

Terhathum Power Company Limited: Ratings reaffirmed

September 25, 2023

Summary of rating action

Instrument * (NPR Million)	Previous Rated Amount	Current Rated Amount	Rating Action
Issuer Rating	NA	NA	[ICRANP-IR] BB; reaffirmed
Long-term Loans	1,000.0	988.0	[ICRANP] LBB; reaffirmed
Short-term Loans	64.5	64.5	[ICRANP] A4+; reaffirmed
Total	1,064.5	1,052.5	

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

Rating action

ICRA Nepal has reaffirmed the issuer rating of [ICRANP-IR] BB (pronounced ICRA NP issuer rating double B) assigned to Terhathum Power Company Limited (TPCL or the company). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any debt instrument.

ICRA Nepal has also reaffirmed the long-term rating of [ICRANP] LBB (pronounced ICRA NP L double B) to the long-term bank loans and the short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to the short-term bank loans of the company.

Rationale

The ratings reaffirmation takes comfort from the last stages of development of NEA's Basantapur substation and associated transmission line, which is likely to remove the evacuation constraints for the operational 7.5MW Upper Khorunga Hydropower Project (HPP) owned by TPCL. This is likely to enable the project to evacuate full energy under the "take or pay" modality as compared to the current "take and pay" modality under contingency evacuation arrangement; which coupled with the low commissioning cost of the project is likely to translate into improved revenue/profitability going forward. ICRA Nepal also notes the company's plan to develop a 2 MW Khorunga-Tangmaya Khola HPP (cascade to the 7.5 MW project) to be funded through the proceeds of proposed 100% rights issuance program, which is likely to add to the company's revenue profile (assuming the success of equity raising program). All these factors are expected to support the company's long-term debt coverage and profitability metrics to some extent. The ratings also factor in the low tariff and offtake risks, amid the already signed power purchase agreement (PPA) under a take or pay modality with the Nepal Electricity Authority (NEA, the sole purchaser and distributor of electricity in Nepal) at predetermined tariff rates fixed tariff escalations for both the projects.

However, the ratings continue to remain constrained by the current moderate to weak financial profile of the company resulting from low energy generation amid evacuation constraint. The project has generated a cumulative net energy equivalent to ~46% of the cumulative PPA contract energy during the first 41 months of its operation (till mid-July 2023). Further, the ratings remain constrained by the project execution risk and funding risk for the 2MW project, as any cost overrun of the project could weaken the overall financial profile of the company further. 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 given the rain-dependent project hydrology amid the absence of snow fed origin of the river.

Going forward, the completion of the required evacuation structures and the projects' ability to achieve the designed operating parameters would remain crucial. Further the company's equity raising program and commissioning of proposed project within the budgeted cost and timeline will also remain among key rating monitorables.

Key rating drivers

Credit strengths

Relatively low project cost – The 7.5MW project was completed at a relatively lower cost of ~NPR 182 million per MW against the budgeted cost of ~NPR 184 million per MW. Similarly, the project started its commercial operation from February 29, 2020, i.e., with a marginal delay of around two months from its RCOD as per the PPA making the project eligible for all five tariff escalations. Further the 2MW project is budgeted to be developed at NPR 201 million per MW through 100% equity financing. The relatively low project cost, availability of tariff escalations and debt-free proposed capex is expected to support the company’s revenue profile and improve the coverage and profitability metrics.

Low tariff and off-take risk; despite the current conditional offtake – The tariff risk and off-take risk for the project is low as the company has a 30-year PPA with NEA for its entire project capacity of 7.5MW and 2MW respectively for both the projects under the take or pay modality. The pre-defined tariff rates for 7.5MW project 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, with similar tariff with eight annual escalations for proposed 2MW project. Although the project is evacuating its energy under the conditional “take and pay” modality through alternative evacuation structure, this is likely to change to the regular “take or pay” modality after the commissioning of NEA’s evacuation infrastructure.

Credit challenges

Evacuation constraints resulting in low generation – The energy generated by the 7.5MW project is currently evacuated through 33kV Jiri-Khimti substation along the Terhathum-Dhankuta-Dharan 33kV transmission line corridor, as a contingency arrangement under conditional “take and pay” offtake modality. The contingency arrangement will give way to regular unconditional evacuation arrangement under PPA after the completion of Basantapur substation and the associated transmission lines under the NEA’s 220 KV Koshi Corridor project. The congestion in the 33kV transmission line has led to the project operation at a reduced capacity resulting in significant revenue losses for TPCL so far. The project only generated net ~60% of contract energy in FY2022 and 51% in FY2023. Nonetheless, the generation has improved to ~94% of contract energy in 2MFY2024 with full evacuation, and the long-term evacuation potential is likely to improve with the gradual strengthening of NEA’s transmission infrastructure along Koshi corridor.

Project execution risk and funding risk – The company is in process for construction of another 2MW Khorunga-Tangmaya Khola HPP; a cascade to the upstream project. The project will be developed through 100% equity to be raised through the 1:1 rights issue (NPR 400 million). The project construction is yet to begin vis-à-vis required commercial operation date (RCOD) of the project is on April 13, 2024, which remains a concern given the limited time headroom. TPCL’s ability to timely raise equity, expediate the project construction and commence the operation within the budgeted cost and timeline will remain key monitorable. Any cost-overrun in the 2 MW project could stretch TPCL’s financial metrics accordingly.

Hydrological risk – Lack of a deemed generation clause in the PPA exposes the project to hydrology risk in case of any adverse river flow scenarios without receiving any compensation for such losses. The 7.5MW project draws its hydrology from two rivers viz. Khorunga river (78% hydrology) and Iwa River (~22% of hydrology) while the 2MW project draws its hydrology from the tailrace of upstream 7.5MW project and Tangmaya Khola. These rivers are largely rain-fed rivers without snow-fed origin and without long-term gauging data. The dependency of the proposed cascade project on the tailrace of upstream project also exposes it to generational vulnerability in case of any operational and maintenance-related disruptions in the upstream project.

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

Links to applicable criteria:

[Issuer Rating Methodology](#)

[Corporate Credit Rating Methodology](#)

Links to previous rating rationale:

[Issuer and Bank Loan Rating Surveillance – June 27, 2022](#)

About the company

Initially incorporated as a private limited company on August 16, 2009, Terhathum Power Company Limited (TPCL) was converted to a public limited company on June 21, 2018, to facilitate public participation. The paid-up capital of the company as of mid-June 2022 was NPR 400 million including NPR 120 million raised from the Initial Public Offering. As of mid-July 2023, the major promoters of the company include Mr. Mohan Kumar Dangi (5.25%), Mr. Bhupati Lal Shrestha (2.76%), Mr. Ganesh Prasad Kattel (2.61%), Mr. Pramod Shrestha (2.25%), Mr. Bijay Sambhample (2%) among others.

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, two months after the RCOD, and was completed at a cost of ~NPR 182 million per MW against the budgeted cost of ~NPR 184 million per MW. The project's contract energy is ~43 GWh corresponding to a contract PLF of 65% and including dry energy mix of ~15%. The project's net energy generation was ~51% of the contract energy in FY2023 which corresponds to a PLF of 33%.

TPCL is also constructing a 2MW Khorunga-Tangmaya Khola hydropower project; a cascade to the upstream 7.5MW project. The project is also a run-of-the-river type to be developed at 40% probability of exceedance (Q40). The budgeted cost of the project is ~NPR 400 million to be financed through 100% equity. The project has entered into a PPA on November 3, 2022, and has the required COD of April 13, 2024.

Key Financial Indicators

Amount in NPR million	Audited			Provisional
	FY2020*	FY2021	FY2022	FY2023
Operating Income (OI)	29.72	67.28	142.80	121.65
OPBDITA/OI (%)	82%	80%	90%	88%
Total Debt/Tangible Net Worth (TNW; times)	4.31	5.88	3.31	3.90
Total Outside Liability/TNW (times)	5.20	6.43	3.34	3.94
Total Debt/OPBDITA (times)	41.97	20.25	7.78	9.28
Interest Coverage (times)	0.57	0.83	1.47	0.98
DSCR (times)	0.57	0.91	1.47	0.93
NWC/OI (%)	-231%	-44%	32%	30%
Current Ratio	0.3	0.2	3.2	1.5

*In operation since February 2020

Annexure-1: Instrument details

Instrument * (NPR Million)	Previous Rated Amount	Current Rated Amount	Rating Action
Long-term Loans (A)	1,000.0	988.0	
Term Loan (long-term; fund based)	1,000.0	988.0	[ICRANP] LBB; reaffirmed
Short-term Loans (B)	64.5	64.5	
Working Capital Loan (short-term; fund-based)	60.0	60.0	[ICRANP] A4+; reaffirmed
Performance Bank Guarantee (short-term; non-fund based)	4.5	4.5	[ICRANP] A4+; reaffirmed
Total	1,064.5	1,052.5	

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About ICRA Nepal Limited

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