

Nepal Hydro Developer Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering (IPO) of Nepal Hydro Developer Limited

Instrument/Facility	Issue Size	Grading Action (July 2017)
IPO (equity) Grading	NPR 39 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 Nepal Hydro Developer Limited (NHDL). 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. NHDL is proposing to come out with an Initial Public Offer of 390,000 numbers of equity shares of face value NPR 100 each at par to be issued to general public and its staffs.

The assigned grading takes into account the weak return potential from the 3.52 MW hydro-electric project (HEP) developed by NHDL on account of moderate operational performance, high project costs (~NPR 198 million per MW) and over capitalization (through injection of equity through IPO). The project operated at an average plant load factor (PLF) at net generation of ~55% in past four years as opposed to contract energy PLF of ~66% resulting in weak earnings, which coupled with fixed tariff have resulted in lower than optimum financial performance. Grading concerns further emanate from uncertainty regarding revenue stream from 6,800 KW Lower Charnawati HEP where investment is planned from proposed IPO proceeds. Apart from the high project execution risks involved in the development of the cascade project, the hydrology risks too is elevated as both projects under NHDL would be in the same river basin. The project is also exposed to interest rate volatility and 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 NHDL so far which provides some comfort.

Nevertheless, the assigned grading factors in the reputation and experience of promoter group in hydropower development in Nepal. With a firm power purchase agreement (PPA) in place and positive demand outlook, the tariff and off-take risks are reduced considerably for the operational project. NHDL has been operating 3,520 KW Charnawati HEP since June 2013 and has plans to develop 6,800 kW Lower Charnawati HEP at a cost of NPR 1,121 million. Considering the limited developments in the planned cascade project, IPO proceeds are likely to be utilized towards downsizing bank loans as of now.

Charnawati HEP is the first hydropower project developed by NHDL, although its major promoters have been actively involved in hydropower project development through various companies. The project was commissioned at a cost of NPR 696 million funded in a debt: equity mix of ~77:23. The tariff rates for contract energy as per PPA are NPR 4 and NPR 7 for wet and dry seasons respectively; with annual escalation of 3% on base tariff for 9 years from Commercial Operation Date (COD). Under the Government of Nepal’s initiative for promoting private sector hydropower developers, the project has been availing promotional tariff rates of NPR 4.80 and NPR 8.40 per unit in wet and dry seasons; which shall remain effective up to 6th year after COD with 5 times annual escalation of 3% on base tariff. The electricity sales revenue shall thereafter be based on the rates as per PPA. The power generated by the project is being evacuated via 7 km, 33KVA transmission line to Makaibari substation at Dolakha. The project has operated at net PLF of ~57% in FY2015 and ~58% in FY2016, lower than contract PLF of ~66% and thus generated an average of ~83% of annual contract energy resulting in revenue loss to the company, in addition to occasional short supply penalty (albeit nominal). In eleven months of FY2017 ending mid-June-17, PLF however declined to ~53% vs. ~63% contract PLF.

Following the survey license for Lower Charnawati HEP (6.8 MW), feasibility study was conducted in Nov-2015, while all other procedures including power generation license, detailed designing, grid connection and PPA with NEA and financial closure are yet to be carried out. The proposed cascade project would utilize the water from tailrace of the current project along with addition of another stream emanating downstream from headwork of current project. The project is planned to be commissioned at a cost of NPR 1,121 million (cost per MW ~NPR 165 million) to be financed in a debt: equity of 70:30. The proportion of NHDL’s investment in the project is yet to be finalized Timely completion of the planned

project within the budgeted time and cost estimates is a key sensitivity for determining the returns generated by the project. Typically, hydro-power projects entails significant project execution risks as they are located in difficult terrain and hence adverse climatic conditions during the construction period and also geological surprises can disrupt construction schedule of any project. Nevertheless, the promoters and management personnel have adequate experience in construction and operation of hydro power projects which mitigates this risk to some extent.

Since the revenues are entirely linked to unit sales from a single operational project, the project returns and also the financial health of the company is entirely dependent on the hydrology of the project stream. Owing to slightly higher PLF in FY2016 (vis-a-vis previous year) and increase in tariff rates, NHDL posted gross sales revenue of ~NPR 104 million in FY2016 compared to ~NPR 97 million in FY2015. The company reported profit after taxes (PAT) of ~NPR 14 million for FY2016 over operating profit¹ of ~NPR 83 million compared to PAT of NPR 0.62 million in FY2015. During 9M FY2017, the company reported PAT of ~NPR 19 million over OPBDITA of NPR 68 million. NHDL had ~NPR 398 million of outstanding term loan payable to the consortium banks as on mid-April 2017 as per unaudited financials, corresponding to a gearing ratio of 1.95 times. NHDL's track record of debt servicing (which began from mid-April 2014) remains good so far; partly supported by current low lending rates and ballooning instalment method of repayment which entails small portion of principal repayment in initial years.

Going forward, the ability of the project to achieve its design operating parameters will be the most important driver for the project returns.

Company Profile

Founded in September 2006 by 10 promoters, NHDL was converted into a public company in July 2014 with the objective of facilitating public participation. Major promoters of the company included Er. Gyanendra Lal Pradhan, Mr. Kumud Kumar Dugar, Mr. Pashupati Murarka, Mr. Dev Kishan Mundara, Mr. Ananda Prasad Pokharel, among others. NHDL has already floated 10% of post IPO paid up capital to project affected local and the final promoter: public holding would be diluted to 75:25 post the proposed IPO, assuming full subscription.

The company is at present operating 3,520 kW Charnawati HEP in Dolakha District of Central Nepal since June 2013 and it has plans to invest in 6,800 kW Lower Charnawati HEP that is in process of PPA and financial closure.

July 2017

For further details please contact:

Analyst Contacts:

Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)

kishor@icranepal.com

Mr. Rajib Maharjan, (Tel No. +977-1-4419910/20)

rajib@icranepal.com

Relationship Contacts:

Mr. Deepak Raj Kafle, (Tel. No. +977-1-4419910/20)

drkafle@icranepal.com

All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website (www.icranepal.com) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents.

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