# Unique Hydel Company Limited

## ICRA Nepal assigns [ICRANP] IPO Grade 5 to the proposed Initial Public Offering (IPO) of Unique Hydel Company Limited

| Instrument/Facility | Issue Size | Grading Action (June 2017) |
|---|---|---|
| IPO (equity) Grading | NPR 220 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 Unique Hydel Company Limited (UHCL). 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. UHCL is proposing to come out with an Initial Public Offer of 2,200,000 numbers of equity shares of face value NPR 100 each at par. Of the total shares, 550,000 shares will be issued to project affected areas while remaining 1,650,000 shares will be issued to general public and staff.

The assigned grading takes into account the poor return potential from the 4,158 KW Baramchi hydro-electric project (HEP) developed by UHCL given its weak operational performance, high project costs (~NPR 216 million per MW), and also over capitalization (through injection of equity through IPO). The project so far has operated with plant load factor (PLF) at net generation of ~42% during 9M FY2015 as opposed to contract energy PLF of ~61% resulting in weak earnings and insufficient cash flows. The project operations were impacted by earthquake in April 2015 and landslides in July 2016 leading to plant shutdown for about two years. Grading concerns also emanate from inadequate generation post commencement of plant operations in 20th April 2017 (~4% PLF vs. ~44% contract PLF for ~2 months). Low PLF mainly due to insufficient hydrology coupled with fixed tariff (lower tariff rates for the initial 980 kW capacity) severely limits the return prospects from the project. The assigned grading is further constrained by the poor financial profile of UHCL marked by accumulated losses and erosion of its net worth per share to NPR 77 per share as on mid-Apr-17 as against face value of NPR 100. Additionally, interest rate volatility in the market 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 UHCL so far.

Baramchi HEP was initially developed as a 980 kW project which was later upgraded to 4,158 kW based on 40% exceedance flow model. The tariff rates for the initial 980 KW capacity as per Power Purchase Agreement (PPA) with NEA were fixed at NPR 3.90 and NPR 5.52 for wet and dry seasons respectively. For balance 3,178 KW, the tariff is NPR 4 and NPR 7 per unit for wet and dry season with 3% escalation for 9 years. Delayed by ~9 months compared to required commercial operational date of 2nd February 2010, the project began commercial operation from 14th November 2010. The run of the river project was commissioned at a cost of NPR 898 million funded in a debt: equity mix of ~58:42. The power generated by the project is evacuated via ~18 km, 33 kVA transmission line to NEA Lamosanghu sub-substation.

The loss of revenue, repair costs (NPR 59 million) and insufficient insurance proceeds for repair cost (NPR 29 million so far) post the earthquake and landslides have severely impacted the financial profile of the project. The project has resumed operations since 20th April 2017. The difficult project terrain had led to elongated plant shutdowns even prior to earthquake and landslides owing to various maintenance issues. The geography could have been further compromised post the earthquake and hence there could be operation disruptions in future as well.

The project so far has operated at PLF (at net generation) of ~43% in 8M FY2014 and ~42% in 9M FY2015; much lower than contract PLF of ~74% and ~61% for the corresponding period respectively, resulting in sizeable revenue loss to the company and substantial short supply penalty. In two months of FY2017 ending mid-June-17, PLF was only ~4% vs. ~44% contract PLF. In absence of deemed generation clause in PPA and the new regulations also requiring generation of at least 40% of contract energy for waiver of penalties to hydropower projects up to 10 MW, the company could be subject to low generation penalties going forward as well.

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. During FY2016, UHCL posted zero gross sales revenue (owing to shut down and loss of profit received from insurance amounting ~NPR 41mn) compared to ~NPR 52 million in FY2015. The company reported net loss of ~NPR 70 million during FY2016 and negative operating profit[1] of ~NPR 20 million. During 9M FY2017 UHCL posted net loss of ~NPR 44 million and negative operating profit of ~NPR 15 million. The company had ~NPR 419 million of outstanding term loan payable to the consortium banks as on mid-April 2017 as per provisional financials, translating into a gearing ratio of 1.88 times. UHCL's debt servicing in the past has been impacted by lack of operational revenue and had to be supported by insurance proceeds and loans from promoters. Given the weak hydrology, poor operational performance, and substantial funds already infused in the project, the project is not expected to generate adequate returns for the investors.

**Company Profile**

Unique Hydel Company Limited (UHCL) was incorporated in 14th July 2000 as a private limited company and was subsequently converted into public limited company on 17th July 2014 to facilitate public participation. UHCL has a small promoter base of seven promoters accounting for entire paid up capital of the company as of now. The major promoters of UHCL include Baramchi Investment Pvt. Ltd. (48.48%), Modi Khola Investment Pvt. Ltd. (45%), Friends of Baramchi Investment Pvt. Ltd. (5.85%). The management plans to use the proposed IPO proceeds to downsize the project loans from banks as well as other project liabilities. The promoter holding after proposed IPO is expected to dilute to 60%, assuming full subscription. 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 30% capital shall be later offered to general public and staffs of UHCL. The shares of the company are proposed to be listed in the stock exchange post proposed IPO.

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