Mountain Hydro Nepal Limited: [ICRANP] LBB- assigned for enhanced amount; short-term rating reaffirmed

July 20, 2020

Summary of rated instruments

Instrument (Amount in NPR Million)	Previous Rated Amount	Current Rated Amount	Rating Action
Long-term loan; Fund-based (Term loan)	3,050	3,255	[ICRANP] LBB-; Reaffirmed/assigned
Short-term loan; Fund-based (Overdraft)	70	70	[ICRANP] A4; Reaffirmed
Total	**3,120**	**3,325**	

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBB- (pronounced ICRA NP L double B minus) to the enhanced long-term loans of Mountain Hydro Nepal Limited's (MHNL). ICRA Nepal has also reaffirmed a short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) assigned to its short-term loan.

Rationale

The rating actions factor in the completion of the 22.1-MW Lower Hewa Khola hydro power project (HPP) under the company (albeit delayed by around three months compared to required commercial operation date (RCOD)), along with the availability of requisite structures for power evacuation. This eliminates the project's execution and evacuation risks. The ratings also consider the project's satisfactory generation trend so far; gross generation of ~82% of the contracted energy for initial ~11 months of operation ending on mid-June 2020. Furthermore, the assigned ratings take comfort from the low tariff and low off-take risks, amid the already signed power purchase agreement (PPA) with the Nepal Electricity Authority (NEA), the sole purchaser and distributor of electricity in Nepal with pre-determined tariff rates and escalations. Additionally, the positive energy demand outlook owing to the supply-demand gap in the power sector as well as the increasing energy consumption in the nation remain rating positives.

Nonetheless, the ratings remain constrained by the unanticipated delays and cost increases towards project completion, leading to the relatively higher project cost of NPR 218 million per MW. This is likely to create further pressure over the company's debt service/coverage indicators. Since the revenues are linked to units generated from a single project, any fall in hydrology and volatility in borrowing rates could further pressurise the debt coverage metrics. The absence of a deemed generation clause in the PPA also accentuates the concern along hydrological risks. The ratings are also constrained by the counterparty credit exposure of the NEA, which has a moderate financial profile (albeit with recent improvements). This is partly mitigated by the sovereign support of the Government of Nepal (GoN) to the NEA and its past track record of timely payments to independent power producers (IPPs). Going forward, MHNL's ability to achieve its designed operating parameters with good support from hydrology along with the interest rate volatility in the market would be the key drivers for determining the company's return metrics and other coverage indicators.

Key rating drivers

Credit strengths

Project commissioned from August 2019 eliminating the execution risks – The 22.1-MW Lower Hewa Khola HPP came into operation from August 6, 2019, three months delayed against its RCOD of May 7, 2019. MHNL would be eligible for all tariff escalations as per the PPA, which gives clarity to the company's revenue profile. However, the slight delay in commissioning attracted a late COD penalty of ~NPR 9.2 million.

Satisfactory energy generations so far and presence of requisite evacuation structures – For ~11 months of operation till mid-June-2020, the project generated ~82% of the contracted energy. The project's net plant load factor (PLF) for this period stood at ~45% (contract PLF of ~61%) corresponding to ~80% of the contract energy. Lower energy receipt by the NEA was mainly on account of the low availability declaration (AD)[1]. While the generation over a longer time frame remains to be seen, the increasing operation trend is likely to aid the company in better predicting the water flow and hence be more precise in providing AD. The generated energy is being evacuated through the NEA's Phidim substation and the availability of requisite evacuation structures has led to low transmission losses (0.09% for ~11 months ending on mid-June 2020).

Low offtake and tariff risk, given long-term PPA at predetermined tariffs and escalations – The offtake and the tariff risk remain low as the company has a 30-year PPA with the NEA. The PPA for the initial 21.6-MW capacity has a "take or pay" clause, ensuring full offtake. Though the PPA for an additional 0.5-MW has 10% reserve margin clauses (applicable only to 0.5MW), this is not expected to have a meaningful impact on the company's revenue profile. The pre-defined tariff rates are NPR 4.8 per kWh for the wet season (mid-April to mid-December) and NPR 8.4 per kWh for the dry season. Over these base tariffs, there is a 3% annual escalation clause for five times in case of the initially contracted 21.6MW and eight annual escalations of 3% for the additional 0.5MW capacity.

Credit challenges

Weak coverage and return metrices – The project was developed at a cost of ~NPR 4,819 million (i.e. ~NPR 218 million per MW, ~28% escalated against the initial per MW cost estimates). There were unanticipated delays of around six months in project completion leading to an increase in costs by ~6% (mainly civil construction costs and increased interest capitalisation) against the estimates at the time of the last rating. The cost structure remains relatively higher and given the fixed tariff structure, the debt service and coverage indicators are expected to remain on a weaker side. For 9M FY2020, the company's interest cover and DSCR was just adequate at 1.10 times and 1.04 times respectively. ICRA Nepal expects these indicators to remain largely similar over the medium term, assuming a similar generation trend. With the sharp ballooning in the repayment schedule in later years, DSCR might remain less than 1 times and hence might require loan restructuring and/or promoter support.

High hydrology risk, given lack of deemed generation clause in PPA – The lack of a deemed generation clause in the PPA exposes the project to high hydrological risks in case of adverse river flow scenarios without receiving any compensation from the NEA for such losses. This concern is further accentuated by the fact that the river flow is dependent on the rain-fed perennial source, which could affect the available hydrology based on rainfall fluctuations in the basin. With the fluctuations in hydrology, generation remained as low as ~66% of the contract energy in the two months ending mid-March 2020, exposing it to penalties, albeit minimal. The contract PLF for the project as per the PPA at ~61% also remains lower compared to most projects. A low contract PLF would result in relatively lower per MW revenues.

Exposure to interest rate volatility – Since the revenues are fixed, the volatility in interest rates would impact the company's profitability and coverage ratios. These indicators could come under further pressure in case the project deviates significantly from its design operating parameters. Additionally, ability to control the operating cost structure would also remain critical. The company's ability to avail of the refinance facilities could provide some support to its liquidity profile.

Stretched liquidity profile – The project had to avail of promoter loans in the past for project completion; NPR 202 million outstanding as of mid-April 2020. Additionally, the payables (mostly to contractors) also remain high at ~NPR 122 million as on the same date. With the debt repayments starting from mid-January 2020, cash flows are likely to remain under pressure, given the high interest burden in the initial years of repayment. Hence, the liquidity profile is likely to remain stretched. Ability to continue the promoter advances and avail further support in case of exigencies, remains to be seen.

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

[1] Amount of energy expected to be generated in next month, which is to be provided to NEA prior to 30 days of start of the concerned month. AD cannot be lower than 60% and 90% of contracted energy for wet and dry seasons respectively. Supply of energy lower than 80% of AD attracts short supply penalty while generation in excess of AD would not be eligible for any payments.

About the company

Incorporated in July 2005 as a private limited company, Mountain Hydro Nepal Limited (MHNL) was converted to public limited company on June 2016 to facilitate public participation. The paid-up capital of the company as of mid-June 2020 was NPR 1,250 million, which was 80% promoter held while 20% was raised through an IPO. As on the same date, Chairman Mr. Sitaram Timalsina and his family members hold ~58% stake (including ~14% stake through S.R. Power Investment Company Private Limited, which is a company held entirely by Mr. Timalsina), among others.

The company is operating a 22.1MW Lower Hewa Khola HPP in Panchthar District, Province 1 of Nepal. It is a run of the river (R-o-R) type project and has been developed at 40% probability of exceedance (Q40). The project was commissioned from August 6, 2019 as against a required COD of May 7, 2019 and was developed at a total cost of ~NPR 4,819 million, financed by ~68% bank loans and rest from equity and promoter loans.

Key Financial Indicators

Amount in NPR million	Provisional
	9M FY2020
Operating Income	340
OPBDIT/OI (%)	90%
PAT/OI (%)	-31%
Gearing (times) (Total debt/Tangible Net worth-TNW)	3.26
OPBDITA/Interest (times)	1.10
DSCR (times)	1.04
NWC/OI (%)	-6%
Total Outside Liabilities/TNW (times)	3.37
Total Debt/OPBDITA (times)	8.61

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About ICRA Nepal Limited

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