

Mandakini Hydropower Limited

Ratings

Instrument / Facilities	Amount (Rs. In Million)	Rating ^[1]	Rating Action
Issuer Rating	NA	CARE-NP BB+ (Is) [Double B Plus Issuer]	Assigned

*The issuer rating is subject to overall gearing of the company not exceeding 1.25x at the end of FY22.

CARE Ratings Nepal Limited (CRNL) has assigned Issuer rating of 'CARE-NP BB+ (Is) [Double B Plus (Issuer Rating)]' to Mandakini Hydropower Limited (MHL). Issuers with this rating is considered to have moderate degree of safety regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to Mandakini Hydropower Limited (SHL) is constrained by project implementation and funding risk associated with the new upcoming hydro power project (Upper Sardi Khola Hydropower (USHP)), subdued operating performance of existing operation power project (Sardi Khola Hydropower), hydrology risk associated with run-of-the-river power generation and exposure to regulatory risk.

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

Going forward, the ability of the company to reduce the gap between operational and contracted plant load factor (PLF) along with the timely receipt of payments from Nepal Electricity Authority (NEA) are the key rating sensitivities. Also, the ability of the company to timely execute the upcoming hydropower project without cost and time overrun is crucial from rating perspective.

Detailed description of the key rating drivers

Key Rating Weaknesses

Project implementation and funding risk in case of USHP

MHL is planning to develop a new hydro power project - Upper Sardi Khola Hydropower Project (USHP) of 2.90 MW at Kaski district of Nepal. The total estimated cost of USHP is around Rs. 560 Mn (i.e., Rs. 193 Mn per MW) which is proposed to be financed in debt equity ratio of 70:30. The debt has not been tied up and the project is currently at initial stage. As on September 20, 2021, company has only obtained the survey license for USHP. The PPA is yet to be entered with Nepal Electricity Authority (NEA). With funding pattern yet to be finalized, the company is exposed towards project execution risk along with completion of the project within the envisaged time and cost. of the company.

Subdued operating performance of Sardi Khola Hydropower Project

MHL has commissioned run-of-the-river 4MW Sardi Khola Hydropower Project (SHP) in December 09, 2017. During FY20, the plant was operated at the Plant Load Factor (PLF) of 53.26% which decreased to 47.61% during FY21 ending on Mid-July 2021. The operating performance in terms of power generation was modest due to hydrology related issues. The annual contracted PLF for SHP is 62.26% of the installed capacity of the plant. For the year ended FY20, the

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

energy generated was 85.63% against contracted PLF which further reduced to 76.64% in FY21. This is crucial from analytical perspective for the company to reduce the gap between operational PLF and contracted PLF.

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). SHP utilizes discharge from Sardi Khola having catchment area of 27 sq. kms based on Perennial River. Also, the company is planning to develop the Upper Sardi Khola Hydropower Project in the same river. Hence, any variation in discharge of water from the aforesaid river/ Khola might impact the energy generation of Sardi Khola Hydropower Project which is of key importance for the company from the revenue generation perspective

Exposure to regulatory risk

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) for regulating generation, transmission and distribution of electricity in Nepal. ERC will be the regulator under the GoN which will be responsible for regulating hydropower companies in Nepal. Policies and directives issued by ERC like approval process for IPO issuance, PPA approval through ERC poses a new challenge to hydropower companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strength

Experienced promoter/directors and management team

MHL is managed under the overall guidance of the company's Board of Directors (BoD), who possesses wide experience in the various sector including hydropower projects. Mr. Mahesh Bahadur Basnet, Chairman, has more than 30 years of experience in various sectors including banking industry. He was also associated with Nepal Electricity Authority (NEA), Nepal Airlines and Kailash Bikas Bank Limited. The other directors of the company have also long experience in various sector including hydropower sector. The day-to-day activities are run by the experienced management team.

Power purchase agreement with sufficient period coverage

MHL had entered into a PPA with NEA as on February 23, 2012 for sale of 3.50 MW power to be generated from the project and the PPA has been amended to 4MW on July 14, 2013. The period of the PPA is 30 years from commercial operation date (COD) or till validity of Generation License 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 every year for 5 times after completion of 12 months from COD date.

Moderate financial performance of the company, however gearing ratio is expected to be increased in future

MHL is generating revenue by selling of power generated through its 4 MW Sardi Khola hydro power plant. The company reported decrease in total operating income by around 8% to Rs. 97 Mn in FY21 (Unaudited; FY21 refer to 12 months ending on Mid-July 2021) from Rs. 105 Mn in FY20. The decrease in revenue during FY21 was due to lower sale of units which was attributed to lower energy generation.

In FY21, the company reported PBILDT of Rs. 80 Mn in FY21 (FY19: Rs. 88 Mn). Also, PBILDT margin declined to 82% during FY21 from 84% in FY20 due to the decrease in total income which resulted in increase in cost due to proportion of fixed cost which deprived it of its scale benefits. Despite decline in PBILDT margin, profitability improved to Rs. 19

Mn with PAT margin 19.80% during FY21 from Rs. 14 Mn with PAT margin 13.28% in FY19. PAT improved on account of decrease in the interest expenses due to the scheduled repayment of the term loan coupled with decline in interest rates. The total debt of the company declined to Rs. 415 Mn during FY21 from Rs. 451 Mn in FY20.

Overall gearing ratio stood at 0.97x at the end of FY21 (FY19: 1.19x) on the back of increase in networth of the company due to accretion of profit to net worth along with scheduled repayment of the term loan. Apart from overall gearing, other coverage indicators including total debt to GCA and Interest coverage ratios also improved and stood satisfactory at 9.60x and 2.19x for FY21 respectively (PY: 10.78x and 1.49x respectively). However, the gearing ratio is expected to increase in future due to the increase in debt levels for the funding of the Upper Sardi Khola Hydropower Project.

Low Power evacuation risk

The power generated from Sardi Khola Hydropower Project (SHP) was proposed to be evacuated through 9km long 33KV Transmission Line to NEA Lahachowk/ New Hemja Substation. However, construction of the Lahachowk substation is under implementation by NEA. Due to which the power generated by SHP is currently evacuated to existing Hemja Substation through 18 km long transmission line on account of which the transmission line loss incurred is higher. On the completion of Lahachowk substation, the company plans to connect the transmission to the Lahachowk substation as a result there will be optimization of the transmission line loss.

Current demand & Supply gap however possible oversupply in future along with moderate counter party risk

As per the NEA's Annual Report for FY21, the current peak electricity demand is 1,482MW. The total domestic installed capacity stands at 1,447 MW which includes 632 MW owned by NEA and 815 MW by private sector IPPs. Overall, during FY21, total energy demand was 8,960 GWh which was met by import of 2,806 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, requiring demand side management.

The company has signed PPA with NEA is owned by Government of Nepal and hence counter party default risk is low; however, timely realization of critical for the company and from analytical perspective also. During FY21, the company received payment from NEA for supply of power generated by SHP within 42 to 59 days.

Favourable Government policies towards 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. As per various directives from NRB whereby 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.

About the Company

Mandakini Hydropower Ltd (MHL) is a public limited company, incorporated in November 12, 2007 as a private limited company and later converted to public limited company in July 15, 2014. Mandakini Hydropower Limited acquired Excelling Investment Limited and Nepal Gurkha Resources Private Limited in July 2021. MHL has two run of the river hydropower projects; 4 MW Sardi Khola Hydropower Project (SHP) at Kaski District which has been in commercial operation since December 09, 2017 and 2.90 MW under construction Upper Sardi Khola Hydropower Project (USHP).

The Sardi Khola Hydropower Project is constructed under BOOT (Build, own, Operate and Transfer) mechanism.

Financial Performance

Particulars	FY18	FY19	FY20
	Audited	Audited	Unaudited
Income from Operations	93	105	97
PBILDT Margin (%)	83.11	83.50	82.37
Overall Gearing (times)	1.33	1.19	0.97
Interest coverage (times)	1.49	1.91	2.19
Current Ratio (times)	NA	1.02	1.05
Total Debt/Gross Cash Accruals (times)	18.96	10.78	9.60

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