

Madame Khola Hydropower Limited

Ratings

Facilities	Amount (Rs. Million)	Ratings ¹	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B(Issuer)]	Assigned
Long Term Bank Facilities	3,325.00	CARE-NP BB [Double B]	Reaffirmed
Total Facilities	3,325.00 (Three Thousand Three Hundred and twenty-five Million Only)		

**The issuer rating is subject to total debt not exceeding Rs. 3,500 Mn at the end of FY24 (FY refers to the twelve-month period ending mid-July)*

CARE Ratings Nepal Limited (CRNL) has assigned the issuer rating of 'CARE-NP BB (Is)' to Madame Khola Hydropower Limited (MKHL). 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 MKHL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to MKHL continue to be constrained by project implementation risk associated with its under-construction hydropower project and operations stabilization risk afterwards. The ratings also factor in risk of natural calamities, hydrology risk associated with run-of-the-river power generation and exposure to volatile interest rate risk. The ratings, however derive strength from experienced promoters and management team with demonstrated track record in operating hydropower projects, low power evacuation risk, presence of power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and favorable government policies towards power sector.

Going forward, the ability of the company to successfully execute the project within envisaged cost and time and early stabilization thereafter will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weakness

Project implementation risk

MKHL is setting up a 24 MW, run-of-river, Madame Khola Hydroelectric Project (MKHP) in Kaski district of Nepal. The estimated cost of the hydropower project is Rs 4,478.10 Mn (i.e., Rs 186.58 Mn per MW) which is proposed to be financed in debt equity ratio of 74:26 (i.e., Rs 3,325 Mn term loan and Rs 1,153 Mn equity). The debt has already been tied up. As per the progress report submitted by the company, as on mid-December 2023, the overall physical progress of the project was around 44% (Financial progress was ~45% as on January, 2024). The project is still at middle stage of construction. Hence, the company continues to remain exposed to the risks associated with project implementation within envisaged cost and timelines. Required Commercial Operation Date (RCOD) of the project has been extended till April 12, 2025. It is crucial for the company to commence its operations before extended RCOD to avail the benefits of all tariff escalations and not be liable for late COD penalty. Any delay in the same would lead to impact on project returns and debt servicing capabilities which is critical from analytical perspective.

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

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 (June to November) and less during the winter season (December to May). The project is proposed to utilize discharge from Madame Khola having catchment area of 48.7 sq kms, based on perennial river. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

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 once the project is operational, which can further impact financial returns of the projects. MKHL 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

MKHL's interest expenses are structured under a floating interest rate framework, wherein a premium is applied to the monthly base rate, resulting in periodic adjustments to the interest rate. The inherent volatility of base rates within Nepalese banks and financial institutions (BFIs), influenced by liquidity availability etc., contributes to fluctuations in interest rates. Additionally, the company's relatively high debt-to-equity ratio renders it susceptible to adverse effects from unexpected interest rate hikes, potentially shrinking margins and impacting overall liquidity.

Exposure to regulatory risk

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) as a regulatory body to regulate generation, transmission and distribution of electricity in Nepal among others. The right granted to ERC for PPA approval, prior approval of IPO issuance, approval of mergers, prescribe condition for maintaining standards of electricity placed outside transmission line and examine the standard, prescribe maintenance of proper internal control system, account systems and auditing method along with perform surprise check, inspect and investigate the licensed persons and imposing fine for non-compliance of applicable act, regulations and directives poses a new challenge to power sector companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strengths**Experienced promoters and management team in hydropower sector**

MKHL has 7 Board of Directors, chaired by Mrs. Susan Karmacharya, who has more than two decades of experience in various sectors including hydropower. Currently, she is chairperson in Money Plant Investment Company Pvt. Ltd and a vice chairperson at Laligurans Batika School and Namuna Hospital. Mr. Dhan Bahadur Shrestha, Managing Director, has ~36 years of experience in different sectors and has been associated with various ministries at administrative level positions. Moreover, the promoters have also worked in development of other hydropower projects such as Yambaling Hydropower Limited's (CARE-NP B+(Is)) Yambaling Khola Hydropower Project (7.27 MW) which is under construction and Eastern Hydropower Limited's (CARE-NP BB(Is)) Pikuwa Khola Small Hydropower Project (5MW) which is operational.

Power purchase agreement with sufficient period coverage

MKHL had entered into a long term PPA with Nepal Electricity Authority (NEA) as on July 31, 2018 for sale of 24 MW power to

be generated from the project. The period of the PPA is 30 years from the date of COD or till validity of Generation License whichever is earlier. PPA period may be extended with mutual consensus during the last six months of validity. The tariff for wet season (June to November) is Rs 4.80 per kWh and for dry season (December to May) is Rs 8.40 per kWh with 3% escalation on base tariff for 8 years. The contracted energy of the project is 142.19 million units (MU). The Plant Load Factor (PLF) of the project is 67.63%. The RCOD of the project is April 12, 2025. Timely completion of project within the extended RCOD are key rating sensitivities.

Low power evacuation risk

The power is to be evacuated through an alignment from the switchyard of operational Super Madi Hydropower Project to Upper Madi Hydropower Project and finally to operational NEA's Lekhnath substation. Length of the transmission line from the Powerhouse is around 32.5 kms. Timely completion of the transmission lines by MKHL will be key rating sensitivity.

Favorable Government policies towards power sector

The Government of Nepal (GoN) has prioritized hydropower generation as a crucial sector for economic development and aims to enhance private sector involvement by offering a range of incentives and facilities. In line with this objective, GoN has introduced a comprehensive tax incentive package, providing full tax exemption for the initial 10 years and a 50% tax exemption for the subsequent five years to individuals or entities engaged in the commercial operation, transmission, and distribution of electricity until mid-April 2027. These incentives are designed to encourage investment and promote growth in the hydropower sector. Additionally, directives from the Nepal Rastra Bank (NRB) mandate that all banks are to allocate a minimum share of their total advances to the energy sector. This strategic initiative is expected to contribute to the financial support and development of projects within the energy sector which augurs well for the sector. The industry outlook of Nepalese power sector is likely to remain stable over the long-term with increasing domestic demand for generation backed by growing national demand with an average growth rate of around 11% p.a. over the last five years (2018-2023). Additionally, increasing cross-border energy trades coupled with fresh bilateral treaty signed between Nepal and India for export of 10,000 MW electricity to India over a period of 10 years has further boosted the demand outlook for the power sector in Nepal.

About the Company

Madame Khola Hydropower Private Limited (MKHL) is incorporated as on August 04, 2015. It is promoted by an institutional as well as individual promoters from different backgrounds. MKHL is setting up of a 24 MW run-of-river Madame Khola Hydroelectric Project (MKHP). The project is constructed under BOOT (Build, Own, Operate and Transfer) model located at Kaski district of Nepal.

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	3,325.00	CARE-NP BB [Double BB]
Total		3,325.00	

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