

Menchhiyam Hydropower Limited

Rating

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B (Issuer)]	Reaffirmed
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 subject to overall gearing of the company not exceeding 2.25x at the end of FY23.

** Details of facilities in Annexure-1.

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB (Is)' assigned to Menchhiyam Hydropower Limited (MHL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Also, CRNL has reaffirmed the rating of 'CARE-NP BB' assigned to the long term bank facilities of MHL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to MHL are constrained by operations stabilization risk amid a significant time and cost overrun leading to a relatively high cost per Megawatt resulting in increased financial burden towards debt servicing in the initial years of commercial operations owing to high interest expense. The ratings are also constrained by hydrology risk associated with run-of-the-river power generation project, exposure to regulatory risk and volatile interest rate risk. The ratings take cognizance of the project in initial phase of commencement of operations as the plant is operating under trial runs.

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 commence the operations of the hydropower project within the expected date, swiftly stabilize the operations leading to operational Plant Load Factor (PLF) as envisaged will be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Operations stabilization risk as debt service burden remains high in initial years of operations owing to high cost of project

MHL is involved in setting up a 4.72 MW Upper Piluwa Khola-II Small Hydropower Project (UPKHP) in Sankhuwasabha district of Nepal. The total cost of the project is Rs. 1,336 Mn (final verification pending) which is funded by debt to equity in the ratio of 63:37 (debt of Rs. 840 Mn and equity of Rs 496 Mn) resulting in relatively higher per Megawatt (MW) cost of Rs. 283 Mn per MW. The initial Required Commercial Operation Date (RCOD) of the project was March 31, 2021, which has undergone multiple extensions and revised to August 04, 2022 citing force majeure and non-completion of proposed NEA's Baneshwor Substation. Significant time overrun has resulted in a higher interest during construction (IDC) leading to higher cost of the project than earlier envisaged. Although the project is already operating under trail runs, commercial operations

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

is yet to commence, delay in which is expected to make the company liable for late COD penalty from NEA. Furthermore, a time overrun of more than six months could result in reduction in the number of annual tariff escalations, if the project's commercial operation is delayed beyond February 04, 2023.

Nonetheless, a relatively high project cost is likely to lead to a longer payback period coupled with elevated debt servicing requirements in the initial years of operations owing to higher interest outgo, exacerbated further by the relatively higher interest rates currently prevailed in the market. The company's ability to adequately service its debt obligations will therefore hinge on its ability to generate sufficient cash flow from operations. Hence, swift stabilization of operations post commissioning resulting in revenue generations at envisaged levels is key from credit perspective and will remain a key monitorable aspect.

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, any variation in discharge of water might impact the energy generation of project which is of key importance for the company from the revenue generation perspective.

Exposure to regulatory risk

Government of Nepal (GoN) has 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.

Exposure to volatile interest rates

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, with substantial upward pressure on interest rates in the last few quarters. A contractionary monetary policy for FY23 coupled with increasing inflation has only added to the upward pressure on interest rates, resulting in the rate hikes taken by BFIs in the first quarter of FY23. Any further 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.

Key Rating Strengths

Experienced board members and management team

MHL has five members in its board of directors, having long experience in various sectors. The board is chaired by Mr. Dipak Khadka who has more than 20 years of work experience in power and hospitality sectors and is associated with various companies as promoter/director. Other directors of the company also have experience of more than 10 years in various

sectors including hydropower projects. Apart from that, the board is aptly supported by an experienced management team across various functions.

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. If COD is delayed by more than 6 months from RCOD, there are restriction clauses in escalation of tariff rates.

Lower Power evacuation risk

The power generated from the project is proposed to be evacuated through 9Km long 33KV Transmission Line to NEA's Baneshwor Substation. The substation is operational and is currently connected to the national grid via Koshi corridor. The construction of transmission line from the powerhouse to the substation which is within the scope of MHL is also completed, thus leading to a low power evacuation risk.

Favorable Government policies towards power sector

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

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 is involved in setting up of 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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