Mailung Khola Jal Vidhyut Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering (IPO) of Mailung Khola Jal Vidhyut Company Limited

Instrument/Facility	Issue Size	Grading Action (February 2017)
IPO (equity) Grading	~NPR 110.44 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 Mailung Khola Jal Vidhyut Company Limited (MKJVCL). 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. MKJVCL is proposing to come out with an Initial Public Offer of 1,104,429 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 368,143 shares will be issued to project affected areas while remaining 736,286 shares will be issued to general public and staff.

The assigned grading is constrained by moderate operational performance of 5MW operational hydel power project Mailung Khola HEP as reflected in lower than contractual Plant Load Factor (PLF) which has resulted in weak earnings profile for the company. Low PLF mainly due to insufficient hydrology resulted in loss of revenue which coupled with fixed low tariff for the project life limits the overall return prospects. Grading concerns also emanate from absence of deemed generation clause in PPA and interest rate volatility in the market which could impact the project earnings and returns. The grading is also constrained by significant delayed COD[1] penalty charged to the project (~NPR 89 million) which is gradually being deducted to the extent of 30% of monthly revenue hence requiring loan from promoters to facilitate debt servicing in initial years.

The project suffered damages during April 2015 earthquake and its aftershocks. Although, damage to the project infrastructure loss was partly recovered from insurance proceeds[2], absence of loss of profit coverage resulted in revenue loss during closure of plant. The project resumed operation after repairs from August 2016. The risks arising due to landslide in future cannot be ruled out as intake, power house and penstock alignment are situated in landslide prone area. The project is also exposed to counterparty credit risks arising out of exposure to loss-making NEA[3] for the energy supplied, although the same is partly mitigated by the fact that NEA is fully owned by Government and has been making timely payments to MKJVCL so far.

On positive side, with a firm PPA in place and positive demand outlook, the tariff and off-take risks are reduced considerably for the project. The grading also takes into account the regulatory advantage emanating from waiver of short supply penalties, as introduced recently by Ministry of Energy for projects up to 10 MW.

Mailung Khola HEP is the first hydropower project developed under MKJVCL. The project was initially proposed to be built on 65% exceedance flow model but was later changed to be built on 40% exceedance flow model. The tariff rates for the project as per PPA (Power Purchase Agreement) with NEA are NPR 3 and NPR 4.25 for wet and dry seasons respectively; subject to annual escalation @ 6% on base tariff for five years. Under the Government's initiative of promoting private sector hydropower developers, the project is entitled to promotional tariff rates of NPR 4.80 and NPR 8.40 per unit in wet and dry seasons; which shall remain effective for up to 7th year after PCOD[4] with 5 times annual escalation of 3% on base tariff. The electricity sales revenue shall thereafter be based on the rates as per PPA. Since, the COD was delayed by ~17 months compared to PCOD, the promotional rates will not be applicable for first 17 months of the project operation resulting in loss of revenue in addition to delayed COD penalty of ~NPR 89 million.

Delayed by ~10 years compared to RCOD[5] of 31st March 2004, the project began commercial operation from 3rd July 2014. Despite significant delay, the run of the river project was commissioned at a cost of NPR 904 million funded in a debt: equity mix of ~70:30. The power generated by the project is evacuated via ~2.7 km, 66kVA transmission line to NEA switching station at Grang which is interconnected to Chilime-Trishuli Transmission Line. The project has operated at PLF (at net generation) of ~64% in 9M FY2015 i.e. prior to earthquake and after resuming operations from 17th August 2016, PLF was ~66% during 5M FY2017. PLF

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[1] Commercial Operation Date

[2] Against the company's estimated total repair cost of ~NPR 140 million against material damage, the company was able to recover only ~NPR 96 million.

[3] Nepal Electricity Authority

[4] Proposed Commercial Operation Date of 7th Feb 2013.

[5] Required Commercial Operational Date

remained much lower than annual design energy PLF of ~89% and thus generated an average of ~70% of contract energy resulting in revenue loss to the company, in addition to substantial short supply penalty. However, the short supply penalty has been waived by Ministry of Energy henceforth for projects up to 10 MW which provides some comfort.

Since the revenues are entirely linked to unit sales from a single operational project, the project returns and the financial health of the company is entirely dependent on the hydrology of the project stream. During 9M FY2015 (i.e. prior to earthquake), MKJVCL posted gross sales revenue of ~NPR 89 million. The company reported net profit of ~NPR 3 million and OPBDITA[6] of ~NPR 48 million in FY2015. There were no operations in FY2016 on account of earthquake in April 2015 which caused damage to various project components. The company reported net loss of ~NPR 7 million in FY2016. However, financials for both the years were benefitted by non-inclusion of depreciation expenses. The company had ~NPR 615 million of outstanding term loan payable to the consortium banks as on July 2016, translating into a gearing ratio of 2.85 times. MKJVCL had paid one instalment prior to earthquake; thereafter banks allowed capitalisation of interest for two quarters after which the company has been paying interest only funded through promoter loans. MKJVCL would be resuming principal repayment from July 2017 and the debt servicing in initial years would remain benefitted from low lending rates (8.75% currently) and ballooning repayments. Management plans to repay bank loans from proposed IPO proceeds which would reduce interest outgo for the project. However, the company is yet to opt for loss of profit policy which remains a concern. Going forward, the ability of the project to minimize the gap between actual generation and contractual energy will be the most important driver for the project returns.

Company Profile

Incorporated in July 2002 as a private limited company, MKJVCL was subsequently converted into public limited company in August 2014 to facilitate public participation. MKJVCL has a large promoter base of four institutional promoters and 155 individual promoters accounting for entire paid up capital of the company as of now. Major promoters of MKJVCL include M/s. Sopan Multiple Company Limited (44.76%), M/s. Asia Pacific Power Tech Co. Pvt. Ltd. (3.83%) along with 157 other promoters with maximum holding of 2.31%. The promoter holding is expected to dilute to 70% after proposed IPO, assuming full subscription. The shares of the company are proposed to be listed in the stock exchange post proposed IPO. As a part of the IPO process, the company would issue 10% of its post IPO capital to the local inhabitants of project affected areas following which remaining 20% capital shall be offered to general public and staffs of MKJVCL. The company is at present operating 5,000 KW Mailung Khola HEP, located in Haku VDC of Rasuwa District of Nepal.

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[6] Operating profit before depreciation, interest, tax and amortization expense