

Kalinchock Hydropower Limited

Rating

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

**The issuer rating is subject to overall gearing ratio of the company not exceeding 2.50x at the end of FY24.*

CARE Ratings Nepal Limited (CRNL) has assigned issuer rating of 'CARE-NP BB (Is)' to Kalinchock Hydropower Limited (KHL). 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 KHL is constrained by project implementation risk associated with its under-construction hydropower project. The rating also factors in the hydrology risk associated with run-of-the-river power generation, risk of natural calamities, power evacuation risk, and the company's exposure to regulatory risk and volatile interest rate risk. The rating, however, derives strength from the company's experienced board members and management team in the related field, 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

KHL is setting up a 5 MW, run-of-river, Sangu (Sorun) Khola Hydroelectric Project (SKHP) in Dolakha District of Nepal. The total cost of the project is estimated at Rs. 1,000 Mn (Rs. 200 Mn/MW). The proposed funding mix for the estimated cost is debt and equity in the ratio of 70:30 (i.e., debt of Rs. 700 Mn and equity of Rs. 300 Mn). The debt of the project has been fully tied up. The company has achieved physical progress of around 50% till end of July 2023. Out of the total capex planned, as on May 14, 2023, the company has incurred a total expenditure of Rs. 241 Mn funded out of promoter's contribution of Rs. 150 Mn, term loan of Rs. 19 Mn and remaining as payables. This exposes the company towards project execution within the envisaged time and cost.

Required Commercial Operation Date (RCOD) of the project has been extended till April 11, 2025 from April 13, 2023 owing to delays in construction amid the pandemic led disruptions. The extension is expected to provide ample cushion to complete the project in revised timeframe, barring any major setback. However, if the project is not completed within the revised 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.

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 (June to November) and less during the dry season (December to May).

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.

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

The power generated by SKHP is proposed to be evacuated to NEA's operational Singati Substation located in Dolakha District of Nepal. The company is required to construct approximately 8 km long 132 kV 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. KHL 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 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

KHL has five directors in its board, chaired by Ms. Indira Panta. She is also the Chairperson of Royal Multipurpose Cooperative Limited. She was former board member of Sahas Hydro Private Limited and vice chairperson of ICA-AP Committee on Cooperatives in Educational Institution. Mr. Ram Chandra Upreti, Director of the company is also the chairman of Nepal Multipurpose Cooperative Limited and Sayapatri Nepal International Private Limited.

Mr. Bhabani Pokharel, Director of the company is also the executive chairman of Subharatna Saving and Credit Cooperative. Mr. Subodh Rayamajhee, Director of the company is also the Managing Director of Sagarmatha Education & Research Academy (SERA). Ms. Ajina Tamrakar, Director of the company is involved in a number of organizations in different capacities, particularly in the field of finance. The promoters have also worked in development of Sahas Urja Company Limited's Solu Khola (Dudhkoshi) Hydroelectric Project (86 MW) which is operational.

Power purchase agreement with sufficient period coverage

KHL has entered into PPA with Nepal Electricity Authority (NEA) as on November 25, 2018 for sale of 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. Timely completion of project within the RCOD is crucial for the company to avail the benefits of all the escalations. Following six-month wet and six-month dry season, the total contracted energy of the project is 29.21 million units (MU) with relatively higher dry energy mix of ~30% 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 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

Kalinchock Hydropower Limited (KHL), incorporated on April 08, 2016, and converted into a public limited company on June 15, 2022 is involved in developing a 5 MW run-of-river Sangu (Sorun) Khola Hydroelectric Project (SKHP) in Dolakha District of Nepal. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

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