

## Mailung Khola Jal Vidhyut Company Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed IPO of Mailung Khola Jal Vidhyut Company Limited

Instrument/Facility	Issue Size	Grading Action (February 2019)
IPO (equity) Grading	NPR 73.63 million	[ICRANP] IPO Grade 5 (Assigned)

ICRA Nepal has assigned an **[ICRANP] IPO Grade 5** to the proposed initial public offering (IPO) of Mailung Khola Jal Vidhyut Company Limited (MKJVCL), indicating poor 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. MKJVCL is proposing to come out with an IPO of 736,286 equity shares with a face value NPR 100 each, at par to the general public and staff of MKJVCL. ICRA Nepal had earlier assigned an IPO Grade 4 to the issue size of NPR 110.44 million (including current proposed issue) of the company in February 2017.

The downward grading assignment in the current exercise mainly factors in the poor operational performance of the 5-MW Mailung Khola hydro-electric project (HEP) as reflected by a low plant load factor (net PLF of ~42% for 9M FY2018 against contract PLF of ~85%). This has resulted in a weak earnings profile for the company. Despite having diverted another stream (Nyam Nyam river) to increase available water discharge, the PLF has declined significantly over past generation levels (~64% PLF reported for 9M FY2015 prior to the April 2015 earthquake). Low PLF mainly due to insufficient hydrology has resulted in significant loss of revenue, which coupled with fixed low tariff limits the overall return prospects from the project. In addition, generation license for usage of water from Nyam Nyam river has not yet been obtained, which creates further uncertainty regarding future generation. Grading concerns also emanate from the absence of a deemed generation clause in the power purchase agreement (PPA) and interest rate volatility in the market, which could impact the project earnings and returns. The grading is also constrained by the penalty for a significant delayed commercial operation date (COD) charged to the project (~NPR 89 million), which is gradually being deducted from monthly revenues. This has impacted cash flows and hence necessitated promoter loans to facilitate debt/interest servicing.

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 the PPA with Nepal Electricity Authority (NEA) are NPR 3.00 per unit and NPR 4.25 per unit for the wet and dry seasons, respectively. These tariffs are subject to annual escalation of 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. This tariff shall remain effective for up to 7th year after proposed COD<sup>1</sup> with five annual escalations of 3% on base tariff. The electricity sales revenue shall thereafter be based on the rates as per the PPA. Since the COD was delayed by ~17 months compared to PCOD, the promotional rates were not made applicable for first 17 months of the project operation resulting in loss of revenue. Additionally, the project was subject to sizeable late COD penalties of ~NPR 89 million which is gradually being deducted from monthly revenues (~NPR 17 million is yet to be deducted as of mid-January 2019).

The project suffered significant damages from the April 2015 earthquake and its aftershocks. Although, damage to the project infrastructures were partly recovered from insurance proceeds (~NPR 96 million against repair costs of ~NPR 140 million), absence of loss of profit (LOP) coverage back then resulted in revenue loss during closure of plant. After repairs, the project resumed operation from August 2016 until the massive flood of July 2017 damaged intake as well as the access road. During FY2018, the company received insurance proceeds of ~NPR 23 million for physical damages and ~NPR 21 million for LOP claims. Since only a minimal portion of insurance receipts (~NPR 7 million) was used to repair the damages, the possibility of operation stoppages on account of uncorrected weaknesses in structures cannot be ruled out either. The project resumed operations from mid-October 2017.

<sup>1</sup> PCOD of February 7, 2013.

Delayed by ~10 years compared to the required COD of March 31, 2004, the project began commercial operation from July 3, 2014. Despite significant delay, the run of the river project was commissioned at a cost of NPR 904 million, funded in a debt-to-equity mix of ~70:30. The same, however, increased to NPR 963 million as of mid-July 2018 after capitalisation of repair costs to the extent not covered by insurance<sup>2</sup>. The power generated by the project is being evacuated through a ~2.7-km, 66kVA transmission line to the NEA switching station at Grang, which is interconnected with the Chilime-Trishuli transmission line. Against an annual contract PLF of ~89%, the project operated at a PLF (at net generation) of ~64% in 9M FY2015, i.e., prior to the earthquake, reducing to ~56% during 11M FY2017 and 42% for 9M FY2018. Thus, the project supplied only ~66% and ~50% of contract energy in 11M FY2017 and 9M FY2018, respectively, resulting in sizeable revenue loss. Additionally, low energy supply attracted substantial short supply penalty (~NPR 37 million for FY2017). However, the quantum of short supply penalty was lowered for FY2018 (~NPR 6 million) after the relaxation in penalty applicability norms for projects up to 10 MW. Though the generation has improved to an extent in H1 FY2019 (supplied ~70% of contract energy), the license for additional discharge utilised has not been obtained and, hence, this limits the extent of 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. For FY2018, MKJVCL posted gross sales revenue of NPR 84 million (NPR 128million for FY2017) and net loss of NPR 12 million over operating profit of ~NPR 36 million. However, the reported profit was benefitted by booking of surplus insurance receipts against physical damage (~NPR 16 million) as income. For H1 FY2019, the company posted gross sales revenue of NPR 82 million, operating profit of NPR 59 million and net profit of NPR 10 million. The company had NPR 595 million of outstanding term loan payable to the consortium of banks and short-term loans of NPR 52 million as of mid-January 2019, translating into a gearing ratio of 2.79 times. The gearing ratio was also impacted by an eroded net worth of NPR 232 million against share capital of NPR 295 million as on the same date. Going forward, the ability of the project to minimise the gap between actual generation and contractual energy will be the most important driver for the project returns.

**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 2002 as a private limited company, MKJVCL was subsequently converted into a 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 ~88% of its current paid up capital. M/s. Sopan Multiple Company Limited is the major promoter of MKJVCL with ~39% stake as of now; the largest stake held by other promoters is 3.35%. 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 has issued 10% of its post IPO capital to the local inhabitants of project affected areas and the remaining 20% capital will be offered to the general public and staff of MKJVCL. The company is at present operating the 5,000-KW Mailung Khola HEP at Haku VDC in the Rasuwa District of Nepal.

**February 2019**

---

<sup>2</sup> Auditors qualified their opinion over financial statements of FY2017 over this matter in addition to financials not being prepared in accordance with Nepal Financial Reporting Standards (NFRS).



For further details please contact:

**Analyst Contacts:**

**Mr. Kishor Prasad Bimali**, (Tel No. +977-1-4419910/20)

[kishor@icranepal.com](mailto:kishor@icranepal.com)

**Mr. Rajib Maharjan**, (Tel No. +977-1-4419910/20)

[rajib@icranepal.com](mailto:rajib@icranepal.com)

**Relationship Contacts:**

**Ms. Barsha Shrestha**, (Tel. No. +977-1-4419910/20)

[barsha@icranepal.com](mailto:barsha@icranepal.com)

**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 the rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

Our parent company, ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies. The international credit rating agency, Moody's Investors Service, is ICRA's largest shareholder.

For more information, visit [www.icranepal.com](http://www.icranepal.com)

ICRA Nepal Limited,  
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu-33, Nepal.  
Phone: +977 1 4419910/20  
Email: [info@icranepal.com](mailto:info@icranepal.com)  
Web: [www.icranepal.com](http://www.icranepal.com)

All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website ([www.icranepal.com](http://www.icranepal.com)) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents.