

Mailung Khola Jal Vidhyut Company Limited

Ratings

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP B (Is) [Single B (Issuer)]	Rating Revised from CARE-NP D (Is) to CARE-NP B (Is)

**The issuer rating is subject to overall gearing ratio of the company not exceeding 1.10x at the end of FY22.*

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has revised the Issuer rating to 'CARE-NP B (Is) [Single B (Issuer Rating)]' from CARE-NP D (Is). Issuers with this rating is considered to have high risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the MKJV considers improvement in debt servicing track record. However, the rating continues to be constrained by subdued operating and financial performance, lower tariff rate impacting the revenue profile, hydrology risk associated with run-of-the-river power generation and exposure to volatile interest rate risk. The rating also took into an account implementation and stabilization risk of project where company has invested.

The ratings 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 the company to successfully reduce the gap between operational PLF and contracted PLF and availability of sufficient hydrology with timely repayment of the debt obligation are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Modest financial risk profile

MKJV reported total income of Rs. 148 Mn during FY21 as compared to Rs. 167 Mn in FY20. MKJV reported revenue of Rs. 126 Mn through the sale of electricity during FY21 against Rs. 138 Mn during FY20. The decrease in revenue through sale of electricity during FY21 was due to flood during August 2020 which led to lower energy generation. Also, the project was impacted due to the lower hydrology during the dry season. Due to the increase in administration expenses coupled with the decrease in revenue, company reported decline in PBILDT margin to 74.17 % during FY21 from Rs. 80.73 % during FY20.

Overall gearing ratio improved to 1.90x at the end of FY21 from 2.25x at the end of FY20 on the back of repayment of term loan and increase in networth due to accretion of profit to net worth. The company had been reporting negative reserves due to loss incurred during initial year of operation which has been improved in FY21. Total debt to Gross Cash Accrual (GCA) ratio deteriorated to 8.61x during FY21 as compared to 6.91x in FY20 due to decrease in gross cash accruals as a result of decline in PAT. The GCA was Rs. 66 Mn during FY21 against Rs. 89 Mn during FY20.

Subdued Operating Performance

MKJV has commissioned run-of-the-river 5 MW run-of-the-river Mailung Khola Hydropower Project (MKHP) at Rasuwa District. The commercial operations commenced in July 3, 2014. During FY20, the plant was operated at 53.80% which decreased to 50.32% during FY21 ending on Mid-July 2021. The operating performance in terms of power generation was low due to less hydrology mainly during the dry seasons. Also, during Mid-July 2020 to Mid- September 2020, there was flood at the project site which led to the lower energy generation. The annual contracted PLF for SHP is 84.87% of the installed capacity of the plant. For

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

the year ended, the energy generated was 63.32% during FY20 and 59.27% in FY21 against contracted PLF. This curtails from analytical perspective for the company to reduce the gap between operational PLF and contracted PLF.

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. Furthermore, promotional tariff rate which ended by FY21 have an impact on revenue of MKJV lowering the revenue for upcoming years.

Investment in companies having under construction projects

MKJV has invested in Mathillo Mailun Khola Jalavidyut Ltd (MMKJ; CARE-NP BB-/A4). Company has invested Rs. 8.42 Mn as on Mid July 2021 (FY20: Rs. 8.42 Mn). MKJV's income from investment will depend upon the satisfactory performance of the MMKJ. As on February 13, 2022, MMKJ has made ~70% of physical progress and 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 a 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 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.

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 5 Board of directors, 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, Civil Engineer, General Manager of the company and has more worked in MKJV for more than 9 years in various positions and is supported by other experienced management team members.

Improvement in debt servicing track record

There were instances of delay in the repayment of interest and principal obligations during FY20 and FY21. This was mainly attributable to low cash accruals due to partial realization as penalties deducted by Nepal electricity Authority (NEA) on the monthly basis attributed to late commencement of operations leading to cash flow mismatches. Apart from this, the total energy generated from the project was also lower during FY20 due to weak hydrology over the year. Furthermore, energy generation declined during the year FY20 on account of shutdown of the plant for more than one month due to flood. During FY21, the company utilized the initial public offering (IPO) proceeds for the prepayment of the bank loan. There has been no delay in the interest and repayments of the term loan since October 2021 onwards and provided the liquidity to an extend to the company. Furthermore, company's ability to improve its operating performance and realize its debtors in a timely manner would also be crucial for timely debt servicing.

Power purchase agreement with sufficient period coverage

MKJV had entered into PPA with Nepal Electricity Authority (NEA) for 5MW as 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 whichever is earlier.

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

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.

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