Shuvam Power Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed IPO of Shuvam Power Limited

Instrument/Facility	Issue Size	Grading Action (December 2018)
IPO (equity) Grading	NPR 58.058 million	[ICRANP] IPO Grade 5 (Assigned)

ICRA Nepal has assigned "**[ICRANP] IPO Grade 5**", indicating poor fundamentals to the proposed initial public offering (IPO) of Shuvam Power Limited (SPL). 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. Thus, the grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively. SPL is proposing to come out with an Initial Public Offer of 580,580[1] units of equity shares of face value NPR 100 each at par. The issue size is made of 400,000-unit shares originally earmarked for general public and 180,580-unit shares unsubscribed by project affected population, which will now be issued to general public. The proceeds from IPO are proposed to be used towards downsizing long term project loans of SPL.

The assigned grading is constrained by the poor financial profile of SPL, which owns and operates the 990-KW Lower Piluwa Hydroelectric Project (HEP) in eastern Nepal. The project's weak operational performance has resulted in an accumulated loss of ~NPR 19 million for SPL as of mid-July 2018. The plant has operated at the maximum recorded plant load factor (PLF) of ~50% during the past three to four years (~44% in FY2018), which was much lower than the contract energy PLF of 79%. The project's energy tariff also remains on the lower side, offsetting the benefits accruing from the extended project life (the project is not to be transferred to Government of Nepal (GoN) after completion of 25 years) and exemption from income tax and royalty payments to the Government. High equity capitalisation post IPO and the modest revenue generation from the project are likely to result in subdued return for the shareholders. Grading concerns also emanate from hydrological risks and interest rate volatility in the market which could impact the project earnings and returns. The project is also exposed to counterparty credit risks, given the moderate financial profile of Nepal Electricity Authority (NEA); although partly mitigated by sovereign support of the GoN to the NEA.

The 990-KW Lower Piluwa HEP was designed and developed at 50% exceedance flow model along the Piluwa river in the Sankhuwasabha district of eastern Nepal. The project started commercial operation from July 2011, ~30 months after the required commercial operation date (COD). The tariff rates for the energy generated by the projects as per the power purchase agreement (PPA) with NEA are NPR 3.90 and NPR 5.52 for the wet and dry seasons[2] respectively with no tariff escalations (as against NPR 4.80 for wet season and NPR 8.40 for wet season for hydro projects below 25 MW). Being a hydropower project with less than 1,000 KW installed capacity, Lower Piluwa HEP is entitled to certain regulatory benefits like indefinite project life with tax holiday, exemption from royalty payment to the Government and exemption from energy short supply penalty. However, these benefits are diluted due to weak project performance and lower energy tariff than peers.

Inadequate generation and penalty for delayed project commissioning and short supply of energy[3] in the initial years have impacted the company's financial profile. The project developers were unable to inject funds to service debt obligations or carry out the necessary repairs for ensuring smooth plant operations, leading to sizeable project downtime. Project loans were restructured (with loan repayment period extended from the earlier 8.5 years to 20 years) by the lender banks factoring in the weak revenue streams of the company. The project downtime decreased after SPL was taken over by new promoters in FY2015. This relatively smoothened the earnings profile, which coupled with the extended loan repayment period, has improved the debt servicing capacity of the company at present. However, the recent spike in interest rates could stretch the company's ability to meet the debt obligations from project revenues.

[1] Out of total size of 600,000 shares, 19,420 shares have been allotted to the project affected population in Q1FY2019.
[2] As per the PPA, four months between mid-Dec to mid-April are classified as wet months and rest as dry months.
[3] Since then, the government has waived short supply penalty for projects less than 1,000 KW installed capacity. Lately, the waiver has been extended to projects less than 10-MW capacity, if the short supply is due to hydrological reasons.

Since the revenues are linked to unit sales from a single operational project, the project returns, and the financial health of the company is primarily dependent on the hydrology of the project. In FY2018, SPL reported gross revenue from energy sales of ~NPR 17 million (corresponding to ~56% of the contract energy) against NPR 15 million in FY2017 (corresponding to 50% of contract energy). The company reported net profit of ~NPR 17 million in FY2018 against net profit of ~NPR 31 million in FY2017 (aided by non-operating income of ~NPR 21 million and ~NPR 34 million, respectively). As on mid-July 2018, the company had ~NPR 108 million of outstanding long-term loan payable to banks, translating into a low gearing of 0.89 times. However, weak project revenues and high interest rates are likely to limit its ability to meet the debt obligations. The gearing level and debt servicing capacity is likely to be comfortable after the project loans are repaid from the IPO proceeds as planned by the management. However, the ability of the company to raise the IPO proceeds to downsize the project loans remains to be seen. Going forward, the ability of the project to minimise the gap between actual generation and contractual energy will be the most important driver for project returns.

Company Profile

Shuvam Power Limited (SPL; erstwhile Baneshwor Hydro Private Limited) was incorporated on July 6, 2004 as a private limited company and subsequently converted into public limited company on December 29, 2015 to facilitate public participation. The name was changed following the acquisition of the majority stake in Baneshwor Hydro by individuals and institutions related to Mr. Shailendra Guragain and his associates in FY2015.

As on mid-July 2018, SPL had a total of 32 individual and institutional promoters. The major promoters of SPL include River Falls Power Limited (70.20%) and Ngadi Group Power Nepal (12.30%) – both entities with controlling interest of Mr. Guragain and his associates. The current 100% promoter shareholding is expected to dilute to 70% after the proposed IPO. Subsequently, the shares of the company are proposed to be listed in the stock exchange.

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