

Universal Power Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed initial public offering (IPO) of Universal Power Company Limited

Instrument/Facility	Issue Size	Grading Action (June 2018)
IPO (equity) Grading	NPR 966.161 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below average fundamentals to the proposed Initial Public Offering (IPO) of Universal Power Company Limited (UPCL). 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. UPCL has proposed an Initial Public Offer of 9,661,610 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 2,100,350 shares will be issued to project affected population while remaining 7,561,260 shares will be issued to the public. The proceeds from proposed IPO will be used to downsize the long-term loans taken for the development of 11 MW Tallo Khare Khola Hydropower project (HPP) being developed by UPCL in Dolakha district of eastern Nepal.

The assigned grading considers the risks associated with timely commissioning of 11 MW Tallo Khare Khola HPP being developed by UPCL. Power from the HEP will be evacuated through 132 KV Lamosanghu-Singati transmission line being developed by Nepal Electricity Authority (NEA). Transmission line projects of NEA have witnessed substantial delays in the past. This poses evacuation risk and timely commencement of operations of Tallo Khare Khola HPP which is expected to commission in July 2019. The grading is also constrained by early stage of development (~44% of total project cost incurred¹ till mid-May 2018) of the 11 MW project; exposing it to typical implementation risks such as increase in time and cost estimates which could affect the project return indicators. Availability of sufficient water discharge also remains a concern given the lack of long term flow data for the river. Counterparty credit risks arising out of exposure to NEA for the energy supplied also remains a concern; although partly mitigated by the sovereign support of Nepal Government to the NEA.

The 11 MW project will be funded almost entirely² through equity, assuming pre-payment of project development loans from IPO proceeds. With paid up capital of NPR 1,134 million as of mid-April 2018 and proposed IPO proceeds of ~NPR 966 million (vis-à-vis project equity requirement of NPR 747 million), UPCL is substantially overcapitalized (compared to industry average of ~30%) voiding benefits of leverage and resulting in subdued return to equity investors.

Nonetheless, the assigned grading factors in experience of the promoters and management personnel in the field of HEP development and operation. The group companies have operational hydropower capacity of ~8.5 MW³ with the first project of the group operating since 2001. With a firm Power Purchase Agreement (PPA) in place for under construction 11 MW Tallo Khare Khola HPP, the tariff and off-take risks are reduced considerably for the project. With promoter’s equity already injected and bank facilities tied up through syndicated loan agreement, funding risk remains low for the project. Furthermore, the financial risk in the project is likely to come down after the pre-payment of loans from IPO proceeds, as planned by the management (assuming full subscription of IPO). Going forward, ability of the company to commission the project within the budgeted time and cost estimates and availability of sufficient hydrology will be the key parameters which can impact returns of the project.

UPCL is developing Tallo Khare Khola HPP, a 11 MW run-of-the-river hydropower project along Khare river in Dolakha district of Eastern Nepal. The electricity generated from this project shall be connected to proposed Singati substation of NEA; ~5 Km from the powerhouse of Tallo Khare Khola HPP. UPCL obtained power generation license for the project in July 2012 from the ministry of energy (MOE) and PPA with NEA was signed in February 2014 (with amendment signed in May 2016).

¹ As per the certified expense report till mid-May 2018. The cost includes advance to contractors.

² Post IPO paid up capital will be ~NPR 2,100 million (including ~NPR 150 million invested in sister companies) while project cost is ~NPR 2,047 million. Uncommitted surplus equity will be deployed in downsizing project loans.

³ Including 4.4 MW Radhi HEP (since 2014), 4 MW Khudi HEP (since 2006) and 183 KW Syange HEP (since 2001).

Project cost for the 11 MW project is budgeted at NPR 2,047 million; to be funded by bank loans of NPR 1,300 million and equity of NPR 747 million in a debt: equity ratio of ~64:36. Entire promoter equity required for the project has been injected while loans are being drawn based on syndicated loan agreement signed with consortium of banks. As per the certified expense report till mid-May 2018, outstanding project loans of UPCL stood at ~NPR 307 million.

As of mid-May 2018, ~35% physical progress⁴ has been achieved in terms of project development, commensurate with the financial progress. Moreover, timely commissioning of the 132 KV transmission line by NEA remains critical for the financial profile of the project. The 40 KM NEA transmission line is in early stages of development. Given the history of delays in commissioning of transmission line by NEA, this remains a concern. However, many other projects (some with earlier COD than 11 MW Tallo Khare Khola HPP) in the basin are dependent on the commissioning of NEA's transmission line for power evacuation which could aid in timely commissioning of the project.

Company Profile

Universal Power Company Limited (UPCL) is an associated company of CEDB Hydro Fund Limited (CHF). CHF and its affiliate companies have ~9% stake in UPCL⁵. UPCL's ownership pattern is highly fragmented with more than 4,700 shareholders (mostly individual). UPCL was incorporated in 3rd December 2002 (as a private limited company) and converted to public limited (30th March 2011) for enabling public participation.

UPCL is developing 11MW Tallo Khare Khola HPP in Dolakha district of Central Nepal. Although Khare HEP is the first project under UPCL, the parent company (CHF) has prior experience in hydropower project development and operation.

The company plans to float an IPO of 46% (~NPR 966 million) of post IPO capital. The issue will be made in two tranches- first tranches (10% of issued capital) to the project affected local population and second tranche (36% of issued capital) to general public. Post IPO paid up capital of UPCL will be ~NPR 2,100 million with ~46% public shareholding.

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⁴ Based on management reports

⁵ Diluted from ~68% due to the conversion of erstwhile preference shares into common equity in September 2017.