, 2017. It is promoted by an institutional promoter and a group of individual promoters to develop Hydropower in Nepal under "BOOT" (Build, Own, Operate and Transfer) model. KBNR is setting up Isuwa Khola Hydropower Project (IKHP) in Sankhuwasabha district of Nepal. The project is proposed to utilize available head and flow from Isuwa Khola (river), which is a tributary of Arun River.

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	9,069.00	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	100.00	CARE-NP A4
Total		9,169.00	

Contact us**Analyst Contact**

Ms. Poonam Agarwal

+977-01-4012630

poonamagarwal@careratingsnepal.com

Mr. Santosh Pudasaini

+977-01-4012628

pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

+977-9818832909

achin.nirwani@careratingsnepal.com

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