

Upper Syange Hydropower Limited

Rating

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

*The issuer rating is subject to the company maintaining overall debt not exceeding Rs. 380 Mn at the end of FY24 (FY refers to the twelve-month period ending mid-July).

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

Detailed Rationale & Key Rating Drivers

The revision in rating assigned to USHL factors in below average operational and financial performance of the company marked by lower than envisaged income from power sales amid sustained high power evacuation risk as the power generated from its operational Upper Syange Hydropower Project (USHP) is still being evacuated through contingent route leading to net losses and inadequate gross cash accruals during FY22 and FY23. The rating takes cognizance of project execution risk associated with its new Dovan Khola Hydropower Project, which is in early stages of implementation. The rating also factors in the hydrology risk associated with run-of-the-river power generation, risk of natural calamities and exposure to volatile interest rate. The rating, however, continues to derive 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.

Going forward, the ability of the company to 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

Below average financial performance amid low power sales

The 2.40 MW USHP at Lamjung district of Nepal came into operation from February 27, 2022. During the first nineteen months of its operations (February 27, 2022 to mid-September 2023), the project's Plant Load Factor (PLF) was below par at around 40% of contracted energy. The plant was shut down from June 2022 for four months on account of breakdown of turbine hindering the power generation for around two months followed by shut down notice issued by NEA as USHP falls under 'Projects Under Contingency Evacuation Plan'. Furthermore, low dispatch instructions from NEA coupled with hydrology issues have led to sustained low power generation. The company reported net loss of Rs. 55 Mn with negative gross cash accruals during FY23.

High power evacuation risk leading to sustained subdued performance

The power generated from USHP was proposed to be evacuated through ~12km 33 kV distribution line to NEA's Khudi Substation, the construction of which had been delayed substantially. Alternatively, since USHP come to operations in February 2022, the power generated from the project is being evacuated through Radhi Bidyut Company Limited's transmission line connected to operational Thakan Besi substation. For projects evacuating power under a contingency plan,

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

the project's modality also changes to take-and-pay from take-or-pay modality as per the terms of PPA, making the project dependent on dispatch instructions from NEA. Low dispatch instructions, particularly during wet season coupled with congestion in the evacuation route, has significantly hampered the TOI of the company since commencing operations. Timely completion and shifting of power evacuation to NEA's Khudi substation, as originally proposed in the PPA, will remain crucial for company's satisfactory operational performance. Until such time, the company is likely to continue to remain exposed to high power evacuation risk leading to modest operating performance.

Project implementation risk associated with Dovan Khola Hydropower Project

The company is developing a 24.5 MW Dovan Khola Hydropower Project after obtaining survey license on May 23, 2018. The company has entered into a long term PPA with NEA as on June 22, 2023. The cost of the project is estimated to be Rs. 4,500 Mn (i.e., ~Rs. 183.67 Mn per MW) to be financed in debt equity ratio of 70:30. The project is in initial stages of implementation and debt component for the project is yet to be tied-up. This exposes the company towards project funding risk in terms of raising equity and debt and completion of the project within the envisaged time and cost.

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

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 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.

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 Private Limited (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 01, 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. Following eight-months of wet and four-month of dry season, the total contracted energy of the project is 14.13 MU with relatively lower dry energy mix of ~20% of the total contracted energy, which, however, remains a constraint for company's income profile.

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. 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. Also, increasing trend of cross-border energy trade and its growing prospect in upcoming days supported by new bilateral agreements between Nepal and India for additional export of power to India from Nepal augurs well for the long-term demand prospect for the power sector in Nepal.

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, commenced operations from February 27, 2022 and located at Lamjung district of Nepal. Also, the company is involved in setting up of a 24.5 MW Peaking run-of-the-river (PRoR) Dovan Khola Hydropower.

Financial Performance

For the year ended Mid-July	FY22	FY23
	(Audited)	(Unaudited)
Income from Operations	15	31
PBILDT Margin (%)	70.22	54.97
Overall Gearing (times)	3.64	2.65
Interest Coverage (times)	0.46	0.32
Current Ratio (times)	0.91	1.04

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