

## Mountain Hydro Nepal Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering (IPO) of Mountain Hydro Nepal Limited

Instrument/Facility	Issue Size	Grading Action (January 2018)
IPO (equity) Grading	NPR 250 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 Mountain Hydro Nepal Limited (MHNL). 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. MHNL is proposing to come out with an IPO of 2,500,000 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 1,250,000 shares will be issued to project affected areas in first tranche and the remaining 1,250,000 shares will be later issued to public and staffs of MHNL.

The assigned grading considers the relatively lower return potential of the 21.6 MW Lower Hewa Khola hydro-electric project (HEP) being developed by MHNL. Low contract Plant Load Factor (PLF) of 61% with relatively higher project costs (NPR 179 million per MW) as compared to other projects impacts the return prospects of the company. The grading also remains constrained by the evacuation risk arising out of possible delay in construction of proposed 132 KVA transmission line by NEA (Kabeli Corridor) which can potentially delay the COD of the project despite the completion of project in time. Any delays in COD due to this could result in cost escalations through incremental IDC and hence could further impact project earnings. Grading concerns also emanate from hydrological risks in absence of deemed generation clause in Power Purchase Agreement (PPA) coupled with river being not gauged<sup>1</sup> and also the interest rate volatility in the market that might have bearing over the project return indicators. The project is also exposed to counterparty credit risks arising out of exposure to loss-making Nepal Electricity Authority (NEA) 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 timely payments to Independent Power Producers (IPPs) so far which provides some comfort.

Nonetheless, the grading considers the significant construction progress achieved in the project (~80% complete as of mid-Oct-17) which reduces execution risks to a large extent. The project is being planned to be in operation shortly after the Required Commercial Operation Date (RCOD)<sup>2</sup> which however would remain contingent upon the timely completion of evacuation structure of NEA. With a firm PPA in place with pre-determined tariff rates and positive demand outlook owing to supply-demand gap in the power sector, the tariff and off-take risks are minimal. Going forward, the ability of the company to commission the project at current cost and timeline estimates and the ability to achieve its design operating parameters will be the key driver for the project returns.

The 21.6 MW Lower Hewa Khola HEP is a run of river (RoR) project located in Panchthar district of Eastern Nepal. The project draws its hydrology from two perennial rivers viz. Hewa River and PHEME River with respective catchment areas of ~237 sq. km and ~110 sq. km that is expected to support the design discharge of 14.80 cumecs at 40% exceedance flow with gross head of ~175 metres. As per the terms of the PPA, the base tariff for wet season is NPR 4.8 per kWh and for dry season<sup>3</sup> is NPR 8.4 per kWh with 3% escalation on base tariff for five times. The contract PLF of the project is 61.44% with an annual production capacity of ~116 GWh of energy. The power generated from the project is to be evacuated through a 5 km, 132 kV transmission line to proposed Phidim Substation of Kabeli Corridor. The Kabeli Corridor is facing issues in land acquisition for some of its transmission line towers and hence this could potentially delay the commercial operation of the project. The Power Generation License was obtained from the Ministry of Energy on 25<sup>th</sup> August 2013, valid for 35 years or 30 years from the date of

<sup>1</sup> However, developer has started to gauge river from last ~3 years.

<sup>2</sup> RCOD as per PPA is 22<sup>nd</sup> April 2018.

<sup>3</sup> Mid-December to mid-April are dry season period; rest being wet season.

COD, whichever is earlier. The PPA was signed with NEA on 25<sup>th</sup> July 2014. The project is being developed on Build Own Operate Transfer (BOOT) basis.

Initially budgeted at a cost of NPR 3,668 million (NPR 170 million/MW), the cost escalated by ~5.5% to NPR 3,869 million (NPR 179 million/MW). Increase in project costs results in lower return prospects given the fixed tariff structure. The project is being funded in debt: equity of 70:30 with sanctioned loan of NPR 2,700 million; rest to be financed from equity, including proposed IPO proceeds. Of the NPR 3,144 million cost incurred till mid-Oct 2017, NPR 2,111 million has been funded through external bank borrowings and balance from promoters' equity. The promoters have already infused equity of NPR 1,000 million (representing 80% of post IPO capital) while remaining equity is to be raised through IPO. Management plans to utilise incoming equity towards project completion. The project is entitled for capital subsidy of NPR 5.5 million per MW provided it gets connected to national grid within FY 2017/18 (NPR 5 million per MW if connected thereafter).

As of mid-Oct 2017, ~80% physical progress has been achieved commensurate to similar financial progress. Although management plans to commission the project shortly after RCOD (plans to start operations from mid-May-2018), there could be some delays in project commissioning on account of uncertainties on completion timeline of the Kabeli Corridor transmission line. Additionally, some of components in project could also remain critical considering the short time frame remaining (~3 months as remaining of now based on management's timeline of completion) in the project implementation (mainly, electromechanical installation and penstock alignment).

### **Company Profile**

Mountain Hydro Nepal Limited (MHNL) was incorporated in 12<sup>th</sup> July 2005 as a private limited company and was converted to public limited company in June 2016 to facilitate public participation. The company is promoted by small promoter base of 28 promoters (incl. 2 institutional promoters) with major holding by Chairman Mr. Sitaram Timalsina and family members at ~73% as of now. The company plans to float 20% of total issued capital to public through the proposed IPO and hence the promoter holding is expected to dilute to 80%, assuming full subscription. The shares of the company are proposed to be listed in the stock exchange. MNHL is developing the 21.6 MW Lower Hewa Khola Hydro Power Project (RCOD: 22<sup>nd</sup> April 2018) in Bharapa, Nagin and Phidim VDCs in Panchthar district of Province No. 1, Nepal.

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