

Mountain Hydro Nepal Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed IPO of Mountain Hydro Nepal Limited

Instrument/Facility	Issue Size	Grading Action (February 2019)
IPO (equity) Grading	NPR 181.611 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an **[ICRANP] IPO Grade 4** to the proposed initial public offering (IPO) of Mountain Hydro Nepal Limited (MHNL), indicating below-average fundamentals. 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 1,816,110 equity shares with a face value NPR 100 each, at par.

The grading is constrained by the relatively lower return potential of the 22.1-MW Lower Hewa Khola hydro-electric project (HEP) being developed by MHNL. A low contract plant load factor (PLF) of ~61% and relatively higher project costs (NPR 205 million per MW) impact the company’s return prospects. The project construction was deferred to match completion of NEA’s Kabeli Corridor. Major chunk of project cost overrun (increased by ~24%) can be attributed to timeline delays leading to incremental interest during construction (IDC) and monitoring costs. Grading concerns also emanate from hydrological risks in absence of a deemed generation clause in the power purchase agreement (PPA), coupled with the river not being gauged over the long term. However, gauge measurements made by MHNL for the last few years provide some comfort. The project is also exposed to counterparty credit risks arising out of its exposure to the Nepal Electricity Authority (NEA) which has a weak financial profile. This is partly mitigated by the fact that the NEA is fully-owned by the Government and has been making timely payments to independent power producers (IPPs) so far. Interest rate volatility in the market could also have a bearing over the project return indicators. The grading action is also impacted by the funding gaps witnessed for the current cost estimates, especially, given the target to start project operations shortly. Any further unexpected cost overruns or timeline delays would have a major impact on the interest capitalisation and hence the overall project metrics.

Nonetheless, the grading considers the significant construction progress achieved in the project (more than 95% complete as of mid-January 2019), reducing execution risks to a large extent. Evacuation risks have also lowered significantly as the corridor project is likely to complete parallelly with this project. The project is now expected to commission by mid-March 2019, against the required commercial operation date (RCOD) of October 10, 2018 (for initial 21.6 MW capacity). With a firm PPA in place, pre-determined tariff rates and a positive demand outlook owing to supply-demand gap in the power sector, the tariff and offtake risks for the project are minimal. Going forward, MHNL’s ability to commission the project at the current cost and timeline estimates and also the ability to achieve its design operating parameters will be the key driver for the project returns.

The 22.1-MW Lower Hewa Khola HEP (earlier 21.6 MW) is a run-of-river (RoR) project located in the Panchthar district of Eastern Nepal. The project draws its hydrology from two perennial rivers - Hewa and PHEME. These rivers have respective catchment areas of ~237 sq. km and ~110 sq. km that are expected to support the design discharge of 14.80 cumecs at 40% exceedance flow with a gross head of ~175 metres. The power generated is to be evacuated through a five km, 132-kV transmission line to the proposed Phidim substation of the Kabeli Corridor. In case of delays in corridor completion, power can be evacuated through the existing 33 kVA line during the first few months of operation, coinciding with the dry season, which is characterised by low generation. Completion of the Kabeli Corridor, by the start of the rainy season, would have a bearing on the project’s ability to achieve its design operating parameters. The power generation licence was obtained from the Ministry of Energy on August 25, 2013, valid for 35 years or 30 years from the date of the COD, whichever is earlier. The project is being developed on a build-own-operate-transfer (BOOT) basis.

The PPA was signed with the NEA on July 25, 2014 for an initial 21.6-MW capacity and for an additional 500 kW capacity, addendum to PPA was signed on January 30, 2019. For 21.6 MW, the RCOD has been



revised to October 10, 2018 (earlier April 22, 2018) while for the incremental 500 kW, the agreed RCOD is February 12, 2019. The project would have to pay late COD penalties as per the PPA, given the expected operations by mid-March 2019. As per the terms of the initial PPA, the base tariff for the wet season is NPR 4.8 per kWh and for the dry season, it is NPR 8.4 per kWh with a 3% escalation on the base tariff for five times. For the incremental 500 kW capacity, there are eight escalations of 3% to these base tariffs. The contract PLF of the project is ~61% with an annual production capacity of ~119 GWh of energy.

Initially budgeted at a cost of NPR 3,668 million (NPR 170 million per MW), the cost escalated by ~24% to NPR 4,531 million (NPR 205 million/MW). An increase in the project costs results in lower return prospects, given the fixed tariff structure. The project is being funded through debt financing of ~67% with a sanctioned loan of NPR 3,050 million. MHNL's equity base would only reach NPR 1,250 million after the proposed IPO, which leads to funding gaps of NPR 231 million. This is planned to be financed through short-term promoter loans and to this end NPR 154 million has already been infused. Any further cost overrun will necessitate increased support from the promoters. As MHNL's shareholding is concentrated across a few individual promoters, its ability to continue the funding support, if required, over a longer tenure, remains to be seen.

As of mid-January 2019, more than 95% physical progress has been achieved, commensurate to similar financial progress. Of the NPR 4,313-million costs incurred till mid-January 2019 (including contractor advances of NPR 428 million), NPR 3,124 million has been funded through external bank borrowings (including bridge gap loans of NPR 280 million) and the balance largely from equity. Proceeds from the proposed IPO is to be utilised as a part of the equity for project completion. The project is entitled for a capital subsidy of NPR 5 million per MW, upon connection to the national grid, which could be used to cover any contingencies.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:

[IPO Grading 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. The company is promoted by 28 promoters (including two institutional promoters) with a major holding by Chairman Mr. Sitaram Timalsina and family members at ~68% as of now. MHNL is developing the 22.1-MW Lower Hwa Khola Hydro Power Project in Bharapa, Nagin and Phidim VDCs in the Panchthar district of Province No. 1, Nepal. MHNL plans to float ~14.5% of the total issued capital through the upcoming IPO to the general public (including unsubscribed shares by affected locals at ~4.5% of the ultimate capital).

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