Aankhu Khola Jalvidut Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Initial Public Offering (IPO) of Aankhu Khola Jalvidut Company Limited

Instrument/Facility	Issue Size	Grading Action (July 2016)
IPO (equity) Grading	NPR 200 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 Aankhu Khola Jalvidut Company Limited (AKJCL). 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. Aankhu is proposing to come out with an Initial Public Offer of 2,000,000 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 800,000 shares will be issued to project affected areas while remaining 1,200,000 shares will be issued to general public and staff.

The assigned grading is constrained by the poor financial profile of AKJCL involved in development and operations of 8,400 KW hydro electric project (HEP). High project costs (~NPR 281 million per MW) coupled with fixed tariff have impacted the profitability for the project. The grading is also constrained by moderate operational performance of the HEP with a PLF[1] at net generation of ~55% for FY15 and ~47% for 10MFY16 as opposed to contract energy PLF of ~63% and ~58% respectively, which coupled with high financial leverage, has resulted in weak earnings and insufficient cash flows. This has, apart from impacting project returns, also resulted in requirement of additional funds (in the form of loans from promoters) to meet funding gap. Lack of strong institutional promoters and diversified promoter base[2] limits the quantum of support that could be expected from promoters in case of distress in future. Further, changes in leadership in the past indicates that the ability of the company to retain experienced personnel in management and operation remains limited, which could impact the smooth operation of the project going forward. Grading concerns also emanate from risks arising from any loss of hydrology which could further impact the project earnings and returns. The project is also exposed to substantial risks arising from interest rate volatility in the market as the loan repayment period has been extended over 20 years and also to counterparty credit risks arising out of exposure to loss-making NEA[3] 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 timely payments to AKJCL so far.

Aankhu Khola HEP is the first hydropower project developed by AKJCL. Delayed by ~18 months compared to RCOD[4] of February 2012, the project has been in operation since August 2013. The project was commissioned at a cost of NPR 2,364 million funded in a debt: equity mix of ~72:28. The tariff rates for contract energy as per PPA (Power Purchase Agreement) with NEA are NPR 4 and NPR 7 for 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 7th year after PCOD[5] 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 12 km, 33kVA transmission line to Dhadingbesi sub-substation. The project has operated at PLF (at net generation) of ~55% in FY15 and ~47% in 10MFY16; lower than annual design energy PLF of ~63% (~58% for 10MFY16) and thus generated an average of ~85% of contract energy over this period resulting in sizeable revenue loss to the company, in addition to occasional short supply penalty.

[1] Plant Load Factor
[2] 1,149 promoters hold 100% of capital as of now with the maximum individual shareholding being 3.33%.
[3] Nepal Electricity Authority
[4] Required Commercial Operational Date
[5] Proposed Commercial Operation Date

Since the revenues are entirely linked to unit sales from a single operational project, the project returns and also the financial health of the company is entirely dependent on the hydrology of the project stream. Owing to project being in full operation in FY15 and also the increment in PLF in FY15[6], AKJCL posted gross sales revenue of ~NPR 223 million in FY15 compared to ~NPR 167 million in FY14. The company reported net losses of ~NPR 77 million for FY15 over OPBDITA[7] of ~NPR 181 million compared to net loss of ~NPR 77 million in FY14. Significant interest expenses has been impacting the profitability so far, accordingly the plans of management to utilize ~80% of current IPO proceeds towards downsizing bank loans (rest towards settling other project liabilities) could reduce the impact to some extent. The company had ~NPR 1,554 million of outstanding term loan payable to the consortium banks as on July 2015 as per audited financials, translating into a gearing ratio of 4.06 times. AKJCL's track record of debt servicing (which began from mid-April 2015 and is spread over 20 years) remains 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. Going forward, the ability of the project to achieve its design operating parameters will be the most important driver for the project returns.

Company Profile

Incorporated in 2008 as a private limited company, AKJCL was subsequently converted into public limited company in August, 2010 to facilitate public participation. AKJCL has a diversified promoter base of 1,149 promoters accounting for entire paid up capital of the company as of now. Major promoters of the company include Mr. Janak Prasad Bhatta (3.33%), Mr. Sharmila Tamang (2.58%) and Mr. Chandra Bahadur Tamang (2.50%), among others. 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 the IPO process, the company would issue 10% of its post IPO paid-up capital to the local inhabitants of project affected areas following which remaining 15% capital shall be offered to general public and staffs of the company. The company is at present operating 8,400 KW Aankhu Khola -1 hydro-electric project, located in Salyankot and Marpak VDCs of Dhading District in Central Nepal.

July 2016

For further details please contact:

Analyst Contacts:
Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Rajib Maharjan, (Tel No. +977-1-4419910/20)
rajib@icranepal.com

Relationship Contacts:
Mr. Deepak Raj Kafle, (Tel. No. +977-1-4419910/20)
drkafle@icranepal.com

[6] Net energy supplied was ~76% and ~87% of contract energy in 11MFY14 and FY15 respectively.
[7] Operating profit before depreciation, interest, tax and amortization expense