

Union Hydropower Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed enhanced Initial Public Offering (IPO) of Union Hydropower Limited

| Instrument/Facility | Issue Size | Grading Action (September 2017) |
|----------------------|------------------------------|---------------------------------|
| IPO (equity) Grading | NPR 250 million ¹ | [ICRANP] IPO Grade 5 (Assigned) |

ICRA Nepal has assigned an “[ICRANP] IPO Grade 5”, indicating poor fundamentals to the proposed Initial Public Offering (IPO) of Union Hydropower Limited (UHL). 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. UHL is proposing to come out with an Initial Public Offer of 2,500,000 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 633,745 shares will be issued to project affected areas while remaining 1,866,255 shares will be issued to general public and staffs of UHL.

The assigned grading takes into account weak project profile of the 3 MW hydel project being developed by UHL led by high project costs (~NPR 271 million per MW), low leverage in the funding mix (Debt: Equity mix of ~50:50) and low tariff rates (vis-à-vis project costs) which severely constrain the project’s return potential. Grading concerns also emanate from the project being substantially delayed (expected operation from mid-Oct-2017) compared to RCOD (Required Commercial Operation Date) of March 2015 and thus the project will suffer from significant penalties (for delayed commissioning) and also lesser number of tariff rate escalations. Though the company has plans to develop three other projects (through SPVs), these provide limited comfort for now as these are in nascent stages of development (only pre-feasibility study completed so far) and are much larger in scale (~125 MW in total) compared to current project approaching completion and hence funding and execution risks remain very high. The proceeds from IPO are inadequate compared to the total equity requirement for the proposed projects (NPR 250 million vs. the equity requirement of NPR 7,361 million out of which UHL plans to invest NPR 1,103 million) and hence the ability to raise large funds from investors in future will be critical. The grading is also constrained by 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 IPPs (Independent Power Producers) in the past. The revenue would remain volatile on account of inherent fluctuations in hydrology, coupled with limited cushion (lower tariff escalations) can additionally lower the return for investors. Going forward, ability of the company to achieve required operating parameters, efficacy of evacuation infrastructures and availability of sufficient hydrology will be the key parameters which can impact returns of the project.

The proposed projects include 72 MW Upper Tamor-A Hydro Electric Project (HEP) in Taplejung, 21.87 MW Hongu Khola HEP in Solukhumbu and 15.73 MW Mewa Khola HEP in Taplejung. UHL currently holds survey license for first two projects while the license for Mewa Khola HEP is held by a SPV Union-Mewa Hydro Limited where UHL plans to hold 35% stake (post IPO of SPV). In the other two projects, UHL plans to have ~10% stake in each of the project SPVs but this may change at a later date. Preliminary feasibility studies for these projects have been completed which shows that capacity of Hongu Khola HEP and Mewa Khola HEP can be enhanced to 29.62 MW and 23.23 MW respectively. As of mid-Jul-17, UHL has spent ~NPR 38 million towards preliminary expenses of these projects.

UHL is constructing a 3 MW Midim Khola (Karapu) Run of River (RoR) hydropower project located in Karaputar VDC of Lamjung district in Western Nepal. The project has a catchment area of ~137 sq. km that is expected to support the design discharge of 7.3 cumecs at 40% exceedance flow. The Power Generation License has been obtained from the Ministry of Energy on August 22, 2012, valid for 35 years including the period of construction. The project is being developed on Build Own Operate Transfer (BOOT) basis. The Power Purchase Agreement (PPA) was signed with NEA on February 10, 2013. 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. However, lower number of escalations will be available for the project as it is expected to be delayed by ~31 months compared to RCOD of March 2015. Nonetheless, firm offtake arrangement in form of PPA along with positive demand outlook reduces the tariff and off-take risks for the project.

The latest estimated project cost is NPR 814 million (NPR 523 million at time of financial closure with plans to be funded in debt to equity ratio of 70:30) which is being funded in a debt: equity ratio of ~50:50 through bank loans

¹ IPO size of the company has been enhanced to NPR 250 mn from earlier graded size of NPR 140 mn

of NPR 406 million and the rest through equity. Major portion of the equity requirements has been injected by promoters (~NPR 384 million) and hence most of the IPO proceeds are planned to be utilized towards preliminary expenses of upcoming projects of the company. In addition, the project is also entitled to a capital subsidy of NPR 5.5 million per MW from Government upon connection to national grid.

The scheme of the project consists of 22 m long and 5.5 m high concrete infilled boulder weir followed by side intake structure with two openings that leads the water from diversion weir to two settling basins. The water is thereafter channeled through 218 m long headrace pipes and 1,121 m long headrace tunnel. Steel penstock pipe, 126 m in length, conveys water from opening of the tunnel to the turbines at the powerhouse generating gross head of ~52 m. The electricity at the powerhouse will be generated through two 1,560 KW Horizontal Axis Francis turbines and two generators with rated generation voltage of 6.3 kV which will be stepped up to 33 kV for transmission over a ~8 km transmission line from the switchyard of the project to the switchyard of proposed Borletar substation of NEA at Lamjung. As the NEA substation at Borletar is expected to be delayed, evacuation till then will be towards Damauli Substation through NEA's ~24 km long transmission line from Borletar to Damauli.

The contract for hydro-mechanical and civil works of the project has been awarded to Cream Hydel Private Limited and High Himalaya Hydro Construction Private Limited. Contract for supply and erection/stringing of transmission line has been awarded to National Electric and Building Solution Private Limited. Electromechanical contract has been awarded to Qiankang Allonward Hydro Equipment Company Private Limited. The project has recently started tests and plans to commence operations from mid-October 2017. Of the NPR 764 million costs incurred till mid-July 2017, ~NPR 362 million has been funded through external bank borrowings and balance from promoters' equity.

Company Profile

Incorporated in August 2006 as a private limited company, Union Hydropower Limited was subsequently converted into public limited company on 16th March 2016 to facilitate public participation. UHL has 11 promoters accounting for entire paid up capital of the company (~NPR 50 million) as of mid-Jul-17. However, share application money to the tune of ~NPR 334 million have been received from 641 investors which is pending conversion to equity. Major promoters of the company include Mr. Kiran Malla (~35% holding as of now), Mr. Shalikram Ghimire (~35%), Mr. Batu Lamichhane (~6%), Mr. Ganesh Karki (~6%), among others. The promoter holding is expected to dilute to ~60% after proposed IPO, assuming full subscription. The shares of the company are proposed to be listed in the stock exchange post proposed IPO. As a part of IPO process, UHL would issue allocated portion to local inhabitants of project affected areas after which remaining amount shall be offered to general public and staffs of UHL.

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