

Grading Rationale
CEDB Hydropower Development Company Limited

Grading

Particulars	Amount (Rs. In Million)	Grading	Grading Action
Initial Public Offering (IPO)	251.823	CARE-NP IPO Grade 4 [IPO Grade Four]	Assigned

The explanatory notes regarding the Grading symbols of CARE Ratings Nepal Limited (CRNL) are attached as Annexure 1

CRNL has assigned ‘CARE-NP IPO Grade 4 [IPO Grade Four]’ grading to the proposed Initial Public Offering (IPO) of CEDB Hydropower Development Company Limited (CHDC). ‘CARE-NP IPO Grade 4’ indicates Below Average Fundamentals. CRNL assigns IPO grades on a scale of Grade 1 to Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. CRNL use modifier {"+" (plus)} with the grading symbols 2, 3 and 4 and the same reflect comparative standing within the category. CRNL’s IPO grading is an opinion on the fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the ‘fundamentals’ of the issuer. CHDC is proposed to come out with IPO of 2.51823 Million equity shares having face value of Rs.100 each at par aggregating Rs.251.823 Million.

Detailed Rationale & Key Grading Drivers

The grading assigned to CHDC is constrained by concentrated investment in hydropower sector, equity commitments with long gestation period of its investments, limited experience in executing large scale projects and high & increasing collection period The grading also factors in project implementation risk related to various under construction projects and hydrology risk associated with run-of-the-river power generation affecting profitability of the company. The grading, however, derives strength from experienced directors & management expertise, track record in operating hydro power projects with healthy plant load factor, comfortable financial risk profile & strong debt service indicators and diversified stream of revenue profile. The grading also considers shortage of power in the country, government support for the power sector and generation license obtained & power purchase agreement concluded for the plants.

Detailed Description of the Key Grading Drivers

Key Grading Weaknesses

Equity commitments, concentrated investment and long gestation period of its investments

CHDC has made investment of Rs.291 Mn as on FY18 (Provisional, refers to 12 months’ period ended mid-July 2018) for the on-going/operational projects in hydropower companies. Being an investment

company, the return prospects of CHDC largely depend upon the performance of its investee companies. The company has balance equity commitments of Rs.319 Mn till Mid July 2020 out of which majority is towards Kasuwa Khola Hydropower Limited (KKHL) to the tune of Rs.312 Mn for Kasuwa Khola Hydroelectric Project (KKHEP), 45 MW which is under construction stage. CHDC has already invested about Rs.52 Mn in KKHEP as equity as on July 16, 2018 out of its contribution of Rs.364 Mn. CHDC is planning to raise Rs.252 Mn through initial public offerings (IPO) during FY20 and balance amount will be infused by the promoters. Out of the total investment book of CHDC, ~42% will be invested in single project, KKHEP. KKHEP is in the nascent stage of construction, the financial closure of the project is yet to be achieved which can impact the revenue prospects of CHDC in short to medium term.

Limited experience in executing large scale projects and inherit project implementation risk

The company, through its subsidiary and associate companies, has two operational plants with an aggregate capacity of 4.58MW, whereas it is setting up plants of aggregate capacity of 73MW. The company is currently implementing its largest project with installed capacity of 45MW through its subsidiary KKHL which is in nascent stage. Thus the company has limited track record in setting up and operating large scale power projects.

High and increasing collection period

Collection period of the CHDC is high and increasing over the period. Average collection period was high at 307 days during FY17, which was increased to 444 days during FY18 and further increased to 480 days during 11MFY19 (refers to 11 months' period ended June 15, 2019). Accumulated management fees and project development fees from the subsidiary and associate companies, in the absence of financial closure for the project, equity injection from promoters and regular cash flows are the main reason for high collection period of CHDC. Majority of debtors includes receivable from KKHL for the accumulated fees charged to them.

Project implementation risk related to various under construction projects

KKHEP (45MW) is in initial phase and yet to start the construction. The project has received the generation license, PPA got signed but the financial closure, forest and explosive approval are yet to be achieved. Tallo Khare HEP (11MW) has achieved ~86% of financial progress till Feb. 2019, RCOD for initial 8.26MW was Dec. 2017 and for additional 2.74MW is July 2019. Tallo Khare HEP experienced time overrun for its initial contracted energy. Dordi I HEP (12MW) has achieved financial progress of ~41% till March 2019 and Rukum Gad HEP (5MW) has achieved financial progress of ~48% till April 2019, which are still in the implementation stage pending only 8 to 9 months for RCOD and continues to

remain exposed to the residual risks associated with project implementation and satisfactory operations thereafter.

Hydrology risk associated with run-of-the-river power generation affecting profitability of the company

Run-of-the-river power is considered an un-firm source of power, as a run-of-the-river project has little or no capacity for water storage and therefore is dependent on the flow of river water for power generation. It, thus, generates much more power during times when seasonal river flows are high and much less during the drier months. CHDC is investing in the companies which generates electricity from discharge of rivers, which are snow fed streams with run-of-the-river, comprising of mountainous and hilly terrain. Hence, the projects are exposed to risk associated with variation in discharge of water from the aforesaid rivers, which may affect the revenue generation and profitability of CHDC.

Key Grading Strengths

Experienced directors and management expertise

CHDC has 5 Board of Directors, chaired by Mr. Anil Kumar Rungta. Mr. Rungta has more than 25 years of experience in investment and finance sector. He is also the chairperson of various hydropower companies in the group. Mr. Vinay Kumar Bhandari is the Chief Executive Officer of the company since 2009. He has more than 26 years of experience in hydropower sector. He worked as Project Development Expert/ Consultant, Electricity Distribution System Consultant and Hydropower & Environmental Specialist for various hydropower projects.

Track record in operating hydro power projects with healthy plant load factor

CHDC, through its subsidiary and associate companies, is operating two hydropower projects. 4.40 MW Radhi Small Hydro Electric Project (RSHEP) located at Lamjung district of Nepal under the name of Radhi Bidhyut Co. Ltd. RSHEP was operated at plant load factor (PLF) of 62.47% against generation capacity during FY18. Another 0.18 MW Syange Khola Hydro Electric Project (SKHEP) located at Lamjung district of Nepal under the name of Syange Bidhyut Co. Ltd. SKHEP was operated at PLF of 64.25% against generation capacity during FY18.

Comfortable financial risk profile and strong debt service Indicators

CHDC's total revenue increased by 0.56% to Rs.87.43 Mn during FY18 (Provisional) over FY17. However, PBILDT has been decreased slightly by 1.14% to Rs.73.07 Mn during FY18 with healthy PBILDT margin of 83.57% over FY17 due to decline in management service and project development

fees revenue during FY18. CHDC reported PAT of Rs.59.83 Mn during FY18 over FY17. CHDC has strong interest coverage ratio and total debt to GCA of 243x and 0.04x as on July 16, 2018 respectively with low debt levels.

Diversified Stream of revenue profiles

The main source of revenue for CHDC is the dividend income from the investments in different hydropower companies. The company generates revenue from different HEP by managing day-to-day operations, charges for the project design and loan arrangement fees. CHDC earned Rs.25 Mn as dividend income from the investments, earned Rs.26 Mn as management fees by managing day to day operations of the different projects and also received Rs.35 Mn during FY18 by providing product design related services and arrangement for the financial closure of the projects.

Shortage of power in the country

As per the statistics presented in report published by Ministry of Energy Nepal on May 2018, the current peak electricity demand is about 1300 MW. The total domestic installed capacity stands 1073 MW which includes 562 MW generated by NEA and 511 MW generated and supplied by private sector IPPs. To meet the current demand, NEA is importing up to 450 MW power from India beside domestic generation.

Government support for the power sector

GoN considers hydropower generation as priority sector and tries to involve private sector participation in power generation by offering different incentives. The sector is exempted from income tax for first 10 years and 50 percent for additional 5 years to those which generate electricity within Mid-April 2024. Income tax will be levied only 20% despite that normal tax rate for entity in Nepal is 25%.

Generation license obtained and power purchase agreement concluded for the plants

Generation license for the all projects which are operational and under construction, under the name of companies where CHDC invested, had received Generation License for 35 years. The operational power plants and under construction projects (other than Mathillo Rukum Gad HEP) had entered into Power Purchase Agreement (PPA) with Nepal Electricity Authority (NEA) for the sale of the power generated by the plants. The PPA is signed for a period of 25 to 30 years from the date of COD or till validity of Generation License.

About the Company

CEDB Hydropower Development Company Limited (CHDC) is public limited company, incorporated on November 30, 2009 as CEDB Hydro Fund Limited, later the name was changed to CEDB Hydropower

Development Company Limited with effective from July 11, 2018. CHDC was promoted by the then Clean Energy Development Bank Limited (now merged with NMB Bank Limited) with the purpose of investment in hydropower projects. The main purpose of CHDC is to invest in hydropower companies and providing project management services to those companies. Paid up capital of CHDC was Rs.587.59 Mn as on July 16, 2018 (Provisional), held by promoter shareholders. After the issuance of Rs.251.82 Mn proposed IPO, promoter-public shareholding is expected to be in the ratio of 70:30.

Analyst Contact

Mr. Giri Raj Kandel

giriraj.kandel@careratingsnepal.com

Tel No.: Tel No.: +977-01-4445473

Relationship Contact

Mr. Sajjan Goyal

sajan.goyal@careratingsnepal.com

Tel No.: 9818832909/+977-01-4445472/3/4

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Annexure 1

CARE Ratings Nepal Limited – IPO Grading Scale

CARE IPO grade	Definition
CARE-NP IPO Grade 1	Strong fundamentals
CARE-NP IPO Grade 2	Above average fundamentals
CARE-NP IPO Grade 3	Average fundamentals
CARE-NP IPO Grade 4	Below average fundamentals
CARE-NP IPO Grade 5	Poor fundamentals

Note:

Modifiers {"+" (plus)} can be used with the grading symbols 2, 3 and 4. The modifiers reflect the comparative standing within the category.