

Grading Rationale

United Idi-Mardi and R.B. Hydropower Limited

Grading

Particulars	Amount (Rs. In Million)	Grading	Grading Action
Initial Public Offer	105.00	CARE-NP IPO Grade 4 [IPO Grade Four]	Assigned

The explanatory notes regarding the Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure 1.

CRNL has assigned grading of ‘CARE-NP IPO Grade 4’ to the proposed Initial Public Offer (IPO) of United Idi-Mardi and R.B. Hydropower Limited (UIMHL). ‘CARE-NP IPO Grade 4’ indicates Below Average Fundamentals. CRNL assigns IPO grades on a scale of Grade 1 to Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. CRNL’s IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the ‘fundamentals’ of the issuer. UIMHL proposes to issue 1.05 Mn shares of face value of Rs.100 each at par aggregating Rs.105 Mn.

Detailed Rationale & Key Grading Drivers

The grading assigned to UIMHL is constrained by time and cost overrun leading to increase in cost of project, exposure to volatile interest rates and power evacuation risk associated with the project. The grading also factors in hydrology risk associated with run of the river power generation and geological risk. The grading, however, derives strength from experience of the board members and management team in hydropower sector, power purchase agreement (PPA) with sufficient period coverage, low project implementation risk and financial closure achieved for initial project cost, however, funds yet to be tied for the cost overrun. Further, grading is supported by moderate counter party risk, shortage of power in the country and government support for the power sector.

Detailed Description of the Key Grading Drivers

Key Grading Weaknesses

Time and cost overrun leading to increase in cost of project and exposure to volatile interest rates

Initially, the total estimated cost of the project was Rs. 1,250 Mn which was increased to Rs. 1,375 Mn (i.e. Rs 196 Mn per MW). The project cost was increased mainly due to shifting of penstock alignment due to landslide at the project site and increase in interest during construction (IDC) component due to time overrun and increase in the interest rates. However, the project is expected to commercially operate from Mid-July, 2019, one year before the RCOD of the project i.e. July 15, 2020. If company is not able to commercially operate the project from expected date, then it might lead to IDC overrun which will increase the project cost. Further, due to tight liquidity position in the market, the interest rate has been high and volatile during the last 1-2 years. Therefore, funding from Bank and Financial Institutions is exposed to volatile interest rate.

Power evacuation risk

The power generated from the project is planned to be evacuated through 6.5 km, 33 KV transmission line at Hemja- Banskot substation at Lahachowk and then from substation through New Modi- Lekhanath 132 KV transmission line (yet to be constructed under the scope of the NEA). The substation and transmission line work within the scope of NEA is ongoing and is not expected to be operational before commissioning of the power plant. As an alternative plan, the company will evacuate power via 4.5 km, 33 KV transmission line from the project to Mardikhola switchyard (4.8 MW operational hydro power project, belongs to same promoters).

Hydrology risk associated with run-of-the-river power generation

Run-of-the-river power is considered an unsteady source of power, as a run-of-the-river project has little or no capacity for water storage and therefore is dependent on the flow of river water for power generation. It, thus, generates much more power during summer season when seasonal river flows are high (Mid-April to Mid-December) and less during the winter season (Mid-Dec to Mid-April). UIMHL is proposed to utilize discharge from Mardi Khola having catchment area of 40 sq. kms. Mardi Khola is a perennial river and is one of the tributary of Seti river which is one of the major tributaries of Sapta Gandaki River. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

Geological Risk

The project area is supposed to pose significant geological risks since it is located in rough terrain and is likely to face adverse climatic condition during operational period like landslides, flash floods and earthquake which can adversely impact project cash flows. The access road is prone to landslides and maintenance is required after each monsoon every year.

Key Grading Strengths***Board members and management team having prior experience in hydropower sector***

UIMHL has total 7 board members. Mr. Surya Bahadur K.C, executive chairperson, along with other directors of the company is involved in other operational and under- construction hydropower companies as chairperson and director. Mr. Roshan K.C, managing director of the company, is also involved as director in other operational and under- construction hydropower companies and is a Director in 'A' class commercial bank. They are also supported by experienced management team.

Power purchase agreement with sufficient period coverage

UIMHL had signed PPA with Nepal Electricity Authority (NEA) on June 7, 2016 for sale of power generated from the project. PPA has been entered for the period of 30 years from the COD or till validity of generation license (obtained on January 14, 2016 for 35 years) whichever is earlier. PPA period may be extended with mutual consensus during the last six month of validity. The tariff rate for wet season (Mid-April to Mid-December) is Rs 4.80 per kWh and for dry season (Mid-December to Mid-April) is Rs 8.40 per kWh with 3% escalation on base tariff for 5 years. The contracted energy is 35.88 Million Units (MU) annually. The Plant

Load Factor (PLF) of the project is 58.50%. Required commercial operation date (RCOD) of the project is July 15, 2020.

Low project implementation risk

The company has achieved financial progress of ~93% i.e. 1,281 Mn till mid-April, 2019. Till end- March 2019, ~95% of access road construction; ~95% of civil work at headwork's, ~90% of civil work at penstock alignment has been completed. Also, ~90% of progress achieved on hydro mechanical works, both turbines have been installed and ~85% of transmission line work is finished. The project implementation risk is reduced to large extent as a result of completion of major part of work. However, the project is still exposed to the residual risks associated with project implementation and satisfactory operations thereafter given the uncertain geology and adverse climatic conditions of the project area.

Financial closure achieved for initial project cost, however, funds yet to be tied for the cost overrun.

Initially, total estimated cost of the project was Rs. 1,250 Mn which was proposed to be financed by debt equity ratio of 74.8:25.2. Financial closure for Rs 930 Mn debt was achieved on July 11, 2016. However, the total project cost was increased to Rs. 1,375 Mn which is to be financed in debt equity ratio of 75:25 (i.e. Rs. 1031 Mn debt and Rs. 344 Mn equity). Financial closure for remaining debt amounting to Rs. 101 Mn debt is in process. Promoters have injected equity of Rs. 315 Mn in the project as on April 13, 2019.

Moderate counter party risk

UIMHL is exposed to counter party payment risk pertaining to NEA, which has been making consecutive losses in past till FY16 and carry huge accumulated loss in its book. However, as per the annual report published by NEA, during FY18 (provisional), NEA earned profit of Rs 1,010.21 Mn (Rs 1,502.28 Mn during FY17). The counter party payment risk is moderated by the fact that, NEA is fully owned by government of Nepal, net loss is declining over the period and NEA is generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producer (IPPs) in past.

Shortage of power in the country

As per the statistics presented in report published by Ministry of Energy, Nepal on May 2018, the current peak electricity demand is about 1300 MW. The total domestic installed capacity stands 1073 MW which includes 562 MW generated by NEA and 511 MW generated and supplied by private sector IPPs. To meet the current demand, NEA is importing up to 450 MW power from India beside domestic generation.

Government support for the power sector

Government of Nepal (GoN) considers hydropower generation as priority sectors and tries to involve private sector participation in generation of hydroelectricity by offering different incentives. GoN has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years to those who generate electricity within Mid-April 2024. Normal tax rate for entity in Nepal is 25%, however only 20% tax rate is applicable for hydro

power project. Furthermore, GoN has declared to provide grant of amount equivalent to Rs. 5 Mn per MW installed capacity after receiving evidence of formal COD of complete power plant.

About the Company

UIMHL was initially incorporated as a private limited company on March 1, 2010 as United Idi-Mardi and R.B Hydropower Pvt. Ltd. Later on, it converted to a public limited company on April 17, 2018. It is promoted mainly by individual promoters from different background along with two institutional promoters for setting up of a 7MW run-of-river, Upper Mardi Khola Hydropower Project in Kaski district of Nepal. This project is constructed under BOOT (Build, own, Operate and Transfer) mechanism. Currently, the share capital of the company is held by 25 promoter shareholders, with Mr. Surya Bahadur K.C (23%), Mrs. Prem Kumari K.C (21.68%), Mr. Anuj Kayal (9.44%), Mr. Roshan K.C (8.78%) and Mr. Sunil Narayan Shrestha (8%) major promoter shareholders of the company. After issue of proposed IPO of Rs 105 Mn, the promoters and public holding ratio is expected to be in the ratio of 75:25.

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ANNEXURE I

CARE Ratings Nepal – IPO Grading Scale

CARE IPO grade	Definition
CARE-NP IPO Grade 1	Strong fundamentals
CARE-NP IPO Grade 2	Above average fundamentals
CARE-NP IPO Grade 3	Average fundamentals
CARE-NP IPO Grade 4	Below average fundamentals
CARE-NP IPO Grade 5	Poor fundamentals

Note:

Modifiers {"+" (plus)} can be used with the grading symbols 2, 3 and 4. The modifiers reflect the comparative standing within the category.