

Yambaling Hydropower Limited

Rating

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP B+ (Is) [Single B Plus (Issuer Rating)]	Assigned

**The issuer rating is subject to overall gearing ratio of the company not exceeding 3.00x at the end of FY23.*

CARE Ratings Nepal Limited (CRNL) has assigned issuer rating of 'CARE-NP B+ (Is)' to Yambaling Hydropower Limited (YHL). Issuers with this rating are considered to offer high risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to YHL is constrained by residual project implementation and operations stabilization risk thereafter associated with its under-construction hydropower project. The rating also takes cognizance of the time and cost overrun of the project leading to a relatively high cost of project resulting in high payback period. Given the relatively higher cost of the project near-term finance burden on the company post commencement of operations is likely to remain higher which would lead to lower returns. The rating also factors in hydrology risk associated with run-of-the-river power generation, risk of natural calamities, power evacuation risk and the company's exposure to regulatory risk and volatile interest rate risk.

The rating, however, derives strengths from the company's experienced promoters and management team in the hydropower sector, presence of power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and government's support for the power sector.

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

Detailed description of the key rating drivers

Key Rating Weaknesses

Cost overrun leading to higher payback period, residual project implementation risk

YHL is setting up a 7.27MW, run-of-river, Yambaling Khola Hydropower Project (YKHP) in Sindhupalchowk district of Bagmati Province in Nepal. The total cost of the project was initially estimated at Rs. 1,200 Mn which has been revised to Rs. 1,584 Mn (Rs. 218 per MW) on account of change in scope coupled with time overrun. The proposed funding mix for the revised cost is debt and equity in the ratio of 70:30 (i.e., debt of Rs. 1,109 Mn and equity of Rs. 475 Mn). The debt of the project has been fully tied up. The company has achieved physical progress of ~86.75% till February 2023. As on mid-April 2023, out of the required Rs. 475 Mn total promoters' contribution, ~Rs. 360 Mn has been infused, and the balance amount is proposed to be raised from an Initial Public Offering (IPO). Since the partial equity portion of the project is yet to be tied up, this exposes the company towards project execution risk in terms of completion of the project within the envisaged time and cost.

Required Commercial Operation Date (RCOD) of the project is currently March 31, 2023. However, the company has applied for further extension till July 31, 2023. If the project is not completed within the RCOD, the company will be liable to pay delay penalty. Furthermore, if COD is delayed by 6 months to 18 months from RCOD, there are restriction clauses in escalation of tariff rate. 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.

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

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 wet season when river flows are high (June to November) and less during the dry season (December to May). The power project is proposed to utilize discharge from Yambaling Khola having design discharge of 1.14m³/s at Q40% and catchment area of 14.15 sq.km. that lies in Sindhupalchowk district of Bagmati province of Nepal. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ khola.

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. YHL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Power evacuation risk

The power generated from the project will be evacuated to Lamosangu Substation via the 132kv transmission line constructed by Balephi A Hydropower Project. The company is required to construct a 33kv transmission line from YKHP's powerhouse switch yard to Balephi Hydropower's Mathillo Balephi "A" Hydropower Project's switchyard where a 132/133 kV transformer is to be installed. Timely completion of the transmission lines as well as substation will be crucial from analytical perspective.

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 risk

Relatively high cost of the project is likely to lead to increased finance burden on the company in initial years of operations. 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**

YHL has seven directors in its board, chaired by Ms. Susan Karmacharya. Ms. Karmacharya is also the Founder and Chairperson of Money Plant Investment Company Private Limited which holds around 40% of the total share capital of the company. Dhan Bahadur Shrestha, Director, has worked with various government bodies at different capacities. The board comprises of directors having experience and exposure in various business sectors. Moreover, the promoters have also worked in development of other

hydropower projects such as Madame Khola Hydropower Private Limited's Madame Khola Hydroelectric Project (24 MW) which is under construction and Eastern Hydropower Limited's Pikhwa Khola Small Hydropower Project (5MW) which is operational.

Power purchase agreement with sufficient period coverage

YHL had entered into a long term PPA with NEA as on January 13, 2016 for sale of 7.27 MW power to be generated from the project on take or pay basis. Hence, power offtake risk will likely remain low once the project is commissioned. The contracted Plant Load Factor (PLF) for total 7.27 MW is 58.89% with total contracted energy of 37.51 MU and shall remain valid for a period of 30 years from COD or till the validity of Generation License i.e., 24 September, 2051 (35 years), whichever is earlier. PPA period may be extended with mutual consensus during the last six months of validity. The validity of the generation license of the company has been extended by a year on account of the project being impacted by the Covid-19 pandemic.

The economic life of the project shall be around 29 years against the debt tenure of 15 years from the commencement of operations. The project's PPA has been executed under the four-month dry season (Mid-December – Mid-April) and eight-month wet season (Mid-April to Mid- December) modality. Tariff rate as per PPA is Rs 4.80 per Kwh for wet season and the tariff rate for dry season is 8.4 per Kwh with 3% annual escalation on base tariff for 5 years. The dry-energy mix is only ~18% of the total contracted energy, when the tariff rates are higher compared to the wet season rate. This could result in lower income levels for the project vis-à-vis peers which have higher dry-energy mix, provided adequate hydrology.

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 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

Yambaling Hydropower Limited (YHL), incorporated on November 21, 2007, as a private limited company, was converted to public limited company on August 29, 2021. The company is involved in developing a 7.27 MW run-of-river Yambaling Khola Hydropower Project (YKHP) in Sindhupalchowk district of Bagmati province in Nepal. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

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