HYM Consult Private Limited: [ICRANP] LB+/ A4 assigned

March 25, 2019

Summary of rated instruments

Instrument	Rated Amount (NPR Million)	Rating Action
Long-term loans, Fund based	900	[ICRANP] LB+ (Assigned)
Short-term loans, Non-fund based (within term loans)	(400)	[ICRANP] A4 (Assigned)
Total	**900**	

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP] LB+ (pronounced ICRA NP L B plus) to the proposed long-term loans of HYM Consult Private Limited (HCPL). ICRA Nepal has also assigned the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the proposed short-term loans of the company.

Rationale

The assigned ratings are constrained by the significant execution risks of the 6-MW Rele Khola Hydroelectric Project (HEP) being developed by HCPL. While the project is required to operate from June 1, 2020, only road excavation has been started so far, raising timeline concerns. The promoters' limited experience in hydropower project development and operation is also an area of concern. The execution risks, however, are mitigated to an extent by the experience of the contractor (Schimmer Infra Pvt. Ltd., India) involved in the project development. The rating action further considers the high evacuation risks for the project as the Kali Gandaki transmission corridor of the Nepal Electricity Authority (NEA) is targeted to be completed only by December 2020. Any delays in corridor completion could defer the project commissioning and hence increase the project costs. This in turn may lead to weakening of coverage and return indicators, given the fixed tariffs. The hydrological risks are also high for the project, given the lack of deemed generation clause in the power purchase agreement (PPA). These risks are further heightened by the presence of stringent terms in the PPA, requiring a minimum of 30% dry energy. Failure to deliver this might impact the wet season (June to November) revenues as well. The rating action is also impacted by the funding risks as the financial closure is yet to be achieved.

Nonetheless, the rating action considers the low regulatory and tariff risks, given the presence of long-term PPA. Additionally, the relatively high share of dry energy (~32%) augurs well for the revenue prospects of the company. Also, the project cost remains largely comparable to similar projects. Moreover, the supply-demand gap in Nepal's power sector is expected to result in healthy offtake. However, the 10% conditional offtake clauses during the peak rainy months from FY2019 to FY2029 raises some concern. Going forward, the company's ability to commission the project within the budgeted cost and stipulated time and achieve the design operating parameters would remain the key rating sensitivities.

Key rating drivers

Credit strengths

Presence of long-term PPA lowers tariff risks - HCPL has entered into a PPA with NEA (the sole purchaser and distributor of electricity in Nepal) for its entire project capacity for a period of 30 years from the commercial operation date (subject to validity of generation licence). The predefined tariff, as per the PPA, is NPR 4.80 per kWhr for the wet season, while that for the dry season[1] is NPR 8.40 per kWhr. For these rates, there is a 3% escalation per annum on the base tariff for eight consecutive years. With a firm PPA in place, the tariff risks for the project are low. However, the project remains

[1] *As per PPA, period from December to May are considered as dry season; rest being considered as wet season.*

exposed to counterparty credit risk, given the moderate financial profile of NEA. However, it is offset by the sovereign support to NEA and its past track record of timely payment to private HEP developers.

Supply-demand gap to result in healthy offtake - In FY2018, the peak power demand in the Integrated Nepal Power System (INPS) surged to 1,508 MW, while the installed operational capacity was only 1,074 MW. The shortfall was met through import of electricity. As per the NEA, the power demand is expected to grow at the rate of ~15% over the next 22 years (driven by an increase in electrification, per capita consumption and higher industrial demand). Hence, the supply-demand gap is expected to persist. At the same time, the Government of Nepal (GoN) has introduced favourable regulations like a compulsory floor of 15% of the total loan of the bank towards the energy sector, and a 10-year tax holiday for hydropower projects, among others. All these are positives for the players in the renewable energy sector. However, the PPA has conditional offtake clauses for 10% energy for five months in the rainy season for FY2019 to FY2029, given the possible overload on INPS during the high generation season.

Healthy mix of dry energy to support return and debt coverage indicators – The contract plant load factor (PLF) for HCPL remains healthy at ~67% given the six-month dry energy mix (commensurate to ~32% of the annual energy) against the four-month dry energy for most projects (commensurate to ~15–20% of annual energy). Since the dry energy tariff is much higher than the wet energy tariff, it would result in higher average tariff for the energy to be generated by the project . At the same time, the project costs are largely comparable to most projects (~NPR 193 million per MW). Hence, the higher average tariff augurs well for the project's return and coverage indicators. However, these indicators could come under pressure in case the project is unable to achieve its design operating parameters.

Credit challenges

Project exposed to significant execution risks at preliminary stage of construction - Hydropower projects typically entail significant project execution risks as these projects are located in difficult terrain and are exposed to adverse climatic conditions during the construction period. Also, natural calamities/geological changes can result in time and cost overruns. Rele Khola HEP's required commercial operation date (RCOD) as per the PPA is June 1, 2020. However, only access road excavation has been started so far, raising timeline concerns. Since a major portion of the project lies in Annapurna Conservation Area, timely approval for construction from concerned authorities would be critical. The promoters also have limited experience in HEP development. These risks are partly mitigated by the experience of the contractor in similar projects. Nonetheless, any timeline delays would result in sharp cost escalations for the project, incremental interest capitalisation as well as project monitoring costs. This would have a negative impact on the return indicators and debt coverage indicators of the project.

High evacuation risks given possible delays in completion of NEA's transmission corridor - The power generated from the project is to be evacuated through the proposed Dana substation, which will be a part of the Kali Gandaki transmission corridor of NEA (~150 kms with three substations). Though NEA has targeted to complete the Dana substation by March 2019, the project commissioning will be contingent upon the completion of the entire transmission corridor. As of now, NEA plans to complete the same by December 2020, while the RCOD of the project is in June 2020. Given the possible delays in NEA's transmission line corridor project, the evacuation risk remains high for the project. In case of any delays therein, the project operation will also be pushed accordingly without any financial compensation.

Financial closure yet to be achieved - The project is likely to be developed at an expected cost of NPR 1,155 million, which is to be funded in a debt-to-equity ratio of ~72:28. The financial closure is yet to be achieved, raising concerns on the funding risks. However, the promoters have already injected ~22% of total project equity requirements till mid-December 2018, which is being used towards initial project development activities. The equity stake is held by a few promoters with the largest promoter having committed ~44% of total equity requirements. Hence, the timely infusion of equity could remain critical, given the short timeframe remaining for the project execution.

High hydrological risks due to lack of deemed generation clause in PPA, stringent PPA terms - Like most of the small rivers in Nepal, Rele Khola is also not a gauged river. Hence, the lack of deemed generation clause in the PPA exposes the project to high hydrological risks as the loss in revenues in case of fall in hydrology will not be compensated. Hydrological risks are further heightened because of the stringent PPA terms in case the project fails to supply a minimum of 30% energy in the dry months. Upon such event, the supplied dry energy would be assumed to be 30% of the deemed annual energy and the additional energy in the wet months would not be paid. Additionally, the project has a relatively small catchment area of ~27 sq km, which raises concerns regarding the sustainability of flow. Since this is a low discharge and high head project[2], a slight fall in hydrology could impact energy generation considerably and create pressure on the debt coverage metrics.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:
Corporate Credit Rating Methodology

About the company

Incorporated in February 2007, HYM Consult Private Limited (HCPL) is the developer of the 6-MW Rele Khola hydropower project in Narchyang VDC, Myagdi District of Gandaki Pradesh, Nepal. The main promoters of the company include Mr. Tara Prasad Bhattarai (~48% stake currently), Ms. Shovana Pokharel (~16% stake) and Mr. Sujan Kumar Kafle (~14% stake), among others. The proposed project has RCOD of June 1, 2020, as per the PPA signed with the NEA.

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[2] *Design discharge of 1.48 cusecs and gross head of 505 meters.*

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