

**Grading Rationale**  
**Nyadi Hydropower Limited**

**Grading**

Particulars	Amount (Rs. In Million)	Grading	Grading Action
Initial Public Offer	405.00	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 grading of ‘CARE-NP IPO Grade 4’ to the proposed Initial Public Offer (IPO) of Nyadi Hydropower Limited (NHL). ‘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’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. NHL proposes to issue 4.05 Mn shares of face value of Rs. 100 each at par aggregating Rs. 405.00 Mn.

**Detailed Rationale & Key Grading Drivers**

The grading assigned to NHL is constrained by project implementation risk and stabilization risk associated with the project, exposure to volatile interest rates, foreign exchange fluctuation risk and power evacuation risk. The grading also factors in hydrology risk associated with run of the river power projects. The grading, however, derives strength from experienced board members and management team in hydropower sector, power purchase agreement (PPA) with sufficient period coverage and financial closure achieved for the project cost. Further, grading is supported by NHL’s association with group having multiple hydropower projects, moderate counter party risk, shortage of power in the country and government support for the power sector.

**Detailed Description of the Key Grading Drivers**

**Key Grading Weaknesses**

***Project implementation risk and stabilisation risk associated with the project***

On the basis of cost incurred till May 30, 2019, the company has achieved financial progress of ~44% of project. As per the progress report of April 2019 submitted by the company, 100% excavation works on Access Tunnel, Headrace Tunnel and Surge Shaft is completed, whereas excavation of Penstock (~40% completed) is in progress. ~65% of concreting works in powerhouse are completed. Though, there is major progress, the project is still exposed to the residual risks associated with project implementation

and satisfactory operations thereafter. Timely completion of the project without cost overrun and satisfactory operations thereafter are the key grading sensitivities.

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

Run-of-the-river power is considered an unsteady 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 summer season when river flows are high (Mid-April to Mid-December) and less during the winter season (Mid-Dec to Mid-April). NHL is proposed to utilize discharge from Nyadi River having catchment area of 154.7 sq kms. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river.

***Foreign exchange fluctuation risk***

NHL has contracted for Civil, Hydro-mechanical and Electro-mechanical works of the project in USD with payment divided into two parts of USD and NPR of which amount payable in USD (i.e. 24.72 Mn) will be based on spot rate. This exposes the company to foreign exchange fluctuation risk. Further NHL has booked Rs. 15.02 Mn as foreign currency loss till May 30, 2019. However, NHL has budgeted for foreign currency fluctuation in its initial budget which mitigates the risk of increase in project cost due to foreign currency fluctuation.

***Power evacuation risk***

Power generated from the project is proposed to be evacuated via 5.5 km long 132 KV transmission line to NEA's proposed Tarikuna Substation. As delay is expected in completion of Tarikuna substation, NHL had submitted an alternate plan to NEA for power evacuation by connecting the powerhouse to transmission line of another operational project via 8.5 km long transmission line. Connection agreement for alternate plan is under process with NEA. Delay in construction of transmission line can lead to revenue losses.

***Exposure to volatile interest rate***

Nepalese banking sectors are fixing interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate is changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions is changed by change in liquidity position which leads to change in interest rate. Interest rate has been changing frequently in Nepal market since last 1-2 year. Therefore, funding from Bank and Financial Institutions are exposed to volatile interest rate.

**Key Grading Strengths**

***Experienced Board Members and management team.***

NHL has total 6 directors chaired by Mr. Om Prakash Shrestha, along with other directors having experience in hydropower sector and involvement in other businesses including hydropower as a

chairperson and director. Mr. Uttam Amatya, CEO of the company, has more than 31 years of experience and is supported by other experience management team members.

***Associated with a group having multiple hydropower projects***

NHL's major stake is owned by Butwal Power Company Limited (BPCL) which owns and operates multiple hydropower projects in Nepal. BPCL owns and operates 9.40 MW Andhikhola project and 12 MW Jhimruk Project apart from stakes in other hydropower projects in different stages.

***Power purchase agreement with sufficient period coverage***

NHL had entered into a long term PPA with NEA as on May 26, 2015 for sale of 30 MW power to be generated from the project. The period of the PPA is 30 years from Commercial Operation Date (COD) or till validity of Generation License. The annual contracted energy for the project is 168.55 million units (MU) (i.e. 28.45MU for dry season and 140.10 MU for wet season) at PLF of 64.14%. The tariff for wet season (Mid-April to Mid-December) is Rs 4.80 per kWh and for dry season (Mid-December to Mid-April) is Rs 8.40 per kWh with 3% escalation on base tariff for 8 years. Required Commercial Operation (RCOD) of the project is April 18, 2020. As per the PPA, the company will be charged penalty in case there is delay in the commercial operation of the project.

***Financial closure achieved for estimated project cost***

Total estimated cost of the project is Rs. 6042.50 Mn which is proposed to be financed through debt equity ratio of 72.81:27.19. Financial closure for Rs 4,400 Mn term loan was achieved on February 03, 2016. The cost incurred till May 30, 2019, is Rs. 2646 Mn and the same is funded through debt of Rs. 1,663 Mn and balance through equity.

***Moderate counter party risk***

NHL is exposed to counter party payment risk pertaining to NEA, which has been making consecutive losses in past till FY16 and carry huge accumulated loss in its book. However, 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, net loss is declining over the period and NEA is generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producer (IPPs) in past.

***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**

Government of Nepal (GoN) considers hydropower generation as priority sector and intends to maximize private sector participation by offering different incentives. GoN has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years to those who generate electricity within Mid-April 2024. Income tax will be levied only 20% despite the normal tax rate for entity in Nepal is 25%. Also, GoN has declared to provide grant of amount equivalent to Rs. 5 Mn per MW installed capacity after receiving evidence of formal COD of complete power plant.

**About the Company**

Nyadi Hydropower Limited is a public company, incorporated on March 1, 2007. It is promoted by Butwal Power Company Limited (BPCL) and Lamjung Electricity Development Company Ltd. (LEDCO) for setting up a 30 MW run-of-river, Nyadi Hydropower Project (NHP) in Marshyangdi Municipality, Lamjung district of Nepal. The power project is proposed to utilize available head and flow from Nyadi River. The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism. As per the Generation License, from Government of Nepal – Ministry of Energy, obtained on February 14, 2013, the project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of Generation License, which is 35 years.

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**ANNEXURE 1**

**CARE Ratings Nepal – IPO Grading Scale**

<b>CARE IPO grade</b>	<b>Definition</b>
<b>CARE-NP IPO Grade 1</b>	Strong fundamentals
<b>CARE-NP IPO Grade 2</b>	Above average fundamentals
<b>CARE-NP IPO Grade 3</b>	Average fundamentals
<b>CARE-NP IPO Grade 4</b>	Below average fundamentals
<b>CARE-NP IPO Grade 5</b>	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.