

Rating Rationale

Upper Hewa Khola Hydropower Company Limited

Rating

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

Details of Facilities in Annexure 1

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

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of UHHCL is constrained by project implementation and stabilization risk including the power evacuation risk. The rating is also constrained by UHHCL’s exposure to regulatory risk, hydrology risk associated with run of the river power generation, significant time overrun and exposure to volatile interest rates and geological Risk. The rating, however, derives strength from board members and management having experience in hydro power sector, presence of power purchase agreement (PPA) with sufficient period coverage. The ratings also factor in moderate counter party risk, achievement of financial closure for full project cost, power demand supply gap in Nepal coupled with increasing demand of power in the country and government support for the power sector. The ability of UHHCL to timely complete the project without any time or cost overrun is the key rating sensitivity.

Impact of Corona Virus on the Project Implementation

The outbreak of Coronavirus disease 2019 (COVID-19) which was recognized as Pandemic by World Health Organization has affected Nepal as well. Government of Nepal (GoN) imposed travel restrictions and countrywide lockdown since March 24, 2020 closing most of the organizations which resulted in slowing down of the economic activities. Due to the pandemic there are several impacts in under-construction projects like unavailability of contract labor and construction material due to partial operations of manufacturing units across Nepal. UHHCL was impacted due to COVID-19 due to unavailability of resources especially in construction of transmission line for the project. Further, with expected delay in completion of NEA’s substation due to COVID-19, UHHCL has delayed delivery of electromechanical equipment also. RCOD of the project was extended to Mid July 2020 however, the company expects to complete the project by Mid Jan 2021.

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

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Project implementation and stabilisation risk

The expected COD of the project is Mid Jan 2021 as per the estimates by the management. Till March 13, 2020, 28.30% of financial progress is achieved. Contract for civil works, Hydro mechanical works, and electromechanical equipment has been entered. The project includes 2,587 m long headrace pipe, 1,258 m long penstock pipe and 72 m long tail race pipe. Two turbines (each having 4450 KW capacity) will be used in the project for the generation of power. As per the progress report of June 2020 submitted by the company, ~59% of the Hewa Head works, ~50% of the Headrace pipe alignment, surge tank, penstock Alignment, ~50% of the powerhouse building, tailrace, switchyard and interconnection, ~52% of Hydro-Mechanical work , ~60% of works related to transmission line has been completed. With the financial progress of 28.30%, the project is unlikely to meet the expected commercial operation date of Mid Jan 2021. Thus, company continues to remain exposed to the risks associated with project implementation and satisfactory operations thereafter. Timely completion of the project within the estimated cost and time and satisfactory operations thereafter are the key rating sensitivities.

Power evacuation risk

The power generated from the project will be evacuated through ~10 Km long 33kV transmission Line to Baneshwor Substation. As per connection agreement for evacuation of power from the project, it is necessary to complete the Baneshwor substation and Baneshwor-Basantapur-New Duhabi 220kV double circuit transmission line which are within the scope of NEA. Although, as per connection agreement, Baneshwor-Basantapur-New Duhabi 220kV transmission line was targeted to be completed by Mid-April 2018, the same is not completed till date. This has led to time overrun of the project as the company slowed down its construction work to align the project parallel to the transmission line work within the scope of NEA. Timely completion of the transmission lines and substation will be key rating sensitivity.

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

Geological Risk

The project area is supposed to pose significant geological risks since it is located in rough terrain and is likely to face adverse climatic condition such as landslides, flooding etc. during construction period

resulting in halt of construction and project cost overrun. The access road is prone to landslides during monsoon and maintenance is required for the same.

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 is proposed to utilize discharge from Hewa Khola (main), Jhutre Khola and Khukuwa Khola having catchment area of 66 sq kms, 4.47 sq kms and 6.83 sq kms respectively. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

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 of the company, has 10 years of experience in hydro power sector and Banking sector in various positions. Mr. Dedaraj Khadka is the managing director of the company, has over two decades of experience in hydropower sector. Similarly, other directors have related experience in hydropower sector. The Board is supported by members of experienced management team.

Power purchase agreement with sufficient period coverage

UHHCL had entered into a long term PPA with Nepal Electricity Authority (NEA) as on January 7, 2016 for sale of 8.5MW power to be generated from the project. 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. The Plant Load Factor (PLF) of the project is 62.16% with the contracted energy of 46.28 million units (MU). RCOD of the project was July 2, 2019 which was extended till Mid July 2020. However, the project will not complete within RCOD as the construction of the project is delayed to align the project with the construction of Baneshwor Substation and 220 KV Koshi Corridor transmission line (Baneshwor- Basantapur- New Duhabi) which is in NEA's scope. As per the management, expected COD of the project is Mid Jan, 2021 and company is in process of applying for RCOD extension. If RCOD is not revised by NEA till COD, the company is required to pay late COD penalty. Further, if COD is delayed by 6 months to 18 months from RCOD, then the number of escalation in tariff rate will decrease to 4 times from 5 times.

Moderate counter party risk

UHHCL is exposed to counter party payment risk pertaining to Nepal Electricity Authority (NEA), which has been making consecutive losses in past till FY16 and carry huge accumulated loss in its book. However, as per the annual report published by NEA, during FY19 (provisional), NEA earned profit of Rs 7,205 Mn. Further, during FY19, NEA achieved gross cash accrual of Rs 11,915 Mn. The counter

party payment risk is moderated by the fact that, NEA is fully owned by government of Nepal, net loss is declining over the period and generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producers (IPPs) in past.

Financial closure achieved for the full project cost

The total estimated cost of the project is Rs. 1409 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 13, 2020, total equity infusion by the shareholders is Rs 232 Mn. Out of the total project cost, UHHCL has incurred Rs. 403 Mn as on March 13, 2020.

Power demand & supply gap coupled with increasing demand of power in the country

As per the NEA's Annual Report for FY19, the current peak electricity demand is 1,320 MW. The total domestic installed capacity stands at 1,178 MW which includes 617 MW owned by NEA and 561 MW by private sector IPPs. Overall, during FY19, total energy demand was 7,584 GWh which was met by import of 2,813 GWh from India whereas balance was met by domestic generation. As per NEA, electricity demand is in increasing trend and is expected to increase in future with increase in electricity consumption through the promotion of electric vehicles by building charging station and replacing cooking gas with electricity, increase in access of population using electricity (78% in FY19) etc.

Government support for the 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. 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

Upper Hewakhola Hydropower Company Ltd. (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 an 8.5 MW run-of-river Upper Hewakhola Small Hydropower Project in Sankhuwasabha district of Nepal. Total share capital of the company is Rs. 232 Mn as on March 13, 2020. Mr. Arjun Prasad Gautam (holds 9.93%), Mr. Keshab Bahadur Rayamajhi (holds 9.01%) and Mr. Bhimlal Paudel (holds 7.19%) are top three shareholders of the company. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism. As per the Generation License, from Government of Nepal – Ministry of Energy, obtained as on April 28, 2015 the project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 35 years.

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Annexure 1: Details of the Facilities rated

S. N.	Name of Bank	Type of the Facility	Amount (Rs. in Million)	Rating
1	Long Term Bank Facilities	Term Loan	986.50	CARE-NP BB-
	Total		986.50	