Super Mai Hydropower Limited: [ICRANP] LBB+/A4+ assigned

March 23, 2020

Summary of rated instruments

Instrument *	Rated Amount (NPR Million)	Rating Action
Long-term loan; Fund based	1,100	[ICRANP] LBB+; Assigned
Short-term loan; Fund based	30	[ICRANP] A4+; Assigned
Total	**1,130**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBB+ (pronounced ICRA NP L double B plus) to Super Mai Hydropower Limited's (SMHL) long-term loan and a short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to its short-term loan.

Rationale

The assigned ratings consider the early completion (21 months before the RCOD[1]) of the project that has been in operations since the last 18 months. The early completion enabled the project to be eligible to avail all the five tariff escalations, which would support the return and coverage indicators of the company amid the fixed tariff and fixed escalation regime. The ratings also consider the project's ability to generate ~83% of the contract energy in the last 12 months ending mid-Feb 2020 and the improvement in generation by ~20% in the three months (mid-Nov 2019-mid-Feb 2020) of the current fiscal year vs. the corresponding three-month period of FY2019. The ratings also consider the experience of the promoters and the key management team in the related sector, which remain a comfort for the operational and maintenance aspects of the project. Similarly, the ratings consider the low tariff risk and low offtake risk, given the power purchase agreement (PPA) with Nepal Electricity Authority (NEA), the sole purchaser and distributor of electricity in Nepal, with pre-determined tariff rates and escalations. The ratings also factor in the positive demand outlook for the energy sector owing to the supply-demand gap in the power sector as well as the increasing energy consumption in the nation.

Nonetheless, the ratings remain constrained by the relatively higher project cost of NPR 1,488 million (NPR 191 million per MW) even though it was within the budgeted cost of NPR 1,500 million. The ratings are also constrained by the 10% reserve margin clause in the PPA, which could impact the revenue profile of the project in case the generation exceeds 90% of the energy for the period specified in the PPA. The ratings are also constrained by the short supply penalty and/or loss of revenue that the company might face for the differences in availability declaration (AD)[2] and actual energy supplied, as indicated in the PPA. Also, the ratings are constrained by the absence of a deemed generation clause in the PPA, which exposes the project to high hydrological risks without any compensation from the NEA in case of adverse flow in the river. This is further accentuated by the fact that the hydrology of the river is dependent on a rain-fed perennial source. The ratings are also constrained by the counterparty credit exposure of the NEA, which has a moderate financial profile (with recent improvements). This, however, is partly mitigated given 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, SMHL's ability to achieve its designed operating parameters, the good hydrology of the river given the rain-fed source, and interest rate volatility in the market would be the key drivers for determining the project's return metrics and the other coverage indicators for the company.

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[1] *Required commercial operations date is July 16, 2020*

[2] *AD cannot be lower than 50% of the contract energy in both dry and wet seasons; supply of energy below 80% of the AD attracts short supply penalty while excess generation is not eligible for any payments*

Key rating drivers

Credit strengths

Experience of promoters in hydropower sector – The company's board and senior management have experience and technical expertise in the hydropower/engineering sector. Mr. Mohan Bikram Karki, Chairman as well as the major promoter of the project, was previously involved as the Managing Director of the operational 998-kW Kutheli Bukhari Small Hydropower Project and is also involved in various capacities in other under-construction hydropower projects such as the 9.6-MW Super Mai A HPP, 3-MW Super Mai Cascade HPP, 9.51-MW Mai Beni HPP and 8.63-MW Chepe Khola Small HPP. Similarly, the engagement of the other promoters and directors in other under-construction as well as operational hydropower projects remains a comfort from an operational and maintenance support perspective at times of need.

Project eligible for all five tariff escalations – The project was constructed in 18 months and was completed 21 months before its RCOD. It has been in operation since October 2018. The early completion of the project was aided by the experience and commitment of the promoters as well as the saving of time related to the construction of the evacuation structures. The company sorted the evacuation of its power through a loop-in-loop-out transmission line sharing mechanism with Panchakanya Mai Hydropower Limited instead of constructing a 12.5-km long transmission line to the Godak substation. The eligibility of the project in availing all five escalations of 3% on the base rate would support its revenue profile in the fixed tariff and fixed escalation regime.

Project generated ~83% of contract energy in 12 months ending mid-February 2020 with improvement in recent times – The operational 7.8-MW Super Mai HEP generated ~83% of the contracted energy in the 12 months ending mid-February 2020. The generation during the wet period (mid-August to mid-October 2019) surpassed the contract energy with a generation of up to 110% of the contract energy during this period. Similarly, the net energy generation from the project improved by ~20% in the three months of FY2020 vis-à-vis the corresponding period in FY2019, mainly due to the good hydrology support in the region. The net generation was also supported by the low transmission loss of ~0.37% in 8.5M FY2019 and 0.41% in 7M FY2020. Going forward, the hydrology support and the generation trend would determine SMHL's revenue profile.

Low tariff risk, given long-term PPA at predetermined tariffs and escalations – The tariff risk is low as the company has a 30-year PPA for the project with the NEA for its entire project capacity of 7.8 MW. The actual generation in the dry season remains in line with the dry energy mix of 17% as per the PPA. 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 with a 3% annual escalation clause in the tariff for five times. With the project being developed within its RCOD, it is eligible for all five escalations.

Moderate return and coverage indicators – The company's return and coverage indicators are expected to remain moderate, supported by a good revenue profile with five tariff escalations given the early completion of the project (21 months before the RCOD). The eligibility for availing all five tariff escalations, amid the fixed tariff and fixed escalation scenario, along with the relatively high contract plant load factor (PLF) of 69%, dry energy mix of 17% and utilisation of the refinancing facilities twice at an interest rate of 7%, is expected to support the return and coverage indicators. The gearing remained at 2.84x as of mid-July 2019 and is expected to decline gradually with the repayment of the term loan and an increase in retention and profit accruals. The term loan is to be fully repaid by 2031. The cumulative debt servicing coverage ratio (DSCR) is expected to be around 1.19x and 1.28x, respectively, at 80% and 85% generation of contract energy. Hence, the project's generation trend would determine the return and coverage indicators going forward.

Credit challenges

Relatively higher project cost and exposure to short supply penalty and/or loss of revenue – The project cost of NPR 1,488 MW (NPR 191 million per MW) for the 7.8-MW project is on the relatively higher side even though it was within the budgeted cost of NPR 1,500 million. This, along with the exposure of the project towards a short supply penalty and/or loss of revenue for failure to properly state the Availability Declaration (AD), could constrain its revenue profile. Going forward, the prudent and effective Availability Declaration (AD), to avoid a short supply penalty and/or loss of revenue, could impact the company's profitability and coverage ratios.

Low offtake risk; however, provision of 10% reserve margin in PPA can impact revenue profile – The offtake risk for the project is low, given the presence of the take-or-pay PPA for the entire energy from the 7.8-MW capacity. However, the provision of a 10% reserve margin clause in the PPA for the specified period empowers the NEA to offtake such 10% energy based on the dispatch instruction of the load dispatch centre. The NEA is not bound to pay any compensation to SMHL for the non-offtake of such energy, which can impact its revenue if such a scenario prevails. Nonetheless, the risk is reduced to some extent, given the present demand-supply gap in the energy sector as well as the increasing energy demand in the country.

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 hydrological risks, given the absence of any compensation for losses in adverse river flow scenarios. Additionally, a rain-fed perennial source could affect the hydrology of the river with fluctuations in rainfall in the basin.

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

Super Mai Hydropower Limited (SMHL), incorporated on July 2, 2017, was established with the objective of investing in and developing a hydropower project. The company's paid-up capital, as of mid-January 2020, was ~NPR 400 million (100% promoter held). The major promoters include Mr. Mohan Bikram Karki (~19%), Mr. Buddhi Bahadur Karki (~14%) and Ms. Sabita Bartaula (~14%) and 14 other shareholders with an aggregate share of ~53%. The company is operating the 7.8-MW Super Mai HPP in Ilam district, Province 1 of Nepal since October 2018. The project is a run-of-the-river (R-o-R) type and has been developed at 40% probability of exceedance (Q40). The project was commissioned 21 months before its RCOD of July 16, 2020 for a total cost of ~NPR 1,488 million against the budgeted cost of ~NPR 1,500 million.

Key financial indicators

Amount in NPR million	**Audited**
	8.5M FY2019
Operating Income	105.4
OPBDIT/OI (%)	86%
PAT/OI (%)	-9%
Gearing (times)	2.84
OPBDITA/Interest (times)	1.45
DSCR (times)	1.34
NWC/OI (%)	16%
Total Outside Liability/TNW (times)	2.85
Total Debt/OPBDITA (times)	8.46

**SMHL's revenue in 7M FY2020 was ~NPR 145 million and it generated around 93% of the contract energy during the period*

Annexure-1: Instrument details

Instrument *	**Rated Amount (NPR Million)**	**Rating Action**
Term Loan (long term; fund based)	1,100	[ICRANP] LBB+; Assigned
Working Capital	30	[ICRANP] A4+; Assigned
Total	**1,130**	

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About ICRA Nepal Limited

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