

## Khanikhola Hydropower Company Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed Initial Public Offering of Khanikhola Hydropower Company Limited

Instrument/Facility	Issue Size	Grading Action (September 2015)
IPO Grading	NPR 139.71 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 Khanikhola Hydropower Company Limited (KHCL). 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. KHCL is proposing to come out with an Initial Public Offer of 1,397,143 numbers of equity shares of face value NPR 100/- each share to be issued to affected locals (1/3<sup>rd</sup>) and general public (2/3<sup>rd</sup>) at par.

The grading assignment factors in the risks associated with lack of availability of adequate evacuation infrastructure which limits the ability of the 6.36 MW run of the river hydro power project to achieve its design operating levels. In the absence of transmission line (to be developed by NEA, Nepal Electricity Authority), the power generated from the project will have to be evacuated through 11kV local grid which can result in higher losses and also limit the quantum of power evacuated. Further, the promoters have limited experience in development of hydro power projects as this is the first project of the group to enter the commercial operational phase. The grading is also constrained by interest rate volatility in the market and the counterparty credit risks arising out of exposure to loss making 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 payments to IPPs (Independent Power Producers) in a timely manner in the past. Further, since the revenues are directly linked to unit sales, any loss of generation on account of shortage of water or silting can negatively impact the project earnings and return indicators.

The grading factors in the strengths arising out of lower execution risks and also risks arising out of geological surprises, the project is nearing completion and bulk of the civil works (~75%) have been completed.. In addition, with a firm PPA in place and positive demand outlook owing to supply-demand gap in the power sector, the tariff and off-take risks are also minimal. In addition, promoters (Including Prabhu Bank among others) have infused substantial equity upfront (NPR 326 million as on Aug-15) which is expected to help the company save on its IDC (interest during construction) costs. The project is also entitled to a capital subsidy of NPR 5 million per Mw from Government and an additional 10% of the same if it is able to connect to national grid by FY 2017/18. Going forward, ability of the company to commission within the budgeted time and cost estimates and also availability of sufficient hydrology and evacuation infrastructure will be the key parameters which can impact returns of the project.

KHCL is constructing a 4.36 Mw small hydropower run of the river project in Tungun and Thosne River and a tailrace cascade project therefrom having capacity of 2 Mw located in Bhattedanda, Sankhu and Ikudol VDCs of Lalitpur District in the Central Development Region of Nepal. Tungun River and Thosne River, having a combined catchment area of 89 sq km are two major tributaries of Khanikhola. The electricity generated from this project shall be evacuated over a 1.5 km transmission line from the switchyard of the project located adjacent to powerhouse of cascade project to the ‘Malta’ substation being constructed by NEA. 33 kV line connecting the substation to ‘Matatirtha’ Substation is being constructed. Until the completion of transmission line by NEA, the generated energy would be offloaded to 11 kV local grid which is capable to evacuate ~3.5 Mw at most. A Power Purchase Agreement (PPA) was signed on B.S 2069/04/05 (20<sup>th</sup> July 2012) with the Nepal Electricity Authority (NEA). 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. The Power Generation License has been obtained from the Ministry of Energy and Initial Environmental Examination (IEE) report has been approved by the Ministry of Energy.

The contract for civil works of the project has been awarded to six Nepalese contractors, Hydro-mechanical contract has been awarded to Structo Nepal Private Limited for main project and North Hydro and Engineering Private Limited for cascade project, and Electro-mechanical works contract has been awarded to Hunan Allonward Hydro Generating Equipment Co. Limited, China. Overall 75% progress has been achieved in Civil Works as of 1<sup>st</sup> August 2015 with plans to complete construction by end of October 2015. Diversion wiew and Cut off works have been completed, concreting works currently in progress in Desander Chamber (2 in number) to be completed by October 2015, tunnel has been completed, power house structure has been completed with machine installation in progress and the tail race too has been completed. Of the NPR 862 million costs incurred till 1<sup>st</sup> August 2015, ~NPR 541 million has been funded through external bank borrowings and balance from promoters' equity.

The cost of the project is around NPR 1,178 million which is being funded through bank loans of NPR 755 million and balance through equity of NPR 423 million. The promoters have already brought in NPR 326 million and intend to raise additional NPR 140 million through an IPO. The equity capital is in excess of the project requirement and surplus arising therefor will be utilized to invest in another upcoming 14.9 Mw project (Mayakhola Hydropower Project) in Sankhuwasabha District. The project is currently under financial closure phase with other initial activities being concluded. Thus, timely completion within the budgeted time and cost estimates is a key sensitivity while assessing the returns generated by this projects. Typically, hydro-power projects entail significant project execution risks as they are located in difficult terrain and hence adverse climatic conditions during the construction period and also geological surprises can disrupt construction schedule of any project. Hence, over the foreseeable future, the return to the shareholders of KHCL is likely to accrue only from the revenue generated by current project.

### **Company Profile**

Established in October 2012 by 9 promoters (4 institutional and 5 individual promoters) as a private limited company, Khanikhola Hydropower Company Limited (KHCL) was converted into public limited company in March 2013 with the objective of facilitating public participation. Major promoter include Pashupati Energy Development Company P. Ltd (51.79%), Baidik Hydro Investment Company P. Ltd. (19.80%), Prabhu Bank Limited (11.63%), Swachha Investment P. Ltd (8.97%) and Mr. Mijas Bhattachan (7.67%). Promoters hold 100% of share capital as of now which is planned to be diluted to 70% post the proposed IPO. The shares of the company are to be listed in the stock exchange after the proposed IPO. As a part of the IPO process, the company would be issuing 10% of its post issue paid-up capital amounting to NPR 46.57 million to the local inhabitants of project location in the first tranche and thereafter 20% of the post issue paid up capital amounting to NPR 93.15 million to general public at par value of NPR 100 per share.

The company is developing 4.36 Mw Tungun-Thosne Hydropower Project and a 2 Mw cascade project namely Khanikhola Hydropower project in Bhattedanda, Sankhu and Ikudol VDCs of Lalitpur district, Central Development Region of Nepal. The company has got a generation license for 35 years which includes the period of construction. The project is being developed on Build Own Operate Transfer (BOOT) basis. The project cost estimated at time of financial closure was ~NPR 1079 million to be funded in debt to equity ratio of 70:30; subsequently project cost has been revised to ~NPR 1,178 million owing to cost escalations which would be borne from equity portion thereby improving debt to equity ratio to 64:36. Expected COD<sup>1</sup> for the project is November 2015. The management is planning to use the surplus proceeds from the proposed IPO post completion of this project to invest into another

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<sup>1</sup> Commercial Operation Date



hydropower project namely Maya Khola Hydropower Project of 14.9 Mw which is currently in financial closure phase.

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