

Terhathum Power Company Limited: [ICRANP-IR] BB assigned; [ICRANP] LBB/A4+ reaffirmed

January 4, 2021

Summary of rated instruments

Instrument *	Rated Amount (NPR Million)	Rating Action
Issuer Rating	NA	[ICRANP-IR] BB; Assigned
Long-term Loans	1,000.0	[ICRANP] LBB; Reaffirmed
Short-term Loans	64.5	[ICRANP] A4+; Reaffirmed
Total	1,064.5	

* Instrument details are provided in [Annexure-1](#)

Rating action

ICRA Nepal has assigned an issuer rating of [ICRANP-IR] BB (pronounced ICRA NP issuer rating double B) to Terhathum Power Company Limited (TPCL). ICRA Nepal has also reaffirmed a long-term rating of [ICRANP] LBB (pronounced ICRA NP L double B) and a short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus).

Rationale

The ratings action factors in the completion of the 7.5-MW Upper Khorunga Small Hydropower Project [albeit a delay of around two months from the actual commercial operation date (RCOD)] at a relatively lower cost of ~NPR 179 million per MW. This eliminates the project execution risks and enables it in availing all the five tariff escalations that would be supporting the company's return and coverage indicators amid the fixed tariff and escalation regime. ICRA Nepal also considers the low tariff and offtake risks amid the already signed power purchase agreement (PPA) with the Nepal Electricity Authority (NEA, the sole purchaser and distributor of electricity in Nepal) at pre-determined tariff rates and escalations. Additionally, the positive demand outlook for the energy sector owing to the supply-demand gap as well as increasing energy consumption in the nation, remain rating positives.

Nonetheless, the ratings remain constrained by the project's high evacuation risks as the 220-kVA Basantapur substation (a part of the Koshi Corridor), to be constructed by NEA, is not yet complete. Hence, the project is currently evacuating the energy through the alternative 33-kV Terhathum-Dhankuta-Dharan transmission line. Given the inherent limitations of this evacuation arrangement, the project is now operating under "take and pay" mechanism (as against the "take or pay" modality specified in the PPA) until the development of the Koshi corridor. This resulted in sizeable revenue losses and weak operational performance with the project generating only ~34% of the contracted energy for the initial ~10 months of operation (till mid-December 2020). The ratings are also impacted by the absence of a deemed generation clause in the PPA, which exposes the project to high hydrological risks without receiving any compensation from NEA in case of any adverse flow in the river. This concern is further accentuated by the fact that the rivers' hydrology is dependent on rain-fed perennial source. 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 to NEA and its past track record of timely payments to independent power producers.

Going forward, completion of the required evacuation structure by NEA and hence the project's ability to achieve its designed operating parameters would remain crucial. Besides, good hydrological support and interest rate volatility in the market would also remain key drivers for determining the project return metrics and debt coverage indicators.

Key rating drivers

Credit strengths

Project developed within the budgeted cost and started operations after two months from RCOD - The 7.5-MW project was completed at a cost of ~NPR 179 million per MW against the budgeted cost of ~NPR 184 million per MW. Similarly, the

project started its commercial operation from February 29, 2020, that is, two months after its RCOD. This makes the project eligible for all five tariff escalations. The availability of all tariff escalations would support the company's revenue profile.

Low tariff and off-take risks amid already signed long-term PPA at predetermined tariffs and escalations - The tariff risk is low as the company has a 30-year PPA with NEA for its entire project capacity of 7.5 MW. The pre-defined tariff rates are NPR 4.8 per kWh for the wet season (mid-April to mid-December) and NPR 8.4 per kWh for the dry season with a 3% annual escalation clause in the base tariff for five times.

Credit challenges

High evacuation risk - The Basantapur substation, which is a part of Koshi corridor and a pre-requisite for power evacuation, is still in the development stage. Hence, the energy generated by the project is now being evacuated through the alternative 33-kV Terhathum-Dhankuta-Dharan transmission line. With other operational projects already evacuating energy through the same transmission line along with lower evacuation capacity of this structure, the project has been operating in reduced capacity so far. Also, energy from the project is being taken on "take and pay" basis by NEA till the required evacuation structure is developed. Given the past track record of delays in completion of transmission line projects by NEA, this exposes the project to substantial evacuation risks.

Weak operational performance - The project has been operational for ~10 months till mid-December 2020. During this period, the project's generation has remained weak with gross energy generation at ~34% of the contract energy. The project operated at a net PLF of ~22% (corresponding to ~38% of the contract energy) for the operational five months of FY2020 while for 5M FY2021, the project operated at a net PLF of ~27% (corresponding to ~31% of contract energy for the period). The weak generation was mainly due to non-development of required evacuation structure by NEA, with the project operating at reduced capacity through the alternative evacuation arrangement.

High hydrology risk due to lack of deemed generation clause in the PPA - Lack of a deemed generation clause in the PPA exposes the project to high hydrology risk in case of any adverse river flow scenarios without receiving any compensation for such losses. Additionally, the source rivers are ungauged as well as rain fed that escalate the risk to some extent.

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](#)

[Issuer Rating Methodology](#)

About the company

Initially incorporated as a private limited company on August 16, 2009, Terhathum Power Company Limited (TPCL) was converted into a public limited company on June 21, 2018 to facilitate public participation. The paid-up capital of the company as of mid-December 2020 was NPR 280 million, which was 100% promoter held. As on the same date, the major promoters included Mr. Mohan Kumar Dangri (8% stake), Mr. Bhupati Lal Shrestha (4%), Mr. Ganesh Prasad Kattel (4%), Mr. Pramod Shrestha (3%), Mr. Bijay Sambhample (3%), Mr. Dharma Raj Khadka (3%), Mr. Lachhuman Tiwari (3%), Mr. Shiva Nath Khapung (3%), Mr. Bhawani Prasad Khapung (3%), Mr. Yadav Khapung (2%) and Mr. Mohit Dangri (2%) and other 275 promoters holding ~65% shares.

The company is operating a 7.5-MW Upper Khorunga small hydropower project in Terhathum district, Province 1 of Nepal. The project is a run-of-the-river type and has been developed at 40% probability of exceedance (Q40). The project was commissioned in February 2020, that is, two months after the RCOD and was completed at a cost of ~NPR 179 million per MW against the budgeted cost of ~NPR 184 million per MW.

Annexure-1: Instrument details

Instrument *	Rated Amount (NPR Million)	Rating Action
Issuer Rating	NA	[ICRANP-IR] BB; assigned

Instrument *	Rated Amount (NPR Million)	Rating Action
Term Loan (long-term; fund-based)	1,000.0	[ICRANP] LBB; reaffirmed
Bridge Gap Loan (short-term; fund-based within the term loan)	(150.0)	[ICRANP] A4+; reaffirmed
Overdraft (short-term; fund-based)	60.0	
Performance Bank Guarantee (short term; non-fund based)	4.5	
Total	1,064.5	

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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.

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