

Rawa Energy Development Limited

Ratings

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

* The issuer rating is subject to total debt not exceeding Rs. 500 Mn at the end of FY24 (FY refers to the twelve-month period ending mid-July)

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to Rawa Energy Development Limited (RAWA) to 'CARE-NP BB- (Is)' from 'CARE-NP BB (Is)'. 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 revision in rating assigned to RAWA factors in subdued operational performance of the power project amid power evacuation challenges as the power generated is still being evacuated through contingent route in addition to other technical challenges since the commencement of operations which led to net losses during FY22 and FY23. The rating also factors in leveraged capital structure and weak debt coverage indicators at the end of FY23. The rating takes note of hydrology risk associated with run-of-the-river power generation, risk of natural calamities and exposure to volatile interest rate risk.

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.

Going forward, completion of originally proposed evacuation structures in timely manner thus removing it from contingency arrangement, ability of the company to reduce the gap between operational Plant Load Factor (PLF) and contracted PLF and availability of sufficient hydrology with timely receipt of payments from NEA will be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Subdued operational performance amid project under contingency arrangement and other technical challenges

RAWA has 3 MW Upper Rawa Khola Small Hydropower Project (URKHP) at Khotang District which commenced its commercial operation since September 20, 2020. The power generation track record since commissioning of the project has remained marred by various challenges leading to below par PLF levels till date. Due to the non-completion of the Baksila substation, an alternative arrangement was done to evacuate power to Buipa substation through a contingency plan. The project currently falls under the 'Projects Under Contingency Evacuation Plan' where PPA's modality changes to take-and-pay from take-or-pay, making the project dependent on dispatch instructions from NEA. Also, the project has been impacted by recurring technical challenges since the commencement of operations. The project was shut down for nine months period from mid-November 2020 to mid-August 2021 and for five months period from mid-April to mid-September 2022 due to breakdown in its generator. The plant has however been in continuous operation since mid-September 2022. The energy generation was subdued at ~43%, ~49% and ~60% of contracted energy during FY22, FY23 and 7MFY24 (Unaudited; refers to the seven-month period ending mid-February, 2024). The company was able to generate income from power sales of Rs 54 Mn in FY23 (FY22: Rs. 43 Mn) and Rs 26 Mn in H1FY24 (Unaudited; refers to the seven-month period ending mid- January, 2024). Thus, timely completion and shifting of power evacuation to Baksila substation and accordingly invocation of original take-or-pay PPA arrangement will remain crucial for company's satisfactory operational performance. Until such time, the company is likely to continue to remain exposed to high power evacuation risk leading to modest operating performance.

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

Leveraged capital structure and weak debt coverage indicators

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. Due to non-completion of the NEA transmission line in timely manner, Interest during Construction (IDC) had increased. The company had taken extended credit period from its creditors for making payments (creditors of project), partial payment of which has been made from proceeds of public issuances. The capital structure of the company stood leveraged with overall gearing ratio of 2.18x at the end of FY23. However, it improved from overall gearing of 2.84x at the end of FY22 on account of successful completion of public issuances amounting to Rs. 84 Mn and scheduled repayment of term loans despite net losses in FY23. Interest coverage ratio and Total debt to Gross Cash Accrual stood negative during FY22 and FY23.

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. RAWA 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

RAWA's interest rates are based on floating interest rate regime, where a certain premium is added to the monthly base rate and interest rate is changed accordingly on monthly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remains quite volatile as they are impacted by available liquidity in the system, which leads to changes in interest rates. Being high debt funded project, higher interest rates than envisaged could result in squeezed margins of the company, impacting its liquidity profile.

Key Rating Strengths**Experienced board members and management team in hydropower sector**

RAWA 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. The company is supported by other experienced team members across various departments.

Low offtake risk and moderate counterparty risk

RAWA 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 2.8Mw 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 0.2MW 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 policies towards power sector

The Government of Nepal (GoN) has prioritized hydropower generation as a crucial sector for economic development and aims to enhance private sector involvement by offering a range of incentives and facilities. In line with this objective, GoN has introduced a comprehensive tax incentive package, providing full tax exemption for the initial 10 years and a 50% tax exemption for the subsequent five years to individuals or entities engaged in the commercial operation, transmission, and distribution of electricity until mid-April 2027. These incentives are designed to encourage investment and promote growth in the hydropower sector. Additionally, directives from the Nepal Rastra Bank (NRB) mandate that all banks are to allocate a minimum share of their total advances to the energy sector. This strategic initiative is expected to contribute to the financial support and development of projects within the energy sector which augers well for the sector. The industry outlook of Nepalese power sector is likely to remain stable over the long-term with increasing domestic demand for generation backed by growing national demand with an average growth rate of around 11% p.a. over the last five years (2018-2023). Additionally, increasing cross-border energy trades coupled with fresh bilateral treaty signed between Nepal and India for export of 10,000 MW electricity to India over a period of 10 years has further boosted the demand outlook for the power sector in Nepal

About the Company

Rawa Energy Development Ltd (RAWA) 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. RAWA 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.

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