

Mandakini Hydropower Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Rating	Rating Action
Issuer Rating	NA	CARE-NP BB+ (Is) [Double B Plus Issuer]	Reaffirmed

* The issuer rating is subject to overall gearing ratio of the company not exceeding 1.25x at the end of FY24.

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB+ (Is)' assigned to Mandakini Hydropower Limited (MHL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to MHL continues to be constrained by the project implementation and funding risk associated with its upcoming Upper Sardi Khola Hydropower Project (USHEP) and moderate operating performance of the operational Sardi Khola Hydropower Project (SHEP) in FY23 (Unaudited, FY refers to the twelve-month period ending mid-July). The rating also factors in hydrology risk associated with run-of-the-river power generation and exposure to regulatory risk.

The rating, however, derives strength from MHL's experienced promoters and management team, presence of Power Purchase Agreement (PPA) with sufficient period coverage, and government support for the power sector. The rating also takes cognizance of the project getting connected to the Lahachowk sub-station from mid-July 2023 and subsequent removal of the project from the list of projects operational under contingency plan by Nepal Electricity Authority (NEA). Consequently, power generation from the project going forward is likely to improve as the project would now be less vulnerable to lower dispatch instructions from NEA, particularly during the high supply wet season. Stabilization of power evacuation from this route post connection, however, remains to be seen and will remain a key monitorable. Furthermore, the rating also notes completion of initial public offering of Rs. 176.41 Mn by the company in August 2022, proceeds of which are expected to be used towards construction of USHEP.

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 2.90 MW Upper Sardi Khola Hydropower Project (USHEP) in Kaski district of Nepal. The total estimated cost of USHEP is Rs. 560 Mn (i.e., Rs. 193 Mn per MW) which is proposed to be financed in debt equity ratio of 70:30. As on mid-September 2023, the company has only obtained generation license for USHEP. Power Purchase Agreement with NEA is yet to be finalized though a draft PPA has been signed. Execution timelines and the corresponding revenue visibility thereafter remains uncertain. The company is exposed towards project execution risk in terms of debt yet to be tied up along with completion of the project within the envisaged time and cost.

Moderate operating performance of Sardi Khola Hydropower Project in FY23

MHL has been operating a run-of-the-river 4MW Sardi Khola Hydropower Project (SHEP) since December 09, 2017 and power generation from the project historically has been moderate. The annual contracted PLF for SHEP is 62.26% of the installed capacity of the plant and during FY23, the plant operated at the Plant Load Factor (PLF) of 43.12% of the generation capacity, decreasing from 53.85% during FY22. Lower power generation is mainly due to lower dispatch instructions during the wet season as the project had been evacuating power under a contingency plan till mid-July 2023. Relatively lower hydrology in FY23 compared to FY22 also impacted PLF levels in FY23. Lower power generation led to year-on-year decline in financial performance of the company in FY23.

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

Run-of-the-river power is considered an unsteady source of power, as run-of-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). SHEP 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.

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 Strengths**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. Sarad Kumar Dahal, Chairman, has more than 24 years of experience in various sectors including hotel and social service. Mr. Hari Prasad Bhatt, Director, has more than 23 years of experience in various sectors including hydropower, hotel and different industries. He is also a promoter of Singati Hydro Energy Limited [CARE-NP BB (Is)] and was also the Chief Executive Officer of Ankhu Khola Hydropower Project. Similarly, other directors of the company also have long experience across various sectors. The day-to-day activities are run by the experienced management.

Improvement in power evacuation setup

Since commencing operations in December 2017, SHP had been evacuating power generated from SHEP through a contingency evacuation plan as the construction of Lahachowk substation had yet to be completed by NEA. However, from mid-July 2023, SHEP has been connected to the Lahachowk substation, and power generated from the project is now being evacuated as per the agreement of the PPA. Consequently, the project is no longer operational under contingency plan. This is expected to resolve power evacuation related issues faced by the company in the past and result in improved power generation of USP going forward. However, streamlining of power generation in a smooth manner, for a reasonable period remains to be seen and will remain a key monitorable aspect.

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

MHL is currently generating income by selling power generated through its 4 MW SHEP. During FY23, the company reported decrease in total operating income by around 14% over FY22 to Rs. 98 Mn. The decrease was due to lesser sale of electricity amid lower dispatch instructions from NEA, particularly during the wet season. Similarly, PBILDT margin declined to 76.72% during FY23 from 79.50% in FY22 due to the decrease in operating income. Despite decline in PBILDT margin, net profitability however remained at Rs. 34Mn (FY22: Rs 33 Mn) with PAT margin of 35.05% for FY23 vis-à-vis 29.22% for FY22 on account of lower interest expenses.

Overall gearing ratio improved to 0.55x at the end of FY23 (FY22: 0.73x) majorly on account of scheduled repayment of loans coupled with increase in equity share capital after IPO (partial issuance of Rs. 64.68 Mn to locals, employees and MFs was completed on July 13, 2022 and the remaining Rs. 111.73 Mn to the public was completed in August 02, 2022). Apart from overall gearing, other debt service coverage indicators including Total Debt to Gross Cash Accruals (GCA) and Interest Coverage Ratio also stood satisfactory at 5.74x and 2.37x, respectively, for FY23 (FY22: 5.98x and 3.04x respectively). However, the gearing ratio is expected to increase in the coming years due to the increase in debt levels for the funding of the upcoming project.

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. 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. 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

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 (SHEP) at Kaski District which has been in commercial operation since December 09, 2017, and 2.90 MW under construction Upper Sardi Khola Hydropower Project (USHEP). The Sardi Khola Hydropower Project is constructed under BOOT (Build, own, Operate and Transfer) mechanism.

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

(Rs. Million)

For the Period	FY21 (A)	FY22 (A)	FY23 (UA)
Income from Operations	97	114	98
PBILDT Margin (%)	81.59	79.50	76.52
Overall Gearing (times)	1.01	0.73	0.55
Interest coverage (times)	2.07	3.04	2.37
Current Ratio (times)	1.00	1.08	1.12
Total Debt/Gross Cash Accruals (times)	10.44	5.98	5.74

A: Audited; UA: Unaudited

Contact Us

Analyst Contact

Ms. Dristi Acharya

Contact No.: + 977-9802353217

Email: dristi.acharya@careratingsnepal.com

Ms. Poonam Agarwal

Contact No.: + 977-01-4012628

Email: poonamagarwal@careratingsnepal.com

Mr. Santosh Pudasaini

Contact No.: + 977-01-4012629

Email: pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

Contact No.: +977 9818832909

Email: achin.nirwani@careratingsnepal.com

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