

Panchakanya Mai Hydropower Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering (IPO) of Panchakanya Mai Hydropower Limited

Instrument/Facility	Issue Size	Grading Action (June 2017)
IPO (equity) Grading	NPR 220 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below average fundamentals to the proposed Initial Public Offering (IPO) of Panchakanya Mai Hydropower Limited (PMHL). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative better position within the grading categories concerned. PMHL is proposing to come out with an Initial Public Offer of 2,200,000 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 1,100,000 shares will be issued to project affected areas while remaining 1,100,000 shares will be issued to general public and staff.

The assigned grading takes into account relatively weak return potential of the hydroelectric projects (HEPs) (aggregate capacity of 18.1 MW) being developed by PMHL. 12 MW Upper Mai HEP has been operational since June 2016, and 6.1 MW cascade project is expected to commence operations from Jul-17. The project returns are expected to remain relatively lower on account of lower contracted capacity (Power Purchase Agreement or PPA signed only for 15.08 MW), lower tariff rates for initial PPA capacity of 3.1 MW in case of 12 MW operational project, relatively high project cost of ~NPR 184 million per MW and also over capitalization (injection of equity through IPO). The projects are also exposed to hydrology risk, interest rate volatility in the market and the counterparty credit risks arising out of exposure to loss-making Nepal Electricity Authority (NEA) for the energy supplied, although the same is partly mitigated by the fact that NEA is fully owned by the Government and has been making timely payments to PMHL so far which provides some comfort.

Nonetheless, the grading takes into account the experience of promoter group which is involved in diversified line of businesses, though PMHL is their first venture in hydropower sector and satisfactory operational performance of the Upper Mai HEP (Plant load Factor or PLF of ~61% in 9MFY17 as opposed to contract energy PLF of ~62% based on PPA Capacity of 9.98 MW).

12 MW Upper Mai HEP is a run of the river (RoR) project located in Mai River of Eastern Nepal. The project was commissioned at a cost of NPR 2,273 million and funded in a debt: equity mix of ~67:33 against original planned funding mix of 75:25. The capacity of the project was initially 3.1 MW and PPA was executed accordingly; subsequently, the project capacity was increased to 12 MW (however, PPA has been revised to 9.98 MW only) hence resulting in two set of tariffs rates for total contract energy. The tariff rates for original contract energy are NPR 3.90 and NPR 5.52 for wet and dry seasons¹ respectively with no escalations. For additional contract energy (up to 9.98 MW), the rates are NPR 4.80 and NPR 8.40 for wet and dry seasons respectively subject to annual escalation after Commercial Operation Date (COD) at 3% on base tariff for 5 years. Lower tariff rates for part energy generated results in subdued revenues, especially in dry months where almost entire generation is billed at lower rates. The generation license of the project has been revised to 12 MW (at Q38 exceedance flow model) by tapping additional water from Rate river, however PPA for incremental capacity has not been signed yet. The power generated by the project is being evacuated via 18.5 km, 132 KVA transmission line to Godak substation at Ilam. The project has operated at PLF of ~61% in 9MFY17 as against contract PLF of ~62% for the period. Generation exceeded contract energy during wet months while the same was ~80% of contract energy during dry months.

PMHL is also constructing a cascade 6.1 MW Upper Mai “C” RoR HEP which is expected to come in operation by mid-Jul-17. The cascade project would utilize the discharge from tailrace of the upstream project and additional discharge available from streams merging with the Mai river. The electricity generated from this project shall be evacuated through the transmission line of the upstream project. The project has a catchment area of ~70 sq. km that is expected to support the design discharge of 4.62 cumecs at 35% exceedance flow. The PPA has been executed for 5.1 MW only against installed capacity of 6.1 MW for which generation license has been obtained. As per the terms of the PPA, the tariff for wet season is NPR 4.8 per kWhr and for dry season is NPR 8.4 per kWhr with 3% escalation for 5 years; lower number of escalations will be available owing to delay in project completion compared to required COD (RCOD) of Feb 2016 (4 escalations expected to be available as per current timeline estimates).

¹ Mid-December to mid-April are dry season period; rest being wet season.

The latest cost estimate of the cascade project is NPR 1,050 million (NPR 899 million before escalations) to be financed in a debt: equity of ~64:36 through bank loans of NPR 674 million and equity of NPR 376 million. ~95% physical progress had been achieved and NPR 904 million costs has been incurred till March 2017. Of this, ~NPR 626 million has been funded through external bank borrowings and balance from promoters' equity. The promoters have infused their share of equity for both these projects (NPR 880 million representing 75% of post IPO capital) while remaining equity is to be raised through IPO. Management plans to utilise incoming equity (assuming full subscription of proposed IPO) towards project completion. The project is entitled for capital subsidy of NPR 5.5 million per MW.

The two projects are being developed at an aggregate cost of NPR 184 million per MW which is on a relatively higher side. Since the tariff for hydro projects are fixed as per PPA, the returns of a project will be subdued due to project cost remains in higher side. Cost of projects developed by PMHL is ~NPR 220 million per MW if PPA capacity is considered. Owing to healthy PLF in 9MFY2017, PMHL posted gross sales revenue of ~NPR 176 million, OPBDITA² of ~NPR 154 million and net loss of ~NPR 3 million. The company had ~NPR 2,046 million of outstanding term loan payable to the consortium banks as on mid-April 2017, and the gearing stood at 2.31 times. PMHL's track record of debt servicing remains good so far; partly benefitted from low lending rates till now (8.5% as of mid-April-17 and ballooning instalment method of repayment which entails small portion of principal repayment in initial years.

Going forward, the ability of the project to achieve its design operating parameters will be the key driver for the project returns.

Company Profile

Panchakanya Mai Hydropower Limited (PMHL) was incorporated on 30th January 2003 as East Nepal Development Endeavour Private Limited. The name of the company was changed to Mai Valley Hydropower Private Limited on 15th January 2009 and finally to PMHL on 21st March 2016. As of now, PMHL has a small promoter base of 13 promoters accounting for entire paid up capital of the company with major holding by Panchakanya Power Development Private Limited at ~49%; rest being largely held by individual promoters associated with Panchakanya Group. The promoter holding after proposed IPO is expected to dilute to 80% assuming full subscription. The shares of the company are proposed to be listed in the stock exchange post proposed IPO. PMHL is at present operating 12 MW Upper Mai HPP in Ilam district of eastern Nepal since June 2016. The company also has one under construction 6.1 MW Upper Mai "C" (cascade) project which is approaching completion.

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² Operating profit before depreciation, interest, tax and amortization expense