

## Rasuwagadhi Hydropower Company Limited

### ICRA Nepal assigns [ICRANP] IPO Grade 4+ to the proposed IPO of Rasuwagadhi Hydropower Company Limited

Instrument/Facility	Issue Size	Grading Action (January 2019)
IPO (equity) Grading	NPR 1,026.315 Million	[ICRANP] IPO Grade 4+ (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4+” grading, indicating below-average fundamentals to the proposed Initial Public Offering (IPO) of Rasuwagadhi Hydropower Company Limited (RHCL). ICRA Nepal assigns an IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of “+” (plus) appended to the grading symbols indicate their relatively better position within the grading categories concerned. RHCL is proposing to come out with an IPO of 10,263,150 equity shares with a face value of NPR 100 each, at par.

The assigned grading is constrained by the time and cost overruns seen in the 111-MW hydropower project (HPP) being developed by RHCL. The project is now expected to be delayed by around 13 months from its commissioning schedule and hence would face incremental interest capitalisation costs, among others. Any unexpected timeline delays in completion of the balance project components could further increase the costs. Further, the project is exposed to significant foreign exchange fluctuation risks on account of the unhedged USD denominated contractual liabilities (~55% of project costs). These would impact the return metrics of the projects, given the fixed tariff structure. The grading is also constrained by the relatively low leverage in the funding mix, which constrains the equity holders of better returns. The grading also considers the evacuation risks for the projects as the Chilime hub for power evacuation is behind its earlier commissioning schedule. This could potentially delay the project commissioning and increase the cost estimates further. The hydrology risk for the projects is also high, given the lack of deemed generation clause in power purchase agreement (PPA). The grading is also constrained by the interest rate volatility in the market and the counterparty credit risks arising out of its exposure to the Nepal Electricity Authority (NEA), which has a poor financial profile. However, this is partly offset by the sovereign support to the NEA, being fully owned by the Government of Nepal and its track record of timely payment to private HPP developers.

Nonetheless, the grading factors in the strength of promoter companies (NEA and Chilime Hydropower Company Limited, which are both direct/indirect Government undertakings) and their significant experience in development and operations of hydropower projects. With a firm PPA in place and positive demand outlook in the power sector, the tariff and off-take risks are also minimal. Funding risks for the projects are also minimal as debt requirements of the projects have been tied up with the Employees Provident Fund (EPF, one of the largest state-owned retirement fund operators) and the promoters have infused their share of equity; with the remaining equity being raised through a series of IPOs. The current physical progress (~65-70%) also minimises the project implementation risks to an extent. Going forward, RHCL’s ability to commission the project within the budgeted time and cost estimates as well as the availability of sufficient hydrology and evacuation infrastructure will be the key parameters driving the project returns.

RHCL is developing a run-of-the-river (ROR) hydropower project in the Bhotekoshi river–Rasuwagadhi Hydroelectric Project with a capacity of 111 MW in the Rasuwa district. The Generation License for the project was obtained from the Ministry of Energy on December 2012, valid for 35 years including the period of construction. The project has faced a time overrun from its earlier commissioning targets. Overall ~65-70% physical progress was achieved in the project’s execution as of mid-December 2018,

with plans to complete construction by mid-February 2020<sup>1</sup> against the required commercial operation date (RCOD) of mid-January 2019 (revised from the initial RCOD of mid-June 2017). Though the RCOD as per the PPA might be further extended, given the delays in the evacuation structure of the NEA, the validity of the generation licence could limit the overall life of the project.

The PPA for the project was signed on November 2011 with the NEA. The agreed tariff for the wet season (mid-April to mid-December) is NPR 4.8 per kWhr and NPR 8.4 per kWhr for the dry season, with 3% annual escalation on successive tariff for eight years. The electricity generated from the project is to be evacuated to the Chilime hub substation through a 10-km long 132kV double circuit transmission line. However, the NEA is still to build the said substation and a 26.5-km long 220 kV double circuit transmission line from the Chilime Hub to the Trishuli 3B hub. This corridor project was started in FY2011 and is currently targeted for completion by mid-July 2019. Though further delays in completion of the evacuation structure is likely, the presence of the NEA as a promoter mitigates this risk of delays to some extent.

The project cost as per the latest estimates is NPR 16,785 million (i.e., ~3% over the earlier estimate of NPR 16,331 million). The cost escalation is primarily on account of incremental consultancy expenses for delayed period, among others. The EPC contracts for project execution have a sizeable USD component at ~USD 94.76 million, ~60% of which remains to be paid over the remaining contract period. Significant currency devaluation (NPR has depreciated by ~15% since execution of these contracts) exposes the project to further project escalation costs. Any unexpected delays would also add to the interest during construction (IDC). Hard cost escalations so far have been avoided, given the fixed price contracts for major activities and hence remains a positive. The project would also be entitled to a capital subsidy of NPR 5 million per MW from the Government upon connection to the national grid. This could be utilised to cover any unforeseen contingencies.

The debt component has been initially tied up with the EPF at a debt-to-equity ratio of 50:50 excluding IDC, which is to be capitalised separately. The agreement to finance the forex losses remains to be completed. Including these, the debt-to-equity ratio for the project would be ~63:37. The project loan is now to be repaid over a period of seven years following its operations, as against an earlier 10-year repayment tenure. This significantly reduces the equity cash flows in the initial years and hence also remains a concern. As of now, 75% of the equity requirements (~NPR 5,132 million) has been brought in with the plans to raise the balance equity through a series of IPOs. Of the NPR 6,581 million costs incurred till mid-December 2018, NPR 2,611 million has been funded through debt, and the rest from equity. The milestone-based payment system has resulted in relatively low financial progress (~40%) compared to the physical progress and hence has helped save IDC in the interim.

Typically, hydro-power projects entail significant project execution risks, being located in difficult terrain and are likely to face adverse climatic conditions during the construction period. Sudden geological surprises can also disrupt the construction schedule of any project. Post the commissioning, any loss of generation due to shortage of water or silting can negatively impact the project earnings and return indicators. Thus, timely completion within the budgeted time and cost estimates and the availability of requisite hydrology and evacuation infrastructure (to be developed by NEA) would be the key factors driving the returns for the project.

**Analytical approach:** For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

#### **Links to applicable criteria:**

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<sup>1</sup> Earlier plan was to start operations from August 2019.



## [IPO Grading Methodology](#)

### **About the company**

Rasuwagadhi Hydropower Company Limited (RHCL) was established in August 2011, as a subsidiary of Chilime Hydropower Company Limited (Chilime; ~44% stake at present, diluted after first tranche of IPO). Chilime, promoted by the NEA, owns and operates the 22.1-MW Chilime HPP and is developing hydropower projects with 270 MW capacity, through various subsidiaries, including RHCL. Around 24% stake as of now is held by the NEA, a Government of Nepal-owned company. RHCL plans to float 49% of its total issued capital to the public through a series of IPOs in various tranches (all at par) after which the promoter holding will dilute to 51%. As a part of the IPO process, the company has already issued 24% of its post IPO paid-up capital amounting to NPR 1,642 million to contributories and employees of the sole lender EPF and employees of the promoter companies. After this proposed issue to the general public (15% of issued capital), RHCL will finally issue 10% of the issued capital to the local inhabitants of the project location<sup>2</sup>.

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<sup>2</sup> This contrasts with regulations that requires issues to be made to affected locals first. Pre-approval for this contradiction has been received from SEBON.



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