

Makar Jitumaya Suri Hydropower Limited

Ratings

Facility/Instrument#	Amount (Rs. in Million)	Ratings ¹	Rating Action
Issuer Rating*	NA	CARE-NP BB+ (Is) [Double B Plus Issuer Rating]	Reaffirmed
Long Term Bank Facilities	1,941.00 (Increased from 1,685.00)	CARE-NP BB+ [Double B Plus]	Reaffirmed
Total Facilities	1,941.00 (One Billion Nine Hundred Forty-One Million only)		

*The issuer rating is subject to total debt of the company not exceeding Rs. 1,990 Mn at the end of FY24 (FY refers to the twelve-month period ending mid-July).

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB+ (Is)' assigned to Makar Jitumaya Suri Hydropower Limited (MAKAR). 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 long term bank facilities of MAKAR.

Detailed Rationale & Key Rating Drivers

The ratings assigned to MAKAR continues to remain constrained by residual implementation risk and stabilization risk thereafter of its Upper Suri Khola Hydropower Project (USKHP), which has commenced trial runs in November 2023 with commercial operations expected by December end 2023. The ratings also factor in the cost overrun of the project, which is being funded by additional debt, leading to increased financial burden on the company during the initial years after the project is commissioned. Furthermore, the ratings also continue to be constrained by hydrology risk associated with run-of-the-river power generation, risk of natural calamities, and exposure to volatile interest rate risk.

The ratings, however, continue to derive strengths from MAKAR's strong parentage and experienced management team, and satisfactory operational performance of Suri Khola Hydropower Project (SKHP) marked by sustained power generation since its commissioning on May 01, 2022. Track record of sufficient hydrology leading to Plant Load Factor (PLF) consistently above 90% of SKHP bodes well for the income prospect of USKHP as well, which is a cascade project of SKHP. USKHP's relatively higher contracted PLF levels and dry energy mix also enhance its revenue profile. However, stabilization of power evacuation after USKHP comes into operations for an extended timeframe will remain a key monitorable as the present evacuation route is relatively cramped. The ratings continue to factor in presence of power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and government support for the power sector.

Going forward, the ability of the company to successfully execute USKHP within envisaged cost and time and early stabilization thereafter will be the key rating sensitivities. Also, the ability of the company to reduce the gap between operational PLF and contracted PLF on sustained basis and availability of sufficient hydrology with timely receipt of payments from Nepal Electricity Authority (NEA) will also be the key rating sensitivities.

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

Detailed description of the key rating drivers**Key Rating Weaknesses****Residual project implementation risk of Upper Suri Khola Hydropower Project**

The company is setting up a 7 MW hydro power project USKHP at Dolakha district of Nepal. The estimated cost of the project has increased by ~20% to Rs. 1,551 Mn (i.e., Rs. 222 Mn per MW) from earlier estimated cost of Rs. 1,295 Mn (i.e., Rs. 185 Mn per MW). The cost overrun was mainly on account of increase in land purchase and development cost, environmental/social mitigation cost, hydro-mechanical cost, access road development and IDC costs. The cost overrun is proposed to be funded through debt, which has been approved, in principle, by the consortium of the banks funding the project. As on mid-October, 2023, ~89% of the total revised project cost had been incurred. As per the management, USKHP has already achieved ~99% physical progress till October end, 2023 and expects USKHP to come into operations by December end 2023, well before the RCOD (Required Commercial Operation Date) of April 11, 2024. This augurs favorably for MAKAR's revenue profile. However, cost overrun is likely to have adverse impact on debt coverage indicators amid fixed tariff structure. Furthermore, though major part of the project work has been completed and trial runs are going on, the company still continues to remain exposed to the risks associated with project implementation and satisfactory operations thereafter of USKHP.

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). SKHP is proposed to utilize discharge from Suri Khola having catchment area of 36.40 sq. kms based on Perennial River. Similarly, USKHP is proposed to utilize discharge from Hulak Khola and Kolung Khola having catchment area of 23 sq. kms and 3.68 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.

Risk of Natural Calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their construction and operations vulnerable to adversities of nature. Floods and landslides that tend to occur in these areas pose threat to these power projects damaging their infrastructures as well as impacting their timely completion. Moreover, disruption in their construction in turn could lead to time and/or cost overrun, negatively impacting the project's financial aspects. Moving forward also, these natural calamities can adversely affect the smooth flow of power generation and distribution, which can further impact financial returns of the projects. MAKAR is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Exposure to volatile interest rate risk

The company's interest rates are based on 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. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed to volatile interest rate.

Key Rating Strengths**Strong parentage and experienced management team**

MAKAR has six members in its Board of Directors, chaired by Mr. Himal Gurung, who has more than 17 years of experience in hydropower and construction sector. He is associated with a number of hydropower companies. The board is supported by experienced professionals. Dolma Impact Fund (DIF), which has invested Rs. 261 Mn equity (34.29% shareholding) in MAKAR, is an institutional investor and is the first commercial impact fund setup in Nepal for providing growth capital to Small and Medium Enterprises (SMEs) with strong entrepreneurial and management capacities.

Satisfactory operating performance of Suri Khola Hydropower Project

SKHP commenced commercial operations from May 01, 2022. During FY23, the project's Plant Load Factor (PLF) was satisfactory at around 94% of contracted energy which improved to 105% of contracted energy during Q1FY24 (Q1FY24 refers to the first quarter ending mid-October, 2024). The power generation was moderated slightly during four months of FY23 (wet season) on account of maintenance activities. Nonetheless, the financial performance of the company has been satisfactory with operating income through sale of electricity of Rs. 164 Mn during FY23 and Rs. 68 Mn during Q1FY24. However, the company reported net loss of Rs. 6 Mn with gross cash accruals of Rs. 38 Mn in FY23 on account of high interest expenses. During Q1FY24, there has been continued improvement in operating performance of SKHP with the company reporting net profit of Rs. 24 Mn with gross cash accruals of Rs. 35 Mn. The energy generation in dry months has been relatively better during FY23, which bodes well for the revenue profile of the company as tariff rates during dry season are higher than wet season. Sustained power generation coupled with annual escalations on tariff rate is likely to improve operational cash flows from the project in upcoming years.

Power purchase agreement with sufficient period coverage

The company had entered into a long term PPA with NEA as on June 3, 2015 and July 26, 2018 for sale of 6.4 MW and 7 MW power to be generated from SKHP and USKHP. The contracted PLF for 6.4 MW and 7 MW is 58.59% and 66.92% with total contracted energy of 32.85 MU and 41.03 MU. PPA has been entered for the period of 30 years from the COD or till validity of generation license whichever is earlier. Tariff rate as per PPA is Rs 4.80 per Kwh for wet season (Mid-April to Mid-December) and the tariff rate for dry season (Mid-December to Mid-April) is 8.40 per Kwh. Number of escalations in tariff rate for SKHP and USKHP are 5 times and 8 times, respectively. It is crucial for the company to complete USKHP within the timelines to have the accelerated clauses of tariff. Any delay in the same would lead to impact on project returns and debt servicing capabilities which is critical from analytical perspective.

Following eight-months of wet and four-month of dry season, the total contracted energy of the project is 32.85 MU (SKHP) and 41.03 MU (USKHP) with relatively lower dry energy mix of ~24% of the total contracted energy for both the projects which remains a constraint for company's income profile.

Lower Power Evacuation Risk

The power generated from Upper Suri Khola Hydropower Project (USKHP) is proposed to be evacuated through 4km long 33KV Transmission Line to switchyard of Suri Khola Hydroelectric Project (SKHP) and then the power from USKHP & SKHP is to be evacuated through 6.9 km long 33 KV Transmission Line to the Singati Substation. Furthermore, power is evacuated through 132 KV Transmission line from Singati to Lamosangu. However, there are expectations of overload in the existing power route which might lead to tripping issues and the company is in the process of installation of new transformer for USKHP. Also, the PPA has been signed as per take-or-pay modality, hence, priority will be given to USKHP for power evacuation as opposed to PPA of other two projects whose power is being evacuated from same route is signed as per take-and-pay modality. However, smooth power evacuation for a reasonable period after USKHP comes into operations remains to be seen and will remain crucial for the company from revenue generation prospective.

Favorable Government policies towards power sector

Government of Nepal (GoN) considers power generation as priority sector and intends to maximize private sector participation in generation of electricity by offering different exemptions and facilities on power sector. 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 2027. As per various directives from NRB, 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. Also, increasing trend of cross-border energy trade and its growing prospect in upcoming days supported by new bilateral agreements between Nepal and India for additional export of power to India from Nepal augurs well for the long-term demand prospect for the power sector in Nepal.

About the Company

Makar Jitumaya Suri Hydropower Limited" (MAKAR) came into existence after the merger between Makar Jitumaya Hydropower Private Limited (MJHPL) and Suri Khola Hydropower Limited in July 15, 2021. MJHPL has two hydropower projects, namely, 6.4 MW Suri Khola Hydropower Project (SKHP) and 7.0 MW Upper Suri Khola Hydropower Project (USKHP) in Gaurishankar Rural Municipality, Dolakha district of Nepal. SKHP commenced operations from May 01, 2022 while USKHP is currently under-construction. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

Financial Performance

For the year ended Mid-July	FY22	FY23	Q1FY24
	(Audited)	(Provisional)	(Provisional)
Income from Operations	25	164	68
PBILDT Margin (%)	49.59	89.36	92.09
Overall Gearing (times)	2.53	2.48	2.54
Interest Coverage (times)	0.60	1.35	2.26
Current Ratio (times)	0.51	2.69	1.81

Annexure 1: Details of Instruments/Facilities

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	1,941.00	CARE-NP BB+
Total		1,941.00	

Contact us

Analyst Contacts

Ms. Poonam Agarwal

+977-01-4012630

poonamagarwal@careratingsnepal.com

Mr. Santosh Pudasaini

+977-01-4012628

pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

+977-9818832909

achin.nirwani@careratingsnepal.com

About CARE Ratings:

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).

Disclaimer

CRNL's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CRNL has based its ratings on information obtained from sources believed by it to be accurate and reliable. CRNL does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CRNL have paid a credit rating fee, based on the amount and type of bank facilities/instruments.

In case of partnership/proprietary concerns, the rating assigned by CARE is, inter-alia, based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors. CARE is not responsible for any errors and states that it has no financial liability whatsoever to the users of CARE's rating.