Mountain Energy Nepal Limited

Ratings

Facility/Instrument	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	**3,592.56 (Decreased from 3,978.52)**	**CARE-NP BBB- [Triple B Minus]**	**Revised from CARE-NP BB+**
Short Term Bank Facilities	**164.50 (Decreased from 641.81)**	**CARE-NP A3 [A Three]**	**Revised from CARE-NP A4+**
Total Facilities	**3,757.06 (Three Thousand Seven Hundred Fifty-Seven Million and Sixty Thousand Only)**		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the long-term bank facilities of Mountain Energy Nepal Limited (MEN) to 'CARE-NP BBB-' from 'CARE-NP BB+'. Also, CRNL has revised the rating assigned to the short-term bank facilities of MEN to 'CARE-NP A3' from 'CARE-NP A4+'.

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the bank facilities of MEN take into account satisfactory financial performance of the company characterised by sustained cash accruals, adequate liquidity, low gearing profile and adequate debt service coverage indicators in FY23 (FY refers to the twelve-month period ending mid-July) and H1FY24 (Unaudited; refers to the six-month period ending mid-January). The ratings also take cognizance of the reduced offtake risk following successful removal of 42 MW Mistri Khola Hydropower Project (MKHP) from contingency plan from December 28, 2023 onwards, which in addition to locked in interest rates on term debt at relatively lower rate till mid-April 2026, enhances the revenue and return prospects for the company going forward. The ratings continue to derive strength from experienced promoters and management team, power purchase agreement (PPA) with sufficient period coverage and government support for the power sector.

The ratings, however, is constrained by moderate operating performance of the power project in FY23. Although 42 MW MKHEP has been removed from contingency plan, streamlining of energy generation during the wet months for the total contracted capacity remains to be seen. The ratings also factor in hydrology risk associated with run-of-the-river power generation, risk of natural calamities and exposure to volatile interest rate beyond fixed rate regime.

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. Any substantial capital expenditure plan or capital commitment that could lead to material deterioration in the company's capital structure from current levels will also remain a key rating sensitivity.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Experienced promoters and management

MEN is managed under the overall guidance of the company's Board of Directors (BoD), who possesses wide experience in the different sectors. The company has seven members in its board, chaired by Mr. Suhrid Raj Ghimire, who has more than three decades of cross sector experience. Mr. Manohar Das Mool, Managing Director, is involved in day to day

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

operations of the company. He is also engaged in different businesses as insurance, pharmaceuticals and paper industry. BODs are further supported by experienced teams across various functions/ departments.

Satisfactory financial performance

MEN generate revenue from two hydroelectric projects i.e., 5 MW Tadi Khola Hydroelectric Project (TKHEP) operating since April 2013 and 42 MW Mistri Khola Hydroelectric Project (MKHEP) operating since June 17, 2021. During FY23, company reported total operating income (TOI) of Rs. 1,182 Mn with 4% y-o-y decline over FY22 levels mainly on account of slight moderation in energy generation amid dry winter. This coupled with increase in scheduled repair and maintenance charges related to its 5 MW TKHEP led to decline in PBILDT in absolute amount to Rs. 926 Mn in FY23 (FY22: Rs. 1,114 Mn). Nonetheless, the company reported substantial gross cash accruals (GCA) of Rs. 631 Mn in FY23 (FY22: Rs. 859 Mn). Till date, income from power sale with regard to 42 MW MKHEP was capped at 68% of contracted energy for six-month period during mid-April to mid-October as per the contingency agreement entered by the company with NEA (dated January 10, 2016). The agreement has been revoked with reference to letter dated December 28, 2023. On top of existing substantial cash accruals generated by the company, incremental prospect for power sales coupled with fixed interest regime (interest rate fixed at 7.25% till mid-April 2026) bodes well for the future return prospects of the company.

Low gearing profile with adequate debt service coverage indicators

Gearing profile of the company was low with overall gearing ratio of 1.03x as on mid-January, 2024 which improved from 1.41x at the end of FY22. The improvement in gearing ratio was on account of accretion of net profit to tangible net worth of the company coupled with scheduled repayment of term loans. Interest coverage ratio stood adequate at 3.13x during FY23 which although declined from 4.50x in FY22 on account of decline in PBILDT. Furthermore, total debt to GCA ratio of the company stood at 6.09x during FY23 (FY22: 4.86x), increased over FY22 level on account of moderated cash accruals in FY23 despite reduced debt levels. Interest coverage ratio and total debt/GCA (annualised) nevertheless improved to 4.58x and 3.73x at the end of H1FY24. Going forward, debt service coverage indicators are expected to steadily improve backed by repayment of debts and prospects of improved cash accruals.

Adequate liquidity position marked by sustained operational cash generation and decent cash reserve

The company has an adequate liquidity position on account of sustained cash generation from operations over the period. During FY23, gross cash accruals of the company was Rs. 631 Mn (FY22: Rs. 859 Mn). Additionally, the company paid cash dividend of Rs. 207 Mn during the same period. The company had decent cash and bank balance of Rs. 291 Mn as on mid- January 2024. Decent cash reserve coupled with sustained operational cash generation bodes favourably from a risk-return trade-off point of view and helps the company adequately safeguard its liquidity position to cover any contingencies.

Power purchase agreement with sufficient period coverage

MEN (through Aadhi Shakti Bidhyut Bikash Company Limited (ASBL) and Robust Energy Limited (REL) had entered into PPA with NEA in 2005 and 2011 for sale of entire power generated by the plants at TKHEP and MKHEP respectively. The PPA is signed for a period of 30 years from the date of COD or till validity of Generation License whichever is earlier. PPA period may be extended with mutual consensus through discussion from last six month of validity. TKHEP has two set of tariff rate which ranges from Rs. 3.90 per kWh to Rs. 8.40 per kWh with 3% annual escalation on base tariff rate for 5 times for 24.78 GWh energy. Tariff for MKHEP is Rs. 5.40 per kWh with 3% escalation on base tariff for next 10 years.

Favourable 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 augers 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.

Key Rating Weaknesses

Moderate operating performance of power projects in FY23; improvement likely going forward on account of project removed from contingency plan

During FY23, the energy generated by 5 MW TKHEP was ~70% of contracted capacity, reduced from ~87% of contracted energy during FY22 on account of dry winter in addition to shut down of plant for a month for scheduled maintenance. However, energy generation was satisfactory at ~85% of contracted capacity during 7MFY24 (Unaudited, refers to the seven-month period ended mid-February 2024). Energy generation for 42 MW Mistri Khola Hydroelectric Project (MKHEP) was subdued at ~70% of contracted energy in FY22, FY23 and H1FY24 on account of project falling under "contingency plan" as per the agreement with NEA.

The company had entered into an agreement with NEA (dated January 10, 2016) stating that until the completion of 220kV Dana-Kushma-New Butwal transmission line, the power generated by MKHEP is to be evacuated through 132kV Dana-Kushma-Pokhara transmission line with contracted energy for contingency period capped at ~68% of total original contracted energy on take or pay basis for six-month period ending Mid-April to Mid-October. The project has been successfully removed from the contingency plan by the NEA from December 28, 2023 onwards. However, streamlining of energy generation during the wet months for the total contracted capacity remains to be seen. The company's ability to continue to reduce the gap between operational PLF and contracted PLF, on a sustained basis, will remain a key monitorable aspect.

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, adversely affecting the smooth flow of power generation and distribution, which can impact financial returns of the projects. MEN is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

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 times when seasonal river flows are high and much less during the drier months. MEN is generating electricity from discharge of Tadi River at TKHEP and Mistri River at MKHEP, which are snow fed streams, comprising of mountainous terrain. Similarly, Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid rivers.

About the Company

Mountain Energy Nepal Limited (MEN) is a public limited company promoted by business persons having experience in the hydropower sector. Aadhi Shakti Bidhyut Bikash Company Limited (ASBL) and Robust Energy Limited (REL) were subsidiaries of MEN and merged into MEN in FY2019. ASBL was involved in the operation of 5MW run-of-the-river Tadi Khola Hydroelectric Project (TKHEP) and REL was involved in the construction of 42MW Mistri Khola Hydroelectric Project (MKHEP). The projects are constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Financial Performance

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

(Rs. In Million)

For the Period	FY21(A)	FY22 (A)	FY23 (A)
Income from Operations	168	1,234	1,182
PBILDT Margin (%)	66.79	90.27	78.34
Overall Gearing (times)	1.72	1.41	1.23
Interest Coverage (times)	5.03	4.50	3.13
Total Debt/Gross Cash Accruals(times)	45.35	4.86	6.09

A: Audited

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	**3,592.56**	CARE-NP BBB- [Triple B Minus]
Short Term Bank Facilities	Fund Based Limit	**164.50**	CARE-NP A3 [A Three]
Total		**3,757.06**	

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About CARE Ratings:
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