

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]	Assigned

The issuer rating is subjected to the overall gearing ratio of company not exceeding 2.10x at the end of FY22.

CARE Ratings Nepal Limited (CRNL) has assigned Issuer rating of 'CARE-NP BB (Is)' to Upper Syange Hydropower Limited (USHL). Issuers with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to USHL is constrained by residual project implementation and stabilization risk associated with its green-field hydropower project, moderate power evacuation risk, 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 strong parentage and experienced management team, presence of power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The rating also factors in current demand & supply gap however possible oversupply in future and government support for the power sector.

Going forward, the ability of the company to successfully execute the project without further cost and time overrun and early stabilization thereafter are the key rating sensitivities.

Detailed Rationale & Key Rating Drivers

Key Rating Weakness

Residual project implementation and stabilization risk

USHL is setting up a 2.4 MW Upper Syange Hydropower Project (USHP) in Lamjung district of Nepal. The estimated cost of the project was envisaged at Rs 479.79 Mn to be funded in debt equity ratio of ~70:30. However, the cost of the project has been revised to Rs. 500.70 Mn and is projected to be funded in debt equity ratio of ~70:30 (Rs. 350 Mn term loan and remaining through equity). The increment in the project cost was majorly on account of delay in project execution impact leading to increase in Interest during construction and administrative expenses. The delay in execution also led to increase in cost of civil construction which also escalated the project cost.

Out of the total capex planned, USHL has incurred total expenditure of Rs. 480.57 Mn out of Rs. 500.70 Mn as on mid-September 2021. The overall physical progress of the project is ~98% till mid-October 2021. The dry test is already completed, and the wet test is expected to be completed shortly. It is expected that the commercial operation from the hydropower project will commence in November 2021 against Required Commercial Operation Date (RCOD) of April 13, 2023. During initial phases of operations, the capital structure of the company is expected to remain leveraged due to high debt equity mix. Furthermore, stabilization and streamlining of revenue shall remain a concern.

Moderate power evacuation risk

The power generated from the project is proposed to be evacuated through ~12 km 33 kV transmission line to the under construction 220 kV Khudi Substation which is expected to be completed by mid-July 2022. Until the completion of

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

substation, the power generated from USHL is proposed to be evacuated through transmission line connected to operational 33kV Thakan Besi Substation under Loop-in Loop-out configuration. USHL has entered into an agreement with NEA for the same. On completion of Khudi Substation, the company plans to connect the transmission to the Khudi Substation. This contingency power evacuation may affect the energy generation during the peak wet season.

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, the sector is prone to regulatory risk and changes in other policies by GoN.

Exposure to volatile interest rate

Nepalese banking sectors are fixing floating interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions will be changed by change in liquidity position which lead to change in interest rate. Interest rate has been changing frequently in Nepal market since last 1-2 year. Therefore, funding from Bank and Financial Institutions are exposed to volatile interest rate.

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. km based on snow-fed river. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola.

Key Rating Strengths

Experienced management team in hydropower sector with strong institutional promoter group

USHL has four 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.

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 for sale of 2.4 MW power to be generated from the project. The contracted Plant Load Factor (PLF) is 67.21% with total contracted energy of 14.13 MU. The period of PPA is 30 years from the date of COD or till validity of generation license (obtained on June 5, 2017), whichever is earlier.

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. RCOD of the project is April 13, 2023. PPA period may be extended with mutual consensus during the last six months of validity.

Current demand & Supply gap however possible oversupply in future along with moderate counter party risk

As per the NEA's Annual Report for FY21, the current peak electricity demand is 1,482 MW. The total domestic installed capacity stands at 1,447 MW which includes 632 MW owned by NEA and 815 MW by private sector IPPs. Overall, during FY21, total energy demand was 8,960 GWh which was met by import of 2,806 GWh from India whereas balance was met by domestic generation. However, considering under construction projects which are expected to generate electricity in next 2-3 years and electricity demand which has not increased substantially in past few years could create a situation of over-supply in near future in wet season, requiring demand side management.

The company has signed PPA with NEA is owned by GoN and hence counter party default risk is low; however, timely realization of payments is critical for the company and from analytical perspective also.

Favourable 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) is required 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. It is setting up of a 2.4 MW Run- of-River (RoR), Upper Syange Hydropower Project (USHP) in BOOT (Build, own, Operate and Transfer) mechanism and located at Lamjung district of Nepal.

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About CARE Ratings Nepal Limited:

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