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Risks that RPL admits to

Aditi Roy Ghatak

The Reliance Power draft red herring prospectus lists as many as 60 risks, some of which are very, very real. For starters, the company admits to having “no operating history” which makes it difficult to estimate its future (Risk Factor 1). RPL says: “You should not evaluate our prospects and viability based on the performance of REL or our other Promoters”. Since commercial operations of its first power plant, Rosa Phase I, may only commence in December 2009, the company says that “our prospects must be considered in light of the risks and uncertainties inherent in new business ventures. As a result, we cannot assure you about our future performance or that our business strategy will be successful”.

Nor can the company give an assurance that its projects will commence operations as expected. (Risk Factor 2). That is the most significant risk because there is no means of judging RPL’s ability to put together a dozen projects in as tricky a country as India. Consider just a few examples: the scheduled completion date for the Butibori power project is in June 2010. This is later than the date on which the project is required to be completed with the government having said categorically, while granting the earlier extension that “no additional extensions would be granted”.

Next, take the memorandum of understanding for the Shahapur project. It expired on April 4, 2007 and the company is negotiating an extension for completion date. It is also seeking an extension of the Butibori lease. “We cannot assure you that we will be able to obtain these extensions and the government may refuse to grant the benefits provided under the agreements and seek recovery of the benefits already provided by it. Without these agreements and the benefits they provide, it is unlikely that we would be able to continue to develop the relevant project”, says RPL.

Consider then the Kalai II project whose future depends on Reliance Energy Limited receiving a Letter of Award from the GOAP. REL has confirmed that it would transfer the project to RPL but there is no certainty that REL itself will be awarded Kalai II. “Failure to develop any of our projects could materially and adversely affect our business, financial condition and results of operations”.

There are other financial issues around RPL securing funds for its significant capital expenditure. “If we are unable to obtain the necessary funds on acceptable terms for expansion, we may not be able to fund our projects and our business may be adversely affected (Risk Factor 3). The 12 projects on anvil need Rs 764,728.0 million in debt. Worse, they face several other variables and, admittedly, “the actual amount of capital requirements to implement these projects may differ from our estimates”, says RPL.

RPL’s ability to finance these capital expenditure plans is also subject to “risks, contingencies and other factors”, which are beyond its control. Adverse developments in the Indian and international credit markets may also increase RPL’s debt-service costs and the overall cost of funds. “We cannot assure you that we will be able to raise sufficient funds to meet our capital expenditure requirements and on terms acceptable to us. If we are unable to raise the capital needed to fund the costs of our projects, or experience any delays in raising such funds, there could be a material adverse impact on our ability to complete these projects on our revenues and profitability”.

RPL intends to finance around 20 per cent of the project costs itself and about 80 per cent of the cost with third-party debt in keeping with the company’s perception of the current market for financing power projects in India. It admits that this standard could change and financial institutions or investors could require additional contributions and reduce RPL’s leverage for the project being financed, negatively impacting on its expected returns.

It is equally possible that RPL will be unable to raise additional capital to fund the remaining costs for the identified projects (Risk Factor 4). The total proceeds from its issue would only cover a part of the completed costs and an estimated additional Rs 254,312 million would be needed.

RPL has mandated certain banks and financial institutions to arrange up to $6 billion in syndicated loans on a secured basis. These mandates include preliminary term sheets that are, however, indicative in nature. They are also subject to conditions and commercial negotiations.

It is possible that the company will fail to fulfil “all or any of these conditions or reach agreement on commercial terms with these banks and financial institutions, in which case they would have no obligation to arrange such loans for us”. This means seeking fresh sources of funding that may not be available eventually.

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Reliance
Power

responds
KOLKATA, Oct 27: The Statesman asked Reliance Power to comment on the risks disclosed in its Draft Red Herring Prospectus. Following are our questions and RPL's responses.

1. Your draft red herring prospectus lists as many as 60 risks, some of which in our view are very, very real. Would you agree?

RPL says: Risks are a part of life and are attached to all activities and businesses. The extent and nature of risk vary with the extent and nature of business. It is desirable that any public offer of a security like "equity shares" involving
a high degree of risk is properly evaluated by the prospective investor before he decides to invest his money. For this purpose among other things, it is the duty of the issuer to disclose to the prospective investor all risks that he can perceive and which are not deemed immaterial. Our Draft Red Herring Prospectus discloses all risks known to us and other those deemed immaterial. In evaluating materiality we have erred on the side of caution. This has resulted in disclosure of nearly 60 risks disclosure of which is considered relevant by the Company in consultation with the Book Running Lead Managers. Your message also does not point out any alleged failure on our part to disclose any risk. Your question indicates that in your view some of these risks are "very, very real". You have not indicated he risks to which you refer. In the absence of such an indication it is not possible to agree or disagree with your view. Please indicate the risks to which you refer to enable us to reply to your question.

2. Your attention is drawn to Risk Factor 1 of your DRHC, and your assertion that RPL having "no operating history" makes it difficult to estimate your future prospects. Please comment.

RPL says: Also, the evaluation of the Risk and its effect, in any, on the investment decision is a function of the investor. It is the investor who will make the investment decision after weighing the disclosed risks against his perception of the Investee Company, its promoters, their track record, its management, the resources available to it, the resources it can raise, its reputation and various other similar features. It is not for the Issuer to provide this evaluation; assistance in evaluation must come from the Investment Advisor of the Investor who knows the investor and his risk appetite.

In Para 2 you have claimed to reproduce words from the Risk Factors after deliberately omitting one word, that is our reference to "no significant operating history" has been converted to "no operating history". This is an indication of the deliberate attempt to misread the Draft Red Herring Prospectus and to create confusion. Having reproduced some part of what is stated under Risk 1 of the DRHP you have asked us to "comment". You will appreciate that any such "comment" is bound to be misunderstood as an attempt to influence investors, which is not correct on the part of an "issuer". There is, therefore, no question of our "commenting" on the Risk Factor which is already disclosed by us.

Please indicate what you intend to convey by asking us to "comment" on a Risk Factor disclosed by us. What is it that you want to know and cannot find in the DRHP. What is the confusion, if any, which you want to draw and publish so that we can address the validity, accuracy, etc of your conclusions and the desirability etc. of publishing the same.

3. There are serious question marks on RPL's ability to commence operations as expected (Risk Factor 2). Please let us have your comments, especially on the fact that although the scheduled completion date of the Butibori project is June 2010, this is later than the date on which the project is required to be completed with the government having said categorically, while granting the earlier extension that "no additional extensions would be granted". What makes you so sure that Government will grant you additional extensions? Have you received any assurance from the Government? If so, please let us have the details thereof.

The MoU for Shahapur project expired on 4 April 2007 and RPL is negotiating an extension for completion date. How certain are you that the extension will be granted?

The Kalai II project depends on REL receiving a Letter of Award from the GOAP. While REL says it will transfer the project to RPL there is no certainty that Reliance Energy itself will be awarded Kalai II. Please let us have your comments, and your assessment of the impact of these risks on potential investors.

RPL says: As in Para 2, in Para 3 also, you are referring to and extracting from the Risk Factors already disclosed by us and asking us to comment on the same and to provide our assessment of these risks on potential investors. As explained above, the duty of the issuer is to disclose risks and all relevant facts related to such risks. Evaluation of the risks and its impact is then correctly, left to the investor.

Para 3 of your Message does not suggest that there is any failure on our part to disclose the risk or any relevant facts related to risk. Further comment is not permissible to an issuer. To your specific question as to whether we have received “any assurance from the Government” of an extension, we have to clarify that no such assurance has been received. The Para also seeks to question our business wisdom of proceeding with certain projects in respect of which we have disclosed the risk that, in certain circumstances, it is unlikely that we would be able to continue to develop the relevant project. You will appreciate that business decisions are the prerogative of the issuer subject to the issuer disclosing the risks, if any related to those business decisions. The evaluation of those risks and consequently, the decision to invest or not is that of the investor. The process of an issue beginning, inter alia, with the filing of a DRHP, does not provide for a further debate on the wisdom or otherwise of the business decision of the issuer and its promoters. We cannot, therefore, enter into this debate. We can only reiterate that we have, in the DRHP, indicated the business which we are likely to conduct and also the risks related to such business. We understand that you have found no lacuna in our disclosure but wish to comment on the business wisdom of the issuer and that the comment is entirely based on the risks which have already been disclosed by the issuer.

We are sure that you will clearly distinguish between the business decision, the risks disclosed except the incompleteness of the disclosure and thereafter express any view that you may have in respect of the business wisdom of the issuer and its promoters in a manner which will clearly bring out that the comments reflect as your views in whatever capacity you claim to the able to make such comment whether as laymen, as experts, as experienced entrepreneurs or otherwise clarifying that the comments are not the views of the issuer and that the issuer has performed its role of describing the business, the business risks, and disclosing all facts relevant thereto.

We may add that the risk factors disclosed by us clearly state that “failure to develop any of our projects could materially and adversely affect our business, financial condition and results of operations.

4. You say in the DRHC that “If we are unable to obtain the necessary funds on acceptable terms for expansion, we may not be able to fund our projects and our business may be adversely affected. (Risk Factor 3). The 12 projects on anvil need Rs 764,728.0 million in debt. You state further that you intend to finance around 20 per cent of the project costs from Reliance Power and around 80 per cent with third-party debt in keeping with the company’s perception of the current market for financing power projects in India. Please comment, especially on the extent of control you have on the funding and the risks to investors from your inability to do so, should such a situation arise.

RPL says: As indicated in the comments on the earlier paragraphs, as an issuer, it is not appropriate for us to comment on the risk factors already disclosed by us or to offer an evaluation of the risk factors. We may only draw your attention to the Section of the DRHP titled “Objects of the Issue” and in particular to the Sub-Section titled “Means of Finance” (Page 35 of the DRHP) as also to the further section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Financial Indebtedness” (Page 205) as also to the discussion about each

Project under the Section titled "Our Business – Description of Projects under Development" (Pages 69 to 84 of the DRHP) wherein financing arrangements have been discussed wherever relevant. We may add that the filing of the DRHP, two entities of the Reliance ADA Group have agreed that they will arrange finance to meet the shortfall, if any, in the firm arrangements made by the Company to meet the financial requirements of the identified projects. This has been communicated to SEBI by our letter dated 19th October 2007. The consequences of our failure to raise the requisite level of funding have already been indicated in the Risk Factors of the DRHP, in particular Risks Factors 3 and 4.

5. RPL admits to the possibility it will be unable to raise additional capital to fund the remaining costs for the identified projects. (Risk Factor 4). The proceeds from your issue would only cover a part of the completed costs and that an estimated additional Rs 254,312 million would be needed. You have mandated certain banks and financial institutions to arrange up to $6 billion in syndicated loans on a secured basis. These mandates include preliminary term sheets that are, however, indicative in nature. They are also subject to conditions and commercial negotiations. It is possible that the company will fail to fulfil "all or any of these conditions or reach agreement on commercial terms with these banks and financial institutions, in which case they would have no obligation to arrange such loans for us". Would you agree this will mean seeking fresh sources of funding that may not be available eventually?

RPL says: The para reproduces and summarises the risks indicated in Risk Factor 4 of the DRHP. The specific question addressed to us whether we would agree that the circumstance described in the said Risk Factor 4 disclosed by us can mean "seeking fresh sources of funding that may not be available eventually". This has already been stated in the Risk Factor. We reproduce below the relevant extract.

"We cannot assure that we will be able to arrange financing on terms that would be acceptable to us, or at all. If we are unable to negotiate terms satisfactory to us, we will have to seek financing from other sources in order to complete the identified projects, as well as the other projects that are currently under development. Other sources of financing may not be available and we may not be able to obtain the capital necessary to fund our projects."

The question of our making any further comment does not arise for the reasons already indicated in our response to other paragraphs, viz. inappropriateness for an Issuer to do so.

We may of course once again draw attention to the further letter addressed by us to SEBI wherein we have indicated that two companies of the Reliance ADA group have agreed they will make good the shortfall, if any, in the funding arrangements for the Identified Projects.

Tomorrow: Other risks confronting RPL