

Rating Rationale

Madhya Bhotekoshi Jalavidyut Company Limited

Rating

Facility/ Instrument	Amount	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B (Issuer)]	Assigned

**The issuer rating is subject to the company maintaining overall gearing not exceeding 2.00x at the end of FY21.*

CARE Ratings Nepal Limited (CRNL) has assigned ‘CARE-NP BB (Is)’ rating to Madhya Bhotekoshi Jalavidyut Company Limited (MBJCL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to MJBCL is constrained by project implementation and stabilization risk associated with the under-construction hydropower project, delay in execution of project and cost overrun in the project, decrease in project life leading to low return from the project and exposure to fluctuation in the foreign currency exchange rates for the unhedged contractual liabilities. The rating is also constrained by hydrology risk associated with run-of-the-river power generation, power evacuation risk and exposure to regulatory risk. The rating, however, derives strength from strong promoter group including Nepal Electricity Authority (NEA) and management expertise in operating hydro power projects, relatively moderate cost of the project and financial closure achieved for the project cost, power purchase agreement (PPA) with sufficient period coverage and moderate counter party risk. The rating also factors in fixed priced Civil & Hydromechanical, Electromechanical and Transmission Line Contracts, current demand & supply gap however expected increase in supply in future and government support for the power sector. Timely execution of the project avoiding any cost overrun and timely completion of Barhabise transmission hub for evacuation of power by NEA will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weakness

Project implementation and stabilization risk associated with under construction hydropower project

Till June 15, 2020, the company has achieved financial progress of ~55% on the basis of cost incurred. As per the progress report submitted by the company, excavation of headrace tunnel is in progress with ~93% completion, whereas excavation works related to penstock tunnel, diversion tunnel and powerhouse is completed. Similarly, 90% of dam works in the headworks is completed. 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

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

totally ruled out, given that the project is being executed in the hilly 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's expected Commercial Operation Date (COD) is February 2021. However, considering the present status of works and pending work in hand achieving COD in February 2021 seems to be challenging. Timely execution of the project avoiding any cost overrun is the key rating sensitivities.

Delay in execution of project and cost overrun

The project is still under construction with expected commercial operation in February 2021. The project execution was delayed due to land acquisition required for the project took longer than anticipated and then due to different natural calamities like Jure landslide of 2014, Massive Earthquake of 2015, Bhotekoshi flood of 2016, border blockade during September 2015 and recently due to COVID-19. Similarly, issues with cash flow management of the civil & hydro-mechanical contractor halted the civil works at plant site for considerable period of time. As per the management, the construction work is going on a satisfactory level and the project is expected to be completed and commissioned by February 28, 2021. The project is unlikely to achieve the February 2021 deadline and further time overrun cannot be ruled out. Delay in the project execution due to various reasons, continuous devaluation of Nepalese Currency as compared to USD and inflation led to cost overrun of the project to around Rs. 2.75 Bn (excluding IDC).

Decrease in project life leading to low return from project

As per initial PPA, RCOD of the project was June 15, 2017, which has been extended to February 28, 2021 as per revised PPA. Even though the project commercially operates within the RCOD, due to multiple delays in the project execution time, project life will be reduced by ~2 years against 30 years as per PPA as generation license obtained on December 03, 2013 will be valid for ~28 years only which will result in significant loss of revenue from project.

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

From the various contracts entered in by MBJCL, USD 89.79 Mn is payable in USD. Out of which USD 39.99 Mn has been already paid on different dates & exchange rates till July 15, 2020 and USD 49.80 Mn will have to be paid further. MBJCL has not taken any measures to hedge itself from foreign currency payment. This exposes the company to foreign exchange fluctuation risk.

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). 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. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/khola.

Power evacuation risk

Power evacuation is proposed through 4 km transmission line of 220 kV, to be built by MBJCL at their own cost (included in the project cost) to NEA's proposed Barhabise substation. MBJCL has awarded contracts for design, supply, construction, testing & commissioning of 220kV transmission line. Barhabise substation is under construction by NEA and MBJCL expects completion of transmission infrastructure before RCOD. Timely completion of transmission infrastructures will be key rating sensitivity.

Exposure to regulatory risk

Government of Nepal has established Electricity Regulatory Commission (ERC) for regulating generation, transmission and distribution of electricity in Nepal. ERC is the regulator under the GoN which is responsible for regulating hydropower companies in Nepal. Policies and the directives issued by ERC like approval process for Initial Public Offer (IPO) issuance, PPA approval through ERC poses a new challenge to hydropower companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strengths

Strong Promoter Group and management expertise in operating hydro power projects

Nepal Electricity Authority (NEA) and Chilime Hydropower Company Limited (Subsidiary of NEA) are major promoter group of MBJCL. NEA is a Government of Nepal entity 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 through optimal utilization of resources within the country. NEA holds majority ownership in CHCL with 51% shareholding and remaining 49% shares is held by general public. CHCL owns and operates 22.1 MW power plant. CHCL through its three subsidiaries MBJCL, Rasuwagadhi Hydropower Company Limited and Sanjen Jalavidhyut Company Limited 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) who possesses wide experience in the hydropower sector. Mr. Hara Raj Neupane is the Chairman of the Company. Mr. Neupane has represented CHCL in the BoD and is deputed to CHCL from NEA who has been employed in NEA from last 30 years and currently serving as Deputy Managing Director at NEA. The company is managed by experienced management team comprising of members mostly deputed from NEA having wide experience in NEA and hydropower sector.

Power purchase agreement with sufficient period coverage

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 is obtained on 3rd December 2013 for 35 years), whichever is earlier. PPA period may be extended with mutual consensus through discussion from last six month of validity. 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) is 60.69% at Q40. Required Commercial Operation Date (RCOD) is February 28, 2021 (revised). Company expects to complete the project by February 28, 2021 however considering the remaining work in the project, it is unlikely that company will be able to complete the project on expected date. Timely extension of PPA is critical for the company as delay from the RCOD will attract penalties from NEA as per the PPA.

Relatively moderate cost of the project and Financial closure achieved for the project cost

Total estimated cost of the project is 17,073.29 Mn with per MW cost of Rs. 167 Mn which is relatively lower as compared to other hydropower projects being developed. 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. Due to delay in the project execution by the various reasons the project cost was increased to Rs. 15.03 Bn excluding IDC (Rs. 17.07 Bn including IDC) as per the latest estimates by the company. EPF has further approved additional loan amount of Rs. 2.75 Bn on July 29, 2020. With approval of EPF for additional loan, total project cost of Rs. 15.03 Bn excluding IDC (Rs. 17.07 Bn including IDC) is proposed to be financed through total debt of Rs. 8.89 Bn, Rs. 6 Bn through equity and balance amount will be paid to the contractors through cash accruals. Out of total equity of Rs. 6 Bn, Rs. 4.5 Bn is already infused whereas balance Rs. 1.5 Bn is proposed to be infused through IPO. MBJCL has incurred Rs. 9.39 Bn over the project till July 15, 2020 and the same is funded through debt of Rs. 5 Bn and rest is through equity.

Fixed priced Civil & Hydromechanical, Electromechanical and Transmission Line Contracts

MBJCL has appointed Guangxi Hydroelectric Construction Bureau (GHCB), China for Civil & Hydromechanical Works as on January 1, 2014. Andritz Hydro Pvt. Ltd, India has been appointed for Electromechanical Works as on July 10, 2014. Further, MBJCL has appointed joint venture of Urja International Pvt., Ltd., Nepal for design, supply, construction, testing & commissioning of 220kV transmission line as on July 27, 2018. These contracts are fixed priced contracts, therefore, mitigating the risk of any cost over runs in these contracts.

Moderate counter party risk

MBJCL is exposed to counter party payment risk pertaining to Nepal Electricity Authority (NEA), which has been making consecutive losses in past till FY16. However, as per the annual report published by

NEA, during FY20 (provisional), NEA earned profit of Rs 11,056 Mn (Rs. 9,812 Mn during FY19). Further, during FY20, NEA achieved gross cash accrual of Rs 16,056 Mn (Rs 14,664 Mn in FY19). The counter party payment risk is moderated by the fact that, NEA is fully owned by government of Nepal, net profit is increasing over the period and generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producers (IPPs) in past.

Current demand & supply gap however expected increase in supply in future

As per the NEA’s Annual Report for FY20, the current peak electricity demand is 1,408MW. The total domestic installed capacity stands at 1,328 MW which includes 632 MW owned by NEA and 696 MW by private sector IPPs. Overall, during FY20, total energy demand was 7,894 GWh which was met by import of 1,720 GWh (~22% of total demand) from India whereas balance was met by domestic generation.

However, considering under construction projects which are expected to generate electricity in next 2-3 years and electricity demand which has not increased substantially in past few years could create a situation of oversupply in near future in wet season. This could put pressure on NEA’s payment capabilities which is sole counter party with majority of PPA signed on take or pay basis.

Government support for the power sector

GoN Government of Nepal (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 for such person/entity who starts commercial operation, transmission and distribution of electricity up to mid-April 2024. 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

About the Company Madhya Bhotekoshi Jalavidyut Company Ltd. (MBJCL) is a public limited company incorporated on July 29, 2010. It is promoted by NEA (a GoN 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. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism. As per the Generation License, from GoN – 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 Licence, which is 35 years.

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