Manakamana Engineering Hydropower Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B (Issuer)]	Reaffirmed
Long Term Bank Facilities	851.75	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	29.52	CARE-NP A4 [A Four]	Reaffirmed
Total Bank Facilities	881.27 (Eight Hundred Eighty-One Million and Two Hundred Seventy Thousand Only)		

** The issuer rating is subject to overall gearing ratio of the company not exceeding 2.50x at the end of FY24.*
Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB (Is)' assigned to Manakamana Engineering Hydropower Limited (MEHL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.
CRNL has also reaffirmed the rating of 'CARE-NP BB' assigned to the long-term bank facilities and 'CARE-NP A4' assigned to the short-term bank facilities of MEHL.

Detailed Rationale & Key Rating Drivers
The ratings assigned to MEHL continue to be constrained by the subdued operations of its power project amid challenges in power evacuation leading to a below average financial performance of the company during FY23 (Unaudited; FY refers to the twelve-month period ending mid-July). The ratings also factor in leveraged capital structure of the company owing to high project cost and accumulation of net losses, hydrology risk associated with run-of-the river power generation, exposure to regulatory risk and volatile interest rates.
The ratings, however, continue to derive strength from MEHL's experienced promoters and management team, presence of Power Purchase Agreement (PPA) with sufficient period coverage, moderate counter party risk and government support for the power sector. The ratings also take cognizance of the successful completion of the initial public offering (IPO) by the company in August 2023, proceeds of which are likely to be used to repay financial obligations.

Going forward, the ability the company to successfully reduce the gap between operational Plant Load Factor (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. The company's ability to attain sufficient cash accruals to fully cover debt obligations from operations will also remain key rating sensitivity.

Detailed description of the key rating drivers
Key Rating Weaknesses
Below average financial performance during initial years of operations due to challenges in power evacuation
MEHL has been operating a run-of-the-river 5 MW Ghattekhola Hydropower Project (GKHP) in Dolakha district of Nepal since November 2020. Although the energy generation of GKHP has improved year-on-year (y-o-y) during FY23, PLF of the project still remained below par at 70% of the contracted energy (FY22: 63%).
Due to inability of NEA to complete the proposed Singati Substation (through which power was proposed to be evacuated from this project) in timely manner, the project had come to operations in November 2020 with alternative power evacuation route from a 33 kv transmission line to Makaibari Lamosangu substation. The lower power generation by the project over FY21-FY23

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

was mainly on account of tripping issues in the alternative transmission line leading to the project being unable to evacuate the generated power in full capacity, particularly during wet seasons. During FY23, MEHL reported net losses of Rs. 31 Mn (FY22: Rs. 44 Mn) owing to lower income from sale of power coupled with high depreciation and interest expense. The company is currently working on switching to evacuation from Singati Substation and constructing the transmission line from its power house to Singati Substation, which is likely to resolve power evacuation related issues and improve energy generation. The company's ability to continue to reduce the gap between operational PLF and contracted PLF on a sustained basis remains to be seen and will remain a key monitorable aspect.

Leveraged capital structure owing to high project cost and accumulation of losses

The initial estimated cost of the project was Rs 876.30 Mn (at Rs. 175 Mn per MW). However, due to a substantial time overrun, there were several revisions in the cost of the project resulting in final cost of Rs 1,370.08 Mn (at Rs. 274 Mn per MW) which was financed through debt equity mix of 64:36. The project cost increased multiple times on account of delay in execution of project mainly due to delay in completion of the Singati Substation and Singati-Lamosangu transmission line, which was under the purview of Nepal Electricity Authority (NEA). The incurred project cost of Rs. 274 Mn per MW is relatively higher compared to other similar projects. Owing to high project cost coupled with accumulation of net losses over FY21-FY23, MEHL's overall gearing ratio stood leveraged at 2.55x at the end of FY23 (PY: 2.28x). Interest coverage ratio was moderate at 1.26x in FY23. However, the capital structure of the company is expected to improve going forward aided by equity infusion of Rs. 280 Mn through IPO, part of which is likely to be used for prepayment of term loans.

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). The project utilizes discharge from Ghatte Khola having catchment area of 30 sq. kms based on Perennial River. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola. Since there is no minimum commitment on revenue in PPA in case of adverse river flows scenario, the company is exposed to hydrology risk of the power project for the generation of revenue.

Exposure to volatile interest rate risk

The company's interest rates are based on a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed to volatile interest rate.

Exposure to regulatory risk

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

Key Rating Strengths

Experienced promoters and management team

MEHL has five members in its Board of Directors, chaired by Mr. Krishna Prasad Upreti, who has more than two decades of experience in the hydropower and financial services sectors. He is the former chairman of Liping Khola Hydropower Project. Mr. Ram Hari Bajgai, Director, is also a director of Madhya Chameliya Hydropower Project (35 MW) and has experience in the co-operative sector and various other business sectors. Furthermore, the day-to-day operations are supported by experienced management team.

Power purchase agreement with sufficient period coverage

MEHL had entered into PPA with NEA for 5 MW as on August 12, 2013 for sale of entire power generated by the plant. The PPA is signed for a period of 30 years for from the date of COD (November 08, 2020). PPA period may be extended with mutual consensus through discussion from last six month of validity. The tariff rate as per PPA is Rs. 4.80 per kWh for wet season (Mid-April to Mid-December) and Rs 8.40 per kWh for dry season (Mid-December to Mid-April) with 3% escalations on annual tariff rate for 5 times. The economic life of the project is 29.67 years.

Favorable Government policies towards power sector

Government of Nepal (GoN) considers power generation as priority sector and intends to maximize private sector participation in generation of electricity by offering different exemptions and facilities on power sector. 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 2027. Also, with government focus more towards reservoir-based hydropower projects; full tax exemption is provided for first 15 years and 50% tax exemption for next 6 years to reservoir and semi- reservoir projects whose capacity is higher than 40 MW, completing financial closure within mid-April 2029. As per various directives from NRB, 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. Also, increasing trend of cross-border energy trade and its prospect in upcoming days with bilateral agreements with the neighboring nations shows positive outlook on long- term demand for the power sector.

About the company

Manakamana Engineering Hydropower Limited (MEHL) is a public limited company, incorporated in July 18, 2010 as a private limited company and later converted to public limited company in July 10, 2021. It is promoted by individual promoters having experience in the hydropower and other sectors for setting up Hydroelectric Project (HEP) in Nepal. MEHL is involved in the operation of 5 MW run-of- the –river Ghattekhola Small Hydropower Project (GKHP) at Dolakha district of Nepal by utilizing available head and flow from Ghatte Khola (river). The project started commercial operation on November 08, 2020.

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

(Rs. In Million)

Particulars	FY21 (A)	FY22 (A)	FY23 (UA)
Income from power sales	44	94	103
PBILDT Margin (%)	4.52	69.31	86.37
Overall Gearing (times)	2.98	2.28	2.55
Interest coverage (times)	0.03	0.80	1.26
Total Debt / Gross Cash Accruals (times)	Negative	228.68	49.26

A: Audited; UA: Unaudited

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	851.75	CARE-NP BB [Double B]
Short Term Bank Facilities	Overdraft	29.52	CARE-NP A4 [A Four]
Total Facilities		881.27	

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