

## Barun Hydropower Company Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Rights issue (equity shares) of Barun Hydropower Company Limited

Instrument/Facility	Issue Size	Grading Action (February 2018)
Rights issue (equity)	NPR 255.15 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned “[ICRANP] IPO Grade 4”, indicating below average fundamentals to the proposed rights issue (equity shares) of Barun Hydropower Company Limited (Barun). ICRA Nepal assigns IPO grading<sup>1</sup> 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. Barun has proposed 1:1 rights share offering of 2,551,500 numbers of equity shares of face value NPR 100 to the existing shareholders at par. Major portion (~90%) of the rights issue proceeds is likely to be used towards pre-payment of long term project loans of Barun while balance is to be invested as seed money in the upcoming project being developed by same promoter group.

The below average fundamental grading factors in weak operational performance of the operational 4.5 MW Hewa Khola Hydroelectric Project (HEP), which is the only operational hydropower project under Barun. The project has been unable to meet its design parameters for the performance. The plant operated at a net plant load factor of ~48% during FY2017 and ~50% during FY2015 and FY2014 vis-à-vis design energy PLF of 66%. Amid weak project performance and proposed capital infusion, incremental returns to equity holders are likely to remain diluted. However, downsizing of loans, especially in the current high interest rate environment is likely to reduce the financial risk in the company. Grading concerns also emanate from hydrological risks inherent in the projects; especially due to the lack of deemed generation clause in the PPA. Being a rain fed river, Hewa Khola’s hydrology is dependent on the annual precipitation received by the region. The hydropower projects in Nepal are also exposed to counterparty credit risks arising out of exposure to loss-making NEA for the energy supplied; although the risk is partly mitigated due to sovereign support of Government of Nepal (GoN) to the NEA.

Nonetheless, the grading factors in the reputation of the major promoters and their prior experience in hydropower sector. Although the 4.5 MW project is the first standalone venture of the major promoter group (Mr. Shailendra Guragain & associates), the promoters were a part of Arun Valley Group<sup>2</sup> in the past. The 4.5 MW project was commissioned in August 2011 and has firm Power Purchase Agreement (PPA) with Nepal Electricity Authority (NEA) eliminating offtake and tariff risk.

The 4.5 MW Hewa HEP project site was affected by flash flood in June 2015 which led to project disruption for ~15 months from June 2015 to August 2016. The incident resulted in material damage of ~NPR 145 million. ~NPR 135 million towards the damage was recovered from insurance companies while the rest was capitalized to the fixed assets block. However, loss of profit policy covered the revenue losses for 6 months vis-à-vis project disruption period of ~15 months; largely affecting FY2016 revenue. Funding requirement (including the fund for long term debt servicing) during the project disruption period, were met by raising short term loans from banks and promoters. This resulted in elevated gearing level for FY2016 which has since then moderated after the project resumption.

Barun owns and operates 4.5 MW Hewa Khola HEP, developed along Hewa river in Sankhuwasabha District of Eastern Nepal. The project was commissioned in August 2011 and was connected to national grid via 33 KV transmission line. Apart from moderate hydrological profile of the river, low evacuation capacity of the grid in the region also partly contributes to the energy loss and therefore the low PLF of Hewa HEP<sup>3</sup>. During FY2017, the project operated for ~11 months. During the period, the project operated at net PLF of 48%, meeting 76% of the PPA contract energy for the period.

<sup>1</sup> Includes grading of IPO, rights issue and further public issue.

<sup>2</sup> The promoters of Barun were involved in the Arun Valley Group when it developed 3 MW Puluwa HEP in eastern Nepal. The project was commissioned in 2003.

<sup>3</sup> Meter reading for Hewa HEP is done at NEA’s Tirtire substation. NEA makes payment to Barun after deducting 5.18% from meter reading (to cover transmission loss to the nearest load centre).



During FY2017, Barun reported profit after tax of ~NPR 73 million (backed by non-operating income of ~NPR 53 million) vs. net loss of NPR 36 million in FY2016. With the management planning to pre-pay the project loans from rights issue proceeds, incremental debt burden of the company is likely to remain low. This is a positive, especially in the rising interest rate scenario in the banking industry of Nepal.

Management plans to invest small portion (~10%) of the rights issue proceeds in one of the projects<sup>4</sup> being developed by a related company. However, given the nascent stage of the project, incremental returns to the shareholders of Barun over foreseeable future is likely to accrue from the revenue generated by the 4.5 MW Hewa Khola project. Therefore, incremental profitability of Barun will depend on the ability of the project to minimize the gap between contract energy and energy delivered. Barun has outstanding project loans of NPR 335 million as on mid-October 2017 (including long term loans of NPR 233 million), translating into gearing ratio of 1.2. Gearing ratio is likely to ease after the proposed equity injection and pre-payment of the long-term project loans.

### Company Profile

Barun, a hydropower development company, was established as private limited company in January 2004 and converted into public limited company in July 2009 to enable public participation. Barun owns and operates 4.5 MW Hewa Khola Hydroelectric project (HEP) in Sankhuwasabha district of eastern Nepal. The project is in operation since August 2011. The energy generated by the project is being sold to Nepal Electricity Authority (NEA) as per the terms of power purchase agreement (PPA).

Barun has 70:30 promoter public shareholding. Mr. Shailendra Guragain and his associates have controlling stake in Barun. As on mid-July 2017, major promoters of Barun include Ms Jamuna Poudel (~11%), Mr. Shailendra Guragain (~4%), Mr. Bhogendra Guragain (~4%), Mr. Dedaraj Khadka (~4%), etc.

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<sup>4</sup> management plans to invest ~NPR 25 million in 40 MW Super Nyadi HEP; another project by same promoter group (separate SPV). This is ~1% of the project's estimated equity need of NPR 2 billion (total cost NPR 7 billion).