Joshi Hydropower Development Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Initial Public Offering (IPO) of Joshi Hydropower Development Company Limited

Instrument/Facility	Issue Size	Grading Action (February 2018)
IPO (equity) Grading	NPR 181.986 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 Joshi Hydropower Development Company Limited (JHDCL). 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. JHDCL is proposing to come out with an Initial Public Offer of 1,819,860 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 371,400 shares will be issued to project affected areas while remaining 1,448,460 shares will be issued to general public and staffs.

The assigned grading is constrained by weak return potential from the 3,000 KW Upper Puwa -1 hydro-electric project (HEP) developed by JHDCL given its poor operational performance so far (net plant load factor – PLF of ~42% for FY17 vs. contract energy PLF of ~65%) and low tariff rates applicable for generations up to initial capacity of the project i.e. 985 kW. Low PLF mainly due to insufficient hydrology has resulted in significant loss of revenue and insufficient cash flows requiring support from promoters/ affiliated companies to repay bank obligations timely. Additionally, JHDCL has been incurring high penalty expenses for lower generation so far. Though the quantum of penalty could be lower going forward owing to policy relaxations for projects up to 10 MW, low generation coupled with fixed tariff for the project life and also over capitalization (through equity infusion from proposed IPO) limits the overall return prospects to shareholders. Grading concerns also emanate from risks arising from any further loss of hydrology and interest rate volatility in the market which could impact the project earnings and returns. The project is also exposed to counterparty credit risks arising out of exposure to loss-making Nepal Electricity Authority (NEA) 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 JHDCL so far.

Upper Puwa-1 HEP is the first hydropower project developed by JHDCL. Initially proposed as a 985 KW project to be built on 55% exceedance flow model, the capacity was later changed to 3,000 KW to be built on 40% exceedance flow model; resulting in two sets of tariff rates for power generated by the project. The tariff rates for 985 KW 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 same is entitled to 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 proposed COD (13th April 2015), with 5 times annual escalation of 3% on base tariff. The electricity sales revenue shall thereafter be based on the rates as per PPA. For balance 2,015 KW, the tariff is NPR 4.80 and NPR 8.40 per unit for wet and dry season with 3% escalation for 5 years. JHDCL, like other Independent Power Producers (IPPs), has also not yet received the incremental revenue from promotional tariff rates.

Delayed by ~13 months compared to required commercial operation date of 19th December 2013, the project began commercial operation from 15th January 2015. The run of river project was commissioned at a cost of ~NPR 564 million funded in a debt: equity mix of ~65:35 (would go down to ~34:66 post IPO). The power generated by the project is evacuated via ~2 km, 33kVA transmission line to Puwa sub-substation. The project has operated at PLF (at net generation) of ~44% in FY16 and ~42% in FY17; much lower than annual design energy PLF of ~65% and thus generated ~65-67% of contract energy resulting in sizeable revenue loss to the company, in addition to substantial short supply penalty (~NPR 4-5 million for FY16 and FY17 which was ~8-10% of gross revenue for these years). The quantum of penalty could remain lower going forward given the policy level relaxation for projects up to 10 MW. PPA has been amended to this effect allowing availability declaration (AD) of up to 50%; penalty will hence only be attracted for generations less than 80% of AD. However, net energy supplied during 6MFY18 was ~13% lower compared to similar period last year despite most of these months being peak wet months, hence raising further concern in incremental generation prospects.

Since the revenues are entirely linked to unit sales from a single operational project, the project return and the financial health of the company is entirely dependent on hydrology of project stream. For FY16 (the first year of full operations) and FY17, JHDCL posted gross sales revenue of ~NPR 55 million each. The company reported net profit of ~NPR 2.4 million for FY17 (~NPR 0.3 million for FY16) over operating profit of ~NPR 43 million (~NPR 42 million for FY17). However, these reported numbers were benefitted by ballooning depreciation method adopted by the company and the auditors have qualified their opinion over this matter. The company had ~NPR 326 million outstanding term loan payable to the consortium banks as on mid-Jan 2018 as per provisional financials, translating into a gearing ratio of 2.08 times. Despite inadequate operational cash flows, JHDCL's debt servicing so far remains supported by advances from promoters and affiliated companies (~NPR 41 million as of Mid-Jan-18 vs. ~NPR 27 million on Jul-15). Management plans to utilize ~75% of current IPO proceeds towards downsizing bank loans (rest towards settling promoter loans) would result in lower interest expenses which along with ballooning instalments-based repayment might support JHDCL in meeting obligations towards bank over medium term. Going forward, the ability of the project to minimize the gap between actual generation and contractual energy will be the most important driver for the project returns.

Company Profile

Incorporated in April 2005 as a private limited company, JHDCL was converted into public limited company in March 2015 to facilitate public participation. Currently, JHDCL is closely held by a group of 12 individual promoters accounting for entire paid up capital of the company (NPR 189.40 million as of mid-Jan-18 including share application of NPR 56.50 million and net worth of ~NPR 180 million); capital to be increased to NPR 189.414 million prior to IPO). Major promoters of JHDCL include Mr. Birendra Bahadur Neupane (23.54% holding), Mr. Binod Thapa (14.25%), Mr. Binit Kumar Sharda (10.00%) and Mr. Sashi Karki (10.00%), among others. The promoter holding is expected to dilute to 51% 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 IPO process, JHDCL would issue 10% of post IPO paid-up capital to locals of project affected areas, after which remaining 39% of post IPO capital shall be offered to general public and staffs of the company. JHDCL has been operating 3,000 KW Upper Puwa-1 HEP from January 2015; the project is located in Puwa-Mahjuwa VDC of Ilam District in Eastern Nepal.

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