

Grading Rationale

NRN Infrastructure and Development Limited

Grading

Particulars	Amount (Rs. In Million)	Grading	Grading Action
Initial Public Offering (IPO)	339.8046	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 NRN Infrastructure and Development Limited (NRNIL). ‘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. The grade assigned to any individual issue represents a relative assessment of the ‘fundamentals’ of the issuer. NRNIL is proposed to come out with IPO of 3.398046 Million equity shares having face value of Rs.100 each at par aggregating Rs.339.8046 Million.

Detailed Rationale & Key Grading Drivers

The grading assigned to NRNIL is constrained by concentrated investment in hydropower sector and long gestation period of its investments, concentrated revenue profile, expected time overrun and project implementation risk related to various under construction projects and lower return on Networth in short to medium term. The grading also factors in hydrology risk associated with run-of-the-river power generation affecting profitability of the company. The grading, however, derives strength from strong and reputed promoters/ directors, projects being developed by strong and experienced group, moderate financial risk profile and debt free investment plan. 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

Concentrated investment and long gestation period of its investments

NRNIL has made investments of Rs.552.85 Mn till July 16, 2019 (provisional) towards equity shares of under construction hydropower companies. Besides NRNIL has made investments of Rs.18.49 Mn in equity shares of banks, insurance and hydropower companies and Rs.4 Mn towards units of mutual fund as on July 16, 2019 (provisional). Being an investment company, the return prospects of NRNIL largely

depends upon the performance of its investee companies. Predominantly, NRNIL investment is concentrated on hydropower sectors, further concentrated on single project Dordi Khola HEP [DKHEP, ~66% of total investment book as on July 16, 2019 (provisional)] being constructed by Himalayan Power Partner Ltd. DKHEP is still in implementation stage with expected time overrun which can impact the revenue prospects of NRNIL in short to medium term. The company has balance equity commitments of Rs.41.50 Mn till Mid July 2021. The company is planning to raise Rs.339.80 Mn through initial public offerings (IPO) during FY20 which is proposed to be invested in hydropower projects.

Concentrated revenue profile

The main source of revenue for NRNIL is expected to be concentrated on dividend income from the investments made in share capital of different hydropower companies. In addition, NRNIL will also generate interest income from bank deposits. NRNIL received Rs.0.83 Mn as dividend income during FY18 (refers to refers to 12 months' period ended mid-July 2018)) from the investments in equity shares listed in Nepal Stock Exchange Limited (NEPSE) which was increased to Rs.2.83 Mn during FY19 (provisional). Further the company earned Rs.19.71 Mn as interest income from bank deposits during FY19 (provisional) which was decreased from Rs.37.33 Mn during FY18 due to increase in the investments and decline in the bank deposits. As NRNIL invests its money in share capital of different hydropower companies, dividend income from those companies will be the major source of income for the company. Diversifying investments will be the key challenges.

Lower return on Networth in short to medium term

NRNIL has investments in hydropower projects and equity shares listed in NEPSE. However, the company has received dividend income only from the investments in equity shares listed in NEPSE and not from the hydropower projects till FY19. Return on Networth (RONW) was low at 3.32% for the FY18 which was further declined to 1.44% during FY19 (provisional). Projected RONW of the company is also at lower side in short to medium term as the under construction power projects are expected to come into operations after 1-3 years.

Expected time overrun and project implementation risk related to various under construction projects

In financial terms, 27 MW Dordi Khola HEP has achieved progress of ~67% till June 15, 2019. The RCOD of the project is August 2019. Considering the current status of the project, it is expected that there will be delay in the project execution and the project has applied for RCOD extension with Nepal Electricity Authority (NEA) till March 2020. 73 MW Middle Tamor HEP has completed only 7.83% in financial terms till April 14, 2019, 28.1 MW Lower Likhu HEP has completed only 16.74% in financial terms till Mid-May 2019 and 14.3 MW Mathillo Mailun Khola HEP has completed 9.19% in financial

terms. The projects are still in the implementation stage 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 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 times when seasonal river flows are high and much less during the drier months. NRNIL 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 NRNIL.

Key Grading Strengths

Strong and reputed promoters/ directors

NRNIL was promoted by a group of Non-Resident Nepali (NRNs) and entities associated with them. The promoters of NRNIL are scattered around the globe. NRNIL has 6 Board of Directors, chaired by Mr. Jiba Nath Lamichhane, who has more than 25 years of experience and is also the chairman of Himalayan Power Partner Ltd., where NRNIL has ~35% holding. He was appointed as the member of the Economic Advisory Council of Prime Minister of Nepal, member of Nepal Investment Board in 2011 and the NRN Board Nepal in 2012. Mr. Lamichhane was awarded by Prawn Janasewshree, one of the highest state honors in 2013 for his outstanding contribution to Nepal and Nepali Diaspora.

Ms. Usha Khatiwada is the Chief Executive Officer of NRNIL and heads day-to-day operations of the company. She has experience of working as Chief Operating Officer at NRNIL for 5 years and has overall experience of over 12 years in various organization including hydropower companies.

Projects being developed by strong and experienced group

Out of four under-construction hydropower projects, where NRNIL has invested, three projects (except 27 MW Dordi Khola HEP) are being developed by companies associated with Sanima Hydro Group (related to Sanima Group). A group of NRN investors, represented by engineering professional, conceptualized Sanima Hydro Group with the main objective of developing hydropower projects in Nepal through private investments. Sanima Hydro group has been developing a number of hydropower projects by setting up Special Purpose Vehicles (SPV) companies with total 511.50 MW projects in different stages. In addition to the hydropower projects, the promoters of Sanima Group have made their

investments in different sectors i.e. Commercial Bank, Life Insurance Company, General Insurance and Merchant Banking.

Moderate financial risk profile and debt free investment plan

NRNIL's total revenue was increased by ~74% during FY18 to Rs.38.16 Mn over FY17, which experienced decline of ~41% to Rs.22.54 Mn during FY19 (provisional) due to lowered interest income backed by decline in bank deposits and lower interest rates in fixed deposits during FY19. Decrease in bank deposits was mainly due to additional investment of Rs.75 Mn towards ongoing projects during FY19 (provisional). PBILDT increased by ~80% to Rs.34.43 Mn during FY18 with PBILDT margin of 90.22%, which declined by ~53% to Rs.16.12 due to lower revenue during FY19 (provisional) with PBILDT margin of 71.50%. NRNIL has not availed any credit facilities from the bank and doesn't have any plans to avail bank facilities in the near future.

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 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 under construction, to be operated under the name of companies where NRN invested have received Generation License for 35 years. The under-construction projects had entered into Power Purchase Agreement (PPA) with NEA for the sale of the power generated by the plants. The PPA is signed for a period of 30 years from the date of COD or till validity of Generation License.

About the Company

NRN Infrastructure and Development Limited (NRNIL) is public limited company, incorporated on September 16, 2012 as NRN Investment Limited, later the name was changed to NRN Infrastructure and Development Limited with effective from February 02, 2017. NRNIL was promoted by a group of Non-

Resident Nepali (NRN) under the Companies Act, 2006 and complying the provision of Act relating to Non-Resident Nepali, 2008. The main purpose of NRNIL is to make investment in the infrastructure sectors with collective investment from various groups of people employed in foreign countries thereby mobilizing the remittance income to more productive sectors. Promoters of the company has injected Rs.792.88 Mn paid up capital, including stock dividend, till April 04, 2019. After the issuance of Rs.339.80 Mn proposed IPO, promoter-public shareholding will be in the ratio of 70:30.

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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.