

Upper Lohore Khola Hydropower Company Limited

Ratings

Facilities/Instruments*	Amount (Rs. Million)	Rating ¹	Rating Action
Long Term Bank Facilities	567.60	CARE-NP BB- [Double B Minus]	Reaffirmed
Total Facilities	567.60 (Five Hundred and Sixty-Seven Million and Sixty Thousand Only)		
Issuer Rating	NA	CARE-NP BB- (Is) [Double B Minus (Issuer)]	Reaffirmed

The issuer rating is subject to the company maintaining overall gearing not exceeding 2.25x at the end of FY24. (FY refers to the twelve- month period ending mid-July)

**Details of Facilities/Instruments to be rated- Annexure 1*

CRNL has reaffirmed Issuer Rating of 'CARE-NP BB- (Is)' assigned to Upper Lohore Khola Hydropower Company Limited (ULKH). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Also, CRNL has reaffirmed the rating of "CARE-NP BB-" assigned to the long-term bank facilities of ULKH.

Detailed Rationale & Key Rating Drivers

The ratings assigned to ULKH continue to be constrained by the project implementation risk and operations stabilization risk thereafter associated with its under-construction hydropower project amid time and cost overrun. The rating is also constrained by the possibility of delay in commercial operations extending beyond the Required Commercial Operation Date (RCOD) leading to a possible penalty for late COD and loss of escalation tariffs, if the COD is delayed by more than six months from RCOD. The rating also factors in hydrology risk associated with run-of-the-river power generation, exposure to volatile interest, regulatory risk and risk of natural calamities.

The rating, however, derives strength from the experienced directors and management team in the power sector, presence of power purchase agreement (PPA) with sufficient period coverage, low power evacuation risk, favorable government policies for the power sector and moderate counter party risk. The rating also takes cognizance of the ongoing Initial Public Offering (IPO) of the company, the proceeds of which is likely to be used partly for funding the remaining cost of the project and partly for debt repayment.

Going forward, the ability of the company to successfully execute the project without further cost and time overrun and early stabilization thereafter will be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Residual project implementation risk and operations stabilization risk thereafter

ULKH is setting up 4MW run-of-river Upper Lohore Hydropower Project (ULHP) in Dailekh district of Nepal. The revised estimated total cost for the project is Rs. 947.22 Mn (i.e. Rs. 236.80 Mn per MW) which is proposed to be funded through debt-to-equity ratio of 60:40. Cost escalations from initially budgeted Rs. 820.72 Mn was partly on account of change in scope of the project but majorly on account of time overrun leading to higher interest during construction and inflated price of machineries than earlier expectations. The revised estimated project cost of Rs. 236.80 Mn per MW is considered relatively higher; thus, the payback period of the company is expected to remain longer.

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

As on mid-July 2023, the verified total expenditure incurred for the project was Rs. 807.13 Mn (~85% financial progress) with ~87% physical progress. Till mid-July 2023 the funding mix has been through term loan of Rs. 567.60 Mn and balance through the promoters' contribution. Progress of the project over the last year had been slower than expected amid reluctance to increase debt for the escalated cost. Funding challenges is expected to ease post completion of the ongoing IPO (currently in process of allotment) by August end 2023. Rest of the funding required for the project is proposed to be utilised from the proceeds of the IPO.

The Required Commercial Operation Date (RCOD) of the project was July 25, 2022 and the company has applied for further extension of the RCOD. If approved, the extended RCOD is likely to provide relief in terms of completing the project within the additional time frame. However, 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 six months from RCOD, there are restriction clauses in escalation of tariff rate as well. Thus, timely approval of RCOD from regulatory bodies and actual COD without further delay would be key monitorable aspect. Furthermore, the company also remains exposed to operations stabilization risk thereafter to achieve the envisaged income.

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 seasonal river flows are high (Mid-April to Mid-December) and less during the winter season (Mid-December to Mid-April). The project is exposed to risk associated with variation in discharge of water from the aforesaid river/khola.

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.

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

Key Rating Strength

Strong promoters and experienced management team

ULKH's board comprises of three directors. The board is chaired by Mr. Kedar Nath Poudel, who has more than 30 years of experience in education, trading and hydropower sectors. He is also a director at Gaurishankar Power Development Limited and Shikhar Power Development Private Limited. Other directors of the company also have experience in various sector. Furthermore, the board is supported by an experienced team across various functions.

Power purchase agreement with sufficient period coverage and low power evacuation risk

ULKH had entered into a PPA with NEA as on March 22, 2018 for sale of power to be generated from 4MW hydro power project. The tenure of the PPA is 30 years from commercial operation date (COD) or till validity of Generation License (obtained on January 4, 2019 for 35 years), whichever is earlier. The contracted energy Plant Load Factor (PLF) for the project is 60.56% with total contracted energy of 21.22 million units (MU). The tariff for wet season (Mid-April to Mid-December) is Rs 4.80 per kWh and for dry season (Mid- December to Mid-April) is Rs. 8.40 per kWh with 3% escalation on base tariff for 8 years after completion of 12 months from COD date.

The power generated from the project will be evacuated through ~19 km long 33kV transmission line to NEA's operational Dailekh Bazar Substation. Construction of the transmission line from powerhouse to the substation is within the scope of ULKH and is in final stage of completion - 17km completed as on mid-July 2023.

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. 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. 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

Upper Lohore Khola Hydropower Company (ULKH) was incorporated as Private Company on November 01, 2017 and later converted to Public Limited Company on July 07, 2021. The company has been promoted by a group of individual promoters having long experience in various sectors. It is setting up 4 MW run-of-river, Upper Lohore Hydropower Project (ULHP) in Dailekh district of Nepal. The project is being constructed under "BOOT" (Build, Own, Operate and transfer) model having 49.80 sq. kms catchment area and 2.50 m3/sec design discharge at 40% exceedance flow. ULKHP

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