

## Arun Valley Hydropower Development Company Limited: Rating downgraded to [ICRANP] LB-

January 17, 2024

### Summary of rating action

Instrument (Limit in NPR million)	Previous Rated Limit	Current Rated Limit	Rating Action
Long-term limits: Fund based	1,385	1,385	[ICRANP] LB-; downgraded from [ICRANP] LBBB-
<b>Total</b>	<b>1,385</b>	<b>1,385</b>	

### Rating action

ICRA Nepal has downgraded the long-term rating assigned to the long-term limits of Arun Valley Hydropower Development Company Limited (AHPC or the company) to [ICRANP] LB- (pronounced ICRA NP L B minus) from [ICRANP] LBBB- (pronounced ICRA NP L triple B minus).

### Rationale

The rating downgrade factors in the delays<sup>1</sup> in debt servicing by AHPC for the quarter ending mid-January 2024, following the expiry of period allowed by the central bank for restructuring/rescheduling<sup>2</sup> of the loans for hydropower projects affected by flood towards the end of FY2023. The delays were caused as a cumulative result of AHPC's low on-balance sheet liquidity and delay in securing additional fund from lenders while its two hydropower projects, 3-MW Piluwa Khola Small HPP (operational from September 2023) and 9.94-MW Kabeli B1 Cascade HPP (still under rehabilitation) were shut down after flood damages in June 2023. Given the extended downtime, the loss-of-profit insurance coverage has expired for the 9.94 MW plant, which is likely to weaken AHPC's revenue profile for FY2024. Further, the company has immediate plans to secure bridge-gap loans for liquidity needs which is likely to increase its debt burden and subdue profitability over the near term. Ability of the company to restart the project at the earliest and secure funds for interim liquidity management remains key rating sensitivity. The company's equity raising plans through the recently approved 1:1 rights issue will also remain key monitorable as it will have a bearing on liquidity and capitalization level going forward.

Rating concern also arises from the rehabilitation cost of the project (estimated at over NPR 300 million) which is likely to increase the project capex and project debt, unless covered by insurance proceeds. Amid fixed tariff and escalation regime this is likely to subdue near term debt coverage indicators. The geological risk related to the hydropower projects continue to remain rating concerns and accordingly. AHPC's ability to secure adequate insurance coverage (including property damage and loss of profit) arising from such risks will remain critical to its long-term financial and operational profile. The hydrology risks arising from changing climatic conditions (including variation in monsoon precipitation) also continues to remain among the rating concerns. ICRA Nepal also takes note of the nearing expiry of the Power Purchase Agreement (PPA) for the 3-MW project (valid till October 2028), which could affect the revenue accruing from the 3-MW project in later years.

Nonetheless, the rating takes comfort of the company's experienced promoters, adequate track record of operations and sizeable portfolio of liquid investments which is being used for project rehabilitation. The rating also factors in the satisfactory operational performance of its 3-MW project (average generation of >85% of contract energy in the last two

<sup>1</sup> Delays are for less than 30 days and therefore doesn't constitute as default as per ICRA Nepal's policy on default recognition.

<sup>2</sup> NRB through amendment (dated October 05, 2023) in Unified directives issued to A, B, C Class banks addressed relaxation of re-scheduling and/or re-structuring of loans to hydropower projects affected by natural calamities provided 10% of interest due is paid.

years; with recent improvements amid upgradation of evacuation infrastructures along the Koshi corridor from 33 KV to 220 KV in August 2021). Notwithstanding the current downtime, the commissioning of 9.94 MW project in April 2022 and its eligibility for all tariff escalation remains a long-term positive for AHPC's revenue profile (tariffs are fully escalated rates for its 3-MW project). Similarly, the rating considers the low tariff and offtake risks for entire installed capacity of AHPC given firm PPA with the Nepal Electricity Authority (NEA) at pre-determined tariffs and escalations under a take-or-pay modality.

Going forward, AHPC's ability to resume the 9.94MW project as soon as possible, ensure PPA continuity (post expiry of PPA) for the 3-MW project, issue and utilise the right issues as planned, timely realise the insurance proceeds, and maintain/achieve the designed operating parameters for both the projects, would remain among the key rating sensitivities.

## Key rating drivers

### Credit strengths

**Experienced promoters with long track record in the hydropower sector** – The company's board and senior management have long experience and technical expertise in the hydropower/engineering sector. AHPC is a part of the Arun Valley Hydropower Group, which has several operational projects throughout the country with the oldest project under the Group operational since 2003). The experience of the promoters and established track record of the Group remain positives. Also, the continued support of the Group remains crucial in the days ahead.

**Satisfactory project performance and low offtake/tariff risk (notwithstanding the recent down-time)** – The 3-MW project under AHPC (operational since 2003) has registered an improved generation of 93% and 87% of contract energy in FY2022 and 11MFY2023 respectively, following upgradation of transmission structures along the Koshi corridor from 33 KV to 220 KV in August 2021. Similarly, the 9.94 MW project generated 75% of contract energy between April 2022 and June 2023. Although the flood damage remains a setback, presence of two operational project with reasonable track record remains a long-term positive. However, the company's ability to negotiate a new PPA for the 3 MW project, following the expiry of the current one will remain a monitorable. The offtake and tariff risks are low for both the projects as PPAs are in place for the entire generation capacity of both the projects under a take-or-pay modality.

**Financial profile supported by low gearing and investment earnings** – AHPC's gearing level also remain relatively low as the old 3 MW project debt has been paid off. AHPC's financial profile also remains supported by its sizeable investment portfolio (mostly made in listed equity shares of multiple companies including group companies) and the non-operating income in the form of dividend income, and trading gains in the secondary market. The non-operating income of AHPC accounted for 53% and 59% of OI in FY2022 and FY2023 respectively.

### Credit challenges

**Rehabilitation cost to add to the project capex and debt levels** – Owing to the flood of June 2023, both of its projects were damaged. While the 3MW project was recommissioned from September 2023, the 9.94MW project (with relatively higher damage across civil, HM, EM, and TL structures; estimated at more than NPR 300 million) remains in advanced rehabilitation stage. Given the longer downtime, its loss of profit insurance has expired which is likely to subdue AHPC's revenue profile for FY2024.

The rehabilitation cost is likely to add to the capex of 9.94-MW Kabeli B1 cascade project which was commissioned in 2022 at a cost of NPR 2,227 million. The addition of cost (and debt) and decline in FY2024 revenue is likely to put pressure on AHPC's debt coverage metrics over the near term, unless covered by the insurance proceeds. AHPC's partial deleveraging plans utilizing rights issue proceeds could offer some comfort, which however, remains to be seen.

**Hydrology and geological risk**– The generational efficiencies of the projects are exposed to hydrology risks which in turn remains dependent on climactic factors (including monsoon fluctuations). Similarly given the project terrain, the risk of events like flood, landslide, etc also remain high. In such cases, the company may have to bear operational losses as there are not any compensation for such losses by the NEA/regulators. Nonetheless, the snow-fed source for the hydrology, along with relatively larger catchment area provide some comfort in this front.

**Interest rate volatility risk, project concentration risk** – Given the relatively fixed revenue profile and high debt funded capex, hydropower companies’ profitability remains dependent on interest rate volatility as it affects the debt burden on the company’s cashflows. Similarly, given the concentrated revenue profile and high dependence on single project, any disruption in the underlying project can have a direct impact on the company’s financial profile.

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

**Links to applicable criteria:**

[Corporate Credit Rating Methodology](#)

[Default Recognition Policy](#)

## About the company

Arun Valley Hydropower Development Company Limited (AHPC) was established on March 12, 1998, as a private limited company before being converted to public ltd. on August 20, 2005. The company’ has two operational projects viz. 3-MW Puluwa Khola Small Hydropower Project, a Q65 R-O-R project commissioned in 2003 and 9.94MW Kabeli B-1 Cascade HEP a Q40 R-O-R project commissioned in April 2022. The latest project was completed at a cost of NPR 2,227 million. Both these projects were affected by June 2023 flood with the 3MW project recommissioned in September 2023 and the 9.94 MW project under rehabilitation.

In addition to owning two projects directly, AHPC also maintains equity investment in multiple group companies in energy sector as well as other listed companies. AHPC also has equity commitments in few upcoming hydropower projects that are in the planning stages. AHPC has a paid-up capital of ~NPR 1,868 million as of mid-July 2023 with 1:1 right issue of equity shares in the pipeline.

## Key Financial Indicators

Particulars (Amount in NPR million)	FY2020	FY2021	FY2022	FY2023	3MFY2024
Operating Income (OI)	69.22	53.43	69.28	262.8	13.2*
OPBDITA/OI (%)	68%	62%	79%	77%	24%
Total debt/Tangible net worth (TNW; times)	0.07	0.31	0.68	0.77	0.77
Total Outside Liability/TNW (times)	0.12	0.62	0.76	0.81	0.83
Total Debt/OPBDITA (times)	1.63	16.78	17.46	7.29	467.55
Interest coverage (times)	11.22	144.17	89.58	1.11	0.08
DSCR (times)	9.66	118.14	73.98	1.77	-
NWC/OI (%)	351%	-808%	-31%	44%	456%

\*low given only 3MW project in operation

## Analyst Contacts

**Mr. Sailesh Subedi**, (Tel No. +977-1-4419910/20)

[sailesh@icranepal.com](mailto:sailesh@icranepal.com)

**Mr. Purushottam Sedhai**, (Tel No. +977-1-4419910/20)

[purushottam@icranepal.com](mailto:purushottam@icranepal.com)

## Relationship Contacts

**Ms. Barsha Shrestha**, (Tel No. +977-1-4419910/20)

[barsha@icranepal.com](mailto:barsha@icranepal.com)

## About ICRA Nepal Limited

ICRA Nepal Limited, the first Credit Rating Agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, technical and analytical skill augmentation.

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](http://www.icranepal.com)

### **ICRA Nepal Limited,**

Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.

**Phone:**+977 1 4419910/20

**Email:** info@icranepal.com

**Web:** www.icranepal.com

All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell, or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website ([www.icranepal.com](http://www.icranepal.com)) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents.