Mountain Hydro Nepal Limited: [ICRANP] LBB-/ A4 (Assigned)

December 12, 2018

Summary of rated instruments

Instrument *	Rated Amount (NPR Million)	Rating Action
Long-term loans, Fund-based	3,050	[ICRANP] LBB- (Assigned)
Short-term loans, Fund-based	70	[ICRANP] A4 (Assigned)
Short-term loans, Non-fund based	(930)	[ICRANP] A4 (Assigned)
Total	**3,120**	

* Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP] LBB- (pronounced ICRA NP L Double B minus) to the long-term loans of Mountain Hydro Nepal Limited (MHNL). ICRA Nepal has also assigned the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the short-term loans (including non-fund based limits) of the company.

Rationale

The assigned rating factors in the relatively high project costs[1] of the 22.1-MW Lower Hewa Khola Hydroelectric Project (HEP) being developed by MHNL. The fixed tariff structure for the project doesn't compensate for the sizeable increase in project costs (~24% compared to initial estimates). Hence, this could lead to a modest debt coverage and return indicators, especially if the project is unable to achieve its design operating parameters. Since the revenues are linked to units generated, any fall in water levels could further pressurise the debt coverage metrics. The rating action is also impacted by the funding gaps witnessed for the current cost estimates, especially given the target to complete the project and start operations shortly. The interest rate volatility in the market also remains a rating concern. Any further cost overruns or timeline delays compared to the company's plans would have a major impact on the interest capitalisation and hence the overall project metrics.

Nonetheless, the rating positively takes into consideration the advanced physical progress achieved in the project (~95%) with plans to start operations from mid-January 2019. This reduces the execution risks to a large extent. The rating also takes into consideration the low evacuation risks as the Kabeli Corridor for power evacuation is also in its final stages of completion. In addition, the regulatory and offtake risks also remain low because of the firm offtake arrangement. Going forward, the company's ability to commission the project within the budgeted cost and stipulated time would remain the key rating sensitivity. Moreover, the timely availability of the Kabeli corridor for power evacuation along with the project's ability to achieve its design operating parameters would be the key rating drivers.

Key rating drivers

Credit strengths

Project under MHNL approaches completion; likely to start operations from mid-January 2019-

The 22.1-MW project under the company has reached advanced stages of construction. As of mid-November 2018, more than 95% physical progress had been achieved, reducing execution risks to a large extent. The project is expected to start operations from mid-Jan-2019, nearly three months behind the current required commercial operation date (RCOD) of October 10, 2018. The application requesting a further RCOD extension is in the pipeline.

[1] *NPR 205 million per MW*

Evacuation risks remain low; alternative evacuation possible for initial dry season energy generation-
The power generated from the project is to be evacuated through the Phidim substation of the Kabeli Corridor. The corridor is expected to be completed by end of December 2018. This is slightly ahead of the targeted project completion date. In case of delays, power can be evacuated through the existing 33 kVA line during the first few months of operation which coincides with the dry season characterised by low generation. Completion of the Kabeli Corridor, by the time the wet months start, would remain a key monitorable.

Presence of long-term power purchase agreement results in low offtake and tariff risks-
MHNL has entered into a power purchase agreement **(**PPA) with the Nepal Electricity Authority (NEA, the sole purchaser and distributor of electricity in Nepal) for a period of 30 years from commercial operations (subject to validity of the generation licence). The PPA is currently for the earlier project capacity of 21.6 MW while the revised PPA for an increased capacity of 22.1 MW is in process. The predefined tariff, as per the PPA, is NPR 4.8 per kWhr for the wet season (Mid-April to Mid-December) while that for the dry season amounts to NPR 8.4 per kWhr. For these rates, there is a 3% escalation per annum on the base tariff for five consecutive years following the operation. With a firm PPA in place, the tariff risks for the project are low. However, counterparty credit risk remains a concern, given the weak financial profile of the NEA. This is partly offset by the sovereign support to the NEA, being fully owned by the Government of Nepal (GoN) and its past track record of timely payment to private HEP developers.

Supply-demand gap to result in healthy off take-
Nepal is a net importer of electricity, even with limited electrification across the country and the current supressed demand (per capita power consumption of <150 KW as per 2015 study[2], among the lowest in Asia). In the fiscal year (FY) 2017-2018, the peak power demand in the Integrated Nepal Power System (INPS) surged to 1,508 MW while the installed operational capacity was only 1,074 MW. The shortfall was met through the import of electricity. As per the NEA, the power demand is expected to grow at the rate of ~15% over the next 22 years (driven by an increase in electrification, per capita consumption and higher industrial demand) and hence the supply demand gap is expected to persist.

Credit challenges

High project cost to result in weak return and debt coverage indicators-
The project cost has increased substantially from the initial estimates of NPR 3,668 million to NPR 4,531 million (~24% cost overrun). The cost metrics (NPR 205 million per MW) is on a slightly higher side, compared to most projects. Any further timeline delays would increase the project costs through incremental interest capitalisation and project monitoring costs. This would have a negative impact on the return indicators and debt coverage ratios of the project. Given the sizeable debt (~67% financing), coverage indicators are likely to remain subdued in the early years of the operation due to high interest obligations.

Funding gap despite project nearing completion-
For current cost estimates, the debt component has been fully tied up at NPR 3,050 million while MHNL's equity after the proposed IPO will be NPR 1,250 million. This leads to a funding gap of NPR 231 million, apart from the sizeable pre-operating expenses so far (~NPR 196 million till mid-Oct-18). This is planned to be financed through short term promoter loans and to this end NPR 126 million of this has already been infused. Additionally, some of the cost components have already crossed the budgeted ceiling though the total cost incurred till mid-October 2018 was NPR 4,249 million (~94% of latest cost estimates). Any further cost overrun will necessitate increased support from promoters. As MHNL's shareholding is concentrated across a few individual promoters, its ability to continue the funding support, if required over longer tenure, remains to be seen.

Hydrology risks remain high given lack of deemed generation clause in PPA-
Like most small rivers in Nepal, Hewa and Pheme Khola are also not gauged. Additionally, lack of the deemed generation clause in the PPA exposes the project to high hydrological risks; hence, loss in revenue in case of a fall in water levels will not be compensated. However, gauge data maintained by MHNL for the last few years provides comfort. Nonetheless,

[2] *Study conducted by Water and Energy Commission Secretariat, GoN*

the contract plant load factor (PLF) for the project as per the PPA at ~61% remains lower compared to most projects. A low contract PLF would result in relatively lower revenues. The return and debt coverage indicators could further come under pressure in case the project is unable to achieve 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 July 2005 as a private limited company, Mountain Hydro Nepal Limited (MHNL) was converted into a public limited company on June 2016 to facilitate public participation. MHNL has 28 promoters (including two institutional promoters) with major holding by the Chairman, Mr. Sitaram Timalsina at ~44% as of now. The promoter's holding (currently at ~94%) is expected to dilute to 80% after the proposed IPO. MNHL is developing the 22.1-MW Lower Hewa Khola Hydro Power Project (RCOD as per PPA: October 10, 2018) in Panchthar district of eastern Nepal.

Annexure-1: Instrument Details

Instrument	Limit (Amount in NPR Million)	Rating Action
Fund-based Long-term	3,050	[ICRANP] LBB-
Fund-based Short-term (Overdraft)	70	[ICRANP] A4
Non-fund Based Short-term LC (within term loan)	(900)	[ICRANP] A4
Non-fund Based Short-term BG (within term loan)	(30)	[ICRANP] A4
Total Rated Loan Limits	**3,120**	

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About ICRA Nepal Limited:

ICRA Nepal Limited, the first Credit Rating Agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, technical and analytical skill augmentation.

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