

## Rating Rationale

### Upper Hewa Khola Hydropower Company Limited

#### Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating <sup>1</sup>	Rating Action
Issuer Rating	NA	CARE-NP BB-(Is) [Double B Minus (Issuer)]	Assigned
Long Term Bank Facilities	986.50	CARE-NP BB- [Double B Minus]	Reaffirmed
<b>Total Facilities</b>	<b>986.50</b>		

*\*The issuer rating is subject to the company maintaining overall gearing not exceeding 2.20x at the end of FY22.*

*Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has assigned Issuer rating of ‘CARE-NP BB- (Is)’ to Upper Hewa Khola Hydropower Company Limited (UHHCL). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations, in Nepal. Also, CRNL has reaffirmed the rating of ‘CARE-NP BB-’ for 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, 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, current demand & supply gap however possible oversupply in future 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.

#### Detailed Description of the Key Rating Drivers

##### Key Rating Weaknesses

##### *Project implementation and stabilisation risk*

The estimated cost of the project is Rs 1,409 Mn (i.e. Rs 166 Mn per MW) which is proposed to be financed in debt equity ratio of 70: 30 (i.e. Rs 986 Mn term loan and Rs 423 Mn equity). The expected COD of the project is July 16, 2021. Till January 28, 2021, 62.55% of financial progress was achieved. As the project is yet to be completed, the company continues to remain exposed to the risks associated with project implementation and satisfactory operations thereafter given that the plant is being constructed in the

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com)

Mountain region where geology and climatic conditions plays a major part in the timely completion of the planned activities. 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 is further evacuated to under construction Inaruwa substation which are within the scope of NEA. However, the construction works of Baneshwor substation has already been completed. The Koshi corridor and the inaruwa substation is expected to be completed by June, 2021. This has led to time overrun of the project as the company slowed down its construction work parallel to the transmission line work within the scope of NEA. Timely completion of the transmission line within the scope of company; and substation and transmission line within the scope of NEA 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 the 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. Also, after operation of project, any loss in power generation due to geological issues can adversely impact project earnings.

***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. 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 period of the PPA is 30 years from the date of COD or till validity of Generation License, whichever is earlier. PPA period may be extended with mutual consensus during the last six months 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. 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 has not been completed within RCOD since the construction of the project was delayed to align the project with the construction of Baneshwor Substation and 220 KV Koshi Corridor transmission line (Baneshwor- Basantapur- Inaruwa) which is in NEA's scope. The Baneshwor substation has already been completed. The under construction NEA Inaruwa substation is expected to be completed by June 2021. As per the management, expected COD of the project is July 2021 and company has applied for the extension of RCOD, if RCOD is not revised by NEA till COD, then delay RCOD penalty will be levied to company by NEA as per PPA. Also the number of escalations in tariff rate will be reduced if delay RCOD is more than 6 months. Receiving of approval for extension of RCOD and completion of project within the extended RCOD are key rating sensitivities.

***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. However, as per the annual report published by NEA, during FY20 (provisional), NEA earned profit of Rs 11,056 Mn (Rs. 9,812 Mn during FY19) resulting the accumulated profit in its book. Further, during FY20, NEA achieved gross cash accrual of Rs 16,056 Mn (Rs 14,664 Mn in FY19). The counter party payment risk is moderated by the fact that, NEA is fully owned by government of Nepal, 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 January 28, 2021, total equity infusion by the shareholders is Rs 300 Mn. Out of the total project cost, UHHCL has incurred Rs. 882 Mn as on January 28, 2021.

***Current demand & supply gap however possible oversupply in future***

As per the NEA’s Annual Report for FY20, the current peak electricity demand is 1,408MW. The total domestic installed capacity stands at 1,328 MW which includes 632 MW owned by NEA and 696 MW by private sector IPPs. Overall, during FY20, total energy demand was 7,894 GWh which was met by import of 1,721 GWh from India whereas balance was met by domestic generation.

However, considering under construction projects which are expected to generate electricity in next 2-3 years and electricity demand which has not increased substantially in past few years could create a situation of oversupply in near future in wet season. This could put pressure on NEA’s payment capabilities which is sole counter party with majority of PPA signed on take or pay basis.

***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. Also, Unified Directive of 2020/21, has directed “Class-A” to allocate minimum 10% of credit to energy sector and “Class-B” and “Class-C” banks to allocate minimum 20% and 15% of total credit respectively to agriculture, energy, SMEs and tourism sector within mid-July 2024.

**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 under BOOT (Build, Own, Operate and Transfer) model located at Sankhuwasabha district of Nepal

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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	<b>CARE-NP BB-</b>
	<b>Total</b>		<b>986.50</b>	