

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 (June 2018)
IPO (equity) Grading	NPR 366.255 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 3,662,550 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 750,000 shares will be issued to project affected areas while remaining 2,912,550 shares will be issued to general public and staffs of UHL.

The assigned grading takes into account weak project profile of the operational 3 MW hydel developed by UHL led by high project cost (~NPR 265 million per MW), and low leverage in the funding mix (Debt: Equity mix of ~50:50 as of now) which constrain the project’s return potential. Return indicators will also be impacted on account of lesser number of tariff rate escalations and penalties led by substantially delayed commissioning of the project (by ~34 months) compared to Required Commercial Operation Date (RCOD). 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) and hence funding and execution risks remain very high. The proceeds from IPO would be inadequate compared to the total equity requirement for proposed projects (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 Government owned and has been making timely payments to UHL so far. The revenue would remain volatile on account of inherent fluctuations in hydrology while lower tariff escalations can additionally reduce 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). UHL plans to have ~10% stake in each of the other two 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. Given the nascent stage of the proposed projects, detailed project feasibility, cost estimates, funding mix and sources, tariff rates etc are not available.

The 3 MW Midim Khola (Karapu) Run of River (RoR) hydropower project is the first project developed by the company. Located in Karaputar VDC of Lamjung district in Western Nepal, the project has been in operation since 29th January 2018 as against RCOD of 28th March 2015. 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 Power Purchase Agreement (PPA) was signed with NEA on February 10, 2013, valid for 30 years from commercial operation date or till validity of generation license whichever is earlier. 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, only two escalations will be available for the project due to delayed COD and hence this remains a major concern. The electricity generated by the project was supposed to be evacuated by ~8 km, 33 kV transmission line to proposed Bhorletar substation of NEA at Lamjung. As the NEA’s Bhorletar substation is yet to be completed, evacuation as of now is being done towards Damauli Substation through NEA’s ~24 km long transmission line from Bhorletar to Damauli.

The project was commissioned at a cost of NPR 795 million funded in a debt: equity mix of ~50:50. Management plans to utilize major chunk of IPO proceeds towards downsizing bank loans and hence debt: equity mix would go down to ~14:86 after IPO. The project has been penalized ~NPR 13 million for the delayed COD which is

¹ IPO size of the company has been enhanced to NPR 366.255 million from earlier graded size of NPR 250 million

being deducted at the rate of 50% of monthly revenue (NPR 4.38 million deducted till mid-Apr-18). Built on 40% exceedance flow model, the project has supplied ~86% of contract energy to NEA in its ~3.5 month of operation till mid-May 2018 leading to sizeable loss in revenue and occasional short supply penalties as well (NPR 0.9 million till mid-Apr-18). The quantum of penalty is expected to remain lower going forward given the policy level relaxation for projects up to 10 MW. PPA has been amended to this effect allowing availability declaration (AD) of up to 50%; penalty will hence only be attracted for generations less than 80% of AD. The project is also entitled to a capital subsidy of NPR 5.5 million per MW from Government.

Since the revenues are entirely linked to unit sales from a single operational project, the project return and the financial health of the company is entirely dependent on hydrology of project stream. For 9MFY18 (project operated for ~2.5 months during this period), UHL posted gross sales revenue of ~NPR 10 million. Impacted by high financial costs of ~NPR 12 million and late COD/short supply penalties of ~NPR 5 million, the company reported net loss of ~NPR 16 million for the period over operating profit of ~NPR 2 million. Losses sustained so far (~NPR 53 million) has already eroded ~14% of UHL's capital (Net worth per share ~NPR 86 as of mid-Apr-18) and hence remains a concern. The company had ~NPR 397 million outstanding term loan payable to the consortium banks as on mid-Apr-2018 (including bridge gap loans pending conversion to term loan), translating into a gearing ratio of 1.22 times. Management plans to utilize ~75-80% of current IPO proceeds towards downsizing bank loans (rest towards settling contractor liabilities) would result in lower interest expenses which along with ballooning instalments-based repayment might support UHL in meeting obligations towards bank over medium term. Going forward, the ability of the project to minimize the gap between actual generation and contractual energy will be the most important driver for the project returns.

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 384 million) as of mid-Apr-18. Major promoters of the company include Mr. Kiran Malla (~45% holding as of now), Mr. Shalikram Ghimire (~27%), Ms. Shnehalata Malla (~22%) among others. The promoter holding is expected to dilute to ~51% 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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