Ru Ru Jalbidhyut Pariyojana Limited: [ICRANP] IPO Grade 3 assigned

August 24, 2020

Instrument	Issue Size (NPR Million)	Grading Action
IPO (equity) Grading	89.695	[ICRANP] IPO Grade 3; assigned

Grading action

ICRA Nepal has assigned a grading of [ICRANP] IPO Grade 3, indicating average fundamentals, to the proposed initial public offering (IPO) of NPR 89.695 million of Ru Ru Jalbidhyut Pariyojana Limited (RJPL). The company is proposing to come out with an IPO issue of 815,411 equity shares. Of this, 407,705 shares are to be issued at a face value of NPR 100 each to the project-affected population; the remaining 407,706 shares would be offered to the general public after adding premium of NPR 20 i.e. at NPR 120 each[1]. ICRA Nepal had earlier assigned IPO Grade 4+ to the company's proposed issue in October 2018.

Rationale

The grading upward takes into account the improved generation trend and hence better return metrics from the 5-MW operational Upper Hudgi Hydropower Project (HPP) developed by RJPL. Reduced outage/transmission losses led by strengthening of evacuation structures coupled with higher discharge has resulted in increased generation in FY2020. Though some decline in river discharge is likely based on the rainfall trend, the overall net generation is expected to remain healthy (~84% for FY2020, ~72-74% in earlier years). Additionally, a relatively lower project cost of ~NPR 149 million per MW and higher dry energy mix at ~19% of the annual contract energy (with similar trend in generation) should result in healthy return and coverage indicators. The company has also paid cash dividend and/or bonus share at ~10% during FY2017 to FY2019. With the downsizing of bank loans from the proposed IPO proceeds, the capitalisation and coverage indicators would further improve. The grading also factors in the promoters' and management team's adequate experience in the sector, which remains a comfort for the project's operational and maintenance aspects. Similarly, the assigned grading also takes note of the low tariff and off-take risks amid the already signed power purchase agreement (PPA) with the Nepal Electricity Authority (NEA), the sole purchaser and distributor of electricity in Nepal, with pre-determined tariff rates and escalations.

Nonetheless, the grading remains constrained by the low PPA rates for the project (~20% lower to new projects); although, it is supported to some extent by the promotional tariff rates for the first seven years of operation. The absence of a deemed generation clause in the PPA also accentuates the concern along hydrological risks. Given the fixed tariff structure, interest rate volatility and control over operating costs will remain crucial. The grading is also impacted by the counterparty credit exposure from the NEA, which has a moderate financial profile (albeit with recent improvements). This is partly mitigated by the sovereign support of the Government of Nepal (GoN) to the NEA and its past track record of timely payments to independent power producers (IPPs). Going forward, the project's ability to achieve its designed operating parameters along with control over its operating cost structure would be the key drivers for determining the company's return metrics.

Key grading drivers

Credit strengths

Improving generation trend – The operational 5-MW Upper Hudgi Khola HPP generated ~88% of the contracted energy in FY2020 against an average generation of ~77% for earlier three fiscals. The improvement in generation was aided by good hydrology support, along with strengthening of the evacuation structure and hence reduced outage levels. In the first full year of operation (i.e. FY2016), the project faced ~2,346 outage hours (~6.5 hours per day) which gradually decreased to only ~729 outage hours (~2 hours per day) in FY2020. The net energy supplied to the NEA was ~84% of the contract energy in FY2020 (~73% in earlier three fiscals), with a slight reduction in transmission loss (3.82% for FY2020 against an average of 4.32% in the earlier three fiscals).

[1] *As applied to Securities Board of Nepal (SEBON); the premium amount is subject to regulatory approval.*

Given the sharp improvement in generation compared to the earlier years, the company was unable to closely predict the generation trend. Hence, it had to sell ~1% energy at zero tariff as the actual generation in some months of FY2020 was higher than the declared energy[2] to the NEA. These are also likely to add up to the future revenue profile. Going forward, the hydrology support and the generation trend would determine the company's revenue profile. While the reduction in outages has been viewed positively, hydrology is prone to fluctuations and hence ICRA Nepal expects the average generation trend over the years to be slightly lower than reported in FY2020.

Low project development cost to support profitability and return parameters – The project has been in operation since March 2015 and was developed within a cost of NPR 745 million (~NPR 149 million per MW), funded in an initial debt-equity ratio of ~63:37. This is expected to support the company's profitability profile in the fixed tariff regime. The improved operation performance along with the planned debt downsizing from the proposed IPO proceeds are likely to aid improvement in the return metrics. It has also provided ~10% returns to shareholders on an average from FY2017 to FY2019. The improved return on net worth of ~16% for FY2020 compared to ~10-13% earlier, remains a positive for future return prospects.

Low tariff risk, given long-term PPA at predetermined tariffs and escalations – The tariff and off-take risks remain low for the project amid the already signed PPA with the NEA. The tariff for the wet season (mid-April to mid-December) is NPR 4 per kWh while that for the dry season is NPR 7 per kWh. For the PPA rates, there is a 3% annual escalation on the base tariff for nine times. The project is eligible for all its escalation clauses. With the Government's initiative to promote hydropower development, the company has also entered into a promotional tariff rate agreement of NPR 4.80 and NPR 8.40 (for wet and dry season respectively) with 3% annual escalation for 5 times on the base tariff. This would be applicable until the completion of seven years from the commercial operation and thereafter the rates will be as per the original PPA. Incrementally, the Government has also waived the short supply penalty for projects up to 10MW. The demand outlook for the energy sector remains good owing to the supply-demand gap as well as the increasing energy consumption in the nation.

Experienced promoters and management team – The company's promoters/board and the senior management have adequate experience and technical expertise in the hydropower/engineering sector. The promoters' current/past association with other hydropower projects and the management team's experience provide comfort in terms of the project's operational aspects. The company has developed in-house maintenance capabilities for routine issues, which remain a positive.

Credit challenges

Exposure to interest rate volatility and rising operating costs amid fixed tariff structure – Since the revenues are fixed, volatility in interest rates would impact the company's profitability and coverage ratios. These indicators could come under further pressure in case the project deviates significantly from its design operating parameters. Additionally, the company has reported a sharp increment in operating costs at CAGR ~13% in the last three fiscals. Hence, its ability to control the operating cost structure would also remain critical.

High hydrology risk, given lack of deemed generation clause in PPA – The lack of a deemed generation clause in the PPA exposes the project to hydrology risk in case of adverse river flow scenarios without receiving any compensation for such losses. This concern is further accentuated by the fact that the river flow is dependent on the rain-fed perennial source, which could affect the available hydrology based on rainfall fluctuations in the basin.

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

Links to applicable criteria:
[IPO Grading Methodology]

About the company

Incorporated on March 22, 2006 as a private limited company, RJPL was converted into a public limited company on July 23, 2015 to facilitate public participation. As on mid-July 2020, the paid-up capital of RJPL stood at ~NPR 326 million. As on

[2] *Expected generation in next month has to be declared to the NEA before the start of month. NEA is not bound to pay for generation exceeding the declared energy.*

the same date, major promoters include Mr. Bharat Prasad Nepal (15%), M/S Subhakarma Investment Company (12%) and M/S Samuchit Investment Company (11%).

RJPL has one operational hydropower project - Upper Hugdi Khola Hydropower Project of 5MW, in Gulmi District of Province-5 of Nepal. A run-of-the-river (R-o-R) type project, it has been developed at 43% probability of exceedance (Q43). The project came into commercial operation from March 23, 2015 as against a required COD of March 28, 2014 and was developed at a total cost of NPR 745 million.

Key Financial Indicators

Amount in NPR million	Audited			Provisional
	FY2017	FY2018	FY2019	FY2020
Operating Income	121	122	124	146
OPBDIT/OI (%)	84%	81%	80%	81%
PAT/OI (%)	32%	28%	29%	41%
Return on net worth	13%	11%	10%	16%
Return on assets	11%	11%	11%	13%
Gearing (times)	1.34	1.09	0.95	0.79
OPBDITA/Interest (times)	2.39	2.23	2.30	3.34
DSCR (times)	1.43	1.13	1.09	1.30
NWC/OI (%)	41%	58%	37%	46%
Total Debt/OPBDITA (times)	4.29	3.95	3.47	2.58

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