# Unitech Hydropower Company Private Limited: [ICRANP] LB+/A4 assigned

**December 23, 2020**

## Summary of rated instruments

| Instrument * | Rated Amount (NPR Million) | Rating Action |
|---|---|---|
| Long-term loan; Fund based | 800 | [ICRANP] LB+; Assigned |
| Short-term loans; Fund based (within term loan) | (120) | [ICRANP] A4; Assigned |
| Short-term loans; Non-fund based (within term loan) | (440) | [ICRANP] A4; Assigned |
| **Total** | **800** | |

** Instrument details are provided in Annexure-1*

## Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LB+ (pronounced ICRA NP L B plus) to Unitech Hydropower Company Private Limited's (UHCPL) long-term loan and a short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to its short-term loans.

## Rationale

The assigned ratings are constrained by the inherent project execution risks associated with the 5.8-MW Upper Phawa Khola Hydroelectric Project (HEP), which is in its initial stage of development. Along with the slackness brought on by the Covid-19 pandemic and these execution risks, the company is unlikely to meet its current required commercial operation date (RCOD) of July 31, 2021, which exposes the project to possible project cost escalation, late COD penalty and loss of tariff escalations. However, the extent of such exposure would remain dependent on the possible extension of the RCOD by Nepal Electricity Authority (NEA) owing to impacts of the lockdown on the hydropower sector in general. The assigned ratings are also constrained by the relatively higher project cost of ~NPR 214 million per MW, which could impact the company's return indicators and coverage ratios. Further, the assigned ratings remain constrained by the monthly short supply penalty as well as the 30% dry energy short supply penalty as indicated in the PPA, which can impact the revenue profile in case of fluctuations in hydrology. Similarly, ratings concern also emanate from hydrological risks, given the absence of a deemed generation clause in the power purchase agreement (PPA) for which no compensation is payable to the company by the NEA in case of adverse flow in the river. The ratings are also constrained by the counterparty credit exposure of NEA, which has a moderate financial profile (with recent improvements). This is partly mitigated by the sovereign support of the Government of Nepal (GoN) to the NEA and its past track record of timely payments to independent power producers (IPPs).

Nonetheless, the rating action considers the moderate to low funding risks as financial closure has now been achieved for the current cost estimates and equity injection is gradually increasing. The ratings also remain supported by the presence of a high dry energy mix of ~30% under the new six-six months dry-to-wet energy mix modality of the PPA and eight tariff escalations on the base rate, which would support the revenue profile, return indicators and other coverage ratios amid the fixed tariff regime. Also, the ratings are further supported by low evacuation risk due to the presence of NEA's operational Kabeli (Amarpur) sub-station. Further, the ratings take comfort from the firm long-term PPA for the entire project capacity, which eliminates the tariff and offtake risks for the energy to be generated by the project.

Going forward, UHCPL's ability to commission the project within the estimated cost and timeline, timely infuse the balance equity from the major promoter, extend the RCOD by the NEA to address slackness in work due to the pandemic related lockdown, and achieve its designed operating parameters as well as interest rate volatility in the market, will all be key drivers for determining the project return metrics and coverage indicators for the company.

## Key rating drivers

### Credit strengths

**Lower evacuation risk** – The power generated from the project would be evacuated through the Kabeli (Amarpur) sub-station of NEA, which is already operational.

**Low tariff and offtake risks with presence of long-term PPA at predetermined tariffs and escalations** – The project's tariff and offtake risks remain low as the company has a 30-year PPA with the NEA (the sole purchaser and distributor of electricity in Nepal) for its entire project capacity. As per the PPA, the pre-defined tariffs are NPR 4.8 per kWh for the wet season (six months) and NPR 8.4 per kWh for the dry season with 3% annual escalation on the base tariff for eight times. However, a provision of 10% reserve margin clause in the PPA empowers the NEA to offtake such 10% energy based on the dispatch instruction of the load dispatch centre, without any compensation to UHCPL in case of the non-offtake of the same. The revenue of the company would be impacted if such a scenario prevails.

**Debt component tied up at current cost estimates, equity being gradually injected -** The project's current cost estimate is NPR 1,243 million, which is to be funded in a debt-to-equity ratio of ~64:36. The financial closure has been achieved through a consortium of three financial institutions. The promoters have already injected ~61% of the total equity requirements till end-November 2020, which is being used towards initial project development. The promoters are committed to inject the balance equity with the progress of the project. However, the timely infusion of equity could remain critical, given the short timeframe planned for the project execution.

### Credit challenges

**High inherent project execution risks**– The 5.8-MW project is in its initial stage of development (25% financial progress so far) with development work just begun, which exposes the project to inherent project execution risks. The execution risk is further accentuated by the project being the promoter's maiden hydropower development project.

**Stretched coverage ratios and financial indicators amid delayed project commissioning and relatively high estimated project cost -** The project has been budgeted to be developed at a relatively high cost of NPR 214 million per MW. With the project being in its initial stage as well as the slackness in development work due to the Covid-19 pandemic, any delay in project execution, for any reason, could lead to the company failing to meet its RCOD of July 31, 2021, leading to project cost escalation and exposing the project to late COD penalty as well as to loss of tariff escalations. All these would impact UHCPL's revenue stream as well as coverage indicators. However, the revenue profile is aided by the presence of ~30% dry energy in the overall mix as well as eight times tariff escalation on the base tariff.

**High hydrological risk amid lack of deemed generation clause with stringent PPA terms -** Like most of the small rivers in Nepal, Phawa River is also an ungauged, rain-fed, perennial river. Hence, the lack of a deemed generation clause in the PPA exposes both the projects to hydrological risk in case of adverse river flow scenarios without receiving any compensation for such losses. Hydrological risks are further accentuated as the PPA for the project has signed under the 6-6 months dry and wet energy modality, with supply of at least 30% dry contract energy. In case the project fails to supply a minimum of 30% energy in the dry months, the supplied dry energy would be assumed to be 30% of the deemed annual energy and the additional energy supplied in the wet months would remain unpaid.

**Analytical approach:** For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

**Links to applicable criteria:**
Corporate Credit Rating Methodology

## About the company

Incorporated on September 26, 2014 as a private limited company, Unitech Hydropower Company Private Limited (UHCPL) was established for the production and distribution of electricity. As of end-November 2020, the paid-up capital of UHCPL was ~NPR 269 million with its major promoters being Mr. Tika Prasad Sangraula (11%), Mr. Narendra Mainali (11%), Mr. Mahendra Prasai (10%), Mr. Ananda Kumar Basnet (9%) and Dr. Shambhu Nawal (8%), among others.

UHCPL is developing a 5.8-MW Upper Phawa Khola HEP on Phawa River in Taplejung district of Province 1 of Nepal. The project was estimated to be developed at a budgeted cost of ~NPR 1,243 million (~NPR 214 million per MW) and was budgeted to be developed at a debt-to-equity ratio of ~64:36. The debt portion is being financed by a consortium of three banks. Out of the total equity requirement, the promoters have already injected ~61% capital commitment. As on end-November 2020, the project achieved ~25% financial progress.

## Annexure-1: Instrument details

| Instrument * | Rated Amount (NPR Million) | Rating Action |
|---|---|---|
| **Fund based facilities; Long term loan (A)** | **800** | |
| Term Loan (long term; fund based) | 800 | [ICRANP] LB+; Assigned |
| | | |
| **Fund-based facilities; Short term loans (B)** | **0** | |
| Bridge gap loan (within the term loan) | (120) | [ICRANP] A4; Assigned |
| | | |
| **Non-fund-based facilities; short term loans (C)** | **0** | |
| Letter of Credit (within the term loan) | (440) | [ICRANP] A4; Assigned |
| | | |
| **Total (A+B+C)** | **800** | |

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## About ICRA Nepal Limited

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Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

For more information, visit www.icranepal.com

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