

## United Modi Hydropower Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 3 to the proposed Initial Public Offering (IPO) of United Modi Hydropower Limited

Instrument/Facility	Issue Size	Grading Action (June 2016)
IPO (equity) Grading	NPR 287.50 million	[ICRANP] IPO Grade 3 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 3”, indicating average fundamentals to the proposed Initial Public Offering (IPO) of United Modi Hydropower Limited (UMHL). 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. UMHL is proposing to come out with an IPO of 2,875,000 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 1,150,000 shares will be issued to project affected areas while remaining 1,725,000 shares will be issued to general public and staff.

The assigned grading factors in the reputation of promoter group and their experience in construction/hydropower development in Nepal. With the company’s first project, 9.9 MW Lower Modi-I HEP<sup>1</sup> being operational from November 2012, UMHL now intends to develop a 10.5 MW Lower Modi-II HEP, a cascade project utilizing the tailrace of current project, at a cost of NPR 1,770 million (~NPR 169 million per MW). The grading takes into account the presence of evacuation infrastructure which substantially reduces the evacuation risks. In addition to this, plans of the company to tap additional streams (emanating upstream of headwork of 9.9 MW project) could improve the operational performance of the operational project as well which has also been factored in the grading.

However, the grading is constrained by the high project costs (~NPR 214 million per MW) and moderate operating performance (PLF<sup>2</sup> at net generation of ~57% in past 2 years ending FY15 as opposed to PLF at contract energy at ~70%) of the Lower Modi-I HEP. Funding risk for the cascade project is high as the debt and equity portions are yet to be tied up. Likely dilution in the profitability indicators of UMHL arising from IPO and uncertainty about the revenue stream from proposed cascade project, especially owing to conditional off-take clauses in PPA<sup>3</sup> for FY19-FY27 has been factored into the grading. Further, since the revenues are directly linked to unit sales and the tariff are fixed<sup>4</sup>, any loss of generation on account of 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 for the energy supplied, although the same is partly mitigated by the fact that NEA<sup>5</sup> is fully owned by the Government and has been making payments to IPPs (Independent Power Producers) in a timely manner in the past. Grading concerns further emanate from the cascade project being in nascent stages with considerable project execution risks and typical implementation risks such as natural calamities/geological surprise along with increase in time and cost estimates. Going forward, ability of the company to commission the proposed project within the budgeted time and cost estimates and also availability of sufficient hydrology will be the key parameters which can impact returns of the project.

UMHL has been operating 9,900 KW Lower Modi-I HEP in Modi River of Parbat district in Western Nepal since November 2012. The Project was commissioned at a cost of NPR 2,114 million funded in a debt: equity mix of ~70:30. The tariff rates for contract energy as per PPA are NPR 4 and NPR 7 per unit for

<sup>1</sup> Hydro-Electric Project

<sup>2</sup> Plant Load Factor

<sup>3</sup> Power Purchase Agreement

<sup>4</sup> NPR 4.8/kWh for wet and NPR 8.4 kWh for dry season for the proposed cascade project in the first year of operation, subject to annual escalations as per PPA

<sup>5</sup> Nepal Electricity Authority

wet and dry seasons respectively; subject to annual escalation after Commercial Operation Date (COD) @ 3% on base tariff for 9 years. Under the Government's initiative of promoting private sector hydropower developers, the project has been availing promotional tariff rates of NPR 4.80 and NPR 8.40 per unit in wet and dry seasons; which shall remain effective for up to 7<sup>th</sup> year after PCOD with 5 times annual escalation of 3% on base tariff. The electricity sales revenue shall thereafter be based on the rates as per PPA. The power generated by the project is evacuated via 7 km 132 kVA line to NEA switching station at Modi Sub-station. The project has operated at an average annual PLF (at net generation) of ~57% in past two years; lower than design energy PLF of ~70% and thus generated an average of ~81% of annual contract energy in past two years resulting in sizeable revenue loss to the company, in addition to occasional short supply penalty.

UMHL plans to use the IPO proceeds to develop 10.5 MW Lower Modi-II HEP as a cascade project utilizing the tailrace of the current operational project. The proposed project has RCOD<sup>6</sup> of July 2019 as per PPA signed with NEA. The project cost of NPR 1,770 million is to be funded in a debt: equity mix of 75:25. The equity capital of NPR 442.5 million for the project will be funded partly through the current IPO and rest through internal accruals of the company. Following the feasibility study in 2016, UMHL has received IEE (Initial Environmental Examination) approval for the project, entered into grid connection agreement and PPA with NEA. With a firm PPA in place, the tariff and off-take risks are reduced considerably, however the conditional off-take clauses for FY19-FY27 raises some concern. As per the PPA, the tariff rates for wet season are NPR 4.80 and for dry season is NPR 8.40 with 3% annual escalation on base tariff for 5 years from COD. Power generated by the project is to be evacuated through a 4 km long 132 kVA single circuit transmission line to the switchyard of current project and then through common line to NEA Modi Substation at Patichaur, Parbat district.

With the project in very initial stages, ability of the company to mobilize funds for the proposed project and timely completion within the budgeted time and cost estimates will have a bearing on the returns of the project. Typically, hydro-power projects entail significant project execution risks as they are located in difficult terrain and hence adverse climatic conditions during the construction period and also geological surprises can disrupt construction schedule of any project. Additionally, time overruns could limit the potential benefits of higher tariff escalations and also could subject the company to penalties. Nevertheless, presence of experienced promoters and management personnel mitigates this risk to some extent.

Since the revenues are entirely linked to unit sales from a single operational project so far, the project returns and also the financial health of the company is entirely dependent on the hydrology of the project stream. Owing to dip in PLF in FY15<sup>7</sup>, UMHL posted gross sales revenue of ~NPR 271 million in FY15 compared to ~NPR 277 million in FY14 despite the annual escalation in PPA tariff rates. Nonetheless, benefitted by lowering term loans and lower interest rates in banking sector, PAT<sup>8</sup> for FY15 was NPR 24.23 million over OPBDITA<sup>9</sup> of ~NPR 231 million on year ending July 2015 compared to PAT of NPR 1.41 million in FY14. The company had ~NPR 1,340 million of outstanding term loan payable to the consortium banks as on July 2015 as per audited financials (~NPR 1,415 million on July 2014), corresponding to a gearing ratio of 1.94 times. UMHL's track record of debt servicing (which began from mid-April 2013) remains good; partly benefitted from the regime of low lending rates in banking system and ballooning instalment method of repayment which entails small portion of principal repayment in initial years.

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<sup>6</sup> Required commercial operation date

<sup>7</sup> Net PLF of 59% in FY14 decreased to 55% in FY15, remaining much lower than design PLF of ~70%.

<sup>8</sup> Profit After Taxes

<sup>9</sup> Operating profit before depreciation, interest, tax and amortization expense



## Company Profile

UMHL was founded on 21<sup>st</sup> November, 2007 as a private limited company and was subsequently converted into public limited company on 11<sup>th</sup> April, 2014 to facilitate public participation. As of April, 2016, UMHL had 349 promoters including 6 major institutional promoters accounting for entire paid up capital of the company. Major promoters of the company include Fidelity Investment Pvt. Ltd. (~10% holding as of now), Prabhu Bank Limited (~10%), Himalayan Infrastructure Fund Ltd. (~8%), Peoples Hydro Cooperative Limited (~4%), among others. The promoter holding after proposed IPO is expected to dilute to 75%, assuming full subscription. The shares of the company are proposed to be listed in the stock exchange post proposed IPO.

**June 2016**

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