

Rasuwagadhi Hydropower Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed Initial Public Offering (IPO) of Rasuwagadhi Hydropower Company Limited

| Instrument/Facility | Issue Size | Grading Action (July 2017) |
|----------------------|-----------------------|----------------------------------|
| IPO (equity) Grading | NPR 1,642.104 Million | [ICRANP] IPO Grade 4+ (Assigned) |

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4+”, indicating below-average fundamentals to the proposed Initial Public Offering (IPO) of Rasuwagadhi Hydropower Company Limited (RHCL). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative better position within the grading categories concerned. RHCL is proposing to come out with an IPO of 16,421,040 numbers of equity shares of face value NPR 100/- each at par. Current offerings size is 24% of the total capital and is reserved to contributories and employees of the lender of the institution (Employees Provident Fund - EPF) and to employees of promoter companies; company will later issue IPO to affected locals (10%) and general public (15%).

The assigned grading takes into account the significant project implementation risks involved in the under-construction 111 MW Rasuwagadhi hydroelectric project (HEP) being developed by RHCL. The project is currently behind their initial commissioning schedule and delay in completion of balance activities can impact the project costs and returns given the fixed tariff structure. The project is also exposed to foreign exchange fluctuation risks on account of unhedged USD denominated contractual liabilities (~56% of project cost). Hydrology risk for the project is high, since the revenues are directly linked to unit sales, hence any loss of generation due to shortage of water or silting can negatively impact the project earnings and return indicators. The grading is also constrained by interest rate volatility in the market and the counterparty credit risks arising out of exposure to loss making NEA (Nepal Electricity Authority) for the energy supplied, although the same is partly mitigated by the fact that NEA is fully owned by the Government and has been making payments to IPPs (Independent Power Producers) in a timely manner in the past.

Nonetheless, the grading factors in the strengths of promoter companies (NEA and Chilime Hydropower Company Limited which are both direct/indirect Government of Nepal undertakings) and have significant experience in development and operations of hydropower projects. In addition, with a firm Power Purchase Agreement (PPA) in place and positive demand outlook owing to supply-demand gap in the power sector, the tariff and off-take risks are minimal. The project would also be entitled to a capital subsidy of NPR 5 million per MW from Government upon connection to national grid. Evacuation risks for the project are also moderate given the fact that the expected timeline for completion of NEA's transmission line is January 2019 compared to expected completion of project in August 2019 which provides some time cushion. Additionally, other projects in the same basin are also expected to come in operation prior to this project which along with presence of NEA as a promoter mitigates the risk of delay in commissioning of transmission line to some extent. Going forward, ability of the company to commission the project within the budgeted time and cost estimates and also availability of sufficient hydrology and evacuation infrastructure will be key parameters driving returns of the project.

RHCL is developing a run of the river (ROR) hydropower project in Bhotekoshi river–Rasuwagadhi Hydroelectric Project (RHEP) of capacity 111 MW in Rasuwa district of Central Development Region of Nepal. The Generation License for the project was obtained from Ministry of Energy on December 2012, valid for 35 years including the period of construction on Build Own Operate Transfer (BOOT) basis. The project has faced substantial time overrun compared to Required Commercial Operation Date (RCOD) as per PPA of June 2017, mainly owing to Apr-2015 earthquake and its aftershocks and subsequent blockades. An application to extend RCOD till August 2019 has been filed to NEA and hence decision of NEA in this matter will have impact upon tariff escalations as well as late COD penalty that is to be paid for delayed operation. Additionally, generation license validity of 35 years could limit overall life of the project. Expected COD for the project is August 2019 against RCOD of June 2017. The electricity generated from the project shall be evacuated from switchyard of the project to Chilime hub substation through a 10 km long 132kV double circuit transmission line. However, NEA has just completed land acquisition and is yet to start construction works for the said substation. In addition, 26.5 km long 220 kV double circuit transmission line from Chilime Hub to Trishuli 3B hub is to be developed by NEA. PPA for RHEP was

signed on November 2011 with NEA and the agreed tariff for wet season is NPR 4.8 per kWhr and for dry season is NPR 8.4 per kWhr with 3% escalation on successive tariff for 8 years.

The contract for civil as well as hydromechanical works of the project has been awarded to China International Water and Electric Corporation (CWE), China and Electro-mechanical contract has been awarded to Voith Hydro Private Limited. Overall ~30% progress has been achieved in project execution as of mid-April 2017 with plans to complete construction by end of August 2019. SMEC International Pty Ltd. Australia is the consultant for the project. These EPC contracts have significant USD component (~USD 92.88 million of which ~USD 69.48 million remains to be paid over the contract period, in addition to possible increase in contract amount for time bound consulting contract). Possible further currency devaluation (NPR has depreciated by ~5% since execution of major portion of these contracts in 2014) exposes the project to escalations in project costs given the long timeline over which contract payments are to be made. As regards physical progress, overall ~30% of works has been completed in the project. Nonetheless, significant portion of headrace tunnel remains to be excavated (~20% complete as of mid-April 2017 out of total length of 4,293 metres). Foundation work for power house structure and fabrication works are in progress. Transmission line contracts are yet to be awarded.

The project cost as per latest management estimates is NPR 16,331 million to be funded in debt to equity ratio of ~58:42¹. The debt component has been tied up with EPF and promoters have brought in substantial share of their equity (~NPR 3,244 million injected out of promoter equity requirements of ~NPR 3,489 million) with plans to raise remaining equity requirements of project (~NPR 3,353 million) through series of IPO. Of the NPR 4,476 million costs incurred till mid-April 2017, ~NPR 1,165 million has been funded through debt and balance from promoters' equity. Capital subsidy to be received from Government is expected to be utilized towards covering contingencies. Typically, hydro-power projects entail significant project execution risks as they are located in difficult terrain and hence adverse climatic conditions during the construction period and also geological surprises can disrupt construction schedule of any project. Thus, timely completion within the budgeted time and cost estimates and the availability of requisite evacuation infrastructure (to be developed by NEA) would be the key factors driving the returns for the project.

Company Profile

Rasuwadghi Hydropower Company Limited (RHCL) is a subsidiary of Chilime Hydropower Company Limited (Chilime; ~62% stake) and was incorporated in August 2011 as a public limited company. Chilime, promoted by NEA, owns and operates 22.1 MW Chilime HEP and is also involved in construction of hydropower projects totaling ~270 MW capacity through various subsidiaries, including RHCL. ~38% stake is held by NEA, a Government of Nepal owned company. RHCL is developing 111MW Rasuwadghi HEP (RCOD:15th June 2017) in Rasuwa district of Central Development Region. RHCL plans to float 49% of total issued capital to public through a series of IPO in various tranches (all at par) after which current promoter holding will dilute to 51%. As part of the IPO process, the company would issue 24% of its post IPO paid-up capital amounting to ~NPR 1,642 million to contributories and employees of the sole lender EPF and employees of promoter companies. Thereafter, the company would issue 10% of its issued capital to the local inhabitants of project location in the second tranche and finally 15% of the post issue paid up capital to general public.

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¹ Financial closure was done at debt: equity of 50:50 excluding interest during construction (IDC); IDC to be capitalized separately and including the same, debt to equity ratio is ~58:42.



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