

Butwal Power Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed Further Public Offering (FPO) of Butwal Power Company Limited

Instrument/Facility	Issue Size	Grading Action
Further Public Offer (Equity shares)	NPR 2,044.58 million	[ICRANP] IPO Grade 3 (<i>Assigned on May 2017 and revalidated with FPO price update on Dec 2017</i>)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 3”, indicating average fundamentals to the proposed Further Public Offering (FPO) of Butwal Power Company Limited (BPCL). ICRA Nepal assigns IPO grading¹ 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. BPCL is proposing to come out with an FPO of 4,081,000 numbers of equity shares of face value NPR 100 each at a premium of NPR 401 (issue price of NPR 501² per share).

The assigned grading factors in strong parentage, diversified business profile and long track record of operations of BPCL, which operates two hydroelectric projects (HEPs) with aggregate capacity of 21.4 MW in Nepal, owns and operates a distribution network (in 64 villages across 4 districts in western Nepal) and also has investments in other hydro power related businesses. Although the distribution business of BPCL is loss making on account of low approved tariff, earnings from operating projects coupled with dividend from investee company (Himal Power Limited, HPL) have resulted in stable earnings stream for the company. Consequently, there has been a sustained reduction in debt levels in the last four years, despite upgradation capex undertaken by the company; resulting in comfortable capital structure and increased financial flexibility. Concerns although emanate from the execution of sizeable project works (in relation to the current operational capacity), namely 37.6 MW Kabeli A HEP and 30 MW Nyadi HEP, by BPCL under subsidiaries Kabeli Energy Limited (KEL) and Nyadi Hydro Limited (NHL) respectively. Hydro power development entails several execution challenges such as difficult terrain, adverse climatic conditions, and weak geology. These challenges will be further enhanced due to simultaneous execution of the two projects and would thus require increased project supervision and management control for commissioning of the projects within the budgeted time and cost constraints. Income of BPCL will be significantly affected by the decline in dividend income from HPL from FY 2020-21 onwards (as 50% of the project ownership in Khimti HEP, being operated by HPL and only revenue source of the company, will be transferred to NEA as per the terms of its PPA). Timely commissioning of the under-construction projects will thus be crucial in continued stability of BPCL earnings.

Financial closure for both the under-construction projects has been achieved which is a source of comfort, however significant funding risks remain as a major portion of equity capital for the projects is yet to be raised. Off-take and tariff risks for the two projects are low as power purchase agreement (PPA) for entire generational capacity has been signed with Nepal Electricity Authority (NEA). Although the counterparty credit risks arising out of exposure to NEA for the energy supplied is a concern; it is partly mitigated by the support extended by Government of Nepal to the NEA. The grading takes into account the return potential of the existing operational hydro power projects and also the under-construction projects, particularly Kabeli A which has a deemed generation clause in the PPA and also an attractive tariff. 60% of the tariff is denominated in USD which not only results in improved project economics but also provides cover for forex exposure on the USD denominated borrowings on the project.

BPCL currently operates two hydropower projects-9.4 MW Andhikhola HEP and 12 MW Jhimruk HEP. Operational performance of both the projects remains satisfactory with both the plants operating at higher than required (as per PPA) plant load factor (PLF) in FY2016. In addition, BPCL owns and operates an electricity distribution network catering to ~ 50,000 customers. The demand is primarily met from its

¹ Includes grading of IPO, rights issue and further public issue.

² Approved from Securities Board of Nepal (SEBON)

operating projects while balance requirement is procured from NEA. The approved distribution tariff does not cover the operating expenses of the business and hence has resulted in sustained loss for the company. Even though the average distribution tariff of BPCL has been revised upwards (from NPR 4.30 to ~NPR 6 per unit) in July 2016, the distribution business remains unprofitable due to high operating cost and high distribution losses.

Kabeli-A HEP is being developed by KEL along Kabeli river in Eastern Nepal. BPCL owns 26% stake in KEL and the balance is held by Gurans Energy Limited (GEL)³-69% and Asia Pacific Technology Company Limited, China-5%. The budgeted project cost is ~NPR 10.7 billion and will be funded in the debt equity ratio of ~79:21. The project is expected to commission by September 2019. The project debt of USD 78.6 million will be financed by International Finance Corporation (IFC) and World Bank (through Hydroelectricity Investment and Development Company Limited). High project cost (NPR 285 million per MW) of this project is compensated by healthy PPA tariff (ranging from NPR 6 to NPR 13 over the project life without seasonal variation in tariff). Moreover, 60% of tariff will be paid in USD over the loan repayment period of 15 years which will help in offsetting the forex risk of the company on the dollar denominated debt. Equity commitment of BPCL towards Kabeli-A will be met out of FPO proceeds while Strong ownership and funding profile of other promoters provides comfort regarding their equity injection capability. The PPA has a deemed energy generation clause which compensates for revenue loss arising from weak hydrology. Power generated by this project will be evacuated through the NEA's proposed 132 KVA Kabeli transmission corridor. The transmission line project is running behind the schedule and its timely completion remains a concern.

Nyadi HEP is being developed by NHL along Nyadi river in western Nepal. BPCL owns ~97% stake in NHL and the balance is held by Lamjung Electricity Development Company (LEDCo). The budgeted project cost is ~NPR 5.9 billion and will be funded in debt equity ratio of 75:25. The project is expected to be commissioned by December 2019. The project debt of NPR 4.4 billion will be financed by a consortium of domestic banks. PPA tariff for this project is NPR 4.8 per unit and NPR 8.4 per unit for wet and dry seasons respectively. Equity commitment of BPCL towards Nyadi will be met out of the FPO proceeds. In addition, NHL is also likely to float an IPO in near future to raise a portion of the project equity. Power generated by this project will be evacuated through a 7KM 132 KV transmission line to Khudi substation along NEA's proposed Marsyangdi corridor double circuit transmission line. The transmission line project is in early stages of development and is expected to be completed by July 2019.

Backed by healthy operational performance of both the projects in FY2016, BPCL posted gross energy sales revenue of ~NPR 682 million in FY2017⁴ as compared to NPR 607 million in FY2016. During FY2016, ~78% of revenue from energy sales came from sales to NEA. BPCL reported a profit after tax (PAT) of NPR 649 million in FY2017 vs. NPR 575 million in FY2016, largely supported by dividend income of NPR 551 million and NPR 531 million respectively.

Company Profile

Butwal Power Company Limited (BPCL) was established in 1966 by Nepal Government and United Mission to Nepal-UMN (an international non-government organization). Nepal Government privatized the company by divesting majority stake to private investors in 2003-04. As on mid-Jan 2017, major shareholders of BPCL include Shangri-La Energy Limited- (~69% stake), Government of Nepal including NEA and NIDC Development Bank (10.2%), Interkraft Nepal (IKN) A.S, Norway (1.9%)¹¹, United Mission to Nepal (1.7%) among others. BPCL has ~13% public shareholding which is likely to increase to ~30% post proposed FPO.

³ GEL holds 69% stake in KEL. GEL is in turn 40% owned by BPCL and 60% owned by Infra Co Asia, an investment vehicle of Private Infrastructure Development Group (PIDG). PIDG is a consortium of different multilateral donor agencies and works in the sector of infrastructure development in the developing countries.

⁴ FY2017 data are taken based on publicly available financial reports.



BPCL owns and operates two hydroelectric projects viz. 9.4 MW Andhikhola HEP and 12 MW Jhimruk HEP and is also engaged in distribution of electricity (64 villages across 4 districts) in western Nepal. Additionally, it is an investment company with equity stake in Himal Power Limited (developer of 60 MW Khimti HEP) ~17%, Khudi Hydropower Limited (developer of 4 MW Khudi HEP) ~60%, Hydro Consult Engineering Limited ~80%, Nepal Hydro & Electric Company ~51%, among others.

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