

Rawa Energy Development Limited

Ratings

Facilities	Amount (Rs. Million)	Rating ¹	Rating Action
Issuer Rating	NA	CARE-NP BB (Is) [Double B (Issuer)]	Reaffirmed

* The issuer rating is subject to overall gearing ratio of the company not exceeding 3.00x at the end of FY23.

CARE Ratings Nepal Limited (CRNL) has reaffirmed the issuer rating of 'CARE-NP BB (Is)' [Double B (Issuer)] assigned to Rawa Energy Development Limited (REDL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The issuer rating assigned to REDL continues to remain constrained by project stabilization risk associated with the operational hydropower project which has been marred by intermittent stoppages owing to breakdown in machineries. The rating also factors in the high project cost and leveraged capital structure of the company, risk of natural calamities, exposure to volatile interest rate risk and regulatory risk coupled with hydrology risk associated with run-of-the river power generation.

The rating, however, derives strengths from experienced board members and management team, presence of power purchase agreement (PPA) with sufficient period coverage, moderate counter party risk and government support for the power sector. The rating also takes cognizance of the approval obtained from Securities Board of Nepal (SEBON) for issue of Initial Public Offering (IPO) of Rs. 84 Mn which shall support the company to reduce its debt levels and maintain short-term liquidity.

Going forward, the ability of the company to attain stabilization of operations of its hydropower project and to successfully reduce the gap between operational Plant Load Factor (PLF) and contracted PLF will be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Project stabilization risk

During FY22 (Audited, FY refers to the twelve-month period ending mid-July), the company reported total income of Rs. 43 Mn through sale of power with PLF of 42.53% of the contracted capacity. Since the commencement of operations from September 2020, the project has been impacted by recurring technical challenges. The project was shut down from mid-November 2020 to mid-August 2021 and from mid-April to mid-September 2022 due to breakdown in its generator. In the 7MFY23 (Unaudited, FY refers to the seven-month period ending mid-February), the plant could operate only for five months owing to the erstwhile breakdown with PLF of 36.37% of the contracted capacity. This has led to delay in stabilization of operations of the hydropower project, resulting in stretched liquidity and cash flow mismatches. The plant has been in continuous operation since mid-September 2022. The company has taken various corrective measures owing to which the company expects no further breakdown which could lead to a substantial period of downtime of the plant.

Relatively high project cost and leveraged capital structure

The total cost of the project was Rs. 686 Mn (i.e., Rs. 229 Mn per MW) which was funded through the debt amount of Rs. 470 Mn and remaining through equity. The company had taken extended credit period from its creditors for making payments (creditors of project) and further due to non-completion of the NEA transmission line, Interest during Construction (IDC) had increased due to the increase in project period. The overall gearing ratio of the company stood at 2.84x during FY22. The

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

leveraged gearing ratio was on account of the high debt funded capital expenses. Total debt to Gross Cash Accrual ratio stood negative during FY22.

The company has obtained approval from SEBON for issue of IPO of Rs. 84 Mn on March 15, 2023, which the company plans to utilize for the purpose of payment of payables, bank loans and to create a reserve fund for emergency use equivalent to around a quarter's cash requirements.

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 wet season when river flows are high (Mid-April to Mid-December) and less during the dry season (Mid-December to Mid-April). The project utilizes discharge from Rawa Khola having catchment area of 68 sq. kms based on Perennial River. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola.

Risk of Natural Calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their construction and operations vulnerable to adversities of nature. Floods and landslides that tend to occur in these areas pose threat to these power projects damaging their infrastructures as well as smooth operations. These natural calamities can adversely affect the smooth flow of power generation and distribution, which can further impact financial returns of the projects. REDL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Exposure to volatile interest rates

Given the relatively higher cost of the project, the company's interest expenses in the initial years of operations remain on the higher side. The company's interest rate is based on a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Exposure to regulatory risk

Government of Nepal (GoN) has recently established Electricity Regulatory Commission (ERC) for regulating generation, transmission and distribution of electricity in Nepal. ERC will be the regulator under the GoN which will be responsible for regulating hydropower companies in Nepal. Policies and directives issued by ERC like approval process for IPO issuance, PPA approval through ERC poses a new challenge to hydropower companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strengths

Experienced board members and management team in hydropower sector

REDL is managed under the overall guidance of the company's Board of Directors (BoD), which possesses wide experience in various sectors including hydropower projects. Company has seven directors in its Board, chaired by Badri Prasad Gautam who has more than three decades of experience in various sectors. He is also a director at Mid-Solu Hydropower Company Limited (MSHCL) and Halesi Urja Private Limited. Mr. Rajendra Prasad Gautam, director, also has more than three decades of experience in various sectors. He is also a director at MSHCL and Dolti Power Company Private Limited. The company is supported by other experienced team members across various departments.

Power purchase agreement with sufficient period coverage

REDL had entered into a PPA with NEA on August 08, 2016 for sale of 2.8 MW power to be generated from the project and later amended to 3MW on August 29, 2018. The period of the PPA is 30 years from commercial operation date (COD) or till the validity of Generation License whichever is earlier. The tariff for 2.8 MW power 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 every year for 5 times after completion of 12 months from COD date whereas, in case of the additional 0.2 MW power, the tariff rate has been set at Rs 4.80 per kWh for dry season (December to May) and Rs 8.40 per kWh for wet season (June to November) with 3% escalation on base tariff every year for 8 times after completion of 12 months from COD date. The contracted energy for the project is 16.82 million units (MU) at PLF of ~64%.

Favorable Government policies towards power sector

Government of Nepal (GoN) considers hydropower generation as priority sector and intends to maximize private sector participation in generation of hydroelectricity by offering different exemptions and facilities. GoN has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years for such person/entity who starts commercial operation, transmission and distribution of electricity up to mid-April 2027. Also, with government focus more toward reservoir-based hydropower projects; Monetary Policy FY23 has provided full tax exemption for first 15 years and 50% tax exemption for next 6 years to reservoir and semi-reservoir projects completing financial closure within mid-April 2029 with a capacity higher than 40 MW. As per various directives from NRB, all the banks (type A, B C, D) have to allocate minimum share of their total advances to energy sector which argues well for the sector.

About the Company

Rawa Energy Development Ltd (REDL) is a public limited company, incorporated on August 16, 2009 as a private limited company and later converted to public limited company on June 28, 2019. It is promoted by business persons having long experience in hydropower and other sectors for setting up Hydroelectric Project (HEP) in the territory of Nepal. REDL has 3 MW Upper Rawa Khola Small Hydropower Project (URKHP) at Khotang District which has been in commercial operation since September 20, 2020. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

Brief financial performance of REDL during FY21 and FY22 are as shown below:

(Rs. in Million)

Particulars	FY21	FY22
	(Audited)	(Audited)
Income from operations	4	43
PBILD Margin (%)	Negative	54.26
Overall Gearing (times)	2.94	2.84
Interest Coverage (times)	NA	0.77
Current Ratio (times)	0.93	0.95
Total Debt / Gross Cash Accruals (times)	Negative	Negative

Contact us

Analyst

Ms. Asmita Manandhar

Contact No.: 977-014012630

Email: asmita.manandhar@careratingsnepal.com

Mr. Santosh Pudasaini

Contact No.: +977-01-4012629

Email: pudasaini.santosh@careratingsnepal.com

Relationship Contact

Name: Achin Nirwani

Contact No.: +977 9818832909

Email: achin.nirwani@careratingsnepal.com

About CARE Ratings:

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).

Disclaimer

CRNL's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CRNL has based its ratings on information obtained from sources believed by it to be accurate and reliable. CRNL does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CRNL have paid a credit rating fee, based on the amount and type of bank facilities/instruments.

In case of partnership/proprietary concerns, the rating assigned by CARE is, inter-alia, based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors. CARE is not responsible for any errors and states that it has no financial liability whatsoever to the users of CARE's rating.