

Mandakini Hydropower Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Rating	Rating Action
Issuer Rating	NA	CARE-NP BB+ (Is) [Double B Plus Issuer]	Reaffirmed

* The issuer rating is subject to overall gearing ratio of the company not exceeding 1.25x at the end of FY23.

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB+ (Is)' assigned to Mandakini Hydropower Limited (MHL). 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 rating assigned to MHL continues to be constrained by the project implementation and funding risk associated with the new upcoming hydro power project (Upper Sardi Khola Hydropower Project (USHP)) and moderate operating performance of the operational Sardi Khola Hydropower Project (SHP). The rating is also constrained by the power evacuation risk associated with the operational SHP - power generated from SHP is currently being evacuated through contingency evacuation route. As such, power generation from the project is likely to remain on the lower side particularly in the wet season, until another arrangement for power evacuation is made, as it is dependent on the dispatch instructions from Nepal Electricity Authority (NEA). The rating also factors in hydrology risk associated with run-of-the-river power generation and exposure to regulatory risk.

The rating, however, derives strength from MHL's experienced promoters and management team, presence of Power Purchase Agreement (PPA) with sufficient period coverage, and government support for the power sector. The rating also factors in the likely improvement in the power evacuation setup of SHP after the project gets connected to the Lahachowk sub-station in the coming months, however, stabilization of power evacuation from this route remains to be seen post connection. Furthermore, the rating also takes cognizance of completion of the initial public offering of the company in August 2022.

Going forward, the ability of the company to reduce the gap between operational and contracted plant load factor (PLF) along with the timely receipt of payments from Nepal Electricity Authority (NEA) are the key rating sensitivities. Also, the ability of the company to timely execute the upcoming hydropower project without cost and time overrun is crucial from rating perspective.

Detailed description of the key rating drivers

Key Rating Weaknesses

Project implementation and funding risk in case of USHP

MHL is planning to develop 2.90 MW Upper Sardi Khola Hydropower Project (USHP) at Kaski district of Nepal. The total estimated cost of USHP is Rs. 560 Mn (i.e., Rs. 193 Mn per MW) which is proposed to be financed in debt equity ratio of 70:30. However, the same has not been finalized yet as the project is currently under planning stage. As on September 20, 2022, the company has only obtained the survey license for USHP. The PPA is yet to be signed with Nepal Electricity Authority (NEA). Hence, the execution timelines and the corresponding revenue visibility thereafter remains uncertain. With the total cost and funding pattern yet to be finalized, the company is exposed towards project execution risk in terms of debt and equity yet to be tied up along with completion of the project within the envisaged time and cost.

Moderate operating performance of Sardi Khola Hydropower Project, albeit improving trend in FY22

MHL has commissioned run-of-the-river 4MW Sardi Khola Hydropower Project (SHP) in December 09, 2017. During FY22 (Unaudited, refers to the twelve-month period ended mid-July 2022), the plant operated at the Plant Load Factor (PLF) of 53.85% of the generation capacity, increasing from 47.61% during FY21 supported by improved hydrology during FY22. The annual contracted PLF for SHP is 62.26% of the installed capacity of the plant. In terms of contracted energy, the energy generated in FY22 improved to 86.49% of contracted PLF from 76.64% in FY21. However, as the project is currently classified under 'Projects Under Contingency Evacuation Plan' with such projects generally getting lower priority in power evacuation from NEA, particularly during the high supply wet seasons, the project's Plant Load Factor (PLF) levels tend to be on the relatively lower side.

Power evacuation risk

SHP is currently evacuating power generated from the project through the contingency evacuation plan as it is yet to be connected to the Lahachowk substation, through which power is proposed to be evacuated from the project. Since the project become operational before the proposed substation, power has been evacuated from the project under the contingency plan till date. Currently power is being evacuated from Hemja substation through 18 km long transmission line, which leads to relatively higher transmission line loss. However, the construction of the Lahachowk substation (under NEA's purview) has now been completed and the project is likely to be connected to the substation in coming months. After connecting to Lahachowk substation, transmission line loss and other evacuation related challenges are likely to improve going forward.

Hydrology risk associated with run-of-the-river power generation

Run-of-the-river power is considered an unsteady source of power, as run-of-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). SHP utilizes discharge from Sardi Khola having catchment area of 27 sq. kms based on Perennial River. Also, the company is planning to develop the Upper Sardi Khola Hydropower Project in the same river. Hence, any variation in discharge of water from the aforesaid river/ Khola might impact the energy generation of Sardi Khola Hydropower Project.

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 Strength**Experienced promoter/directors and management team**

MHL is managed under the overall guidance of the company's Board of Directors (BoD), who possesses wide experience in the various sector including hydropower projects. Mr. Mahesh Bahadur Basnet, Chairman, has more than 30 years of experience in various sectors including banking industry. He was also associated with Nepal Electricity Authority (NEA), Nepal Airlines and Kailash Bikas Bank Limited. The other directors of the company have also long experience in various sector including hydropower sector. The day-to-day activities are run by the experienced management team.

Power purchase agreement with sufficient period coverage

MHL had entered into a PPA with NEA as on February 23, 2012 for sale of 3.50 MW power to be generated from the project and the PPA has been amended to 4MW on July 14, 2013. The period of the PPA is 30 years from commercial operation date (COD) or till validity of Generation License whichever is earlier. 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 every year for 5 times after completion of 12 months from COD date.

Moderate financial performance of the company, however gearing ratio is expected to increase in future

MHL is generating revenue by selling of power generated through its 4 MW SHP. During FY22, the company reported increase in total operating income by around 18% over FY21 to Rs. 114 Mn supported by higher power sale which was attributed to increased energy generation. Similarly, MHL's PBILDT increased to Rs. 85 Mn in FY22 from Rs. 79 Mn in FY21. However, PBILDT margin declined to 75.10% during FY22 from 81.59% in FY21 due to the increase in operating expenses. Despite decline in PBILDT margin, net profitability however improved to Rs. 29 Mn with PAT margin of 25.58% during FY22 from Rs. 15 Mn with PAT margin of 15.03% in FY21 aided also by lower interest expenses in FY22 due to the scheduled repayment of the term loans.

Overall gearing ratio improved to 0.73x at the end of FY22 (FY20: 1.01x) majorly on account of scheduled repayment of loans coupled with increase in equity share capital after IPO (partial issuance of Rs. 64.68 Mn to locals, employees and MFs was completed on July 13, 2022 and the remaining Rs. 111.73 Mn to the public was completed in August 02, 2022). Apart from overall gearing, other debt service coverage indicators including Total Debt to Gross Cash Accruals (GCA) and Interest Coverage Ratio also improved and stood satisfactory at 6.76x and 2.88x for FY22 respectively (PY: 10.44x and 2.07x respectively). However, the gearing ratio is expected to increase in future due to the increase in debt levels for the funding of the upcoming project.

Favorable Government policies towards power sector

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

Mandakini Hydropower Ltd (MHL) is a public limited company, incorporated in November 12, 2007 as a private limited company and later converted to public limited company in July 15, 2014. Mandakini Hydropower Limited acquired Excelling Investment Limited and Nepal Gurkha Resources Private Limited in July 2021. MHL has two run of the river hydropower projects; 4 MW Sardi Khola Hydropower Project (SHP) at Kaski District which has been in commercial operation since December 09, 2017 and 2.90 MW under construction Upper Sardi Khola Hydropower Project (USHP). The Sardi Khola Hydropower Project is constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Brief financial performance of MHL during last 3 years is given below:

Amount in NPR

For the Period	FY20 (A)	FY21 (A)	FY22 (UA)
Income from Operations	105	97	114
PBILDT Margin (%)	83.50	81.59	75.10
Overall Gearing (times)	1.19	1.01	0.73
Interest coverage (times)	1.91	2.07	2.88
Current Ratio (times)	1.02	1.00	1.08
Total Debt/Gross Cash Accruals (times)	10.78	10.44	6.76

A: Audited; UA: Unaudited

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