

## Mailung Khola Jal Vidhyut Company Limited

### Ratings

Facility/Instrument	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Issuer Rating	NA	<b>CARE-NP B+ (Is)</b> <b>[Single B Plus (Issuer)]</b>	Revised from CARE-NP B (Is)

*\*The issuer rating is subject to overall gearing not exceeding 1.10x at the end of FY23*

CARE Ratings Nepal Limited (CRNL) has revised Mailung Khola Jal Vidhyut Company Limited's (MKJC) issuer rating to 'CARE-NP B+ (Is)' from 'CARE-NP B (Is)'. Issuers with this rating are considered to offer high risk of default regarding timely servicing of financial obligations in Nepal.

### Detailed Rationale & Key Rating Drivers

The revision in the issuer rating of MKJC considers improvement in operating performance of the project during FY22 (Audited; FY refers to the twelve-months period ended mid-July) and 5MFY23 (Unaudited, refers to the five-months period ended mid-December) marked by improvement in Plant Load Factor (PLF) leading to sustained revenue growth and gross cash accruals. However, the rating continues to be constrained by moderate debt service coverage indicators, low tariff rate impacting revenue profile, hydrology risk associated with run-of-the-river power generation, and exposure to regulatory risk. The rating also took into an account implementation and stabilization risk of project where company has invested.

The rating, however, continues to derive strengths from experienced directors and management team, Power Purchase Agreement (PPA) with sufficient period coverage and government support for the power sector.

*Going forward, the ability of the company to successfully reduce the gap between operational 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 risk profile

MKJC has been operating 5 MW run-of-the-river Mailung Khola Hydropower Project (MKHP) at Rasuwa District since July 2014. During FY22, MKJC reported total operating income (TOI) of Rs. 114 Mn as compared to Rs. 126 Mn in FY21 through the sale of electricity. Although power generation increased in FY22, the company reported decrease in revenue on account of cessation of promotional tariff rates in FY22, which was NPR 4.80 and NPR 8.40 per unit in wet and dry seasons under the Government's initiative of promoting private sector hydropower developers effective for 7 years after COD (available till FY21).

PBILDT margin increase to 75.46 % during FY22 from Rs. 74.79 % during FY21 on account of lower operating expenses. In absolute amount, PBILDT of the company decreased to 86 Mn during FY22 from Rs. 95 Mn in FY21. Similarly, PAT of the company decreased to Rs. 17 Mn during FY22 as compared to 28 Mn during FY21. Furthermore, Gross cash accruals (GCA) stood at Rs. 62 Mn during FY22 (PY: Rs. 67 Mn).

The capital structure of the company stood moderately leveraged with total gearing ratio of 1.22x as on mid-July 2022 which improved from 1.86x as on mid-July 2021 due to decline in term liabilities with scheduled repayment of loans coupled with increased networth on account of infusion of additional equity and accretion of profit to networth

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and in other CRNL publications

Furthermore, Interest coverage ratio improved to 2.29x during FY22 from 1.94x during FY21 on account of decline in interest expenses. Furthermore, Total debt to GCA ratio improved to 7.45x during FY22 as compared to 8.33x in FY21 on account of repayment of term loan. Despite sequential improvement in the debt coverage indicators in FY22 over FY21, the company's overall financial risk profile remains weak. Improvement in hydrology leading to adequate cash flow generation from the project will be critical from credit perspective.

#### **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.

#### **Lower tariff rate impacting revenue profile**

MKJC'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 MKJC has enjoyed promotional tariff rate for few years providing extra revenue, MKJC'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 MKJC for upcoming years.

#### **Investment in companies having under construction projects**

MKJC has invested in Mathillo Mailun Khola Jalavidyut Ltd (MMKJ; CARE-NP BB-/A4). Company has invested Rs. 25.92 Mn as on Mid July 2022 (PY: Rs. 8.42 Mn). MKJC's income from investment will depend upon the satisfactory performance of the MMKJ. As on July 16, 2022, MMKJ has made ~79% of physical progress which exposes the project to execution and stabilization risk associated with the 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 Strengths**

##### **Experienced directors and management team**

MKJC is managed under the overall guidance of the company's Board of Directors (BoD). MKJC has seven Board of directors, chaired by Dr. Birendra Prasad Mahato, who has vast experience in various sector and is also director of Sopan Multiple Company Limited. Mr. Tara Prasad Pokhrel, director, has experience in various sector. He is Chairman of Kantipur Engineering College and managing director of Agni Cement Industries Pvt. Ltd. [CARE-NP BB/A4]. Similarly, other directors of the company also have experience in diverse business sector. Company management team is led by Mr. Binay Chipalu, Civil Engineer, General Manager of the company and has more worked in MKJC for around a decade in various positions and is supported by other experienced management team members.

### Improved operating performance of power project

The annual contracted PLF for MKHP is 84.87% of the installed capacity of the plant. The operating performance in terms of power generation was low due to less hydrology mainly during the dry seasons. Also previously, there was flood at the project site which led to the lower energy generation. However, there has been steady improvement in company's PLF level on account of improved hydrology during wet season, however hydrology remains similar to previous year during dry season. During FY22, the PLF from the project stood at 66.04% of the generation capacity (PY: 50.32%). The PLF has continued the improving trend in 5MFY23 as well and improved to 87.77% of total generation capacity. Even accounting for the dry season offsetting the year average for FY23 to some extent, the company's overall PLF levels are likely to continue to improve over the FY22 levels during FY23. The ability of the company to continue to reduce the gap between operational PLF and contracted PLF and availability of sufficient hydrology remains a key monitorable aspect.

### Power purchase agreement with sufficient period coverage

MKJC had entered into PPA with 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 2026. 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

MKJC 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. MKJC 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.

### Financial Performance

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

For the Period	(Rs. In Million)		
	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	139	127	114
PBILDT Margin (%)	80.73	74.79	75.46
Overall Gearing (times)	2.21	1.86	1.22
Interest Coverage (times)	2.16	1.94	2.29
Current Ratio (times)	1.85	2.47	2.82
Total Debt/Gross Cash Accruals(times)	6.77	8.33	7.45

A: Audited

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