



INITIAL PUBLIC OFFERING | NEPSE: 804

6-Month Price Target : NPR. 400-450

Stock Rating : Stable
Industry View : Attractive in the long term

the analyst

February 17, 2014
NMB Capital Limited

KEY RATIOS & STATISTICS (A: actual, F; forecasted)

P&L Items ('000s)	10/11A	11/12A	12/13A	13/14F	14/15F	15/16F
Operating Profit	48,634	44,158	53,335	76,428	76,428	69,428
Other Income	-	-	-	7,000	7,000	
Net Profit	10,721	8,472	21,203	35,684	39,837	35,767
Interest Expenses	33,114	30,921	26,664	25,415	20,820	18,427

BS Items ('000s)	10/11A	11/12A	12/13A	13/14F	14/15F	15/16F
Investments	-	31,500	31,555	121,500	131,500	131,500
Capital	152,500	152,500	153,000	300,000	300,000	300,000
Reserves	2,076	941	2,866	3,8550	78,38	114,154
Long Term Debt	254,154	197,360	225,260	198,296	175,496	152,693

Indicators	10/11A	11/12A	12/13A	13/14F	14/15F	15/16F
Dividend/Share	5.2	6.3	12.6	-	-	-
Earnings/ Share	7.0	5.5	13.9	11.9	13.3	11.9
G.P. Margin	97%	97%	97%	97%	97%	97%
Price /Earnings	-	-	-	-	-	-
OC/Project Cost	2.6%	2.4%	2.3%	n/a	n/a	n/a
Net Worth	101.4	100.6	101.9	112.8	1126.1	138.1
Return on Assets	2.5%	1.8%	4.4%	6.5%	6.9%	5.9%
Return on Equity	6.9%	5.5%	13.6%	10.5%	10.5%	8.6%
Current Ratio	0.94	0.37	0.55	1.3	1.7	1.8
Cash Balance	7	2	3	13	29,063	60,791
Debt/Capital	167%	129%	147%	66%	58%	51%

Industry Comparables	10/11A	11/12A	12/13A	13/14F	14/15F	15/16F
EPS	67.3	45.2	34.1			
DPS incl. bonus	47.5	30.2	24.6			
ROE	17.3%	18.4%	14.0%			
Net Worth	361	245	245			
Dividend Payout	53.3	28.4	28.6			
MPS/BVPS	2.0	2.5	3.0			
P/E	12.9	13.9	21.9			

RHDC

- OWNERSHIP PATTERN & BOD
- THE COMPANY
- RECENT DEVELOPMENTS
- INVESTMENT THESIS & VALUE DRIVERS
- RELATIVE VALUATION
- RISKS
- RECOMMENDATION

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OWNERSHIP PATTERN (listed according to ownership stake)

Major Promoter Shareholders (51%)

M/s Arun Valley Hydropwer Limited (AHPC) (16.5%)
Mr. Guru Prasad Neupane (6.9%)
Mr. Deda Raj Khadka (5.8%)
Mr. Bachharaj Tater & Family (9.8%)
Mr. Shivaratan Sharda & Family (9.3%)

10% Affected Area Locals | Ordinary Share Holders 39% | Promoters 51%

BOD

Mr. Baccharaj Tater (Chairman) | Mr. Guru Prasad Neupane (Executive Director)
Mr. Shivaratan Sharada | Mr. Ramesh Neupane
Mr. Deda Raj Khadka | Mr. Vivek Tater | Mr. Kubermani Nepal

THE COMPANY

RHDC has been operating 2,400 Kilo Watt (kW) Ridikhola project, located at the borders of Gulmi and Palpa districts, since November 2009. The company has also acquired and refurbished Rairang Hydropower project of 500 kW in 2012 located at Dhading district operational since 2004. At present, the net generation capacity of the two projects of RHDC is 2,900 kW.

The company has planned to develop Iwakhola Hydropower Project of 9,900 kW capacity located at the borders of Panchthar and Taplejung districts. The Power Purchase Agreement (PPA) for the project has been concluded with Nepal Electricity Authority (NEA). The tariff rates are NPR 4.8 for wet season and NPR 8.4 for dry season with 3% escalation for 5 years. The approval for Initial Environment Examination (IEE) has been received and the grid connection agreement with NEA for evacuation of the generated power has also been signed. At present the preparation of Detailed Project Report (DPR) for the project is under progress. After completion of all projects RHDC will have a total capacity of 12.8 MW; roughly four times the capacity of AHPC and half the capacity of Chilime Hydropower Company Limited (CHCL).

RECENT DEVELOPMENTS

The company had recently issued 10% shares equivalent to NPR 30 million for the project affected people of Gulmi and Palpa districts. The company now intends to issue NPR 117 million worth of shares (39% of its paidup capital) to the general public. ICRA Nepal has provided a rating of 3 indicating average fundamentals. As per the company's annual report of 2012/13 the amount collected from the sale of shares to the general public shall be used to repay the bank loan of Ridikhola Project and invest in Iwakhola Project. According to the credit ratings document provided by ICRA, the management plans to raise the balance equity from the accruals of Rairang Hydropower Limited and the Initial Public Offering (IPO) of Rairang Hydropower Limited or IPO of the Special Purpose Vehicle (SPV) formed for the Iwa Project itself (if any).

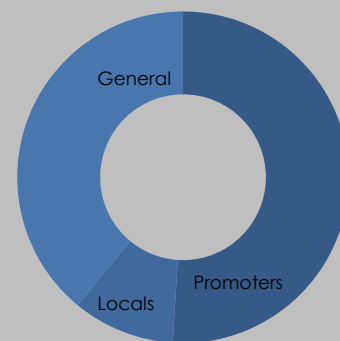
IPO Distribution & Cost

Presented below is an attempt to simulate cost per share in the IPO assuming the following:

TOTAL FUNDS INVESTED	50,000
INTEREST/ OPPORTUNITY COST	12.00%
SERVICE CHARGE	1.00%
ESTIMATED ALLOTTED PERCENTAGE	2.00%
DAYS BEFORE ALLOTMENT	45
DAYS AFTER ALLOTMENT	80
PAR VALUE	100
ESTIMATED MARKET PRICE	300
COST PER SHARE	270

* ESTIMATED ALLOTTED PERCENTAGE is the least allotment an investor might get given the same amount of fund is collected as in Sanima Mai Hydro's IPO. The cost per share is calculated assuming you will sell the stock in 125 Days after applying for the shares. The cost per share considers all the cost that you might incur (interest expenses before allotment, interest expenses after allotment on the remaining funds, estimated brokerage and commission expenses, etc).

OWNERSHIP CHART



Ridikhola Project

Type of Project	Run-of River
Capacity	2400kW
Energy	15.7 GWh
Construction	24 Months
Project Cost	NRs. 400 mill
Operation	27/10/2009

Rairang Project

Type of Project	Run-of River
Capacity	500kW
Energy	2.3 GWh
Operation	2004
Renovation	2012

Iwakhola Project

Type of Project	Run-of River
Capacity	9,900 kW
Energy	56.6 GWh
Construction	30 Months
Est. Operation	Dec 2017
Est. Cost	1,494.8 mill
IRR	15.9%
Payback	6.7 years

INVESTMENT THESIS

- Promoters have rich technical and practical experience in the field of hydropower development. AHPC a public limited company which has already issued shares to the general public is a major promoter shareholder of the company.
- Currently the company is operating two hydropower projects and is looking to expand its operations through a new project with an estimated capacity 9,900 kW.
- Defensive and non cyclical stock; isn't drastically affected by the interest rate fluctuations and liquidity crisis that is prevalent in the present market which continues to dictate earning of BFIs. Today, BFIs make up almost 70% of NEPSE. BFIs reaction to interest rate changes is imminent but the effect on hydro is lagged and only if they have a significant debt portion.
- Offers sectoral diversification to the client's portfolio, low beta, stable earnings and ample opportunity for reinvestment & growth.
- The earnings of the project are subject to tax exemption; year 1 commences from the commercial operation of the project.
 - | 1 - 10 years : 0% tax | 11 - 15 years : 10% tax | 16 - 20 years : 20% tax |
- The market for energy in this context is ever growing with few producers entering the field essentially because of high barriers to entry. Competition in this field is minimal and very few alternatives exist(diesel/ wind/ solar power companies).

VALUE DRIVERS

- Constant returns from the current project, with ample opportunity for increased dividends and capital appreciation with the completion of Iwakhola project.
- Project only incurs initial cost but when the new project will come in the operation the operational costs are minimal.
- The core earning comes from the sale of electricity to NEA. This income remains relatively constant over years (with some nominal growth as agreed on the PPA). Other sources of income is from interest income from the retained earnings with possibility of reinvestment in newer projects utilizing the already existent expertise and additional manpower.

POWER PURCHASE AGREEMENT (PPA)

The PPA has been signed with NEA for Iwa Khoka Hydropower Project as per which the tariff for wet season is NPR 4.80 per unit and for dry season is NPR 8.40 per unit for 9,900 kW capacity with 3% escalation for 5 years.

With a firm PPA in place, the tariff and off-take risks are reduced considerably for the project. In addition, as the promoters have infused equity upfront, the company is expected to save on its IDC (Interest During Construction), which will also be helped by low interest rates prevailing currently.

REGULATION

According to the amended Securities Registration and Issuance Regulation – 2065, hydropower companies must float shares to locals before they open their issue to the general public. "A company has to float a minimum of 30 per cent shares to the public and out of the 30 per cent, five per cent has to be separated for the company's staff, 10 per cent for locals and the remaining for the general public," states the amended regulation that has fixed a lock in period of three years for shares distributed to locals.

Relative valuation, also referred to as comparable valuation, is a very useful and effective tool in valuing an asset. Relative valuation involves the use of similar, comparable assets in valuing another asset. In the real estate market, relative valuation forms the framework for valuing a piece of real estate. Anytime real estate is valued, the valuation process always integrates the value of other nearby properties that have been sold. The effectiveness of comparable valuation is that the process specifically relies on the value of other assets that have been bought or sold. Since no two assets are exactly the same, any relative valuation attempt should incorporate differences accordingly. But first and foremost, you can't begin to apply relative valuation effectively if you are dealing with apples and oranges.

A similar and effective approach can be utilized with respect to stocks (STOCKS ARE ASSETS, TOO). A stock is share in a business and the fundamentals of the underlying business can be used to determine the value of similar stocks. The biggest limitation is the assumption that the market has valued the business correctly. Second, all valuation metrics are based on past performance. Future performance drives stock prices and relative valuation does not account for growth. Finally, relative valuation is no assurance that the "cheaper" company will outperform its peer.

TICKER NAME	(2007-08)	(2008-09)	(2009-10)	(2010-11)	(2011-12)	(2012-13)
CHCL	16.7	12.4	10.3	8.0	13.1	21.6
BPCL	30.1	31.4	30.4	17.8	12.1	29.4
AHPC					16.3	14.8
GROUP AVERAGE	23.4	21.9	20.4	12.9	12.6	21.9

Price Earnings (PE) RATIO

IN THE NEWS Feb 02, 2013)

{ Source: <http://www.myrepublica.com/> }

RHDC would be the sixth hydropower company to issue primary shares. So far, Arun Valley Hydropower Development Company, Butwal Power Company, Chilime Hydro Power Company (BPCL), National Hydro Power Company and Sanima Mai Hydropower have gone public. Similarly, Upper Tamakoshi Hydro Power (UTHP) has sought permission of Sebon to float 25.42 million units of shares, while Barun Hydropower Company has applied at Sebon to issue 243,000 units of shares to the people in the project affected area.

IPO SIZE

NPR 117 million

ISSUE MANAGER

CIVIL CAPITAL MARKET LTD.

APPLICATION LIMIT

MAX UNITS : 10,000

MIN UNITS : 50

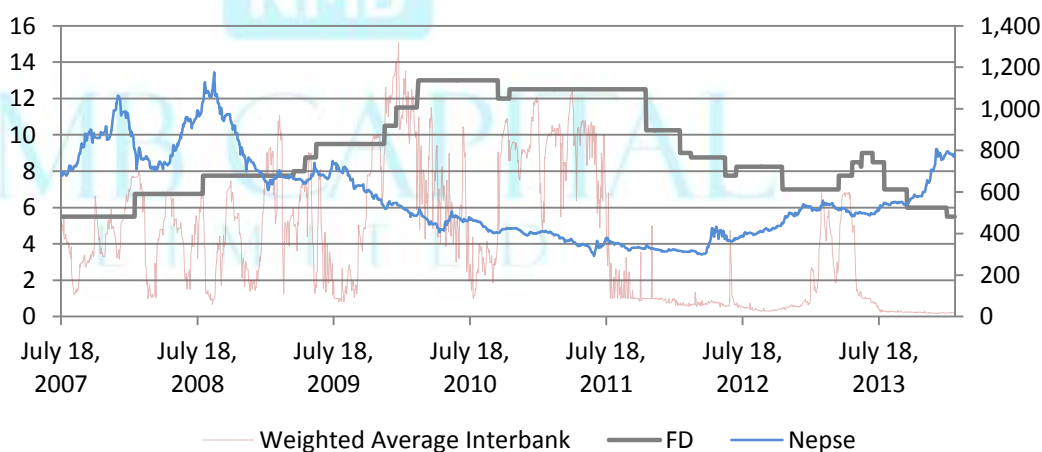
ICRA NEPAL RATING

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(AVERAGE FUNDAMENTALS)

RISK FACTORS

- Hydro power companies are mostly funded in 70-30 debt-equity model (with minor variations). Most of the funding by BFIs are based on floating interest rate models. So hydropowers aren't completely shielded from interest rate fluctuations. If Nepal again sees high interest rate regime like in 2010 for a prolonged period then the project might incur cash flow problems. Deposit interest rates have historically always hovered around 6-8% and deducing from this we can safely assume that lending rates might hover around 10-15%. But high interest rates for extended period might be detrimental to the project and its viability.
- Risk of natural disasters and risk of change in environmental conditions of the areas surrounding the project may cause the river water to dry up.
- Risks associated with timely completion and overrun of costs of Iwa Khola Project.
- The energy is bought by the state run NEA hence the counter party credit risk is low and NEA has been making timely payments.
- The major hurdle for the company remains to be the construction of transmission line by NEA for power evacuation of the Iwa Khola Project. NEA has to construct a 90 Km long transmission line from Damak substation to Kabeli Substation and also substations at this location as part of connection agreement. It is expected that NEA will complete construction of the transmission line within the next two years whereas the Commercial Operation Date of Iwa Khola project is July 2018. Failure to do so in time would lead to additional interest cost to the company and lost revenues.
- Risk of other cheaper alternative power sources such as solar power. NEA in 2012 signed a memorandum of understanding (MoU) with the Chinese solar energy firm, to setup a 30 MW solar station, the largest ever solar energy project in Nepal.



Source:

Weighted Average Interbank: NRB

INDUSTRY COMPARABLES (FY 2012/13)

Particulars	CHCL	BPCL	AHPC
Installed Capacity	22.1 MW	29.1 MW	3.0 MW
Energy Generation	150 GWh	103.5 GWh	19.5 GWh
Income From Sales to NEA ('000s)	968,553	512,085	70,098
Operating Profit ('000s)	1,069,766	74,950	71,700
Net Profit ('000s)	965,047	286,403	57,241
EPS	55.2	28.2	18.8

RECOMMENDATION

Over the past year IPOs of different companies, including that of a hydropower company have received overwhelming response. Low interest rates on bank deposits & loans, significant rise in stock price of companies after being listed on the NEPSE and high demand in hydropower scrips in the secondary market will lead to the IPO of RHDC being oversubscribed by many folds.

As the company is already generating revenue from sales of energy from its two different projects investors can anticipate constant returns from the company. Increased returns and capital appreciation are possible if the company is successfully able to complete construction of the Iwa Khola Hydroproject on time. The major risk for the company is the timely construction of 90 Km long transmission line from Damak substation to Kabeli Substation as part of connection agreement from which the power of Iwa Khola Project is to be evacuated.

Hydropower companies offer stable and handsome returns in the long run to the investors. Being stable by nature they are more attractive for value investors as opposed to the short term investors in the present context. The project developers have adequate experience in hydropower development; AHPC which is already listed on the NEPSE is a major promoter of the company. In our view, investors looking for value in the long term should invest in the IPO. In addition investors looking to diversify their portfolio which has significant weightage in the BFls scrips should invest heavily in this IPO.

insight



Sanima Mai Hydropower Limited received application of around NPR 6 billion in its IPO. RHDC has limited the maximum amount that an individual/ institution can apply to NPR 1 million; hence the IPO might not be able to collect funds in the similar range. Financial Institutions, insurance companies and other large individual investors have been significantly limited because of the lower cap on fund size. In the recently concluded IPO of Century Commercial Bank the maximum amount that the investors could invest was NPR 100 million. Also limiting maximum application size to NPR 1 million would mean that there is good probability of the retail (smaller) investors making up for more than 40% of the total fund collected. If this happens then all the investors will be allotted shares uniformly.

Lastly, if retail investors make up for more than 40% of the total funds collected and if the IPO of RHDC is able to collect funds lower than that of Sanima Mai Hydropower, then investors should expect to be allotted more than 2%.

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