The Melamchi Water Supply Project
Finance 663: International Finance
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The Case: The case is set in January 2014. The Executive Director of the Melamchi Water Supply Development Board (MWSDB), Krishna Prasad Acharya was leading a board meeting that was deciding on financing a funding gap in the Melamchi Water Supply Project. The Government of Nepal recently committed $13.1 million to the project, and Acharya was mulling over whether to reach out to private investors or to the current consortium of donors headed by the Asian Development Bank for the remaining $25 million. MWSDB had been meeting with group of private investors for the last few months but so far Acharya has not met investors who are keenly interested in the investment.

The MWSP is a project that aims to bring 170 million liters of drinking water per day (MLD) to parched Kathmandu valley through a 27.5 kilometer tunnel. The project has a history of co-financiers pulling out, cost overruns, and sluggish overall progress since the loan was first approved in 2000. If the ADB approves the additional loan it will have a 45.6% stake in the $355.3 million project, which is expected to be completed by 2016. As the lead financier of the sovereign debt for the project, the ADB has a vested interest in the success of the project, however, Acharya feels that this is the right time to get private investors involved in the project as the political and investment environment in the country is improving.

The project’s estimated financial internal rate of return (FIRR) of 7.93% was greater than the weighted average cost of capital (WACC) of 7.9%, however, financial viability of the project is dependent on Kathmandu Upatyaka Khanepani Limited (KUKL), the newly established water utility, to rationalize tariffs and enhance revenues. Cancellation of the project at this stage would result in the investment to date becoming a dead weight loss, as the project would remain incomplete, which is detrimental to the achievement of the Government of Nepal (GON) and the ADB.

Are current co-financiers equally committed to the project? Is this the right time to involve private investors in the project? Will the ADB provide an additional loan? What are the impacts of renewed political environment in the country? Acharya takes a long pause and asks MWSDB board members to re-evaluate the risk for the project before reaching out to the ADB and investors for additional funding.

Perspectives: The case is written from the perspective of lead financier, ADB. Students need to evaluate the perspective of other donor agencies and the Government of Nepal.

Key Issues:
- Valuation of a project and analysis of key financial metrics
- Cost of capital
- Social, political, economic, and environmental risks of the project
- Structuring of sovereign debt
- Risk management
- Perspectives of sovereign funds and multilateral donor agencies
- Institutions and Governance
Objectives:

The case requires valuation of the project in developing country based on revenues expected in the longer term. The risks related to infrastructure financing through sovereign debt and dynamics between different stakeholders- government, donor agencies, and contractors, in the success or failure of a critical infrastructure project. Analyze the social, political, economic, and environmental risks related to projects and integration of risk management. Understanding the need of foreign direct investment for the government and returns for donor agencies and recommend the course of action for ADB.

Case Brief Descriptions:

Melamchi Water Supply Project (MWSP) is an infrastructure project in Nepal that aims to bring 170 million liters of drinking water per day (MLD) to parched Kathmandu valley through 27.5 kilometer tunnel. The $355.3 million project is expected to be completed by 2016. The Asian Development Bank (ADB) along with other multi-lateral donor agencies have provided sovereign debt to Government of Nepal (GON) for the project. The project however has been marred by cost overrun, sluggish progress, political interferences, and financing challenges. MWSDB has to decide whether to ask ADB or private investors for additional funding.