CARE Ratings NEPAL

July 2018

Grading Rationale

Panchthar Power Company Limited

Grading

Facility	Amount (Rs. In Million)	Grading	Grading Action
Initial Public Offer (IPO)	192.50	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 I

CRNL has assigned grading of 'CARE-NP IPO Grade 4' to the proposed Initial Public Offer (IPO) of Panchthar Power Company Limited (PPC). '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. PPC proposes to issue 1.925 Million shares of face value of Rs.100 each at par aggregating Rs. 192.5 million.

Detailed Rationale & Key Grading Drivers

The grading assigned to Panchthar Power Company Limited (PPC) is constrained by short track record of operations and lower PLF, however improving over the period; leveraged capital structure and weak debt coverage indicators; hydrology risk associated with run of the river power projects and power evacuation risk. The grading, however, derives strength from promoter support to the project in form of equity infusion during FY17 and 9MFY18 and experience of management; operational project achieved COD in February 2017 and cash profit during 9MFY18, although cash losses during FY17; Power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk and prompt bills realisation from NEA; shortage of power in the country and government support for the power sector.

Sufficient hydrology, timely receipt of the payment from NEA and timely completion of Kabeli Corridor transmission line to evacuate full power generated from the project are the key grading sensitivities.

Detailed Description of the Key Grading Drivers

Key Grading Weaknesses

Short track record of Operations and lower PLF, however improving over the period

The commercial operation of the project was started from February 2017. During FY17 (mid-July 2016 to mid-July 2017), the project has operated at PLF of 25.99% for 5 months which is much lower than contracted energy PLF 48.89% for the 5 months, due to delay in construction of Godak-Phidim section of 132kV kabeli Corridor transmission line. During 9MFY18 (mid-July 2017 to mid-April 2018), the PLF was low at 34.67% against projected PLF of 61.30% due to limitation of power evacuation. Timely completion of 132kV transmission line and adequate power generation and evacuation are the key grading sensitivities.

Leverage capital structure and weak debt coverage indicators

Debt equity and overall gearing ratios was high at 2.63x and 2.78x as on July 15, 2017, which is expected to be further deteriorate on back of decline in net worth due to projected losses during FY18. The debt protection metrics of the company was also weak as on July 15, 2017 marked by negative total debt/GCA and low interest coverage ratio of 0.91x during FY17. However, the interest coverage ratio improved to 1.21x during 9MFY18 (UA).

Power evacuation risk

The Power generated from the project was planned to be evacuated by 132kV kabeli Corridor transmission line but due to delay in construction of Godak-Phidim section, the power has not been transmitted to its full capacity. At present power is being transmitted alternatively through Phidim-Tilkini 33kV line. Timely competition of transmission lines is critical for future cash flows of the company and is the key grading sensitivity.

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

Run-of-the-river 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. It thus, generates much more power during times when seasonal river flows are high and much less during the drier months (Mid-Dec to Mid-April). PPC is proposed to utilize discharge from Hewa Khola (main tributaries of Tamor river of Nepal and joins Tamor river at Majhi Gaun), which are perennial stream (perennial river), having catchment area of 208 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, PPC's operations are restricted to single plant which exposes it to risks arising out of single site nature of operations.

Key Grading Strengths

Experienced management and promoters support to the project in the form of equity infusion during FY17 and 9MFY18(UA);

PPC is professionally managed company consists of 6 Board of Directors; Mr. Umesh Shrestha is the chairman of PPC who have 10 years of experience in hydropower sector and 20 years in others businesses including Agro based industries and education sector of Nepal. He is also Chairman of Sanigad Hydro P. Ltd. (38.5 MW) & Kalanga Hydro P. Ltd. (15.3MW) and Director at Bungal Hydro P. Ltd.(10.7 MW). The Management team is led by Mr. Pushpa Jyoti Dhungana who is the Managing Director of the company and have 15 years of experience in hydro power sector as former MD at Pati Khola Hydropower P Ltd. (1 MW).

The promoters of the company has continuously supporting the project by infusing equity towards the project. They have infused Rs. 87.64 Million equity during FY17 and Rs. 71.84 Million equity during 9MFY18 (UA) ended on Mid-April 2018.

Operational project and Cash profit during 9MFY18 (UA), although cash losses during FY17

PPC has started commercial operation from Feb 2017 and was in operation for 5 months in FY17 where it has earned revenue from sale of electricity of Rs. 89 Million. PPC incurred net loss of Rs. 45 Million and cash loss of Rs. 8 Million during FY17. However, PPC was able to earn cash profit of Rs. 30 Million over total revenue of Rs.196 million during 9MFY18 (UA).

Power purchase agreement with sufficient period coverage

PPC had signed a long term power purchase agreement (PPA) with NEA as on September 16, 2011 for sale of 12MW power which was upgraded to 14.9MW consequently on July 11, 2012, for a period of 30 years from the date of COD or till validity of Generation License (received on December 6, 2012 for 35 years), whichever is earlier. The tariff for wet season (Mid-April to Mid-December) is Rs 4.8 per kWh and for dry season (Mid-December to Mid-April) is Rs 8.4 per kWh with 3% escalation on base tariff for 5 years. The estimated annual PLF of the project at the contracted energy is 62.90%.

Moderate counter party payment risk

PPC is exposed to counter party payment risk pertaining to NEA, which has been making losses over the period. 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 earned cash profits during FY17 and further, NEA has been making timely payment to independent power producer (IPPs) in past. As per PPA, NEA has to make payment within 45 days from day of receipt of invoice. As per the details for sale of energy from COD to 9MFY18, NEA has made the payment within 45 days from the date of issuance of invoice. Continued realizations of invoices in a timely manner would be important going forward.

Government support for the power sector

GoN considers hydropower generation as priority sectors and tries to involve private sector participation in generation of hydroelectricity by offering different facilities such as a person and entity who get permission for commercial operation, transmission and distribution of electricity up to mid-April 2024 will get full tax exemption for first 10 years and 50% tax exemption for next 5 years, no income source will be asked for investment made within mid-April 2019 in hydro-electricity project. Further, normal tax rate for entity in Nepal is 25% however only 20% tax rate is applicable for hydro power project. Only one percent of customs duties is levied to the import of hydroelectric machinery, equipment, and tools required for production, transmission and distribution of hydroelectricity. PPC is getting all above benefits.

About the Company

PPC is Public Company, incorporated on November 3, 2008 as Panchthar Power Company Private Limited, later name was changed on August 9, 2016. PPC is currently running 14.9 MW Hewa Khola 'A' hydro power project in run –of –river scheme located at Panchthar district. The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism. The project started its commercial production and sale of power from February 4, 2017 whereas amended RCOD date was January 20, 2017. The total cost of the project as per the Bank's loan agreement was estimated at Rs. 2398 million which was funded through Debt: Equity of 3:1. Further, the total cost of the completed project was Rs. 2,615 million (cost per Mw Rs. 175.50 Mn) due to cost overrun on back of increase in exchange rates and raw material prices and was funded through debt of Rs. 1798 million and rest by equity and internal accruals.

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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.