

Khani Khola Hydropower Company Limited: [ICRANP] LB-/A4 Assigned

December 14, 2020

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Long-term loan; Fund-based	838.36	[ICRANP] LB-; Assigned
Short-term loan; Fund-based	60.00	[ICRANP] A4; Assigned
Total	898.36	

*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 minus) to Khani Khola Hydropower Company Limited's (KKHC) long-term loan and a short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to its short-term loan.

Rationale

The assigned ratings are constrained by the subdued operating performance of the company's two operational hydro-electric projects¹ (HEPs), on account of non-availability of requisite evacuation structures, despite being operational for around four years. Evacuation of power through 11kVA local feeders has resulted in sizeable tripping losses and the projects could supply only ~30-40% of contract energy in the last three fiscal years. This resulted in accumulated losses of ~NPR 119 million as of mid-July 2020. KKHC's debt service indicators have also remained weak so far (0.11 times in FY2020) and had to be supported by promoter advances. Hydrological risks also remain high, given the fact that both of KKHC's operational projects derive hydrology from the same streams and the power purchase agreement (PPA) does not cover deemed generation clauses. Rating concerns further arise from the interest rate volatility in the market and the counterparty credit exposure with the Nepal Electricity Authority (NEA), which has a moderate financial profile (with recent improvements). This is partly mitigated by the sovereign support of the Government of Nepal to the NEA and its past track record of timely payments to independent power producers.

Nonetheless, the ratings factor in the financial strength of the company's promoters who have extended support to meet debt servicing over the years. The ratings are also supported by the recent improvements in generation trend of the 4.36 MW project², after shifting to a better evacuation structure from March 2020 onwards. The project generated ~84% of contract energy in 4M FY2021, substantially higher than ~35-49% generation in comparable periods of earlier three fiscals. Further, the ratings take comfort from the positive demand outlook for the energy sector, owing to the supply-demand gap in the power sector as well as the increasing energy consumption in the nation. Also, firm long-term PPAs for the projects with fixed tariff and fixed escalations eliminate the offtake and tariff risks. Going forward, timely completion of repairs to the 2-MW project along with the sustained improvement in generation from both projects would remain critical for the company's financial profile.

Key rating drivers

Credit strengths

Strong promoter group – KKHC is mainly promoted by institutions and individuals affiliated to the Prabhu Group. The promoters have supported KKHC by extending incremental interest free loans over the years, which has aided the debt servicing so far. ICRA Nepal derives comfort from the established track record of the promoter's support, while assigning the ratings, and also expects similar support in case of financial exigencies.

¹ 4.36-MW Tungun-Thosne HEP became operational in October 2016 and its cascade 2-MW Khanikhola HEP was operational from December 2016

² The 2-MW project is still under repairs for damages caused by the July 2019 floods.

Improved generation after availability of better evacuation arrangement – The projects have shifted to a better evacuation arrangement from March 2020 onwards, after suffering heavily by evacuating through 11 kVA local feeders prior to this. The energy generated is now being evacuated through the Malta substation to the Mandu substation before being finally connected to the national grid through Kulekhani-I’s transmission line. This arrangement has evidenced the ability to evacuate the improved generation wherein the 4.36-MW project generated and supplied ~84% of contract energy in 4M FY2021, substantially higher than ~35-49% generation in comparable periods from the earlier three fiscals. The projects’ ability to sustain/improve the generation trend would remain critical in determining its future revenue metrics and, hence, would remain a key monitorable.

Low offtake and tariff risks – The offtake risks remain low for the projects as they have a 30-year PPA with the NEA (the sole purchaser and distributor of electricity in Nepal) on a take-or-pay basis. The predetermined tariff with five escalations lowers the tariff risks for the projects. Both projects are also eligible for all the tariff escalations as provided in the PPAs.

Credit challenges

Weak financial profile with sizeable accumulated losses – KKHC’s financial profile has depleted over the years with sizeable YoY losses on account of lost revenues amid the non-availability of requisite evacuation structure of NEA (i.e., Malta to Matatirtha transmission line). The company’s net worth, hence, stood negative at ~NPR 119 million as of mid-July 2020 and recovering the same would remain a major challenge, despite the improved generation. Additionally, the 2-MW project is still to complete the repairs to damages caused by the July 2019 floods. Significant delays in repairs were mainly on account of imported electromechanical equipment being stuck in customs point since the start of Covid-19. Any further unexpected delays in completion of these repairs would also impact the company’s future revenue profile.

Subdued debt service indicators requiring promoter support so far, recent loan rescheduling could provide comfort – Given the weak revenues, KKHC’s internal cash accruals have remained inadequate to serve its debt obligations till FY2019 with DSCR remaining less than 1.0 time in the last four fiscals. The shortfall had to be met through promoter advances. However, the outstanding debt has been rescheduled over a 16-year period starting from April 2020, against the earlier plans of repayment over 12 years. Though the revenue performance has improved in recent months, sustainability of the same remains to be seen. Further, the seasonality in revenues, along with the company’s ability to control the operating costs would have a bearing over its debt-servicing capacity, especially given the ballooning repayment structure. KKHC’s track record in debt servicing and augmenting its liquidity profile would be crucial from a rating perspective.

High hydrological risks amid lack of deemed generation clause in PPA and weak generation trend in dry season³ – The lack of a deemed generation clause in the PPAs exposes the company to hydrological risks in case of adverse river flow scenarios without receiving any compensation for such losses. The risk is further accentuated by the fact that both the operational projects lie in the same river. Since these are relatively low discharge projects, a slight fall in hydrology could impact the energy generation considerably and create pressure on the debt coverage metrics. Rating concerns further emanate from the projects’ weak generation in the past dry seasons, wherein the earlier evacuation structures could also have transmitted the entire contract energy. The 4.36-MW project generated ~49% of the contract energy for the dry season in the last four fiscals, while the 2-MW project generated only ~27% of its dry season contract energy from FY2017 to FY2019 (not operational afterwards).

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 as a private limited company in October 2012, Khani Khola Hydropower Company Limited (KKHC) was converted to a public limited company on March 27, 2013. The company’s paid-up capital was ~NPR 466 million as of mid-July 2020, which was 70% promoter held and 30% public held. As on date, the company’s major promoters include Pashupati Energy Development Company Private Limited (~36% stake), Baidik Hydro Investment Company Private Limited (~14%), Prabhu Bank Limited (rated IR BBB by ICRA Nepal, holds ~8% stake), Swachha Investment Private Limited (~6%), and

³ Period from mid-December to mid-April, when the projects are supposed to generate 15% of the annual contract energy.

Mr. Mijas Bhattachan (~5%). The company has been operating two run-of-river type projects since FY2017, viz. a 4.36-MW Tungun-Thosne Hydropower Project and its 2-MW cascade project, namely the Khanikhola Hydropower Project in Bhattedanda, Sankhu and Ikudol VDCs of Lalitpur district, Province 3 of Nepal.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Provisional)
Operating income (OI; NPR million)	35	69	63	51
Profit after tax (NPR million)	-127	-162	-149	-151
OPBITDA/OI (%)	-51%	47%	53%	25%
RoCE (%)	-7%	-12%	-5%	-6%
Total debt/Tangible net worth (TNW; times)	2.47	5.06	30.67	-8.57
Total outside liabilities/TNW (times)	2.55	5.23	31.59	-9.08
Total debt/OPBITDA (times)	-47.02	28.44	29.17	81.16
Interest coverage (times)	-0.39	0.33	0.35	0.15
DSCR (times)	-0.31	0.31	0.29	0.11
Net working capital/OI (%)	-31%	-17%	-21%	-74%

Source: Company data

Annexure-1: Instrument details

Instrument	Rated Amount (NPR Million)	Rating Action
Fund based facilities; Long term loan (A)	838.36	[ICRANP] LB-; Assigned
Term Loans I-IV	838.36	
Fund-based facilities; Short term loans (B)	60.00	[ICRANP] A4; Assigned
Demand Loan	30.00	
Overdraft	30.00	
Total (A+B)	898.36	

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