

Rating Rationale
Upper Hewakhola Hydropower Company Limited

Rating

Facility	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	986.50	CARE-NP BB- [Double B Minus]	Assigned
Total Facilities	986.50		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP BB-’ to the long term bank facilities of Upper Hewakhola Hydropower Company Limited (UHHCL).

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of UHHCL is constrained by project implementation risk including stabilization risk and power evacuation risk thereafter given its initial stage of construction. The rating is also constrained by significant time overrun in the project and exposure to volatile interest rates, hydrology risk associated with run of the river power generation and geological risk. The rating, however, derives strength from experience of the board members and management in hydro power sector, UHHCL’s power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The rating also factors in achievement of financial closure for estimated project cost, shortage of power in the country and government support for the power sector.

Ability of the company to timely complete the project within projected required commercial operation date (approval pending) within envisaged time and cost, timely completion of Baneshwor Substation and Koshi Corridor Transmission Line, availability of sufficient hydrology and timely receipt of the payments from NEA are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Project implementation risk and stabilisation risk

Required commercial operation date (RCOD) of the project is July 02, 2019. The project is at initial stage of construction. Till mid-March, 2019, about 14% financial progress has been achieved. Till May, 2019, required land has been purchased, contract for hydro mechanical work has been awarded, memorandum of understanding has been entered for supply of electro mechanical equipment and contract for civil works has been awarded for track opening; infrastructure development works and alignment works. Contract for construction of transmission line and remaining portion of civil works is expected to be awarded soon. As major part of the project work still remains to be completed, the company continues to remain exposed to risks associated with project implementation and satisfactory operations thereafter.

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

Power evacuation risk

Power generated from the project will be evacuated through Baneshwor substation and 220kV double circuit Koshi Corridor transmission line within the scope of Nepal Electricity Authority (NEA) which is yet to be completed. This has led to time overrun of the project since the company slowed down its construction work to align with the work progress of transmission line within the scope of NEA. Construction of ~10Km long 33kV transmission line from powerhouse to Baneshwor Substation within scope of the company is pending. Timely completion of Baneshwor Substation and Koshi Corridor Transmission Line will be the key rating sensitivities.

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 seasonal river flows are high (Mid-April to Mid-December) and less during the winter season (Mid-Dec to Mid-April). UHHCL has proposed to utilize discharge from Hewa Khola (main), Jhure Khola and Khukuwa Khola having total catchment area of 66.14 Km². Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid rivers.

Geological Risk

The project area is supposed to pose significant geological risks since it is generally located in rough terrain and is likely to face adverse climatic condition during construction period which may result in delay in construction and project cost overrun. The access road is prone to landslides during monsoon and maintenance is required for the same.

Key Rating Strengths***Board members and management having experience in hydro power sector***

UHHCL has six directors on its Board. Mr. Keshav Bahadur Rayamajhi, chairman, has ten years of experience in hydropower sector and Banking sector in various positions. Mr. Dedaraj Khadka, managing director, has over two decades of experience in hydropower sector. Similarly, other directors have related experience in hydropower sector. Board is supported by members of experienced management team across various functions.

Power purchase agreement with sufficient period coverage

UHHCL had entered into a PPA with NEA on January 7, 2016 for sale of 8.5 MW power to be generated from the project. RCOD of the project is July 2, 2019. However, the project is not expected to be completed within RCOD since construction of the project was delayed. Expected commercial operation date (COD) of the project is mid-July, 2020 and approval from NEA for RCOD extension is under process. The contracted energy of the project is 46.28 million units (MU) and the Plant Load Factor of the project is 62.16%. The period of the PPA is 30 years from the date of COD or till validity of Generation License (received on April 28, 2015 for 35 years), whichever is earlier. PPA period may be extended with mutual consensus during the last six month of validity.

The tariff for wet season (Mid-April to Mid-December) is Rs 4.80 per kWh and for dry season (Mid-December to Mid-April) is Rs 8.40 per kWh with 3% escalation on base tariff for 5 years.

Moderate counter party risk

UHHCL is exposed to counter party payment risk pertaining to NEA, which has been making consecutive losses in past till FY 2016 and carry huge accumulated loss in its book. However, as per the annual report published by NEA, during FY18 (provisional), NEA earned profit of Rs 1,010.21 Mn (Rs 1,502.28 Mn during FY17). The counter party payment risk is moderated by the fact that, NEA is fully owned by Government of Nepal (GoN), net loss is declining over the period and NEA is generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producer (IPPs) in past.

Financial closure achieved for estimated project cost

Total estimated project cost is Rs. 1,409.37 Mn to be funded in debt equity ratio of 70:30 (i.e. Rs. 986.50 Mn debt and Rs. 422.87 Mn equity). UHHCL achieved the financial closure for the project on March 25, 2016. Till March 14, 2019, UHHCL availed bridge gap loan of Rs. 50 Mn and total equity infused by shareholders was Rs. 180 Mn (including calls in advance of Rs. 20 Mn).

Shortage of power in the country

As per the statistics presented in report published by Ministry of Energy, Nepal on May 2018, the current peak electricity demand is about 1,300 MW. The total domestic installed capacity stands at 1,073 MW which includes 562 MW generated by NEA and 511 MW generated and supplied by private sector IPPs. To meet the current demand, NEA is importing up to 450 MW power from outside beside domestic generation.

Government support for the power sector

GoN considers hydropower generation as priority sectors and tries to involve private sector participation in generation of hydroelectricity by offering different incentives. GoN has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years to those who generate electricity within Mid-April 2024. Normal tax rate for entity in Nepal is 25%, however only 20% tax rate is applicable for hydro power project. Furthermore, GoN has declared to provide grant of amount equivalent to Rs. 5 Mn per MW installed capacity after receiving evidence of formal COD of complete power plant.

About the Company

UHHCL is a public company, incorporated as on March 13, 2012 as Upper Hewakhola Hydropower Pvt. Ltd. Later on, it converted to a public company on June 6, 2018. It is promoted by institutional as well as individual promoters from different backgrounds for setting up of 8.5 MW run-of-the-river Upper Hewakhola Small Hydropower Project in Sankhuwasabha district of Nepal. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism. Currently, share capital of the company is held by promoter shareholders

where Mr. Arjun Prasad Gautam (holds 6.93%), Mr. Bhimlal Paudel (holds 6.32%) and Mr. Keshab Bahadur Rayamajhi (holds 4.95%) are major three promoter shareholders of the company.

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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	986.50	CARE-NP BB-
Total		986.50	