

Menchhiyam Hydropower Limited

Rating

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B (Issuer)]	Assigned
Long Term Bank Facilities	840.30	CARE-NP BB [Double B]	Reaffirmed
Total Bank Facilities	840.30 (Eight hundred Forty million and three hundred thousand only)		

* The issuer rating is subjected to the company maintaining the overall gearing not exceeding 2.25x at the end of FY22.

** Details of facilities in Annexure-1.

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB' assigned to the long term bank facilities of Menchhiyam Hydropower Limited (MHL). Also, CRNL has reaffirmed the issuer rating of 'CARE-NP BB (Is)' assigned to MHL. The 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 ratings assigned to MHL continue to remain constrained by the residual project implementation and stabilization risk, relatively high cost per MW, hydrology risk associated with run-of-the-river power generation project, exposure to regulatory risk and volatile interest rate.

The ratings, however, continue to derive strength from the experienced board members and management team, power purchase agreement with sufficient period of coverage, favorable government policies towards power sector and low power evacuation risk.

Going forward, the ability of the company to timely complete the project at the envisaged project cost without any further time or cost overrun and early stabilization of the project would remain as the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Residual project implementation and stabilization risk thereafter

The company is setting up a 4.72 MW Upper Piluwa Khola-II Small Hydropower Project (UPKHP). The estimated cost of the green-field project is Rs 1,240.67 Mn which is proposed to be funded in the debt equity ratio of ~68:32 (debt of Rs. 840.30 Mn and equity of Rs 400.37 Mn). The debt has been fully tied up. The project is at final stage of construction and the expected COD of the project is in April 2022.

Out of the total capex planned, UPKHP has incurred total expenditure of Rs. 1,167.38 Mn out of Rs. 1,240.67 Mn. The electro-mechanical (EM) contractor has been mobilized at the site for the installation of EM equipment, control panel and switchyard. The erection and stringing of transmission poles and other remaining works are going on simultaneously. Thus, the company is exposed towards residual project implementation risk with-in the envisaged time and cost and satisfactory operations thereafter.

Relatively high cost per MW

The cost per MW for UPKHP is Rs. 262.85 Mn per MW which is relatively higher as compared to other hydropower project with similar installed capacity. The high project cost directly affects the debt repayment capacity and adequate dividend

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications.

payout in the future considering the increased in debt requirement and equity commitment. However, the company plans to partially prepay the debt from the IPO proceeds; thus mitigating the debt repayment weightage. The company is also planning for the development of cascade project and the high cost of UPKHP will be shared with the cascade; thus maintaining moderate overall project cost per MW.

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- December to Mid-April). MHL is proposed to utilize discharge from Piluwa Khola having catchment area of 83 sq kms based on Perennial River. The project has 4.15 m³/s design discharge at 43% exceedance flow. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/khola.

Exposure to regulatory risk coupled with volatile interest rate

Electricity Regulatory Commission (ERC) under the Government of Nepal (GoN) is 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.

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.

Key Rating Strength

Experienced board members and management team

MHL has 5 board of directors having long experience in various sector. The board is chaired by Mr. Dipak Khadka has more than 20 years of work experience in power, hospitality etc. He has been associated with various companies at the board level. Other directors of the company also have experience of more than 10 years in various sector including hydropower projects. Apart from that, the day-to-day operations are managed by the experienced management team.

Power Purchase agreement with sufficient period of coverage

MHL had entered into a PPA with NEA as on August 28, 2015 for sale of 4.72 MW power to be generated from the project. The period of the PPA is 30 years from commercial operation date (COD) or till validity of Generation License (obtained on December 18, 2015 for 35 years), whichever is earlier. PPA period may be extended with mutual consensus during the last six month of validity. The contracted energy for the project is 26.46 million units (MU) (i.e. 5.42 MU for dry season and 21.04 MU for wet season), at PLF of 64%. 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 times in every year after completion of 12 months from COD date.

Lower Power evacuation risk

The power generated from the project will be evacuated by 9Km long 33KV Transmission Line to NEA at Baneshwor Substation. The power from Baneshwor Substation is further evacuated to national grid. The construction of NEA's Baneshwor substation has currently come into operation. Therefore, there is no major power evacuation risk except the construction of transmission line from the powerhouse to the NEA substation which is under the scope of the company.

Favorable Government policies towards power sector coupled with moderate counter party risk

Considering the significance and potential of hydropower sector in Nepal, GoN has placed the hydropower generation in the priority sector and intends to maximize involvement of private sector by offering different exemptions and facilities. Also,

NEA is the sole counter party for the selling and distribution of electricity in Nepal. 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.

About the Company

Menchhiyam Hydropower Limited (MHL) is a Public Limited company, incorporated on November 08, 2017 as a Private Limited company, which was then converted into public company on July 15, 2021. The company has been promoted by a group of individual businessmen. It is developing a 4.72 MW run-of-river, Upper Piluwa Khola-II Small Hydropower Project (UPKHP) in Sankhuwasabha district of Nepal by utilizing available head and flow from Piluwa Khola (river). The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Annexure 1: Details of the Facilities rated

Nature of the Facilities	Type of facilities	Amount (Rs. in Mn)	Rating
Long Term Bank Facilities	Term Loan	840.30	CARE-NP BB
Total Facilities		840.30	

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