

Grading Rationale

Madhya Bhotekoshi Jalavidyut Company Limited

Grading

Facility/ Instrument	Amount (Rs. In Million)	Grading	Grading Action
Initial Public Offer (IPO)	1440	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]’ to the proposed Initial Public Offer (IPO) of Madhya Bhotekoshi Jalavidyut Company Limited (MBJCL). ‘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. 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. MBJCL is proposed to come out with an IPO of 14.40 Million equity shares having face value of Rs.100 each at par aggregating Rs.1440 Million representing 24% of total capital reserved for employees of Promoter entities & Employees Provident Fund (EPF) and contributories of EPF. The company will later offer shares to project affected locals (10%) and General public (15%).

Detailed Rationale & Key Grading Drivers

The grading assigned to MBJCL is constrained by project implementation risk - delay in execution of project & cost overruns, exposure to fluctuation in the foreign currency exchange rates for the unhedged contractual liabilities, hydrology risk associated with run-of-the-river power generation, financial closure not achieved for revised project cost, exposure to volatile interest rates and no major developments towards power evacuation. The grading, however, derives strength from strong promoter group and management expertise in operating hydro power projects, power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk, fixed priced Civil & Hydromechanical and Electromechanical contracts, shortage of power in the country ensuring offtake and government support for the power sector.

Timely completion of the project within the revised cost estimates, transmission of the power through appropriate infrastructure, sufficient hydrology and timely receipt of the payments from Nepal Electricity Authority (NEA) are the key grading sensitivities.

Detailed Description of the Key Grading Drivers

Key Grading Weaknesses

Project implementation risk - delay in execution of project and cost overruns

The project is still under construction with revised Required Commercial Operation Date (RCOD) in April 2020 which is revised from initial RCOD of June 15, 2017. This exposes MBJCL to project implementation risk. The project execution was delayed due to delayed land acquisition for the project and occurrence of natural calamities like Jure landslide of 2014, Earthquake of 2015 and Bhotekoshi flood of 2016 and also due to border blockade during September 2015. Delay in the project execution coupled with continuous devaluation of Nepalese Currency vis-a-vis USD and inflation lead to cost overrun of the project. The project is still in the implementation stage and continues to remain exposed to the residual risks associated with project implementation and satisfactory operations thereafter. However, further delays in execution cannot be ruled out, given that the plant is being executed in the mountainous region where the uncertain geology and adverse climatic conditions of the area leads to high project implementation risks and plays a major part in the timely completion of the planned activities. The company expects to achieve Commercial Operation Date (COD) during June 2019.

Exposure to fluctuation in the foreign currency exchange rates for the unhedged contractual liabilities

Significant amount involved on the contracts (Civil & Hydro-mechanical, Electro-mechanical and Consulting Services for Construction Supervision) is denominated in USD; USD 90.52 Million for three contracts awarded. Out of the total foreign exchange exposure, MBJCL has already paid USD 31.64 Million till mid-May 2018 while significant amount has yet to be paid. However, MBJCL has not taken any hedging measures. The project is exposed to risk associated with fluctuation in foreign currency exchange rates.

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

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 times when seasonal river flows are high and much less during the drier months. MBJCL is proposed

to utilize discharge from Bhotekoshi river (main river in the Sapta Koshi basin of Nepal), which are snow fed streams, having catchment area of 2388 sq kms, comprising of mountainous terrain. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river. Further, MBJCL's operations are restricted to single plant which exposes it to risks arising out of single site nature of operations.

Financial closure achieved for the initial project cost, however, debt is not tied-up for the revised project cost

The project was appraised by Employees Provident Fund (EPF) and the financial closure for the initial project cost was done as on December 8, 2011. The initial project cost estimates of Rs.12.28 Bn (excluding IDC) was proposed to be financed in a debt-equity mix of 1:1. The equity portion of the project is Rs.6 Billion as per the loan agreement, the additional amount required in excess of tied up cost, if any, shall be arranged by the MBJCL and Chilime Hydropower Company Limited (CHCL) and IDC to be capitalized separately. Due to delay in the project execution as mentioned above, the project cost increased to Rs. 14.84 Bn excluding IDC (Rs. 16.40 Bn including IDC). The remaining amount of project cost is proposed to be financed through Bridge Gap Loan which is currently not tied up. The proposed debt-equity mix of total revised cost is expected to be in the ratio of 59:41 including IDC. The funding of the project is exposed to volatile interest rate, as the interest rate on loan will be reviewed annually based on prevailing market interest rates.

No major developments towards Power Evacuation

Power evacuation will be through 4 kms of transmission line of 220 kV, to be built by MBJCL at their own cost (included in the project cost); MBJCL is in the process of awarding contract for the construction of transmission lines; to the delivery point at Barhabise transmission hub. Barhabise transmission hub is expected to be completed by November end, 2019.

Key Grading Strengths

Strong Promoter Group and management expertise in operating hydro power projects

NEA and CHCL are major promoters of MBJCL. NEA is a Government of Nepal corporation established to generate, transmit and distribute power by planning, constructing, operating and maintaining all generation, transmission and distribution facilities in Nepal's power system. CHCL was incorporated in 1995 by NEA with an objective of hydroelectricity generation. NEA holds majority ownership in CHCL (51% shareholding) and remaining 49% shares is held by

general public. CHCL owns and operates 22.1 MW power plant. CHCL has established three subsidiaries MBJCL, Rasuwagadhi Hydropower Company Limited and Sanjen Jalavidhyut Company Limited. CHCL, through its three subsidiaries, is developing four hydropower projects with aggregate capacity of 270.3 MW.

MBJCL is managed under the overall guidance of the company's Board of Directors (BoD), mostly from NEA, who possesses wide experience in the Power sector. Mr. Hara Raj Neupane is the Chairman of the Company. Mr. Neupane is an employee of NEA from last 29 years and currently serving as Deputy Managing Director at NEA and Director in CHCL. The company is led by CEO Mr. Mani Kumar Kafle; who has more than 28 years of experience in NEA and assisted by senior management team members with wide experience in their respective fields.

Power purchase agreement with sufficient period coverage and moderate counter party risk

MBJCL had signed a long term power purchase agreement (PPA) with NEA as on November 14, 2011 for a period of 30 years from the date of COD or till validity of Generation License (which was obtained on 3rd December 2013 for 35 years), whichever is earlier. RCOD was June 15, 2017 as per initial PPA, which has amended to April 10, 2020 as per revised PPA. The tariff 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 8 years. The contracted Plant Load Factor (PLF) of 102 MW is 60.69%. NEA has been making losses in the past which may lead to the counter party risk. Counter party risk is mitigated to moderate level as NEA is a Government of Nepal's owned organization and over the period the net losses are decreasing and NEA is able to generate positive gross cash accrual in FY17.

Fixed priced Civil & Hydromechanical and Electromechanical contract

MBJCL has appointed Guangxi Hydroelectric Construction Bureau, China for Civil & Hydro-mechanical Works as on January 1, 2014 with contracted amount of USD 62.09 Mn plus Rs. 2.58 Bn. The works as per contract shall be completed within June 30, 2019 (revised completion date). Andritz Hydro Pvt. Ltd, India has been appointed for Electro-mechanical Works as on July 10, 2014 with contracted amount of USD 20.46 Mn plus Rs. 407 Mn. The works as per contract shall be completed within December 27, 2018 (revised completion date). The contracts for Civil & Hydro-mechanical and Electro-mechanical works are fixed priced contracts, therefore, mitigating the risk of any cost over runs in these contracts.

Shortage of power in the country ensuring offtake

As per 'White paper on current Situation of Energy sector and immediate Action Plan' published by Ministry of Energy Nepal on July 2017, the current peak electricity demand is 1,306 MW which will reach to 1,742 MW in the dry season. The electricity generation in the country at present is not adequate to meet the current demand of the country. To meet the current demand, NEA is able to provide only 976 MW electricity (including 300MW imported from India as on Mid July 2017) through National Grid. At present Nepal faces 330MW electricity shortage. The gap of demand and supply is expected to be increased substantially in coming days.

Government support for the power sector

Considering the immense gap on demand and supply of electricity, Government of Nepal (GoN) is emphasizing on development of hydropower generation and has estimated the hydropower potential in the country to be 83,290MW theoretically (of which technical potential of 45,610MW and economical potential of 42,133MW) out of which hardly 920MW (installed capacity) has been harnessed. GoN considers hydropower generation as priority sectors and tries to involve private sector participation in generation of hydroelectricity by offering different incentives. Through budget speech of FY 2017/ 18 GoN provided income tax exemption for first 10 years and 50 percent tax exemption for additional 5 years to those producers who generate electricity within Mid-April 2024; further lump sum capital subsidy Rs. 5 Mn per MW will be granted to those producers who generate and connect the generated electricity to national grid. Income tax will be levied only 20% despite that normal tax rate for entity in Nepal is 25%.

About the Company

Madhya Bhotekoshi Jalavidyut Company Ltd. (MBJCL) is a public limited company promoted by NEA (a Government of Nepal Corporation) and Chilime Hydropower Company Limited (CHCL, 51% subsidiary of NEA) for setting up 102 MW run-of-river, Middle Bhotekoshi Hydroelectric Project in Sindhupalchowk district of Nepal. After the proposed IPO, the major promoter shareholders of the company would be CHCL (37% shareholding) and NEA (10% shareholding). The project is located at downstream from the confluence of Chaku Khola and Bhotekoshi River. RCOD was June 15, 2017 as per initial PPA; which has amended to April 10, 2020 as per revised PPA. The paid up capital of the company will be Rs. 6 Bn.

The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism. As per the Generation License, from Government of Nepal – Ministry of Energy, dated December 3, 2013, the project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 35 years.

MBJCL has incurred Rs. 5.09 Bn excluding IDC (Rs. 467 million interest is capitalized) over the project till February 12, 2018 which shows the financial progress of ~34% of total project cost. Same is funded through debt of Rs. 2.23 Bn and balance from promoter's equity.

Analyst Contact

Mr. Giri Raj Kandel

giriraj.kandel@careratingsnepal.com

Tel No.: Tel No.: +977-01-4232610

Relationship Contact

Mr. Sajan Goyal

sajan.goyal@careratingsnepal.com

Tel No.: 9818832909/+977-01-4233436

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**

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.