

Menchiygam Hydropower Private Limited

Ratings

| Instrument / Facilities | Amount (Rs. In Million) | Rating ^[1] | Rating Action |
|---------------------------|-------------------------|-----------------------|---------------|
| Long Term Bank Facilities | 840.30 | CARE-NP BB [Double B] | Assigned |
| Total Facilities | 840.30 | | |

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP BB' to the long-term bank facilities of Menchiygam Hydropower Private Limited (MHPL).

Detailed Rationale & Key Rating Drivers

The rating assigned to Menchiygam Hydropower Private Limited (MHPL) is constrained by project implementation risk, hydrology risk associated with run-of-the-river power generation and exposure to volatile interest rate.

The rating, however, derives strength from experienced promoters and management team, presence of power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The rating also factors in current demand & supply gap however possible oversupply in future and government support for the power sector.

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

Detailed description of the key rating drivers

Key Rating Weaknesses

Residual project implementation and power evacuation risk

MHPL is setting up a new hydro project of 4.72 MW and the expected COD of the project is September 16, 2021. The estimated cost of the project is Rs 1,240 Mn which is proposed to be funded in the debt equity mix of Rs 840.30 Mn and Rs 400.37 Mn respectively. The debt for the total project cost has been fully tied up.

As on April 12, 2021, the company has incurred an expenditure of Rs. 986.30 Mn towards the project and the same has been funded through term loan of Rs. 705.46 Mn and the promoters' contribution of Rs. 280.84 Mn in the form of equity capital. The project has achieved around 78.67% of physical progress. It is critical for the company to complete the project within time and cost envisaged to achieve the targeted revenues.

The Power generated from the project will be evacuated to NEA Baneshwor Substation which is further evacuated to National grid. The construction of NEA Banseshwor substation has been almost completed. Further delay in the construction of the transmission line and substation may result delay in the project which may also lead to increase in project cost and loss in revenue.

Exposure to volatile interest rate

Nepalese banking sectors are fixing floating interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions (BFIs) remains volatile to change in liquidity position which lead to change in interest rate. Interest rate has been changing frequently in Nepal market since last 2-3 years. Therefore, funding from BFIs is subject to volatile interest rate.

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

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

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). MHPL 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, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/khola.

Key Rating Strength

Experienced promoters, directors and management in various sector

MHPL has 5 board of directors having long experience in various sector. The board is chaired by Mr. Dipak Khadka, who has more than 20 years of work experience. Mr. Hari Shankar Puri, Director, is also director at Arun Khola Hydropower Project and chairman at Bholenath General Suppliers. Other directors of the company have experience in various sector. Mr. Senak Pokharel, Executive Director, has more than 20 years of experience and he is supported by other experienced management team.

Power purchase agreement with sufficient period coverage

MHPL had entered into a PPA with NEA as in August 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. 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. 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%. Required Commercial Operation (RCOD) of the project was March 31, 2021. However, the ministry of Energy, water resources and irrigation has extended RCOD by one year for COVID impacted hydropower projects. The expected COD of the project is September 16, 2021. If COD doesn't fall within RCOD, the company is bound to pay penalty to NEA as per the PPA. Further, number of escalations in tariff rate will be reduced if there is delay in COD of the project than RCOD by more than 6 months.

Moderate counter party risk

MHPL is exposed to counter party payment risk pertaining to Nepal Electricity Authority (NEA), which has been making consecutive losses in past till FY16. However, as per the annual report published by NEA, during FY20 (provisional), NEA earned profit of Rs 11,056 Mn (Rs. 9,812 Mn during FY19) resulting the accumulated profit in its book. Further, during FY20, NEA achieved gross cash accrual of Rs 16,056 Mn (Rs 14,664 Mn in FY19). 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 generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producers (IPPs) in past.

Current demand & supply gap however possible oversupply in future

As per the NEA's Annual Report for FY20, the current peak electricity demand is 1,408MW. The total domestic installed capacity stands at 1,328 MW which includes 632 MW owned by NEA and 696 MW by private sector IPPs. Overall, during

FY20, total energy demand was 7,894 GWh which was met by import of 1,721 GWh from India whereas balance was met by domestic generation.

However, considering under construction projects which are expected to generate electricity in next 2-3 years and electricity demand which has not increased substantially in past few years could create a situation of oversupply in near future in wet season. This could put pressure on NEA's payment capabilities which is sole counter party with majority of PPA signed on take or pay basis.

Government support for the power sector

Government of Nepal (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 2024. Further, no income source will be asked for investment made within mid-April 2020 in hydro-electricity project. Also, Unified Directive of 2020/21, has directed "Class-A" to allocate minimum 10% of credit to energy sector and "Class-B" and "Class-C" banks to allocate minimum 20% and 15% of total credit respectively to agriculture, energy, SMEs and tourism sector within mid-July 2024.

About the Company

Menchhiyam Hydropower Private Ltd. (MHPL) is a private company, incorporated on November 08, 2017. The company has been promoted by institutional promoters and individual businessmen. It is developing a 4.72 MW run-of-river, Upper Piluwa Khola -2 Small Hydropower Project (UPKSHP) 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. As per the Generation License, from Government of Nepal – Ministry of Energy, obtained on December 18, 2015 the project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 35 years.

Annexure 1: Details of Instrument / Facilities

| Name of the Instrument / Bank Facilities | Type of the Facility | Amount (Rs. in Million) | Rating assigned |
|--|----------------------|-------------------------|-----------------|
| Long Term Bank Facilities | Term Loan | 840.30 | CARE-NP BB |
| Total | | 840.30 | |

Contact Us

Analyst

Ms. Elisha Lamichhane
Contact No.: 977-01-4012628
Email: elisha.lamichhane@careratingsnepal.com

Senior Analyst

Ms. Shalini Sanghai
Contact No.: +977-01-4012629
Email: shalini.sanghai@careratingsnepal.com

Relationship Contact

Name: Achin Nirwani
Contact No.: +977 9818832909
Email: achin.nirwani@careratingsnepal.com

About CARE Ratings Nepal Limited:

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.