

Upper Hewa Khola Hydropower Company Limited

Ratings

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Long Term Bank Facilities	986.50	CARE-NP BB [Double B]	Rating revised from CARE-NP BB- to CARE-NP BB
Total Facilities	986.50 (Nine Hundred and Eighty-Six Million and Fifty Thousand Only)		
Issuer Rating	NA	CARE-NP BB (Is) [Double B (Issuer)]	Rating revised from CARE-NP BB- to CARE-NP BB

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

Details of instruments/facilities in Annexure-1

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

Further, CRNL has revised the issuer rating assigned to UHHCL to 'CARE-NP BB (Is)'. Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations in Nepal.

Detailed Rationale & Key Rating Drivers

The revision in rating assigned to the bank facilities and issuer rating of UHHCL factors the successful commissioning of the project. The rating continues to be constrained by project stabilization risk, hydrology risk associated with run-of-the-river power generation, exposure to volatile interest rate risk and regulatory risk.

The ratings, however derive strength from experienced board members and management team, presence of power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The ratings also factor in current demand & supply gap; however, possible oversupply in future and government support for the power sector.

Going forward, the ability of the company to stabilize of the operations of newly commenced hydro power project and to generate energy equivalent to contracted are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Project stabilization risk

As on March 22, 2022, UHHCL had incurred an expenditure of Rs 1,245 Mn towards the project which has a total cost of Rs. 1,409 Mn. The expenditure incurred has been funded through total loan of Rs. 945 Mn and balance from the promoters' contribution in the form of equity capital and unsecured loans. As per the progress report of February 2022 submitted by the company, the overall progress of the project is ~98%. The company has completed the dry test and the wet test of the project. Though the project has started commercial operations in March 2022, the company continues to remain exposed to the post project implementation risk. Being a new unit, the stabilization and streamlining of production remains to be seen. Furthermore, the power generated from the project evacuated through operational Chatara substation due to non-completion of the Inaruwa substation which reduces the power evacuation risk of the project to an extent. However, the smooth evacuation of the power remains crucial from revenue generation perspective.

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

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

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.

Exposure to volatile interest rate

Nepalese banking sectors are fixing floating interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions (BFIs) remains volatile to change in liquidity position which lead to change in interest rate. Interest rate has been changing frequently in Nepal market since last 2-3 years. Therefore, funding from BFIs is subject to volatile interest rate.

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.

Key Rating Strength**Experienced board members and management team in hydropower 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. 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 contracted energy of the project is 46.28 million units (MU) (i.e., 6.96 MU for dry season and 39.33MU for wet season). The Plant Load Factor (PLF) of the project is 62.16%.

Favorable Government policies towards 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. As per various directives from NRB whereby 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.

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

Annexure-1: Details of Instruments/Facilities

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

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