

Union Hydropower Limited

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

Instrument/Facility	Issue Size	Grading Action (March 2017)
IPO (equity) Grading	NPR 140 million	[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 1,400,000 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 400,000 shares will be issued to project affected areas while remaining 1,000,000 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) coupled with low tariff rates (as per NEA¹ norms)² which severely constrain the project’s return potential. Additionally, low leverage in the funding mix (Debt: Equity mix of ~49:51) further restricts the return prospects for equity investors. Grading concerns also emanate from the project being substantially delayed 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 project is ~80% complete and is expected to be commissioned by mid July 2017, early monsoon or lack of coordination among various contractors involved in construction activities could further delay the commissioning. Although major portion of equity has been raised from promoters, the funding risk is still there (out of total project cost ~NPR 814 mn, debt arrangement has been made for ~NPR 366 mn which can go to ~NPR 400 mn and equity has been raised ~NPR 326 mn and balance equity ~NPR 88 mn has to be raised). The ability to raise balance funds from promoters will be critical for timely commissioning of the project. 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. The revenue would remain volatile on account of inherent fluctuations in hydrology, coupled with limited cushion (lower tariff vis-a-vis project costs) can additionally lower the return for investors. Going forward, ability of the company to commission within the budgeted time and cost estimates, 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.

UHL is constructing a 3 MW Midim Khola (Karapu) run of river 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 PPA³ 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 ~26 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 which was to be funded in debt to equity ratio of 70:30) which is being funded in a debt: equity ratio of ~49:51 through bank loans of NPR 400 million (only NPR 366 million approved as of now, bank can go maximum at NPR 400 mn as discussed, sanction of the same is pending) and the rest largely through equity. The equity portion is expected to come from promoters only and IPO proceeds are likely to be utilised towards preliminary expenses of upcoming projects of the company. Among these, the company has recently received survey license for Mewa Khola hydropower project (15.73 MW) in Taplejung. The promoters have already put in equity of ~NPR 326 million (including calls in advances of ~NPR 276 million) into the project

¹ Nepal Electricity Authority

² NPR 4.80 and NPR 8.40 per unit for wet and dry season respectively in the first year of operation.

³ Power Purchase Agreement

development. In addition, the project is also entitled to a capital subsidy of NPR 5.5 million per MW from Government if it is able to connect to national grid by FY 2017/18; this is expected to be utilized towards covering contingencies.

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 channelled 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. Till mid-March 2017, ~80% physical progress has been achieved with plans to complete construction by mid-July 2017. Of the NPR 466 million costs incurred till mid-March 2017, ~NPR 294 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-March-17. However, calls in advance to the tune of ~NPR 276 million have been received from 478 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. Considering management plans to further expand the promoter base, the promoter holding is expected to dilute to ~75% 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 following which remaining IPO amount shall be offered to general public and staffs of UHL.

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