

Grading Rationale

Ngadi Group Power Limited

Grading

Facility	Amount (Rs. In Million)	Grading	Grading Action
Right Share Issue	Rs. 160.6664Mn	CARE-NP IPO Grade 3 [IPO Grade Three]	Assigned

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

CRNL has assigned grading of ‘CARE-NP IPO Grade 3’ to the proposed Right Share Issue of Ngadi Group Power Limited (NGPL). ‘CARE-NP IPO Grade 3’ indicates 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’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. NGPL proposes to issue 16,06,664 shares of face value of Rs.100 each at par aggregating Rs. 160.6664 Mn.

Detailed Rationale & Key Grading Drivers

The grading assigned to Ngadi Group Power Limited (NGPL) derives strength from reputed Board Members having experience in hydropower sector and its power purchase agreement (PPA) with Nepal Electricity Authority (NEA) with sufficient period coverage and its healthy financial risk profile characterized by low gearing levels and comfortable debt coverage indicators. The grading also factors in shortage of power in the country and government support to the power sector.

The grading, however, is constrained by operating at low plant load factor (PLF) over the period, promotional tariff rate ending in FY20 will lead to lower revenue, execution risk of the project under construction in which NGPL has invested, moderate counter party risk and hydrology risk associated with run-of-the-river power generation. Sufficient hydrology to generate contracted energy and timely receipt of the payments from NEA are the key grading sensitivities.

Detailed Description of the Key Grading Drivers

Key Grading Strengths

Reputed board members having experience in hydropower sector

NGPL has 7 Board of Directors including one independent director. The board is chaired by Dr. Bhogendra Kumar Guragain, who has more than 15 years of experience in financial and power sector. He is currently director at Sunrise Bank Ltd. (rated CARE-NP 'A-'), Barun Hydro Power Ltd. (4.5 MW), Siuri Nyadi Power Ltd. (40MW under construction), and chairman of Shuvam Power Ltd. (990 KW) and River Falls Power Ltd. (1 MW). Mr. Shailendra Guragain, Managing Director of NGPL, is involved in financial and power sector since last 20 years. He is President of Independent Power Producers' Association Nepal (IPPAN), chairman of Barun Hydro Power Ltd and Siuri Nyadi Power Ltd., managing director of River Falls Power Ltd., and director of Shuvam Power Ltd.

Power purchase agreement with sufficient period coverage and moderate counter party risk

NGPL had signed PPA for 0.99 MW capacity with NEA on August 2, 2007 for sale of power. Later, the project capacity was increased to 4.95MW and PPA was amended on Jan 19, 2009. The contracted energy for 0.99 MW was 7.36 Million Units (MU) annually which was increased for additional capacity at 24.74 MU annually for the period of 30 years from the required commercial operation date (RCOD; i.e. February 12, 2011). PPA period may be extended with mutual agreement six month prior to the expiry of PPA validity.

The project has two set of tariff rate. Tariff rate for initial contracted energy (i.e. 7.36 MU) is Rs 3.90 per kWh and Rs 5.52 per kWh for wet and dry seasons respectively with no escalation. Further, tariff rate for additional annual contract energy (i.e. 24.74 MU) is Rs 4 per kWh and Rs 7 per kWh for wet and dry season respectively with 3% annual escalation on base tariff rate for 9 years. However, as per government's initiative of promoting private sector hydropower developers, the project has been availing promotional tariff rates of Rs 4.80 per kWh and NPR 8.40 per kWh in wet and dry seasons respectively for upto November 2019, with 3% annual escalation on base tariff for 5 years.

Healthy financial performance

Commercial operation of the project started from October 16, 2012. NGPL achieved Rs 140.44 Mn revenue during FY18 which increased from Rs 139.83 Mn during FY17 on back of increase

in units of power sale and escalation in tariff rate by 3%. The PBILDT of the company increased to Rs 118.81 Mn during FY18 from Rs 109.19 Mn during FY17 on back of increase in revenue and decline in operating expenses. The net profit (PAT) of the company increased to 58.67 Mn during FY18 from Rs 51.39 Mn during FY17 and gross cash accruals (GCA) increased to Rs 89 Mn during FY18 from Rs 81.51Mn during FY17 mainly on back of higher PBILDT. During Q1FY19, the company achieved revenue of Rs 50.50 Mn and PAT of Rs 27.69 Mn.

Low gearing level with comfortable debt coverage indicators

Debt equity ratio and overall gearing ratio of the company was low at 0.61x each as on July 16, 2018 (0.75x and 0.79x as on July 15, 2017), which is expected to improve further after issue of proposed right shares. Total Debt/GCA was 4.06x at the end of FY18 (5.22x at the end of FY17). The interest coverage ratio of the company was comfortable at 3.00x in FY18 which is marginally declined from 3.02x in FY17.

Shortage of power in the country

As per the statistics presented in report published by Ministry of Energy Nepal on July 2018, the current peak electricity demand is about 1300MW. 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 upto 450 MW power from 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; and further lump sum capital subsidy Rs. 5 Mn per MW will be granted to those producers who generate and connect the generated electricity to national grid within FY17/18. Income tax will be levied only 20% despite that normal tax rate for entity in Nepal is 25%.

Key Grading Weaknesses***Operating at low PLF over the period***

The annual contracted PLF of the project is 74.03% of the installed capacity of the plant. The project has been operated at low PLF during over the period. Presently, NGPL revenue is depended on revenue received from this project only. During FY18, the PLF from the project was low at 55.07% which was improved from PLF of 51.61% during FY17. Further, the project achieved PLF of 88.95% during Q1FY19 against 91.06% during Q1FY18. The power generation from the project as a percentage to the contracted power as per the PPA, was 74.39% in FY18 and 69.72% in FY17. Operated PLF was lower than contracted energy PLF on annual basis due to hydrology problems; as a result, there was short supply penalty of Rs 0.93 Mn in FY18 and Rs 8.57Mn in FY17 as well as revenue losses.

Promotional tariff rate ending in FY20 will lead to lower revenue

The promotional tariff rates availed by the company will expire from Mid-November, 2019; thereafter, electricity sales revenue will be based on the original set of PPA rates, which will impact NGPL revenue.

Execution risk of project under construction in which NGPL has invested

As on July 16, 2018, NGPL has invested Rs. 153.25 Mn in Barun Hydro Power Co. Ltd., Rivers Falls Power Ltd., Shuvam Power Ltd., and Siuri Nyadi Power Ltd. Out of the total investments Rs 134.58 Mn (i.e. 87.82% of total investment) has been invested in Siuri Nyadi Power Ltd., a 40.27MW project under initial stage of construction which has project execution and operational risk. Barun Hydropower Co. Ltd, and Shuvam Power Ltd., are operating 4.5MW Hewa Khola Hydroelectric Project (HKHEP) and 0.99MW Lower Piluwa Hydroelectric Project (LPHEP) respectively.

Moderate counter party risk and prompt bills realization from the NEA

NGPL is exposed to counter party payment risk pertaining to NEA, which has been making consecutive losses in past till FY 2016 and carry huge accumulated loss in its book. As per the annual report published by NEA, during FY18 (provisional), NEA earned profit of Rs 1,010.21 Mn (Rs 1,502.28 Mn during FY17). The counter party payment risk is moderated by the fact that, NEA is fully owned by government of Nepal and NEA is generating positive gross cash

accruals and further, NEA has been making timely payment to independent power producer (IPPs) in past.

NGPL has been issuing separate bill for PPA based revenue and promotional tariff based revenue. During FY18 and Q1FY19, it received payment for PPA based revenue from NEA within stipulated time. However, the company is receiving payment for promotional tariff based revenue with delays. The amount for promotional tariff based revenue of Rs 18.06 Mn from Mid-March, 2018 to Mid-October, 2018 is not received yet.

Hydrology risk associated with run-of-the-river power generation

Run-of-the-river (ROR) power is considered an uneven 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. ROR, therefore, generates much more power during times when seasonal river flows are high (Mid-April to Mid-December) and much less during the drier months (Mid-Dec to Mid-April). NGPL utilizes discharge from Siuri Khola, having catchment area of 21.1 sq kms based on water source from forest. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

About the Company

NGPL, incorporated on Feb 21, 2006 as Ngadi Group Private Limited was later changed to public limited company on March 18, 2015. The company is operating 4.95 MW Siuri Khola Hydropower Project (SKHP), a run –of –river scheme which is located at Lamjung district, Nepal. The power generated from the project is evacuated through 8Km long 33KV Transmission Line to Thakan Beshi substation at Khudi VDC of Lamjung district, from where it is connected to national grid. The project was completed with total cost of Rs 924.01 Mn (cost per Mw Rs. 186.67 Mn) funded in Debt: Equity ratio of 66:34. NGPL share capital has been distributed in promoter and public shareholders in 70:30 ratios. Mr. Bhogendra Guragain and Mr. Sailendra Guragain are the major promoter shareholders of the company who hold 10.79% and 8.57% company's shares respectively.

During FY18, NGPL earned net profit of Rs 58.67Mn on total revenue of Rs 140.44 Mn and during Q1FY19, the company earned net profit of Rs 27.69Mn on total revenue of Rs 50.50 Mn.

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Annexure 1

CARE Ratings Nepal – 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.