

Grading Rationale
Bindhyabasini Hydropower Development Company Limited

Grading

Facility	Amount (Rs. In Million)	Grading	Grading Action
Initial Public Offer	250	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

CARE Ratings Nepal Ltd. (CRNL) has assigned grading of ‘CARE-NP IPO Grade 4+’ to the proposed Initial Public Offer of Bindhyabasini Hydropower Development Company Ltd. (BHDCL). ‘CARE-NP IPO Grade 4+’ indicates Below Average Fundamentals. CRNL assigns IPO grade on 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. BHDCL proposes to issue 2.5 Million shares of face value of Rs.100 each at par aggregating Rs. 250 Million.

Detailed Rationale & Key Grading Drivers

The grading assigned to BHDCL is constrained by short period of operation coupled with weak financial performance during FY19, moderate debt service coverage indicators, and execution risk of under construction project in which BHDCL has invested and plans to invest. The grading is also constrained by exposure to volatile interest rates, and hydrology risk associated with run of the river power generation. The grading, however, derives strength from experienced board members and management team including financial support from directors, power purchase agreement (PPA) with sufficient period coverage, and financial closure achieved for total estimated debt and injection of promoter share capital in full. The grading also derives strength from moderate project cost even after cost and time overrun, comfortable level of operational plant load factor (PLF), moderate counter party risk, and low project implementation risk however, exposed to project stabilization risk. Further, the grading is also supported by shortage of power at present coupled with increasing demand of power in the country, government support for the power sector, and low power evacuation risk.

Detailed Description of the Key Grading Drivers

Key Grading Weaknesses

Short period of operation coupled with weak financial performance during FY19

BHDCL’s Rudi-A project is operating since May 19, 2019 (~9 months). During FY19, it has earned Rs 47 Mn revenue from power sale and incurred net loss of Rs 22 Mn and cash loss of Rs 10 Mn because of low level of operational PLF being in initial year of operation. It has negative reserve and surplus of Rs 22 Mn at the end of

FY19. However, during Q1FY20 (Unaudited, UA), BHDCL has earned net profit of Rs 23 Mn and cash profit of Rs 36 Mn on back of increase in revenue from power sales to Rs 82 Mn by increase in operational PLF.

Moderate debt service coverage indicators

Company's overall gearing ratio and interest coverage ratio was moderate at 2.68x and 1.96x respectively in FY19. Similarly, the total debt to gross cash accruals (GCA) was negative in FY19. However, the company has been timely making payment for its debt obligation till date.

Execution risk of under construction project, in which BHDCL has invested and plans to invest

BHDCL has made investment of Rs 31 Mn into Peoples Energy Ltd. (PEL, 48.8 MW under-construction project), Rs 22 Mn into United Modi Hydropower Ltd. (9.9 MW operational project), and Rs 1 Mn into Hydro Electricity and Development Company Ltd. Further, out of Rs 250 Mn proposed initial public offer (IPO), BHDCL is planning to make additional invest of Rs 200 Mn into PEL. PEL is developing 48.8MW Khimti 2 Hydropower Project in Dolakha/ Ramechape district which is in initial stage of construction as a result it has high project execution and stabilization risk. Further, BHDCL will not receive any income on above investment during the construction period in next 4-5 years. Even after execution of the project, income from investment will be depend upon the satisfactory performance of the project.

Exposure to volatile interest rate

Nepalese banking sectors are fixing interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions is changed by change in liquidity position which lead to change in interest rate. Interest rate has been changing frequently in Nepal market since last 1-2 year. Therefore, funding from Bank and Financial Institutions are exposed to volatile interest rate.

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). Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river. Rudi A is utilizing discharge from Rudi Kola and Chheduwa Khola located at Kaski District, having catchment area of 53.43 sq kms. Similarly, Rudi B is proposed to utilize discharge from Karbu, Tago, Kaiyu and Ligur Khola, having catchment area of 35.3 sq km. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

Key Grading Strengths

Experienced board members and management team, and financial support from directors

BHDCL has 9 board of directors majorly belonging to RM group. RM Group is led by Mr. Krishna Acharya, who is founder chairperson of BHDCL. RM group is involved into diversified business including hydropower (15.4MW operational and 223.8 MW under construction), manufacturing, media, software and consultancy services, hotel, education etc. The board is chaired by Mrs. Sita Acharya, spouse of Mr. Krishna Acharya, who has more than a decade of experience. The management team is led by Mr. Janardan Aryal, General Manager, who has more than two decades of working experience in various sector including ~5 years of experience in hydropower sector. He has been supported by other experienced management team. Further, the directors have provided financial support in form of advance of Rs 117 Mn in FY19 to support the operations of the company.

Power purchase agreement with sufficient period coverage

BHDCL has entered into PPA with Nepal Electricity Authority (NEA) for both the project. The period of the PPA is 30 years or till the validity of Generation License, whichever is earlier. PPA period may be extended with mutual consensus during the last six month of validity. The contracted energy for the Rudi A is 46.86 million units (MU) and for Rudi B is 33.21 MU. Rudi A and Rudi B 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 5 times on yearly basis.

Financial closure achieved for total estimated debt and promoter share capital has fully injected

Rudi A project was completed at total cost of Rs. 1,555 Mn which was funded in debt equity ratio of 68:32. Financial closure of Rs 870 Mn debt for initial 6.8 MW capacity and Rs 191 Mn debt for additional 2 MW capacity of Rudi A was achieved on August 8, 2014 and November 7, 2014 respectively. Similarly, total estimated cost of Rudi B is Rs 1,152 Mn which is proposed to be funded in debt equity ratio of 68:32. Financial closure of Rs 789 Mn debt for Rudi B was achieved on July 25, 2016.

Company plans to raise Rs 1,000 Mn equity share capital from promoter and public shareholders in the ratio of 75:25, out of which Rs 875 Mn is required for funding equity part of the both project cost and balance will be invested in other project. Till July 16, 2019, promoter shareholders have fully injected Rs 750 Mn equity share capital and balance Rs 250 Mn will be raised from public shareholders.

Moderate project cost even after cost and time overrun

Rudi A has been completed with total cost of Rs 1,555 Mn (i.e. Rs 177 Mn per MW) which was increased by 8.37% from initial estimated project cost of Rs 1,435 Mn (i.e. Rs 163 Mn per MW). Similarly, estimated total cost of Rudi B is Rs 1,152 Mn (i.e. Rs 174 Mn per MW) which was increased by 9.51% from initial estimated cost of Rs 1,052 Mn (i.e. Rs 159 Mn per MW) mainly due to increase in civil cost, hydro-mechanical cost, infrastructure development cost, and interest during construction (IDC) cost. Though the cost of the project

has increased, project cost per MW is still at a relatively moderate level however, final cost of the project completion is yet to be concluded.

Further, Required Commercial Operation Date (RCOD) of Rudi B is June 15, 2019 (extended from initial RCOD of July 16, 2017) and expected to come into commercial operation by February 2020. The company has requested to NEA for further extension of RCOD and if RCOD is not revised by NEA till COD BHDCL is required to pay late COD penalty. Further, if COD is delayed by 6 months to 18 months from RCOD, then the number of escalation in tariff rate will decrease to 4 years from 5 years.

Comfortable level of operational plant load factor (PLF) although low PLF during FY19 being initial stage of operation

The annual contracted PLF of the Rudi A is 61.64% of installed plant capacity. Rudi A has been operating since March 19, 2019 and operated at 61.22% PLF (against generation capacity) during the 9 months ending Mid December, 2019. The power generated from the project was at satisfactory level during 5MFY20 (i.e. 5 months' period ending Mid-December, 2020) which was 78.91% PLF. However, the plant was operated at low PLF of 38.68% (against generation capacity) during FY19 (operated for 4 months) due to issues related to transmission line and hydrology. Due to low PLF during FY19, company has suffered significant revenue losses along with short supply penalty of Rs 5 Mn was levied by NEA.

Moderate counter party risk

BHDCL is exposed to counter party payment risk pertaining to Nepal Electricity Authority (NEA), which has been making consecutive losses in past till FY2016 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 generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producers (IPPs) in past. During FY19 and 5MFY20, the company has received payment from NEA for supply of power generated from Rudi A, within 42 to 62 days.

Low project implementation risk however existence of project stabilization risk

Rudi B is expected to commercially operate from Mid Feb, 2020. On the basis of cost incurred till October 17, 2019, the project has achieved ~93% financial progress. Further, dry and wet test was completed successfully on January 31, 2020 and BHDCL is generating and supplying power from Rudi B as test generation as a result project implementation risk is very low. However, the project is still exposed to the stabilization risk.

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 and replacing cooking gas with electricity, increase in access of population using electricity etc.

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 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.

Low power evacuation risk

The power generated from Rudi A project has been evacuated through 4.5 km long 33 KV transmission line to NEA Mijunredanda Substation at Kaski district. The power generated from Rudi B project is also proposed to be evacuated to NEA Mijuredanda Substation. For evacuation of power generated from Rudi B, BHDCL has constructed 3.5 Km long 33 kV transmission line from Rudi B powerhouse to Rudi A switchyard. The power evacuation risk is low, as all transmission line work for Rudi B project is completed, NEA substation is operational and company is evacuating power generated from Rudi B as test generation.

About the Company

BHDCL is Public Company, incorporated on Dec 18, 2000 as Bindhyabasini Hydropower Development Company Ltd. as a private company. Later on March 13, 2017 it was converted to public limited company. It has two run of the river hydropower project; 8.8 MW operational Rudi Khola-A Hydropower Project (Rudi A) and 6.6 MW under construction Rudi Khola-B Hydropower Project (Rudi B). The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism. Generation License, from Government of Nepal – Ministry of Energy, was obtained on Dec 27, 2013 for Rudi A and on June 9, 2017 for Rudi B, which will be valid for 35 years from the license obtained date. The project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License. It is promoted by individual promoters from different background. Mrs. Sita Acharya (17.30% stake), Mr. Sudeep Acharya (10.50% stake), Seed Infra Pvt. Ltd. (7.13% stake), Mr. Bharat Bahadur Pandey (6.24% stake), and Mr. Dil Sundar Shrestha (6.02% stake) are major promoter shareholders of the company.

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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.