

Rating Rationale

Mailung Khola Jal Vidhyut Company Limited

Rating

| Particulars | Amount | Rating ¹ | Rating Action |
|---------------|--------|------------------------------------|---------------|
| Issuer Rating | NA | CARE-NP D (Is) [Single D (Issuer)] | Assigned |

CARE Ratings Nepal Limited (CRNL) has assigned Issuer rating of ‘CARE-NP D (Is)’ to Mailung Khola Jal Vidhyut Company Limited (MKJV). Issuers with this rating are considered to be in default or are expected to be in default soon.

Detailed Rationale & Key Rating Drivers

The rating assigned to MKJV is constrained by on-going delays in the repayment of bank debt obligations, moderate financial risk profile marked by lower generation of energy during FY20 (Unaudited, refers to 12 months ended Mid-July 2020), lower tariff rate impacting revenue profile and high collection period for posted rate leading to cash flow mismatches. The rating is also constrained by project implementation and stabilization risk of projects where the company has invested, exposure to volatile interest rates, hydrology risk associated with run-of-the-river power generation and exposure to regulatory risk. The rating, however, derives strength from experienced directors and management team, presence of power purchase agreement with sufficient period coverage and moderate counter party risk. The ratings also factor in current demand and supply gap however possible oversupply in future and government support for the power sector. The ability of company to reduce the gap between operational Plant load factor (PLF) and contracted PLF, availability of sufficient hydrology and timely receipt of the payments from Nepal Electricity Authority (NEA) and timely repayment of the bank debt obligations are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

On-going delays in the repayment of bank debt obligations

MKJV has delayed the payment of bank debt obligations due to cash flow mismatches during FY20 (delays being more than 30 days) and still has ongoing delays for repayment obligations for the Quarter ended October 16, 2020. The delay in repayment of the bank loans during FY20 was on account of low cash accruals due to partial release of the posted amount by NEA. The total posted receivable amount from NEA based on the promotional tariff rate as on July 2020 is Rs. 90.79 Mn. Also, Out of the total late Commercial Operational Date (COD) penalty, Rs. 9.39 Mn was deducted on the monthly basis during FY20 which also lead to low cash accruals leading to cash flow mismatches. Apart from this, the total energy generated from the project was low during FY20 due to weak hydrology. Further, energy

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

generation declined during the current year on account of shutdown of the plant for more than one month due to flood. The ability of MKJV to generate sufficient cash flow from operations, maintain liquidity and timely service its debt obligation is the key rating driver.

Moderate financial risk profile marked by lower generation of energy during FY20

MKJV reported revenue of Rs. 148 Mn through the sale of electricity during FY20 against Rs. 152 Mn during FY19. The decline in the revenue was attributed to flood during Aug-Sep 2019 which led to nil generation of energy. However, PBILDT of the company improved during FY20 despite decrease in revenue on the back of decline in late COD penalty. PAT of the company increased substantially during FY20 due to increase in PBILDT, decline in interest cost and non-operational income of insurance claim of Rs. 27 Mn. Overall gearing ratio improved to 2.19x at the end of FY20 on the back of repayment of term loan and increase in net worth due to accretion of profit to net worth. However, company has been reporting negative reserves due to loss incurred during initial year of operation. Total debt to Gross Cash Accrual (GCA) ratio improved to 6.61x during FY20 as compared to 15.24x in FY19.

Lower tariff rate impacting revenue profile

MKJV's tariff for wet season is Rs. 3 per kWh whereas for dry season is Rs. 4.25 kWh with 6% escalation on base tariff for 5 years. Existing rate after availing all the escalations available is Rs. 3.72 and 5.27 per kWh for wet and dry season respectively which is fixed for project life. Though MKJV has enjoyed promotional tariff rate for few years providing extra revenue, MKJV's base tariff rate is lower as compared with other hydropower companies. Further, promotional tariff rate which is ending by FY21 will have an impact on revenue of MKJV lowering the revenue for upcoming years.

Project operated at lower PLF

The annual contracted PLF for MKJV is 84.87% of the installed capacity of the plant. The project has been operated at a lower PLF over the period. During FY19, project operated at 59.73% PLF against generation capacity which declined to 53.80% during FY20. Further, PLF against contracted capacity as per the PPA was 70.31% during FY19 which declined to 69.32% during FY20. The total energy generated from the project has been lower than contracted energy due to weak hydrology. Further, energy generation declined during FY20 due to non-operation of plant for more than one month due to flood. The ability of the company to reduce the gap between operational PLF and contracted PLF and availability of sufficient hydrology is the key rating sensitivity.

Project implementation and stabilization risk of projects where company has invested

MKJV has invested in Mathillo Mailun Khola Jalavidyut Ltd which is a 14.3 MW hydropower project. Company has invested Rs. 8.42 Mn as on Mid July 2020. MKJV's income from the investment will depend upon the satisfactory performance of the MMKJ. MMKJ is in initial stage of construction which exposes the project to execution and stabilization risk associated with the project

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 wet season when river flows are high (Mid-April to Mid-December) and less during the dry season (Mid-December to Mid-April). MKHP utilizes discharge from Mailung Khola which is a perennial river and having partly snow-fed and partly rain fed having catchment area of 85 sq. kms. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola.

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.

Key Rating Strengths***Experienced directors and management team***

MKJV is managed under the overall guidance of the company's Board of Directors (BoD). MKJV has 6 Board of directors and is chaired by Dr. Birendra Prasad Mahato, who has vast experience in various sector and is also Chairman of Machhapuchchhre Bank Limited. Company management team is led by Mr. Binay Chipalu, General Manager who has worked in MKJV for more than 9 years in various positions and is supported by other experienced management team members.

Power purchase agreement with sufficient period coverage

MKJV entered into PPA with Nepal Electricity Authority (NEA) for 5 MW on July 24, 2001 for sale of entire power generated by the plant. The PPA is signed for a period of 25 years from Commercial Operation Date or till validity of Generation License (which was obtained on March 16, 2004 for 34 years), whichever is earlier. The tariff for wet season is Rs. 3 per kWh whereas for dry season is Rs. 4.25 kWh with 6% escalation on base tariff for 5 years. Under the Government's initiative of promoting private sector hydropower developers, the project has been availing promotional tariff rates of Rs 4.80 and Rs 8.40 per unit in wet and dry seasons respectively; which shall remain effective for 7 years after COD with 5 times annual escalation of 3% on base tariff (available till Mid-July 2021).

Moderate counter party risk

MKJV 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 and gross cash accrual of Rs 16,056 Mn. 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.

MKJV has outstanding receivables of Rs. 91 Mn regarding promotional tariff at the end of FY20. The average collection period from NEA during FY20 was 54 days (FY19: 37 days) for other than promotional tariff.

Current demand & supply gap however expected increase in supply 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 1,720 GWh (~22% of total demand) 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. This could put pressure in NEA's payment capabilities which is sole counter party with majority of PPA signed by NEA are 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.

About the Company

Mailung Khola Jal Vidhyut Company Limited (MKJV) is a public limited company, incorporated in July 22, 2002 as a private limited company and later converted to public limited company in August 22, 2014. It is promoted by institutional and individual promoters from various background for setting up Hydropower Project in Nepal. MKJV is involved in the operation of 5 MW run-of-the-river Mailung Khola Hydropower Project at Haku Village, Rasuwa District which has been in commercial operation since July 3, 2014. As per the Generation License, from Government of Nepal – Ministry of Energy, obtained on March 16, 2004, the project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 34 years respectively. As on July 15, 2020, major shareholder of the company are M/S Sopan Multiple Company Limited (holds 39.17%), M/S Asia Pacific Power Tech Company Nepal (holds 3.35%), and Mr. Kriti Kumar Mahato (holds 2.03%).

Brief Financial Performance during the last 3 years is as follows:

(Rs. In Million)

| Particulars | FY18 (Audited) | FY19 (Audited) | FY20 (Unaudited) |
|-------------------------|-------------------|-------------------|---------------------|
| Income from Operations | 86 | 154 | 150 |
| PBILDT | 35 | 107 | 116 |
| PAT | (13) | 7 | 55 |
| Overall Gearing (times) | 3.15 | 2.86 | 2.19 |

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