

Upper Tamakoshi Hydropower Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering (IPO) of Upper Tamakoshi Hydropower Limited

Instrument/Facility	Issue Size	Grading Action (January 2018)
IPO (equity) Grading	NPR 2,647.50 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 Upper Tamakoshi Hydropower Limited (UTHL). 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. UTHL is proposing to come out with an IPO of 26,475,000 numbers of equity shares of face value NPR 100/- each at par. Of the total shares, 10,590,000 shares will be issued to project affected areas while remaining 15,885,000 shares will be issued to general public.

The assigned grading takes into account the relatively lower return potential of the 456 MW Upper Tamakoshi hydro-electric project (HEP) being developed by UTHL. Significant delay in project commissioning (mainly due to earthquake/blockades), high cost of borrowing during construction and unhedged foreign currency contractual liabilities has resulted in high cost escalations for the project. Low tariff rates coupled with escalated project cost (~NPR 144 million per MW including IDC¹) constraints the return potential from the project. Additionally, the borrowing costs for the project remain on the higher side (currently 12% for majority of loans) which along with high debt component in funding mix (~84% including IDC) also limits the quantum of returns to shareholders during the loan repayment period. Any delays in project commissioning compared to current timeline estimates can further impact the project costs and returns given the fixed tariff structure. Hydrology risk for the project is high as the river has not been gauged historically (i.e. prior to the commencement of project activities). Moreover, there is no deemed generation clause in Power Purchase Agreement (PPA). Hence, any loss of generation due to shortage of water or silting can negatively impact the project earnings and return indicators. 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 (Nepal Electricity Authority) 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.

Nonetheless, the grading factors in the significant construction progress achieved in the project (~92% complete as of mid-Oct-17) which reduces execution risks to a large extent. The grading also considers the strategic importance of the project to the country being the largest project in development so far and hence funding risks is considered to be minimal for the financing gap (~NPR 5 billion) created by cost escalations. NEA, as the main promoter (~55% holding presently), brings in significant experience in development and operations of HEPs; other promoters are also Government undertakings which provides additional comfort. 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 minimal. Evacuation risks for the project are also low as the project would itself be constructing the required substation for evacuation. The project would also be entitled to capital subsidy of NPR 5 million per MW from Government upon connection to national grid. Going forward, ability of the company to commission the project within the budgeted time and cost estimates and also availability of sufficient hydrology and operations meeting design criterion will be key parameters driving the returns of the project.

UTHL is developing a peaking run of the river (ROR) hydropower project with 4 hours peaking capacity in Tamakoshi river– 456 MW Upper Tamakoshi Hydroelectric Project (UTHEP) in Dolakha district of Central Development Region of Nepal. The project has a large catchment area of ~1,745 sq. km that is expected to support the design discharge of 66 cumecs while the gross head available for the

¹ Interest during construction

project is 822 metres. The generation license for the project was obtained from Ministry of Energy on December 2010, valid for 35 years including the period of construction on Build Own Operate Transfer (BOOT) basis. The project has faced substantial time overrun compared to Required Commercial Operation Date (RCOD) as per PPA (25th December 2015 for 4 units and 14th July 2016 for remaining 2 units (i.e. 304 MW and 152 MW respectively), on account of Apr-2015 earthquake and subsequent blockades. An application to extend RCOD has been filed to NEA and hence decision of NEA in this matter will have impact upon project life (life could be limited by the validity of generation license) and COD penalty that is to be paid for delayed operation. Currently, the expected COD for the project is mid-January 2019. The electricity generated from the project shall be evacuated from switchyard of the project to proposed Khimti substation through a 47 km long 220 kV double circuit transmission line. PPA for UTHEP was signed on December 2010 with NEA and the agreed tariff for wet season is NPR 3.63 per kWhr and for dry season is NPR 6.96 per kWhr (vs. tariff of NPR 4.8 and 8.4 respectively applicable to other current PPA) with 3% escalation on successive tariff for 9 years. The project is being developed in 32% exceedance flow model and hence the project would be running at full capacity for only 32% times in a year (mostly in rainy season). Lower tariff compared to current tariff rates (~24% lower for wet season) impacts the potential earnings of the project especially given the fact that ~87% of annual energy would be generated in wet season which would be billed at lower tariff.

The contract for civil works of the project has been awarded to Sinohydro Corporation Limited of China, electro-mechanical contract has been awarded to Andritz Hydro GmbH of Austria, hydromechanical works to Texmaco Limited of Kolkata, India and transmission line contracts to KEC International Limited, India with overall consulting support from joint venture of Norconsult AS and Lahmeyer International GmbH, Norway. The contracts have sizeable foreign currency component (~USD 236 million and ~11 million Euro); hence significant currency devaluation and increase in contract amount for time bound consulting contract has further added up to cost escalations. Overall, ~92% physical progress has been achieved in project execution as of mid-Oct 2017 reducing the execution risks considerably and the expected COD is mid-January 2019.

Against initial cost estimate of NPR 35,294 million, the project cost as per latest estimates has increased to NPR 46,630² million (both excluding IDC; including which total cost is now estimated at NPR 65,860 million) to be funded in debt to equity ratio of ~84:16. Financial closure was done at debt: equity of 70:30 excluding interest during construction (IDC); IDC to be capitalized separately and including the same, debt to equity ratio is expected ~84:16. ~64% of the debt component (NPR 20 billion) has been tied up with Employees Provident Fund (EPF), Nepal Doorsanchar Company Limited (NTC), Rastriya Beema Sansthan (RBS) and Citizen Investment Trust (CIT) which carries floating interest rates taking deposit rates availed by these institutions from banks as a benchmark. As a result, borrowing cost for UTHL has remained high which along with delayed commissioning has resulted in significant IDC costs. Remaining debt has been arranged as soft loans from Government that has been routed through NEA and this carries fixed interest rate of 10.5%. Though there is ~NPR 5 billion funding gap (exclusive of IDC) as per current cost estimates, involvement of public sector promoters and UTHEP being a national priority project provides some comfort regarding the timely closure of the same. Nonetheless, high borrowing costs along with equated principal instalment based repayments for the loans raised is expected keep cash flow streams of UTHL in stress during the loan repayment period of 10 years (15 years for Government loans).

As of now, promoters have fully infused their share of their equity (~NPR 5,401 million) and first tranche of IPO has also been raised (NPR 2,542 million) with plans to raise remaining 25% equity requirements of project (~NPR 2,648 million) through proposed IPO. Of the NPR 44,984 million costs incurred till mid-Jul-2017, ~NPR 39,011 million has been funded through debt and balance from equity. Capital subsidy to be received from Government (NPR 5 million per MW upon connection to national grid) is expected to be utilized towards covering contingencies. Going forward, timely

² Cost revision proposal is being reviewed by a special committee under board of the company and hence is subject to change accordingly.



completion within the budgeted time and cost estimates and the availability of requisite hydrology would be the key factors driving the returns for the project.

Company Profile

Incorporated in March 2007 as a public limited company, Upper Tamakoshi Hydropower Limited (UTHL) is currently a subsidiary of NEA (~55% shareholding as of now; 41% after IPO). All the promoters of the company i.e. NEA, Nepal Telecom (~8% shareholding), Rastriya Beema Sansthan (~3% shareholding) and Citizen Investment Trust (~3% shareholding) are entities promoted by Government of Nepal. UTHL is developing the 456 MW Upper Tamakoshi HEP in Dolakha district of Central Development Region of Nepal which is the largest hydropower project in development in Nepal. The company plans to float 25% of total issued capital to public of which 10% is earmarked for project affected locals while the remaining 15% will be floated to general public. UTHL has already issued shares to contributories of EPF and employees of UTHL, NEA and lending institutions, including which the total public holding in the company post the proposed IPO would be 49%; rest being held by the four promoters.

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