

Maya Khola Hydropower Company Limited: Ratings reaffirmed

March 5, 2020

Summary of rated instruments

Instrument *	Rated Amount (NPR Million)	Rating Action
Long-term loan; Fund based	1,750	[ICRANP] LBB-; reaffirmed
Short-term loans; Fund based	75	[ICRANP] A4; reaffirmed
Short-term loans; Non-fund based	(1,000)	[ICRANP] A4; reaffirmed
Total	1,825	

* Instrument details are provided in [Annexure-1](#)

Rating action

ICRA Nepal has reaffirmed the long-term rating of [ICRANP] LBB- (pronounced ICRA NP L double B minus) for Maya Khola Hydropower Company Limited's (MKHCL) long-term loan. ICRA Nepal has also reaffirmed the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) for the company's short-term loans.

Rationale

The ratings remain constrained by the significant execution risks of the 14.9-MW Maya Khola Hydroelectric Project (HEP) being developed by MKHCL. While the project's revised required commercial operation date (RCOD) is mid-July 2020, only ~40% physical progress had been achieved till January 2020 with some contracts yet to be awarded. Though the experience of the promoters in hydropower development provides some comfort, significant delays in project completion would lead to high penalties as well as loss of tariff escalations. The ratings are also impacted by the high evacuation risks as the Baneshwor substation (under the Koshi corridor), where the power is to be evacuated, has achieved only a moderate level of construction. This could push the project commissioning and hence increase the project costs, leading to modest debt coverage and return indicators, given the fixed tariffs. However, the presence of higher penalty clauses is likely to create pressure on the Nepal Electricity Authority (NEA) for the timely completion of the transmission line project. As the revenues are linked to the units generated, the inability of the plant to achieve its design operating parameters in case of weak hydrology could further pressurise the debt coverage metrics. The timely infusion of the remaining equity also remains a concern, given the weak financial position of one of the company's largest promoters¹.

Nonetheless, the regulatory and offtake risks remain low because of the firm offtake arrangement and stringent penalty terms (for delays by the offtaker as well as the developer). Going forward, MKHCL's ability to commission the project in a timely manner and within the estimated cost would remain the key rating sensitivity. Additionally, the timely availability of the NEA's evacuation structures, the achievement of the design operating parameters as well as interest rate volatility in the market would be the key drivers for determining the project return metrics and coverage indicators.

Key rating drivers

Credit strengths

Presence of long-term PPA results in low tariff risks – MKHCL has entered into a power purchase agreement (PPA) with the NEA (the sole purchaser and distributor of electricity in Nepal) for its entire project capacity for a period of 30 years from commercial operation (subject to the validity of the generation licence). The predefined tariff, as per the PPA, is NPR 4.8 per kWhr for the wet season (mid-April to mid-December) and NPR 8.4 per kWhr for the dry season. For these rates, the escalation is 3% per annum on the base tariff for five consecutive years after operation. With a firm PPA in place, the tariff risks for the project are low.

¹ Khani Khola Hydropower Company Limited (KKHC) is the largest promoter of MKHCL with ~14% of present equity commitment of ~NPR 641 million; only 50% of this has been infused till February 2020

Experienced promoter group – The two largest promoters of the company are directly linked to the hydropower sector, with Khani Khola Hydropower Company Limited (KKHC; ~12% stake at present) being the developer and operator of the 6.36-MW Khani Khola HEP. Pashupati Energy Development Company (~18% stake), on the other hand, has been involved in multiple hydropower projects as a promoter/consultant. This provides some comfort where development risks are concerned. Another major promoter (~9% stake) is Prabhu Insurance Limited (of the Prabhu Group).

Low offtake risk, given current demand-supply gap and increasing energy utilisation – The company has a PPA for the offtake of energy under the take-or-pay model with the NEA. Any failure in the offtake of power would be compensated by the NEA. Also, a gap in the demand and supply of energy in Nepal would ensure the healthy offtake of energy. Nepal is a net importer of electricity even with limited electrification across the country and the currently suppressed demand (per capita power consumption of <150 KW as per a 2015 study²; among the lowest in Asia). In FY2018-2019, the peak power demand in the Integrated Nepal Power System (INPS) surged to 1,320 MW while the installed operational capacity was only 1,182 MW. The large shortfalls in some dry months were met through the import of electricity. As per the NEA, the power demand is expected to grow at a rate of ~15% over the next 22 years, driven by an increase in electrification, per capita consumption and industrial demand. Hence, the supply-demand gap is expected to persist, resulting in the healthy offtake of the energy to be generated by the project.

Credit challenges

High project execution risks – The 14.9-MW project has achieved ~40% physical progress so far, which exposes it to inherent project execution risks. The project's critical component remains the headrace tunnel, which was ~40% complete till January 2020. The rock quality found herein is adverse in many places, against expectations. Hence, any major geological surprises during the remaining excavation process could stretch the project timeline and increase the costs. This risk is partly mitigated by the experience of the developer/contractor in similar civil works. Nonetheless, contracts for the hydromechanical works and the transmission line are yet to be awarded. Any timeline delays would increase the project costs through hard cost escalations, incremental interest capitalisation as well as project monitoring costs. This would have a negative impact on the project's return indicators and debt coverage ratios.

Evacuation risks remain high though high penalty clauses provide some comfort – The power from the project is to be evacuated through the NEA's proposed Baneshwor substation at Sankhuwasabha (under the Koshi Corridor). The evacuation structures are still at a moderate level of construction with a targeted completion date of April 2020 (for package 1 and 2; completion of package 3 would not be required for the evacuation of power from MKHCL). Given the track record of delays in the NEA's transmission line projects, evacuation risks remain high. However, these risks are mitigated to some extent by the presence of high penalty provisions on the part of the NEA and the developer towards the timely completion of the respective transmission line and generation projects. As a super six project³, MKHCL's project would be entitled to a penalty of 45% of the lost revenue (5% in other PPAs). Additionally, multiple projects are being developed in the corridor with some of these having earlier RCODs compared to MKHCL's project. These would also create timeline pressure on the NEA for the completion of the transmission line corridor. However, in the event of delay by MKHCL, the company will also have to pay higher penalty (28% against 5% in other PPAs).

Timely equity infusion critical, given weak financial profile of largest promoter; debt component fully tied up – The equity requirement for the project is NPR 752 million. Of this, commitments for ~85% have been received and ~50% of the equity requirements had been infused till March 1, 2020. However, the largest promoter i.e. KKHC (largest in terms of committed amount of NPR 90 million, of which only NPR 45 million has been injected) has a weak financial profile⁴. Hence, the sourcing of the remaining equity commitment and the timely raising of the balance 50% equity would remain critical. Nonetheless, the tie-up of the debt component (debt to equity of 70:30) provides relief regarding the debt-funding risks.

High interest rates during construction could increase gearing levels, leading to low debt coverage ratio – As a low discharge project with a location that is relatively easier to access, the current project cost estimates are comparatively lower (NPR 168 million per MW). Nonetheless, this could witness escalations, given the possible delays in project execution. Cost overruns, if any, would have to be financed either through incremental equity or through short-term debts, which could

² Study conducted by Water and Energy Commission Secretariat, GoN

³ Refers to six projects that were initially studied by the Department of Electricity Development (DoED) and later auctioned to private developers through competitive bidding

⁴ KKHC has sustained sizeable losses till mid-January 2020, eroding its net worth to (NPR 7.57) per share against the par value of NPR 100

increase the gearing levels. The promoters' ability to increase equity in a timely manner if there is a cost overrun would also remain critical. Additionally, the high interest rates during the construction period (12.77% as of now; interest is to be capitalised during construction) would add to the debt component. This could affect the project's ability to serve its debt obligations from its cashflows. The coverage indicators are, hence, likely to remain moderate in the early years of operation due to the high interest obligations.

Hydrology risks remain high, given lack of deemed generation clause in PPA – Like most of the small rivers in Nepal, Mayakhola is not a gauged river. Additionally, the lack of a deemed generation clause in the PPA exposes the project to high hydrological risks. Hence, the loss of revenue in case of a fall in hydrology will not be compensated. The project's contract plant load factor (PLF), as per the PPA, also remains on the slightly lower side at ~62% compared to most projects. The low contract PLF would result in relatively lower revenue. The return and debt coverage indicators could come under further pressure if the project is unable to achieve the design operating parameters.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

About the company

Incorporated in May 2010 as a private limited company, Maya Khola Hydropower Company Limited (MKHCL) was converted into a public limited company in December 2016. MKHCL is developing the 14.9-MW Maya Khola HEP in the Sankhuwasabha district of eastern Nepal. The current estimated cost of the project is NPR 2,502 million, which is to be financed at a D:E ratio of 70:30. As of March 1, 2020, the company's paid-up capital, including advances, was ~NPR 385 million (out of the required equity of NPR 752 million), which was 100% promoter held. The project is a run-of-the-river (R-o-R) type and is being developed at a 40% probability of exceedance (Q40). The PLF of the project is ~62% with an annual production capacity of ~82 GWh of energy. The dry energy mix of the project in the overall energy is ~15%.

Annexure-1: Instrument details

Instrument *	Rated Amount (NPR Million)	Rating Action
Fund-based facilities; Long-term loan (A)	1,750	[ICRANP] LBB-; reaffirmed
Fund-based facilities; Short-term loans (B)	75	
Bridge gap loan (within term loan)	(200)	[ICRANP] A4; reaffirmed
Working capital loan	75	[ICRANP] A4; reaffirmed
Non-fund based facilities; short-term loans (C)	-	
Letter of credit (within term loan)	(1,000)	[ICRANP] A4; reaffirmed
Bank guarantee (within working capital loan)	(0.3)	[ICRANP] A4; reaffirmed
Total (A+B+C)	1,825	

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