

Upper Syange Hydropower Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B Issuer]	Reaffirmed

* The issuer rating is subject to overall gearing ratio of the company not exceeding 2.10x at the end of FY23.

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB (Is)' assigned to Upper Syange Hydropower Limited (USHL). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to USHL continues to be constrained by operations stabilization risk and power evacuation risk associated with its green-field hydropower project. The rating also factors in the hydrology risk associated with run-of-the-river power generation and exposure to volatile interest rate and regulatory risk.

The rating, however, derives strength from USHL's experienced promoters and management team, presence of Power Purchase Agreement (PPA) with sufficient period coverage, moderate counter party risk and government support for the power sector. The rating also takes cognizance of successful commencement of commercial operations of USHL. However, as power is currently being evacuated through contingency evacuation route, power generation from the project is likely to remain on the lower side as it is dependent on the dispatch instructions from Nepal Electricity Authority (NEA).

Going forward, the ability of the company to successfully reduce the gap between operational Plant Load Factor (PLF) and contracted PLF and availability of sufficient hydrology with timely receipt of payments from NEA will be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Project stabilization risk

The 2.40 MW Upper Syange Hydropower Project (USHP) at Lamjung district of Nepal came into operation from February 27, 2022. The initial Required Commercial Operation (RCOD) of the project was January 15, 2019. As per the latest cost verification report as of February 2022, the total cost of the project was Rs. 500.20 Mn (i.e., ~Rs. 208.42 Mn per MW) which was financed by debt of Rs. 350 Mn, equity of Rs. 133 Mn and rest through short-term loans. The project has been evacuating power through the contingency plan owing to delay in construction of the 'Khudi' substation (under the purview of NEA) through which power was originally proposed to be evacuated. As the project currently falls under 'Projects Under Contingency Evacuation Plan' as per NEA, its power generation is dependent on the dispatch instructions from NEA. Projects under the contingency evacuation plan generally get lower priority in power evacuation from NEA, particularly during the high supply wet seasons, leading to low PLF levels. Thus, until a firm resolution of proper power evacuation is reached, the company will remain exposed to operations stabilization risk and this will remain a key monitorable aspect.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications.

High power evacuation risk

The power generated from the project is proposed to be evacuated through ~12km 33 kV distribution line to the under-construction NEA Khudi Substation which is currently under construction. Power generated from the project is currently being evacuated through Thakan Besi substation via Damauli- Udipur- Manang transmission line, which makes the project fall under the 'Projects Under Contingency Evacuation Plan' list of NEA. Once the Khudi Substation is operational, USHL will shift its power connection to the Khudi Substation and until such time the company will remain exposed to high power evacuation risk.

Hydrology risk associated with run-of-the-river power generation

Run-of-the-river power is considered an unsteady source of power, as a run-of-the-river project has little or no capacity for water storage and therefore is dependent on the flow of river water for power generation. It, thus, generates much more power during summer season when river flows are high (mid-April to mid-December) and less during the winter season (mid-December to mid-April). USHL is proposed to utilize discharge from Upper Syange river having catchment area of 63.90 sq. kms based on snow-fed river. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola.

Exposure to regulatory risk

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) for regulating generation, transmission and distribution of electricity in Nepal. ERC will be the regulator under the GoN which will be responsible for regulating hydropower companies in Nepal. Policies and directives issued by ERC like approval process for IPO issuance, PPA approval through ERC poses a new challenge to hydropower companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Exposure to volatile interest rate risk

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Key Rating Strengths**Experienced management team in hydropower sector with strong institutional promoter group**

USHL has five board of directors, chaired by Mr. Bir Bahadur Ghale. He has more than 25 years of experience in hydropower sector. He is also associated with Hydro Energy Concern Pvt. Ltd (HECPL) in the capacity of managing director. HECPL is operating more than 40 Micro Hydro Projects (less than 1 MW) across the country with total capacity of about 3.2 MW. He has been supported by other experienced management team members. Other directors of the company also have experience in various sectors. Furthermore, the board is supported by an experienced team across various functions.

USHL is being promoted by a group of institutional promoters namely Kriti Venture Fund Limited (KVGL), Vesna Venture Fund Limited (VVFL) and HECPL. KVFL is an investment company established with objectives to invest in energy/infrastructure, manufacturing, health, education, tourism and agriculture sectors. On other hand, VVPL is a private company established by

a group of professionals having long experiences in various sectors including hydro power/energy sector and other financial sector.

Power purchase agreement with sufficient period coverage

USHL had entered into a long term PPA with NEA as on October 1, 2015, on take or pay basis, for sale of 2.4 MW power to be generated from the project. The contracted Plant Load Factor (PLF) for total 2.4 MW is 67.21% with total contracted energy of 14.13 MU (dry season: 2.82 MU and wet season: 11.32 MU). PPA has been entered for the period of 30 years from the COD or till validity of generation license (obtained on June 5, 2017 for 35 years) whichever is earlier. PPA period may be extended with mutual consensus during the last six months of validity. Tariff rate as per PPA is Rs 4.80 per KWh for wet season (mid-April to mid-December) and Rs 8.40 per KWh for dry season (mid-December to mid-April) with 3% annual escalation on base tariff for 5 years.

Favorable Government policies towards power sector

Favorable Government policies towards power sector Government of Nepal (GoN) considers hydropower generation as priority sector and intends to maximize private sector participation in generation of hydroelectricity by offering different exemptions and facilities. GoN has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years for such person/entity who starts commercial operation, transmission and distribution of electricity up to mid-April 2024. As per various directives from NRB whereby all the banks (type A, B C, D) have to allocate minimum share of their total advances to energy sector which argues well for the sector.

About the Company

Upper Syange Hydropower is a Public Limited company, incorporated as on January 26, 2009 as Upper Syange Hydropower Private Limited and converted to Public limited on March 30, 2017. It is promoted by both individual and institutional promoters from different background. 2.4 MW Run- of-River (RoR), Upper Syange Hydropower Project (USHP) is constructed under BOOT (Build, own, Operate and Transfer) mechanism and located at Lamjung district of Nepal. USHL commenced operations from February 27, 2022.

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