

Isuwa Energy Private Limited

Rating

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Long Term Bank Facilities	3,966.00 (Increased from 3,044)	CARE-NP BB- [Double B Minus]	Reaffirmed
Short Term Bank Facilities	-	-	Rating Withdrawn
Total Facilities	3,966.00 (Three Billion Nine Hundred and Sixty-Six Million Only)		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB-' assigned to the long-term bank facilities of Isuwa Energy Private Limited (IEPL). Furthermore, CRNL has withdrawn the rating of 'CARE-NP A4' assigned to the short-term bank facilities of IEPL upon request of withdrawal of the same from IEPL and confirmation that the proposed facility has not been used for mobilizing funds, and as such, no amount is outstanding against the rated facility.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of IEPL continue to remain constrained by the project implementation risk associated with its under-construction hydropower project. The capacity of Isuwa Khola Cascade Hydroelectricity project (IKCHEP) has been enhanced to 40.1 MW from earlier capacity of 37.70 MW, which has increased total project cost. Debt requirement for additional capacity is yet to be tied up. The progression of project construction has been relatively slower which along with risk related to possibility of geological surprises during construction exposes the company towards execution risk in terms of completion of the project within envisaged time and cost. The ratings factor in exposure to power evacuation risk related to its under-construction substation, moderate hydrology risk associated with peaking run of the river power generation, risk of natural calamities, and exposure to volatile interest rate risk.

The ratings, however, derive strength from experienced promoters and management team in hydropower sector, low offtake risk, relatively low cost of project and moderate counter party risk

Going forward, the ability of the company to successfully execute the project within the estimated cost and time and early stabilization thereafter are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Project implementation risk related to its under-construction hydropower project

IEPL is setting up a 40.1 MW (amended from 37.7 MW) peaking run-of-river Isuwa Khola Cascade Hydroelectric Project (IKCHEP) in Sankhuwasabha district of Nepal. With the enhancement of project capacity, the estimated cost of the project has been revised to Rs. 4,957 Mn (Rs. ~124 per MW), which is proposed to be funded in the debt equity mix of ~80:20 (i.e., term debt of Rs. 3,966 Mn and equity of Rs. 991 Mn). The estimated cost of the project for the earlier capacity was Rs.3,806 Mn (~Rs. 100 Mn per MW) to be financed in debt equity mix of ~80:20. Debt funding requirement for the additional capacity to the tune of Rs. 922 Mn is yet to be tied up. IEPL has incurred total expenditure of Rs. 988 Mn till December end, 2023 (Rs. 780 Mn as on mid-January, 2023). Financial progress of around 20% (based on revised project cost) has been achieved as

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

on December end, 2023. The pace of the progression of physical works is slower than envisaged. Being a cascade of Isuwa Khola Hydropower Project (IKHP) being developed by KBNR Isuwa Power Limited [CARE-NP BB/A4], IKPCHEP draws water directly from tailrace of IKHP. Thus, generation from the project is contingent upon operation of upstream project (~46% physical progress of IKHP as on May 16, 2023), which heightens project implementation risk. Since majority of the works is still pending, the company continues to remain exposed to the risks associated with project implementation within envisaged cost and timelines.

The Required Commercial Operation Date (RCOD) of 37.7 MW is April 12, 2024 and for additional 2.4 MW is June 18, 2027. If COD doesn't fall within RCOD, the company is bound to pay penalty to NEA as per the PPA. The number of escalations in tariff rate will also be reduced if COD of the project is delayed by more than 6 months. It is, therefore, critical for the company to complete the project within the timeline to avail the accelerated clauses of tariff. Any delay in the same would impact the project's expected returns and debt servicing capabilities which is critical from credit perspective.

Power Evacuation Risk

The power generated from the project will be evacuated by ~16 Km long 220 KV transmission line to NEA's Sitalpati Substation located at Sankhuwasabha district, Nepal. At present, NEA's Sitalpati substation is under construction stage which is expected to be completed before commencement of the project. Furthermore, IEPL is responsible for construction of ~16 Km long transmission line from the project's powerhouse up to Sitalpati Substation. Completion of the transmission line and the substation in timely manner is critical from revenue generation prospective.

Moderate hydrology risk associated with peaking 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 wet season when river flows are high (June to November) and less during the dry season (December to May). IKHP is proposed to utilize discharge from Isuwa river having catchment area of 152 km² with 12.6 m³ /sec design discharge at 58.71% exceedance flow. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river. However, the risk is mitigated to some extent in the project due to peaking reservoir of six hours for dry season which will be used during peak time of dry season giving higher revenue to the company.

Risk of Natural Calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their construction and operations vulnerable to adversities of nature. Floods and landslides that tend to occur in these areas pose threat to these power projects damaging their infrastructures as well as impacting their timely completion. Moreover, disruption in their construction in turn could lead to time and/or cost overrun, negatively impacting the project's financial aspects. Moving forward also, these natural calamities can adversely affect the smooth flow of power generation and distribution, which can further impact financial returns of the projects. IEPL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Exposure to volatile interest rate

The company's interest rates are based on 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. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed to volatile interest rate.

Key Rating Strengths**Experienced promoters and management team**

IEPL has two board of directors having long experience in various sector including both operational and under construction hydropower projects in Nepal. The board is chaired by Mr. Bikram Bista who has more than two decades of work experience in various business domains including hydropower sector, which is operational since July 2020. He is also an executive committee member of Independent Power Producers' Association of Nepal, which is an umbrella organization of independent power producers in Nepal.

Mr. Birendra Neupane is the Managing Director of the company, having vast experiences of around 4 decades including 15 years of experience in hydropower sector. He has been associated with various operational and under construction hydropower projects. The directors are also supported by the experienced management team to run the day-to-day activities.

Low offtake risk and moderate counterparty risk

IEPL had entered into a long term PPA with Nepal Electricity Authority (NEA) as on January 11, 2021 for sale of 37.70 MW power to be generated from the project and on February 23, 2023 for additional 2.4 MW. The period of the PPA is 30 years from the date of COD or till validity of Generation License, whichever is earlier. PPA period may be extended with mutual consensus during the last six months of validity. The tariff for wet season (June to November) is Rs 4.80 per kWh and for dry season (December to May) is Rs 8.40 per kWh with 3% escalation on base tariff for continuous 8 years. The contracted energy for the project is 278.61 million units at PLF of 79.31%. The required commercial operation (RCOD) of the project for 37.7 MW is April 12, 2024 and for additional 2.4 MW is June 18, 2027. The company has signed PPA on 'take or pay' basis with NEA which is owned by Government of Nepal and hence counter party default risk is low; however, timely realization is critical for the company and from analytical perspective also.

Relatively low cost of project

The cost per MW at present estimation is Rs. 123.61 Mn per MW, which is relatively lower compared to other hydropower plants in Nepal. The project is a cascade project of 97.20 MW Isuwa khola HEP developed by KBNR Isuwa Power Limited (KBNR). Being a cascade project, civil construction works has been reduced which are mainly related to headwork structure and surge tank etc. The low project cost reduces the pay-back period of investors and normally supports in achieving the breakeven at lower revenue. However, it is very critical from analytical perspective to complete the project within the envisaged cost to achieve its envisaged project returns.

Industry Outlook

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 2027. Also, with government focus more toward reservoir-based hydropower projects; Monetary Policy FY23 has provided full tax exemption for first 15 years and 50% tax exemption for next 6 years to reservoir and semi-reservoir projects completing financial closure within mid-April 2029 with a capacity higher than 40 MW. As per various directives from NRB, 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

Isuwa Energy Private Limited (IEPL) is a private limited company, incorporated on January 22, 2018 by a group of individual promoters for setting up of a 40.1 MW (amended from 37.7 MW), peaking run-of-river, Isuwa Khola Cascade Hydroelectric Project in Sankhuwasabha district of Nepal. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	3,044.00	CARE-NP BB-
Long Term Bank Facilities	Proposed	922.00	CARE-NP BB-
Total Facilities		3,966.00	

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