

**Grading Rationale**  
**Mountain Energy Nepal Limited**

**Grading**

<b>Particulars</b>	<b>Amount (Rs. In Million)</b>	<b>Grading</b>	<b>Grading Action</b>
Initial Public Offering (IPO)	393.6054	CARE-NP IPO Grade 4+ [IPO Grade Four Plus]	Assigned

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

CRNL has assigned ‘CARE-NP IPO Grade 4+ [IPO Grade Four Plus]’ grading to the proposed Initial Public Offering (IPO) of Mountain Energy Nepal Limited (MENL). ‘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 use modifier {"+" (plus)} with the grading symbols 2, 3 and 4 and the same reflect comparative standing within the category. The grading of 2+, 3+ and 4+ is better than 2, 3, and 4, respectively. 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. MENL is proposed to come out with IPO of 3.936054 Million equity shares having face value of Rs.100 each at par aggregating Rs.393.6054 Million.

**Detailed Rationale & Key Grading Drivers**

The grading assigned to MENL is constrained by project implementation and stabilization risk associated with 42MW Mistri Khola Hydroelectric Project (MKHEP), operational project operated at low plant load factor (PLF), exposure to volatile interest rates and hydrology risk associated with run of the river power generation. The grading, however, derives strength from experience promoter and management team, track record of operating hydropower project, power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The grading also factors in achievement of financial closure for under construction project with relatively low cost per megawatt (MW), shortage of power at present coupled with increasing demand of power in the country, government support for the power sector and major developments towards power evacuation.

## **Detailed Description of the Key Grading Drivers**

### **Key Grading Weaknesses**

#### ***Project implementation and stabilisation risk***

On the basis of cost incurred till October 17, 2019, the company has achieved financial progress of ~73% of the total project cost. The project is under construction with expected COD in May 31, 2020 which is revised from initial RCOD of May 16, 2016 due to delay in construction of Kali Gandaki Transmission Corridor part (Dana-Kushma transmission line & substations). As per the financial progress, company has made a significant progress in Civil works, Hydromechanical works and Electromechanical works with ~89% progress. Though, there is major progress, the project still continues to remain exposed to the residual risks associated with project implementation and satisfactory operations thereafter.

#### ***Current project operated at low PLF***

The annual contracted PLF of the Tadi Khola Hydroelectric Project (TKHEP) is 74.52% of the installed plant capacity. The project has been operating at low PLF over the period. During FY18, the PLF from the project was low at 57.36% (over installed capacity), which further decreased to 54.77% during FY19. The power generation from the project as a percentage of the contracted power as per the PPA, was 77.18% in FY18 and the same has reduced to 73.50% in FY19. As a result, there was short supply penalty of Rs.7.21 Mn during FY19 as well as revenue losses. MENL reported revenue of Rs. 117 Mn revenue in FY19 with Rs. 60 Mn PAT and Rs. 86 Mn Gross Cash Accruals.

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

Run-of-the-river (ROR) power is considered an uneven 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. ROR, therefore, generates much more power during times when seasonal river flows are high (Mid-April to Mid-December) and much less during the drier months (Mid-Dec to Mid-April). MENL is generating electricity from discharge of Tadi River at TKHEP and proposed to utilize discharge from Mistri River at MKHEP, which are snow fed streams, comprising of mountainous terrain. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid rivers.

#### ***Exposure to volatile interest rate***

Nepalese banking sector fix interest rates on lending, based on quarterly published base rate by the banks. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, funding from Banks and Financial Institutions are exposed to volatile interest rate.

**Key Grading Strengths*****Experienced promoter and management team***

MENL has 5 Board of Directors, chaired by Mr. Suhrid Raj Ghimire, who is a leading Nepali businessman heading Continental Group with business interest in automobile trading, capital goods, energy and construction, with over 30 years of experience in running businesses. Mr. Shyam Sundar Khetan is the managing director of the company, is engaged in business of real estate development. Mr. Min Bahadur Gurung, top shareholder of MENL, is the Chairman/ Managing Director of Bhat-Bhateni Group, the largest retail chain of supermarkets in Nepal. The other Directors of the company are Mr. Chandra Prasad Dhakal (Chairman of Global IME Bank Ltd), Mr. Dol Raj Sharma and Mr. Maohar Das Mool. Mr. Bijendra Lal Rajbhandary is the project control and contracts manager of the company who has more than 2 decades of experience in Nepal Electricity Authority at different functions.

***Track record in operating hydro power project***

MENL is already operating 5 MW Tadi Khola Hydro Electric Project (TKHEP) located at Nuwakot district of Nepal. The project is in operation since March 2013. The plant generated Rs.144 Mn revenues through sales of energy.

***Power purchase agreement with sufficient period coverage***

MENL (through former ASBL and REL) had entered into PPA with Nepal Electricity Authority (NEA) as on March 28, 2005 and February 3, 2011 for sale of entire power generated by the power plants of TKHEP and MKHEP respectively. The PPA is signed for a period of 30 years from the date of COD or till validity of Generation License (which are obtained on November 22, 2011 for TKHEP and November 6, 2011 for MKHEP for 35 years), whichever is earlier.

Required Commercial Operation Date (RCOD) for MKHEP was May 16, 2016 as per initial PPA which was revised to December 31, 2019 as per revised PPA, however the same is expected to be extended till May 31, 2020. TKHEP has two set of tariff rate. Tariff rate for initial contracted energy (i.e. 7.86 GWh) is Rs. 3.90 per kWh and Rs. 5.52 per kWh for wet and dry seasons respectively with no escalation. Similarly, tariff rate for additional annual contract energy (i.e. 24.78 GWh) is Rs. 4.80 per kWh and Rs. 8.40 per kWh for wet and dry season respectively with 3% annual escalation on base tariff rate for 5 times. As per government's initiative of promoting private sector hydropower developers, TKHEP has been availing promotional tariff rates of Rs. 4.80 per kWh and Rs. 8.40 per kWh in wet and dry seasons respectively for initial contracted energy for upto 7 years from Commercial operation date (COD) which is till mid April 2020, with 3% annual escalation on base tariff for 5 years. Tariff for MKHEP is Rs. 5.40 per kWh with 3% escalation on base tariff for next 10 years.

***Moderate counter party risk***

MENL is exposed to counter party payment risk pertaining to Nepal Electricity Authority (NEA), which has been making consecutive losses in past till FY 2016 and carry huge accumulated loss in its book. However, as per the annual report published by NEA, during FY19 (provisional), NEA earned profit of Rs 7,205 Mn (Rs 2,897 Mn during FY18). Further, during FY19, NEA achieved gross cash accrual of Rs 11,915 Mn (Rs 7,107 Mn in FY18). 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 producers (IPPs) in past.

***Financial closure achieved for the project cost, relatively low cost per MW***

MKHEP has achieved the financial closure for the project on May 19, 2013. The estimated project cost of Rs.5.64 Bn which is proposed to be financed in a debt-equity mix of 75:25. Bank sanctioned Rs.4.24 Bn term loan for the project and the company has already withdrawn Rs.2.90 Bn term loan October 17, 2019 towards the project execution. MKHEP is projected to be completed at the cost of Rs.134 Mn per MW, which is relatively low cost as compared to other operational and under-construction HEP.

***Shortage of power at present coupled with increasing demand of power in the country***

As per the NEA's Annual Report for FY19, the current peak electricity demand is 1,320 MW. The total domestic installed capacity stands at 1,178 MW which includes 617 MW owned by NEA and 561 MW by private sector IPPs. Overall, during FY19, total energy demand was 7,584 GWh which was met by import of 2,813 GWh from India whereas balance was met by domestic generation. As per NEA, electricity demand is in increasing trend and is expected to increase in future with increase in electricity consumption through the promotion of electric vehicles by building charging station and replacing cooking gas with electricity, increase in access of population using electricity

***Government support for the power sector***

GoN considers hydropower generation as priority sector and intends to maximize private sector participation in generation of hydroelectricity by offering different exemptions and facilities. GoN has 5 December 2019 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. Income tax will be levied only 20% despite the normal tax rate for entity in Nepal is 25%. Also, GoN has declared to provide grant of amount equivalent to Rs. 5 Mn per MW installed capacity after receiving evidence of formal COD of power plant.

***Major developments towards Power Evacuation***

Power evacuation will be through 4 Kms long 132 kV transmission line to NEA's under construction 220kV Dana substation. The power will be further evacuated through NEA's under construction Dana-

Kushma-New Butwal (DKB) transmission line. As per NEA’s Annual report for FY19, Dana - Kushma transmission line and Dana and Kushma substation is under construction. For Kushma-New Butwal transmission line, contracts had been awarded by NEA with the construction completion deadline of December 2020. NEA and the company has entered into an agreement stating until the completion of DKB transmission line, the power generated by MKHEP will be evacuated through Dana-Kushma-Pokhara transmission line, with minimum agreed energy of around ~68% from Mid April to Mid October and 100% for remaining months of the contracted energy. All the works related with arrangements for power evacuation at the company’s end has been completed.

**About the Company**

Mountain Energy Nepal Limited (MENL) is a public limited company promoted by business persons having experience in the hydropower sector. MENL earlier had two subsidiaries companies namely Aadhi Shakti Bidhyut Bikash Company Limited (ASBL) and Robust Energy Limited (REL) which were acquired by MENL during FY19. ASBL was involved in the operation of 5MW run-of-the-river Tadi Khola Hydroelectric Project (TKHEP) at Tadi Rural Municipality, Nuwakot District which has been in commercial operation since April 2013. REL was involved in the construction of 42MW MKHEP, Required Commercial Operation Date (RCOD) of which was December 31, 2019 and is expected to be revised till May 2020. The projects are under BOOT (Build, own, Operate and Transfer) mechanism. As per the Generation License, from Government of Nepal – Ministry of Energy, the projects shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 35 years.

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**DISCLAIMER**

CRNL’s IPO grading is a onetime assessment and the analysis draws heavily from the information provided by the issuer as well as information obtained from sources believed by CRNL to be accurate and reliable. However, CRNL does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. CRNL’s IPO grading does not take cognizance of the price of the security and it is not a recommendation to buy, sell or hold shares/securities. It is also not a comment on the offer price or the listed price of the scrip. It does not imply that CRNL performs an audit function or forensic exercise to detect fraud. It is also not a forecast of the future market performance and the earnings prospects of the issuer; also it does not indicate compliance/violation of various statutory requirements. CRNL shall not be liable for any losses incurred by users from any use of the IPO grading.

**ANNEXURE 1****CARE Ratings Nepal – IPO Grading Scale**

<b>CARE IPO grade</b>	<b>Definition</b>
<b>CARE-NP IPO Grade 1</b>	Strong fundamentals
<b>CARE-NP IPO Grade 2</b>	Above average fundamentals
<b>CARE-NP IPO Grade 3</b>	Average fundamentals
<b>CARE-NP IPO Grade 4</b>	Below average fundamentals
<b>CARE-NP IPO Grade 5</b>	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.