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 (December 2016)
IPO (equity) Grading	NPR 181.90 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 1,819,000 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 371,300 shares will be issued to project affected areas while remaining 1,447,700 shares will be issued to general public and staff.

The assigned grading is constrained by the poor financial profile of JHDCL involved in development and operations of 3,000 KW Upper Puwa -1 hydro electric project (HEP). The grading is also constrained by poor operational performance of Upper Puwa-1 HEP with PLF[1] at net generation of ~44% for FY16 as opposed to contract energy PLF of ~65% which has resulted in weak earnings and insufficient cash flows. Low PLF mainly due to insufficient hydrology[2] resulted in loss of revenue and penalty expenses as per PPA which coupled with fixed tariff for the project life limits the return prospects going forward also. 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 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 JHDCL so far.

Upper Puwa-1 HEP is the first hydropower project developed under JHDCL. The project was 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 PCOD[4] 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.

Delayed by ~13 months compared to RCOD[5] of 19th December, 2013, the project began commercial operation from 15th January, 2015. The run of the river project was commissioned at a cost of NPR 564 million funded in a debt: equity mix of ~65:35. The power generated by the project is evacuated via ~1 km, 33kVA transmission line to Puwa sub-substation. The project has operated at PLF (at net generation) of ~44% in FY16; much lower than annual design energy PLF of ~65% and thus generated an average of ~67% of contract energy during the year resulting in sizeable revenue loss to the company, in addition to substantial short supply penalty. Net energy supplied was ~80% of contract energy in 3MFY17, these months fall within the wet season and hence the generation is high.

[1] Plant Load Factor
[2] As discussed with the management local people divert the water upstream of the headworks for irrigation purpose resulting in weak hydrology specially in dry season.
[3] Nepal Electricity Authority
[4] Proposed Commercial Operation Date
[5] Required Commercial Operational Date

Since the revenues are entirely linked to unit sales from a single operational project, the project returns and the financial health of the company is entirely dependent on the hydrology of the project stream. For FY16 (the first year of full operations), JHDCL posted gross sales revenue of ~NPR 55 million in FY16 compared to ~NPR 11 million in 6MFY15. The company reported net losses of ~NPR 5 million for FY16 over OPBDITA[6] of ~NPR 49 million. However, these reported financial number for Jul-16 do not include penalty for low generation and royalty expenses, considering the same net loss of the company comes around ~NPR 15 million. The company had ~NPR 357 million of outstanding term loan payable to the consortium banks as on July 2016 as per provisional financials, translating into a gearing ratio of 2.49 times. JHDCL's track record of debt servicing so far remains benefitted from the regime of low lending rates in banking system and ballooning instalments which entails small portion of principal repayment in initial years. Despite that, repayment falling due in dry season however had to be managed from other sources owing to very low revenue during these months. As a consequence, management plans to downsize bank loans from IPO proceeds. 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 subsequently 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. Major promoters of the company include Mr. Birendra Bahadur Neupane (28.44%), Mr. Binod Thapa (15.56%) and Mr. Binit Kumar Sharda (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 the IPO process, the company would issue ~10% of its post IPO paid-up capital to local inhabitants of project affected areas following which remaining ~39% of post IPO paid-up capital shall be offered to general public and staffs of the company. The company is at present operating 3,000 KW Upper Puwa-1 HEP, located in Puwa-Mahjuwa VDC of Ilam District in Eastern Nepal.

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[6] Operating profit before depreciation, interest, tax and amortization expense