

Manakamana Engineering Hydropower Limited

Ratings

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B (Issuer)]	Assigned
Long Term Bank Facilities	861.27	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	20.00	CARE-NP A4 [A Four]	Assigned
Total Bank Facilities	881.27 (Eight Hundred Eighty One Million and Twenty Seven Thousand Only)		

** The issuer rating is subject to overall gearing ratio of the company not exceeding 2.50x at the end of FY23.
Details of instruments/facilities in Annexure-1*

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP BB (Is)' to Manakamana Engineering Hydropower Limited (MEHL). Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations in Nepal.

CRNL has also assigned the rating of 'CARE-NP BB' to the long term bank facilities and 'CARE-NP A4' to the short term bank facilities of MEHL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to MEHL are constrained by the subdued operations of its power project amid challenges in power evacuation leading to a below average financial performance of the company in FY21 (Audited, refers to the twelve-month period ended mid-July 2021) and FY22 (Unaudited, refers to the twelve-month period ended mid-July 2022). The ratings also factor in relatively high project cost leading to high payback period, hydrology risk associated with run-of-the river power generation, exposure to regulatory risk and volatile interest rates.

The ratings, however, derive strength from MEHL's experienced promoters and management team, presence of Power Purchase Agreement (PPA) with sufficient period coverage, moderate counter party risk and government support for the power sector. The ratings also takes cognizance of the improvement in power evacuation setup of the company after switching to the newly operational Singati-Lamosangu transmission line, however, stabilization of power evacuation for an extended timeframe remains to be seen.

Going forward, the ability the company to successfully reduce the gap between operational Plant Load Factor (PLF) and contracted PLF and availability of sufficient hydrology with timely receipt of payments from Nepal Electricity Authority (NEA) will be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Below average financial performance during initial years of operations due to challenges in power evacuation

MEHL has been operating a run-of-the-river 5 MW Ghattekhola Hydropower Project (GKHP) in Dolakha district of Nepal since November 2020. The contracted PLF of the projects is 61.83% of the generation capacity. However, over the last two financial years (FY21 & FY22), the project operated at low PLFs of 49.24% and 63.26%, respectively, of the contracted energy.

Due to inability of NEA to complete the proposed Singati Substation (through which power was proposed to be evacuated from this project) in timely manner, the project had come to operations in November 2020 with alternative power evacuation from a 33 kv transmission line to Makaibari Lamosangu substation. The substantially lower power generation by the project over FY21-FY22 was mainly on account of tripping issues in the alternative transmission line leading to the project being unable to evacuate the generated power in full capacity. MEHL reported net losses of Rs. 89.76 Mn in FY21 and Rs. 38.15 Mn in FY22 due

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

to lower income from sale of power coupled with high depreciation and interest expense. Lower PLF generation leading to lesser revenue generation and resulting in stressed liquidity and cash flow mismatches. The lower than expected free cash accruals has led to instances of delay in the repayment of term loan interest and installments in past.

However, the project's PLF levels have improved considerably to 89.71% of contracted energy in the initial month of operations of FY 23 (Mid-July to mid-August 2022) after the project got connected to the recently operational Singati Substation and started evacuating power through the 132 kv Singati-Lamosangu transmission line from Mid-May 2022. The company's ability to continue to reduce the gap between operational PLF and contracted PLF leading to an improved overall financial risk profile on a sustained basis remains to be seen and will remain a key monitorable aspect.

Relatively high project cost leading to high payback period

The initial estimated cost of the project was Rs 876.30 Mn (at Rs. 175 Mn per MW). However, due to a substantial time overrun, there were several revisions in the cost of the project resulting in final cost of Rs 1,370.08 Mn (at Rs. 274 Mn per MW) which was financed through debt equity mix of 64:36. The project cost increased multiple times on account of delay in execution of project mainly due to delay in completion of the Singati Substation and Singati-Lamosangu transmission line, which were under the purview of Nepal Electricity Authority (NEA). The capital structure of the company is expected to remain leveraged characterized over the near term marked by high overall gearing due to capex term loans. MEHL's overall gearing ratio stood at 2.50x at the end of FY22 (PY: 2.98x) mainly on account of high project cost, impacted also by the net losses over FY21-FY22. Interest coverage ratio was 0.86x in FY22. The incurred project cost of Rs. 274 Mn per MW remains relatively higher compared to other similar projects, thus the payback period of the company is expected to remain higher.

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). The project utilizes discharge from Ghatte Khola having catchment area of 30 sq. kms based on Perennial River. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola. Since there is no minimum commitment on revenue in PPA in case of adverse river flows scenario, the company is exposed to hydrology risk of the power project for the generation of revenue.

Exposure to volatile interest rate risk

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system, which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company 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 Strengths

Experienced promoters and management team

MEHL has five members in its Board of Directors, chaired by Mr. Krishna Prasad Upreti, who has more than two decades of experience in the hydropower and financial services sectors. He is the former chairman of Liping Khola Hydropower Project. Mr. Ram Hari Bajgai, Director, is also a director of Madhya Chameliya Hydropower Project (35 MW) and has experience in the co-operative sector and various other business sectors. Furthermore, the day-to-day operations are supported by experienced management team.

Power purchase agreement with sufficient period coverage

MEHL had entered into PPA with NEA for 5 MW as on August 12, 2013 for sale of entire power generated by the plant. The PPA is signed for a period of 30 years for from the date of COD (November 08, 2020). PPA period may be extended with mutual consensus through discussion from last six month of validity. The tariff rate as per PPA is Rs. 4.80 per kWh for wet season (Mid-April to Mid-December) and Rs 8.40 per kWh for dry season (Mid-December to Mid-April) with 3% escalations on annual tariff rate for 5 times. The economic life of the project is 29.67 years.

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

Manakamana Engineering Hydropower Limited (MEHL) is a public limited company, incorporated in July 18, 2010 as a private limited company and later converted to public limited company in July 10, 2021. It is promoted by individual promoters having experience in the hydropower and other sectors for setting up Hydroelectric Project (HEP) in Nepal. MEHL is involved in the operation of 5 MW run-of- the –river Ghattekholra Small Hydropower Project (GKHP) at Dolakha district of Nepal by utilizing available head and flow from Ghatte Khola (river). The project started commercial operation on November 08, 2020.

Brief financial performance of MEHL during last 2 years is given below:

(Rs. In Million)

Particulars	FY21 (A)	FY22 (UA)
Income from power sales	43.63	94.15
PBILDT Margin (%)	4.52	73.62
Overall Gearing (times)	2.98	2.50
Interest coverage (times)	0.03	0.86
Total Debt / Gross Cash Accruals (times)	Negative	102.73

A: Audited; UA: Unaudited

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	861.27	CARE-NP BB [Double B]
Short Term Bank Facilities	Overdraft	20.00	CARE-NP A4 [A Four]
Total Facilities		881.27	

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