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RPL, its finances, its debt

Part 5

Aditi Roy Ghatak

Reliance Power Limited will need to borrow 80 per cent of its project costs. But will it be able to service the debt?

The Draft Red Herring Prospectus of the company voices fears around meeting RPL obligations under the debt financing arrangements (Risk Factor 10) for the 12 power projects with a total estimated cost of Rs 955,910 million. RPL intends to finance 80 per cent of the cost of each of its prospective projects with third-party debt and expects to borrow substantially in the future.

The ability to meet these debt service obligations and to repay the outstanding borrowings will depend primarily upon the cash flow generated by the business and RPL cannot guarantee sufficient cash generation “to service existing or proposed borrowings, comply with covenants or fund other liquidity needs”. Failure would, however, lead to RPL being declared defaulter under the terms of borrowings, accelerate the maturity of its obligations or take over of the financed project.

Other aspects include RPL’s indebtedness and the conditions and restrictions imposed by its financing arrangements that “could adversely affect our ability to conduct our business and operations” (Risk Factor 11). The financing arrangements for Rosa Phase I contain certain restrictive covenants wherein RPL has agreed not to create a lien over 51 per cent of the equity interest in Rosa Power Supply Company Limited (RPSCL). RPSCL has agreed not to make certain restricted payments, including the distribution of dividends, redemption or repurchase of any class of its shares that will result in a long-term debt to equity ratio higher than 4:1, prepaying any indebtedness prior to its maturity date and investments in equity, unless certain conditions are satisfied.

RPL also needs finances for the other 11 projects and the future borrowings, “including any borrowings in connection with the development and construction of the identified projects, may contain restrictive covenants and events of default” that could limit RPL’s ability to undertake certain types of transactions and could adversely affect its liquidity. For example, “our financing arrangements for Rosa Phase I give lenders a pledge over all the existing and future assets of RPSCL. If we seek to develop Rosa Phase II under RPSCL, we will not be able to grant a lien over the assets of RPSCL without a release from current lenders to RPSCL. This restriction could adversely affect our ability to finance Rosa Phase II”, says the draft red herring prospectus.

Reliance Power is also relying on Reliance ADA group and its affiliates in certain key aspects of its business as well as ancillary support services (Risk Factor 5). It has non-binding MOUs with Reliance Energy, RNRL, Reliance Energy Transmission and Reliance Energy Trading for, among other matters, EPC services, fuel, power evacuation and off-take arrangements. It also has several firm agreements with affiliates of the Reliance ADA group for the provision of other services, especially for its key personnel.

The risk here is that RPL cannot assure investors that its “affiliates will enter into definitive agreements on the basis of the non-binding MOUs or, if they do, that those agreements
will be on terms commercially acceptable to us”. Since affiliates of the Reliance ADA group will have multiple roles with respect to RPL, the company may be limited in its ability to negotiate agreements with its affiliates to obtain the most favourable terms.

Significantly, much of RPL’s development plans depend on the success of its affiliates. For example, Reliance Natural Resource is currently in litigation over its rights to gas reserves that RPL intends to use to supply its Shahapur Gas and Dadri projects. It also intends to develop power generation projects around Reliance Natural Resource’s CBM discoveries. These will reflect the results of RPL’s exploration of four CBM blocks allotted to a consortium led by it. If its affiliates are “not successful in maintaining and expanding their own businesses, it could cause us to delay, cancel or downsize certain projects under development and otherwise may have a material adverse affect on our business, financial condition and results of operations”, says RPL. There is also the financial angle ensuing out of the fact that RPL affiliates will provide services to it and “payments to them are likely to precede the time at which we begin to generate revenues and shareholder returns”, RPL says. Proceeds from this offering or from related debt financing may be distributed to them pursuant to these arrangements.

We cannot assure debt service: RPL

KOLKATA, Oct 28: The Statesman asked Reliance Power to comment on aspects of its Draft Red Herring Prospectus forming part of the report published alongside. Our questions and RPL’s answers are published below.

Q. There are fears around RPL meeting its obligations under the debt financing arrangements (Risk Factor 10) for the 12 power projects with a total estimated cost of Rs 955,910 million, 80 per cent of it financed through debt. Are you in a position to guarantee sufficient cash generation to service existing or proposed borrowings, comply with covenants or fund other liquidity needs? If not, would you agree it could lead to RPL being declared a defaulter and losing control of the projects?

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RPL says: You are asking us to confirm the facts and/or views already expressed,disclosed and published in the DRHP. In this para you refer to Risk Factor 10 and asking us whether we are in a position to guarantee sufficient cash generation to service existing or proposed borrowings, etc. This is already stated in the Risk Factor which, inter alia, states that “we cannot assure you that we will generate sufficient cash to enable us to service existing or proposed borrowings, etc.” The question is therefore rhetorical. The Risk Factor clearly states that we cannot assure generation of sufficient cash. What is the point in asking whether we can guarantee sufficient cash generation? If we could we would not have stated the Risk Factor.

However, it is ultimately for the investors to take a view based on the various factors enumerated therein, the relevant factors enumerated therein, the relevant facts set out in the DRHP including facts about business, strategy, funding requirements, etc. and form an informed judgement as to whether the investor would, under the circumstances, like to make an investment or not.

The same comments apply to the second question raised in this Para about losing control of the Projects. This has already been disclosed in the Risk Factors wherein it is clearly stated that:

"If we fail to meet our debt service obligations or financial covenants required under the financial documents, the relevant lenders could declare us in default under the terms of our borrowings, accelerate the maturity of our obligations or take over the financed project."

Q. RPL mentions that its indebtedness and the conditions and restrictions imposed by its financing arrangements "could adversely affect our ability to conduct our business and operations". (Risk Factor 11). RPL also needs finances for the other 11 projects and the future borrowings, and in particular accepts that its ability to finance Rosa Phase II could be adversely affected. Please comment.

RPL says: The Para again summarises the Risk Factor 11 of the DRHP and asks us to comment on the same which for the reasons already stated, viz. inappropriateness for an issuer to seek to evaluate risk factors disclosed by the issuer, we are unable to do.

In relation to this Risk Factor, we must once again draw attention to the subsequent letter filed with SEBI wherein we have indicated that the Board of Directors of Reliance Capital Limited and Reliance ADA Group Private Limited, two of the Promoter Group companies, adopted resolutions on October 18, 2007 respectively that they shall arrange/provide the requisite funds to meet any shortfall in financing of the Identified Projects in the event Reliance Power is unable to tie-up the entire debt of Rs 254,312 million (US $ 6.4 billion), to ensure that the said Identified Projects of Reliance Power are completed in a timely manner.

Tomorrow: RPL and conflicts of interest