

Rating Rationale
Mountain Energy Nepal Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	4,605.83	CARE-NP BB+ [Double B Plus]	Assigned
Short Term Bank Facilities	14.50	CARE-NP A4+ [A Four Plus]	Assigned
Total Facilities	4,620.33		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP BB+’ to the long-term bank facilities and ‘CARE-NP A4+’ to the short-term bank facilities of Mountain Energy Nepal Limited (MENL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of MENL is constrained by project implementation and stabilization risk associated with 42MW Mistri Khola Hydroelectric Project (MKHEP), operational project operated at low plant load factor (PLF), exposure to volatile interest rates and hydrology risk associated with run of the river power generation. The rating, however, derives strength from experience promoter and management team, track record of operating hydropower project, power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The ratings also factors in achievement of financial closure for under construction project with relatively low cost per megawatt (MW), shortage of power in the country, government support for the power sector and major developments towards power evacuation. The ability of MENL to timely complete the project without any time or cost overrun, timely completion of transmission infrastructure and sufficient hydrology for the generation of the contracted energy are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Project implementation and stabilisation risk

On the basis of cost incurred till October 17, 2019, the company has achieved financial progress of ~73% of the total project cost. The project is under construction with expected COD in May 31, 2020 which is revised from initial RCOD of May 16, 2016 due to delay in construction of Kali Gandaki Transmission Corridor part (Dana-Kushma transmission line & substations). As per the financial progress, company has made a significant progress in Civil works, Hydromechanical works and Electromechanical works with ~89% progress. Though, there is major progress, the project still continues to remain exposed to the residual risks associated with project implementation and satisfactory operations thereafter. Timely

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

completion of the project and transmission of the power through appropriate infrastructure are the key rating sensitivities.

Current project operated at low PLF

The annual contracted PLF of the Tadi Khola Hydroelectric Project (TKHEP) is 74.52% of the installed plant capacity. The project has been operating at low PLF over the period. During FY18, the PLF from the project was low at 57.36% (over installed capacity), which further decreased to 54.77% during FY19. The power generation from the project as a percentage of the contracted power as per the PPA, was 77.18% in FY18 and the same has reduced to 73.50% in FY19. As a result, there was short supply penalty of Rs.7.21 Mn during FY19 as well as revenue losses. The ability of the company to reduce the gap between operational PLF and contracted PLF and availability of sufficient hydrology is the key rating sensitivity. MENL reported revenue of Rs. 117 Mn revenue in FY19 with Rs. 60 Mn PAT and Rs. 86 Mn Gross Cash Accruals.

Hydrology risk associated with run-of-the-river power generation

Run-of-the-river (ROR) power is considered an uneven 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. ROR, therefore, generates much more power during times when seasonal river flows are high (Mid-April to Mid-December) and much less during the drier months (Mid-Dec to Mid-April). MENL is generating electricity from discharge of Tadi River at TKHEP and proposed to utilize discharge from Mistri River at MKHEP, which are snow fed streams, comprising of mountainous terrain. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid rivers.

Exposure to volatile interest rate

Nepalese banking sector fix interest rates on lending, based on quarterly published base rate by the banks. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, funding from Banks and Financial Institutions are exposed to volatile interest rate.

Key Rating Strengths

Experienced promoter and management team

MENL has 5 Board of Directors, chaired by Mr. Suhrid Raj Ghimire, who is a leading Nepali businessman heading Continental Group with business interest in automobile trading, capital goods, energy and construction, with over 30 years of experience in running businesses. Mr. Shyam Sundar Khetan is the managing director of the company, is engaged in business of real estate development. Mr. Min Bahadur Gurung, top shareholder of MENL, is the Chairman/ Managing Director of Bhat-Bhateni Group, the largest retail chain of supermarkets in Nepal. The other Directors of the company are Mr. Chandra Prasad Dhakal (Chairman of Global IME Bank Ltd), Mr. Dol Raj Sharma and Mr. Maohar Das

Mool. Mr. Bijendra Lal Rajbhandary is the project control and contracts manager of the company who has more than 2 decades of experience in Nepal Electricity Authority at different functions.

Track record in operating hydro power project

MENL is already operating 5 MW Tadi Khola Hydro Electric Project (TKHEP) located at Nuwakot district of Nepal. The project is in operation since March 2013. The plant generated Rs.144 Mn revenues through sales of energy.

Power purchase agreement with sufficient period coverage

MENL (through former ASBL and REL) had entered into PPA with Nepal Electricity Authority (NEA) as on March 28, 2005 and February 3, 2011 for sale of entire power generated by the power plants of 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 (which are obtained on November 22, 2011 for TKHEP and November 6, 2011 for MKHEP for 35 years), whichever is earlier.

Required Commercial Operation Date (RCOD) for MKHEP was May 16, 2016 as per initial PPA which was revised to December 31, 2019 as per revised PPA, however the same is expected to be extended till May 31, 2020. TKHEP has two set of tariff rate. Tariff rate for initial contracted energy (i.e. 7.86 GWh) is Rs. 3.90 per kWh and Rs. 5.52 per kWh for wet and dry seasons respectively with no escalation. Similarly, tariff rate for additional annual contract energy (i.e. 24.78 GWh) is Rs. 4.80 per kWh and Rs. 8.40 per kWh for wet and dry season respectively with 3% annual escalation on base tariff rate for 5 times. As per government's initiative of promoting private sector hydropower developers, TKHEP has been availing promotional tariff rates of Rs. 4.80 per kWh and Rs. 8.40 per kWh in wet and dry seasons respectively for initial contracted energy for upto 7 years from Commercial operation date (COD) which is till mid April 2020, with 3% annual escalation on base tariff for 5 years. Tariff for MKHEP is Rs. 5.40 per kWh with 3% escalation on base tariff for next 10 years.

Moderate counter party risk

MENL is exposed to counter party payment risk pertaining to Nepal Electricity Authority (NEA), which has been making consecutive losses in past till FY 2016 and carry huge accumulated loss in its book. However, as per the annual report published by NEA, during FY19 (provisional), NEA earned profit of Rs 7,205 Mn (Rs 2,897 Mn during FY18). Further, during FY19, NEA achieved gross cash accrual of Rs 11,915 Mn (Rs 7,107 Mn in FY18). The counter party payment risk is moderated by the fact that, NEA is fully owned by government of Nepal, net loss is declining over the period and NEA is generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producers (IPPs) in past.

Financial closure achieved for the project cost, relatively low cost per MW

MKHEP has achieved the financial closure for the project on May 19, 2013. The estimated project cost of Rs.5.64 Bn which is proposed to be financed in a debt-equity mix of 75:25. Bank sanctioned Rs.4.24 Bn

term loan for the project and the company has already withdrawn Rs.2.90 Bn term loan October 17, 2019 towards the project execution. MKHEP is projected to be completed at the cost of Rs.134 Mn per MW, which is relatively low cost as compared to other operational and under-construction HEP.

Shortage of power at present coupled with increasing demand of power in the country

As per the NEA's Annual Report for FY19, the current peak electricity demand is 1,320 MW. The total domestic installed capacity stands at 1,178 MW which includes 617 MW owned by NEA and 561 MW by private sector IPPs. Overall, during FY19, total energy demand was 7,584 GWh which was met by import of 2,813 GWh from India whereas balance was met by domestic generation. As per NEA, electricity demand is in increasing trend and is expected to increase in future with increase in electricity consumption through the promotion of electric vehicles by building charging station and replacing cooking gas with electricity, increase in access of population using electricity

Government support for the 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 5 December 2019 announced full tax exemption for first 10 years and 50% tax exemption for next 5 years to those who generate electricity within mid-April 2024. Income tax will be levied only 20% despite the normal tax rate for entity in Nepal is 25%. Also, GoN has declared to provide grant of amount equivalent to Rs. 5 Mn per MW installed capacity after receiving evidence of formal COD of power plant.

Major developments towards Power Evacuation

Power evacuation will be through 4 Kms long 132 kV transmission line to NEA's under construction 220kV Dana substation. The power will be further evacuated through NEA's under construction Dana-Kushma-New Butwal (DKB) transmission line. As per NEA's Annual report for FY19, Dana - Kushma transmission line and Dana and Kushma substation is under construction. For Kushma-New Butwal transmission line, contracts had been awarded by NEA with the construction completion deadline of December 2020. NEA and the company has entered into an agreement stating until the completion of DKB transmission line, the power generated by MKHEP will be evacuated through Dana-Kushma-Pokhara transmission line, with minimum agreed energy of around ~68% from Mid April to Mid October and 100% for remaining months of the contracted energy. All the works related with arrangements for power evacuation at the company's end has been completed.

About the Company

Mountain Energy Nepal Limited (MENL) is a public limited company promoted by business persons having experience in the hydropower sector. MENL earlier had two subsidiaries companies namely Aadhi Shakti Bidhyut Bikash Company Limited (ASBL) and Robust Energy Limited (REL) which were acquired by MENL during FY19. ASBL was involved in the operation of 5MW run-of-the-river Tadi

Khola Hydroelectric Project (TKHEP) at Tadi Rural Municipality, Nuwakot District which has been in commercial operation since April 2013. REL was involved in the construction of 42MW MKHEP, Required Commercial Operation Date (RCOD) of which was December 31, 2019 and is expected to be revised till May 2020. The projects are under BOOT (Build, own, Operate and Transfer) mechanism. As per the Generation License, from Government of Nepal – Ministry of Energy, the projects shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 35 years.

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Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	4,605.83	CARE-NP BB+
Short Term Bank Facilities	Working Capital Loan	14.50	CARE-NP A4+
Total		4,620.33	