

Unique Hydrel Company Limited

Ratings

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

**The issuer rating is subject to total debt of the company not exceeding Rs. 400 Mn at the end of FY24*

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP B (Is)' assigned to Unique Hydrel Company Limited (UHCL). 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 UHCL continues to be constrained by its weak financial risk profile characterized by sustained muted operating performance amid hydrology related challenges leading to modest debt service coverage indicators. The rating continues to be constrained by the inadequate cash generation from the project amid lower-than-expected power generation resulting in dependence of the company on financial support from the promoters to meet its financial obligations. The rating also factors in hydrology risk associated with run-of-the-river power generation, risk of natural calamities, exposure to regulatory risk and volatile interest rates.

The rating, however, continues to derive strengths from experienced promoters and management team in hydropower sector, Power Purchase Agreement (PPA) with sufficient period coverage, low power evacuation risk and government support for the power sector. While the rating takes cognizance of the measures taken by the company to mitigate the hydrology related challenges, the project's ability to materially improve its operating performance for a sustained period remains to be seen.

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 Nepal Electricity Authority (NEA) will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Weak financial risk profile marked by lower operational PLF

UHCL has been operating a 4.2 MW run-of-the-river Baramchi Hydropower Project (BHP) in Sindhupalchowk district, Nepal since November 2010. The contracted PLF of the project is 61.31% of the installed capacity, however the project has been operating at low PLF over the period due to actual hydrology levels being substantially lower than earlier expectations. During FY23 (Unaudited; FY refers to the twelve-month period ending mid-July), PLF of the project remained lower, albeit slightly improved to 57.48 % of total contracted capacity (FY22: 56.74%). Consequently, UHCL reported total operating income (TOI) of Rs. 61 Mn during FY23 through sale of electricity (FY22: Rs. 62 Mn). Similarly, PBILDT margin of the company decreased to 64.21% during FY23 against 68.62% during FY22 due to increase in administrative expenses. Consequently, the company incurred net losses, impacted also by relatively high interest outgo.

Furthermore, the capital structure of the company stood moderate with total gearing ratio of 1.36x at the end of FY23 which improved from 1.45x at the end of FY22 on account of decline in term liabilities with scheduled repayment of loans. However, the interest coverage ratio stood modest at 1.09x during FY23 deteriorated from 1.65x during FY22 on account of high interest expenses coupled with decline in PBILDT. Total debt/GCA increased to 100.60x during FY23 from 10.19x during FY22 on account of decline in gross cash accruals. The company continues to depend on financial support from

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

promoters to meet cash flow mismatches. Since the power plant is still facing issues related to hydrology, timely infusion by the promoters to support the cash flow of the company when required remains critical for timely payment of the debt obligations. Improvement in hydrology leading to adequate cash flow generation from the project will be critical from credit perspective.

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

Run-of-the-river (ROR) 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. UHCL utilizes discharge from Baramchi Khola (tributary of Balephi river), a perennial river, having catchment area of 14.75 sq kms. The company is in the process to add water diversion from the Majhe Khola for dry season which is expected to improve the power generation and revenue for the company. However, the project is still exposed to risk associated with variation in discharge of water from the aforesaid river.

Risk of natural calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their 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. These natural calamities can adversely affect the smooth flow of power generation and distribution, which can impact financial returns of the projects. UHCL 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 risk

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.

Exposure to regulatory risk

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) as a regulatory body to regulate generation, transmission and distribution of electricity in Nepal among others. The right granted to ERC for PPA approval, prior approval of IPO issuance, approval of mergers, prescribe condition for maintaining standards of electricity placed outside transmission line and examine the standard, prescribe maintenance of proper internal control system, account systems and auditing method along with perform surprise check, inspect and investigate the licensed persons and imposing fine for noncompliance of applicable act, regulations and directives poses a new challenge to power sector companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strengths

Experienced promoters and management team in hydropower sector

UHCL is managed under overall guidance of the company's Board of Directors (BoD), who possesses wide experience in power sector as well as other industries. The company has three members in its BoD, chaired by Mr. Prakash Kumar Shrestha who has more than three decades of experience in various sectors including banking sector. Mr. Gyanendra Lal Pradhan, director, has more than 26 years of experience in power generation through his association with different companies. He is also Executive Chairman at Hydro Solutions and National Council Member at Confederation of Nepalese

Industries (CNI). Ms. Swasti Shrestha, director, has more than 15 years of experience in Hydropower sector with major specialization in Hydropower. The BOD is further supported by other experienced management team members.

Power purchase agreement with sufficient period coverage

UHCL entered into PPA with NEA as on November 18, 2009 for 4.2 MW for sale of power generated by the plant. The period of PPA is 30 years from date of the commercial operation date (COD). The tariff for 0.098 MW for wet season (Mid-April to Mid-December) is Rs 3.9 per kWh and for dry season (Mid-December to Mid-April) is Rs 5.52 per kWh and for additional contract energy it is Rs 4 & Rs 7 per kWh for wet & dry season respectively with 3% escalation every year on base tariff for 9 times after completion of 12 months from COD date.

Low power evacuation risk

The power generated from the project is evacuated through 33KV Transmission Line to NEA Laamo Sangho Substation. A single transmission line connects to NEA sub-station. In overall aspect, there is lower power evacuation risk with no tripping problem. However, smooth power evacuation for a reasonable period remains to be seen and will remain a key monitorable.

Favorable government policies towards power sector

Government of Nepal (GoN) considers power generation as priority sector and intends to maximize private sector participation in generation of electricity by offering different exemptions and facilities on power sector. 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 towards reservoir-based hydropower projects; full tax exemption is provided for first 15 years and 50% tax exemption for next 6 years to reservoir and semi- reservoir projects whose capacity is higher than 40 MW, completing financial closure within mid-April 2029. 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 augurs well for the sector. Also, increasing trend of cross-border energy trade and its prospect in upcoming days with bilateral agreements with the neighboring nations shows positive outlook on long- term demand for the power sector.

About the Company

UHCL is Public Company, incorporated on July 14, 2000, promoted by institutional as well as individual promoters from different background. It is currently operating 4.2 MW Baramchi Hydropower project in run-of-river scheme located at Sindhupalchowk district, Nepal. The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism. The project started commercial operation on November 14, 2010.

Financial Performance

For the Period	(Rs. In Million)		
	FY21 (A)	FY22 (A)	FY23 (UA)
Income from Operations	55	62	61
PBILDT Margin (%)	57.25	68.62	64.21
Overall Gearing (times)	1.72	1.45	1.36
Interest Coverage (times)	0.78	1.65	1.09
Current Ratio (times)	1.72	4.61	5.28
Total Debt/Gross Cash Accruals(times)	Negative	10.21	103.62

A: Audited, UA: Unaudited

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