Terhathum Power Company Limited: [ICRANP] LBB/A4+ assigned

August 26, 2019

Summary of rated instruments

Instrument *	Rated Amount (NPR Million)	Rating Action
Long-term loan; Fund-based	1,000	[ICRANP] LBB (Assigned)
short-term loan; Fund-based (BGL, within term loan)	(150)	[ICRANP] A4+ (Assigned)
short-term loan; Fund based	60	[ICRANP] A4+ (Assigned)
Short-term loans; Non-fund based (within term loan)	(500)	[ICRANP] A4+ (Assigned)
Short-term loans; Non-fund based	4.5	
Total	**1,064.5**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBB (pronounced ICRA NP L double B) to the long-term loans, and a short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to the short-term loans of Terhathum Power Company Limited (TPCL).

Rationale

The assigned rating factors in the relatively lower cost of development (~NPR 183 million per MW) of the 7.5MW -Upper Khorunga Small Hydropower Project and expected healthy levelized tariff for the project amid the fixed tariff structures. The expected completion[1] of the project within the budgeted cost and within the estimated timeline of the Required Commercial Operation Date (RCOD) of December 17, 2019 would enable the project in utilising all the tariff escalations[2], thus reflecting a good revenue profile. The rating also takes into consideration the low tariff risk and low offtake risk arising from the firm power purchase agreement (PPA) with pre-determined tariff rates at take or pay model, and the positive demand outlook for the energy sector, owing to the supply-demand gap in the power sector as well as increasing energy consumption in the nation. Similarly, the evacuation risk remains low amid an already built and operational Jiri Khimti substation of Nepal Electricity Authority (NEA) for evacuation of power to be generated by the project. Going forward, TPCL's ability to commission the project within the budgeted cost (NPR 1,376 million), meet the estimated timeline of RCOD, achieve the designed operating parameters, collect IPO proceeds to avoid incremental interest[3] as well as interest rate volatility of the market would be the key drivers in determining the project return metrices and other coverage indicators for the company.

Nonetheless, the rating is constrained by the lack of deemed generation clause in the PPA as well as rain-fed perennial sources[4] for the project, which add to the hydrological risks under adverse scenarios. Despite these, the hydrology is comforted to some extent, the catchment basin being one of the highly precipitated areas. Also, the assigned rating is constraint to some extent by the limited experience of the Board of Directors in the operation and maintenance of hydropower projects, this being the first hydropower venture of the Group that is nearing completion. The project is also exposed to counterparty credit risks arising out of its exposure to the NEA, which has a weak financial profile. This is partly mitigated by the fact that NEA's financial profile is improving since FY2016-17 and by the fact that it is fully owned by the Government and has been making timely payments to independent power producers (IPPs) so far.

1 ~85% of physical progress with substantial completion of Civil, hydromechanical and transmission line works. However, electromechanical works is in installation phase and is being done by the Andritz Hydro.
2 Tariff escalations is 3% p.a. for 5 times starting from 12 months after the COD month,
3 The company plans on utilizing NPR 60 million of bridge gap loan against the IPO issue to meet the funding gap till the same is collected.
4 Khorunga river (78% of the design discharge) and Iwa river (~22% of the design discharge).

Key rating drivers

Credit strengths

Expected project completion within the budgeted cost and timeline to support return and debt coverage indicators – TPCL's budgeted cost of the project is on a relatively lower side (NPR 183 million per MW). Also, the project is expected to be completed within the same budget and the estimated timeline of RCOD. This would enable the project in utilising all the five tariff escalations, resulting in a relatively healthy levelized tariff amid fixed tariff structures. After utilisation of all the escalations, the fifth escalated rate would remain effective till the life of the project, thus supporting the overall revenue profile in the longer term. All these would support the revenue in the days ahead and result in moderate return and coverage indicators. The indicators also remain supported by the ballooning repayment model as well as the deferment of the principal repayment of loan by six months (grace period) due to the expected early completion of the project. Nonetheless, these indicators could come under pressure if the project fails to achieve its designed operating parameters, is unable to complete the project within the budgeted cost and estimated timeline along with a change in the rescheduling of repayment.

Minimal funding gap with injection of 100% promoter equity and fully tied-up debt component – The entire project cost of NPR 1,376 million is to be funded at a debt-equity ratio of 73:27. The debt has been tied up at NPR 1,000 million and is being gradually utilised (~74% as of mid-July 2019). Also, of the total equity funding requirement of ~NPR 376 million, so far, the entire promoters' equity (NPR 280 million) has already been injected and the remaining equity (~NPR 96 million) has been planned from the proposed IPO. However, till the IPO proceeds are realised, the funding has been planned through the bridge gap loan of NPR 60 million against the proposed IPO (by the current lead bank), contractors' retention and rest through the promoters' loan. The early realisation of the IPO proceeds to repay the bridge gap loan of NPR 60 million within the stipulated time, would remain a factor in determining the extra interest burden that the company may have to bear.

Low tariff risk, given presence of long-term PPA at predetermined tariff rates and escalations – The tariff risk is low as the company already has a PPA for the project with the NEA (the sole purchaser and distributor of electricity in Nepal) for its entire project capacity for a period of 30 years from the COD. The PPA has a predefined tariff rate for the purchase of the energy i.e., the tariff for the wet season (mid-April – mid-December) is NPR 4.8 per kWh while that for the dry season is NPR 8.4 per kWh. An escalation of 3% per annum is allowed on the base tariff for five consecutive years after 12 months of the COD. However, to avail of all the five tariff escalations, it is imperative that the project starts operations latest by six months of RCOD.

Low offtake risk on the back of PPA, current demand-supply gap and increasing energy utilisation: The company has a PPA for the offtake of energy under the take-or-pay model with the NEA. Any failure in the offtake of power would be compensated by the NEA. Also, a gap in the demand and supply of energy in Nepal would ensure the healthy offtake of energy. Nepal is a net importer of electricity, even with limited electrification across the country and the currently supressed demand (per capita power consumption of <150 KW as per a 2015 study[5]; among the lowest in Asia). In the fiscal year (FY) 2017-2018, the peak power demand in the Integrated Nepal Power System (INPS) surged to 1,508 MW while the installed operational capacity was only 1,074 MW. The shortfall was met through the import of electricity. As per the NEA, the power demand is expected to grow at a rate of ~15% over the next 22 years (driven by an increase in electrification, per capita consumption and industrial demand). Hence, the supply-demand gap is expected to persist, resulting in the healthy offtake of the energy generated by the project.

[5] *Study conducted by Water and Energy Commission Secretariat, GoN*

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Credit challenges

Hydrology risk is high, given the lack of deemed generation clause in PPA – The hydrology risk of the project remains high, given the lack of a deemed generation clause in the PPA. This could result in the loss of revenue in case of adverse flow of the rivers from where the project draws its hydrology. Also, the source-rivers being rain-fed escalates the risk to some extent. Nonetheless, high rainfall intensity of the catchment zone provides some comfort.

Limited experience of the promoters in the hydropower sector – The project is the first hydropower venture nearing completion, being promoted by the company. The promoters lack prior experience of operation and maintenance of hydropower projects. Their ability remains to be tested, especially under a scenario when the current project has two headworks sites and depends on two rivers viz. Khorunga (78% of the design discharge) and Iwa (22% of the design discharge) for its hydrology.

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 in August 16, 2009 as a private limited company, Terhathum Power Company Limited (TPCL) was converted to a public limited company on June 21, 2018. The paid-up capital of the company as of mid-July 2019 is NPR 280 million which is 100% promoter held. The company plans to float an IPO of NPR 120 million after which the same would reach to NPR 400 million. Thus, after the IPO, the shareholding ratio between the promoters and the public would be held in a 70:30 ratio. The major shareholders include Mr. Mohan Kumar Dangi (8%), 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 Dangi (2%). The rest of the ~65% shares are held by 275 individual shareholders.

TPCL is developing a 7.5-MW Upper Khorunga Small Hydropower Project in Terhathum district of Province 1 of Nepal. The estimated development cost of the project is NPR 1,376 million which is likely to be funded in a debt-equity ratio of 73:27. The debt is being funded by a consortium of three banks led by Machhapuchchhre Bank Limited for a total of NPR 1, 000 million. The project is a Run-of-the-River type with a contract plant load factor (PLF) of ~65% and an annual production capacity of ~43 GWh of energy. The dry energy mix is ~15% of the total annual production capacity.

Annexure-1: Instrument details

Instrument *	Rated Amount (NPR Million)	Rating Action
Term loan (long-term; fund-based)	1,000	[ICRANP] LBB (Assigned)
Bridge Gap Loan (short-term; fund-based within the term loan)	(150)	[ICRANP] A4+ (Assigned)
Overdraft (short-term; fund-based)	60	[ICRANP] A4+ (Assigned)
Letter of Credit (short-term; non-fund based within the term loan)	(500)	[ICRANP] A4+ (Assigned)
Performance Bank Guarantee (short term; non-fund based)	4.5	[ICRANP] A4+ (Assigned)
Total	**1,064.5**	

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About ICRA Nepal Limited:

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