

## PRESS RELEASE

### DARAMKHOLA HYDRO ENERGY LIMITED

June 2023

#### Ratings

Instruments/ Facilities	Amount (NPR. Mn)	Ratings	Rating Action
Long Term Bank Facilities	1,300.00	IRN BB-	Assigned
Short Term Bank Facilities	(1,235.00)	IRN A4	Assigned
Issuer Rating	NA	IRN BB- (Is)	Assigned
<b>Total</b>	<b>1,300.00</b>		

Details of facilities are in Annexure 1 below

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has assigned the long term rating of IRN BB- (Double B Minus) to the long term bank facilities of NPR 1,300.00 Mn and short term rating of IRN A4 (A Four) to the short term bank facilities of NPR 1,235.00 Mn.

Infomerics Nepal has also assigned an issuer rating of IRN BB- (Is) [Double B Minus (Issuer)]. Issuers with this rating are considered to have the moderate risk of default regarding timely servicing of financial obligations.

#### Detailed Rationale

The rating assigned to Daramkhola Hydro Energy Limited (DKHEL) derives strength from the presence of a large number of individual promoters, including locals. The rating also takes note of the power purchase agreement (PPA), which is based on a take or pay arrangement with NEA<sup>1</sup> and covers the majority of the project's lifespan. The PPA has predetermined rates with an escalation clause; thereby reducing tariff risk and offtake risk. Additionally, the project's power evacuation is ensured through a Loop in Loop Out arrangement with NEA, where the power to be generated shall be evacuated through the switching substation to an operational NEA transmission line, providing added comfort. The rating also factors in moderate counterparty risk, improving demand for electricity and GoN<sup>2</sup> support to the power sector. However, these rating strengths are constrained by the delay in project commissioning. The RCOD for the 7.3 MW capacity has already crossed the deadline, and there is less than a month remaining until the RCOD of an additional 2.3 MW capacity. As of mid-March 2023, the project achieved only ~70% financial progress and over 80% physical progress as of mid-April 2023. Given the management expected commercial operational date of October 18, 2023, it is likely that the project will experience delays, exposing it to a significant penalties and tariff escalation losses. The rating further takes note of high project cost of ~NPR 224 Mn per MW, which could constrain profitability and return indicators going forward. Additionally, there is a funding risk, given ~21% (within 38%) of overall equity requirement is yet to be raised from the initial public offerings (IPO); however, financial closure with the banks for the required debt funding and equity from promoters remains positive. The expected proceeds from IPO is likely to improve the overall gearing and debt coverage indicators, assuming full subscription of IPO. Going forward, the ability of the company to commence its project within the RCOD (for additional capacity) and within the estimated cost will be a key rating sensitivities.

#### Detailed Description of Key Rating Drivers

#### Key Rating Strengths

<sup>1</sup> Nepal Electricity Authority- Government organization and sole electricity off taker in Nepal

<sup>2</sup> Government of Nepal

## **Promoted by a large group of individuals mostly comprising locals**

DKHEL's capital structure is strengthened by a significant number of individual promoters, particularly local stake holders. Currently, the company boats over 830 shareholders, collectively contributing to a total equity of NPR 635.50 Mn. Although, the directors have limited prior experience in the hydropower sector, their affiliation with various government offices offers some reassurance. Mr. Nar Bahadur Pun, the Chairman, is a former member of parliament and is also involved in establishment of various mini-micro hydropower. Hence, the substantial and diverse base of promoters instills confidence and is expected to facilitate the project going forward.

## **Power Purchase Agreement in place at predetermined rates; lowering the tariff and offtake risk**

The power purchase agreement (PPA) for initial 7.3 MW was executed on January 2017, while the PPA for the enhanced capacity of 9.6 MW was executed on October 2018. The PPA is for 30 years from the commercial operation date (COD) and cover the entire capacity of 9.6 MW, subject to a 10% reverse margin clause, under take or pay arrangement with NEA. The combined net contracted plant load factor (PLF) is 63.54%, considering a contracted energy of ~53.43 gWh. The tariff rate specified in the PPA is NPR 4.80 per kWh for wet season (mid-April to mid-December) and NPR 8.40 per kWh for dry season (mid-December to mid- April) with 3% annual escalation on base tariff for five times after completion of 12 months from COD for 7.3 MW and eight times for additional 2.3 MW. Hence, considering the same, the tariff risk and offtake risk remains low.

## **Low power evacuation risk**

The power generated from the project will be evacuated through Loop in Loop Out (LILO) arrangement with NEA at the Manewa switching substation. Subsequently, it will further be connected to an operational 33KV Harichaur- Kharbang transmission line.

## **Low funding risk**

The estimated project cost of NPR 2,150 Mn is expected to be funded in a debt equity of ~60:40. For this, DKHEL has already tied up a facilities agreement for term loan of NPR 1,300 Mn. The equity portion is expected to be funded through promoter and public in a ratio of ~62:38, of which promoter has already infused equity of NPR 635.50 Mn as of February 2023 while the remaining is expected to be raised through initial public offerings (IPO). Hence, the funding risk remains low given only ~21% (*among ~38% only ~21% is expected to be used for project funding*) of overall equity requirement is to be raised through public.

## **Improving market demand with Government support for the power sector**

According to the NEA's Annual Report the total available energy in the system increased by ~25% to 11,064 GWh, out of which NEA and its subsidiaries contributed ~47.32% whereas import from India and purchase from domestic IPP<sup>3</sup> accounted for 13.94% and 38.74% respectively. Hence, the contribution of the internal generation to the total energy consumption remained higher at ~86% in FY22 vis-à-vis 68% in FY21. Similarly, the total energy consumption was 8,823 GWh in FY22, an increment of ~22% over FY21. The total export to India soared to 493 GWh in FY22 against 38 GWh in FY21. With this the net import of electricity reduced to 1,050 GWh representing ~9.5% of total electricity available. Hence remains positive in view of improving generation, growing demand with scope of export<sup>4</sup>. Also, GoN considers hydropower generation as priority sector and intends to maximize private sector participation in generation of hydroelectricity by offering different exemptions and facilities. 100% tax exemption is given to all such person/entity who starts commercial operation, transmission and distribution of electricity up to mid-April 2027 for first ten years and 50% tax exemption for next five years.

<sup>3</sup> Independent Power Producers

<sup>4</sup> NEA has already exported NPR 11.16 bn between June 2, 2022 to December 18, 2022

## Key Rating Weaknesses

### High project cost

The initial estimated project cost of NPR 1,862 Mn (~NPR 194 Mn per MW) has been adjusted to NPR 2,150 Mn which is ~ NPR 224 per MW. This increase of ~15% from the previous budgeted is due to the elevated prices of various construction materials. The higher budgeted cost, coupled with the potential risk of exceeding the budget, could have an adverse impact on the project's profitability and return indicators, particularly in the fixed tariff and escalation regime. Therefore, it is crucial for the company to ensure that the project is completed with the allocated budget and time frame.

### Delay in project commissioning

Daram Khola Hydroelectric Project, with a capacity of 9.6 MW, is approaching its final stage of development. As of mid-March 2023, the reported financial progress stands at ~70%, while the reported physical progress exceeds 80% as of mid-April 2023. The approved required commercial date of operation (RCOD) for the initial 7.3 MW was set for Feb 04, 2023. However, this deadline has already passed, leaving less than a month until the RCOD for the enhanced capacity of 2.3 MW on Jun 27, 2023. With the management expected commercial operational date of October 18, 2023, it is likely that the project will experience some delays, thereby exposing the project to a sizeable penalty and tariff escalation losses.

### Hydrology risk associated with run-of-the-river (ROR) power generation

Run-of-the-river (ROR) projects have limited or no capacity for storing water, making them highly dependent on the flow of the river for power generation. This leads to higher generation during the wet season and lower generation during the dry season. ROR projects are directly exposed to risks associated with variations in the discharge of water from the river. The project has a design discharge of 10.30 m<sup>3</sup>/s at 40% exceedance flow. Furthermore, the lack of a deemed generation clause in the power purchase agreement (PPA) exposes the project to hydrology risks in case of adverse river flow scenarios, without receiving any compensation for such losses.

**Analytical Approach:** Standalone

### Applicable Criteria:

[Corporate Credit Rating Methodology](#)

[Issuer Rating Methodology](#)

### About the Company:

DKHEL is a public limited company incorporated in December 2015. The company is developing Daram Khola Hydroelectric Project (DKHEP) of 9.6 MW in Baglung district of Nepal. The project has 247 km<sup>2</sup> catchment area and 10.30 m<sup>3</sup>/s design discharge at 40% exceedance flow. DKHEL is promoted by a large group of individuals especially the locals. Mr. Nar Bahadur Pun (Niraj) is the chairman of the company.

### Annexure:1 Detail of Facilities:

Name of Instruments/ Facilities	Type of Facilities	Amount (NPR Mn.)	Ratings
Fund Based Bank Facilities- Term Loan	Long Term	1,300.00	IRN BB-
Fund Based Bank Facilities- Bridge Gap Loan	Short Term	(300.00)*	IRN A4
Non Fund Based Bank Facilities- LC/BG <sup>5</sup>	Short Term	(935.00)*	IRN A4
<b>Total Facilities</b>		<b>1,300.00</b>	

\*within Term Loan

<sup>5</sup> Letter of Credit/ Bank Guarantee

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## About Infomerics Credit Rating Nepal Limited:

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