

Api Power Company Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Rights Issue of Api Power Company Limited

Instrument/Facility	Issue Size	Grading Action (June 2016)
Rights Issue (equity)	NPR 2,000 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below average fundamentals to the proposed rights issue offering (equity) of Api Power Company Limited (API). ICRA Nepal assigns 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 relative better position within the grading categories concerned. API is proposing to come out with 1:2 rights issue of 20,000,000 numbers of equity shares of face value NPR 100/- each to be issued to existing shareholders at par. The proposed issue is being made in order to augment the capital required to invest in equity share of Siddhakali Power Limited (will be 80% subsidiary of API, currently controlled by the group and its associates) which is developing 75 MW Trishuli Galchhi project with RCOD¹ May 2020.

The assigned grading factors in the rich experience of the promoters and management personnel in the field of hydropower (group has four operational projects of total 14.4 MW with its first 3 MW project is operational since 2003 and five projects totalling 157.9 MW in various stages of development). With the company’s first project, 8.5 MW Naugarh HEP² being operational from August 2015, API now intends to develop 8 MW Upper Naugarh HEP and 75MW Trishuli Galchhi HEP (under its 80% subsidiary Siddhakali Power Limited) for which PPA has been signed for later project with NEA.

However, the grading is constrained by the company’s upcoming projects³ being in nascent stages and the poor operating performance of the operational project⁴ on account of lack of requisite evacuation structures from NEA⁵. Likely dilution in the profitability indicators of API arising from 1:2 rights issue and uncertainty about the revenue stream from proposed projects with considerable project execution and power evacuation risk has been factored into the grading.

With pending financial closure for both proposed projects; funding risk remains high. However, past track record of other group companies provides some comfort regarding the ability of the promoters to manage funding source for the project. The grading is also constrained by power evacuation and off- take risk⁶ for proposed project, interest rate volatility in the market and the counterparty credit risks arising out of exposure to loss making NEA for the energy supplied, although the same is partly mitigated by the fact that NEA is fully owned by the Government and has been making payments to IPPs (Independent Power Producers) in a timely manner in the past. Grading concerns further emanate from the typical implementation risks such as natural calamities/geological surprise and increase in time and cost estimates. Further, since the revenues are directly linked to unit sales and the tariff are fixed⁷, any loss of generation on account of hydrology can negatively impact the project earnings and return indicators.

¹ Required commercial operation date

² Hydro-Electric Project

³ Both of the proposed projects i.e. 75 MW Trishuli-Galchhi project (to be developed under Siddhakali Power Limited, 80% subsidiary of API) and 8 MW Upper Naugarh Gad hydel project are in pre-construction stages.

⁴ 8.5 MW Naugarh Gad hydel project, operating since August 2015 at PLF of ~33% against contract PLF of ~70%.

⁵ Nepal Electricity Authority

⁶ Proposed transmission line and substation for 75 MW project construction of which is not started by NEA increase power evacuation risk to the project. Further, conditional PPA for 75 MW project during wet season from FY20-FY29 also increase off-take risk.

⁷ NPR 4.8/kWh for wet and NPR 8.4 kWh for dry season for proposed 75 MW project in the first year of operation, subject to annual escalations as per PPA

Going forward, ability of the company to commission the proposed projects within the budgeted time and cost estimates and also availability of sufficient hydrology and evacuation infrastructure will be the key parameters which can impact returns of the project.

API is operating an 8.5 MW small hydropower run of the river project in Naugarh river (Naugarh Gad HEP) since August 2015 in Dethala VDC of Darchula District in the Far Western Development Region of Nepal. The project was commissioned at a cost of NPR 1,454 million funded in a debt:equity of ~53:47. The electricity generated from this project was to be connected to 132 kVA Balanch Substation of NEA, however owing to delayed commissioning of the same, the electricity is currently being evacuated through ~130 KM long 33 KVA transmission line resulting in significant power losses.. Going forward, the ability of the project to achieve its design operating parameters will be the most important driver for the project returns.

The proposed 75 MW Trishuli Galchhi HEP has RCOD of May 2020 as per the Power Purchase Agreement (PPA) signed with NEA and is being commissioned at a cost of NPR 14,044 million to be funded in a debt:equity of 70:30. API will invest ~NPR 3,371 million in equity for the project Following the feasibility study in 2015, Siddhakali Power Limited (the company developing 75 MW hydroelectric project) has received EIA (Environment Impact Assessment) approval for the project, entered into grid connection agreement and PPA with NEA. The project is however, yet to complete detailed designing, receive power generation license and complete the financial closure Part equity capital will be met through proceeds of the current rights issue by API which eventually will hold 80% in Siddhakali Power Limited. With a firm PPA in place, the tariff and off-take risks are reduced considerably, however the conditional off-take clauses for FY20-FY29 raises some concern. As per the PPA, the tariff rates for wet season are NPR 4.80 and for dry season is NPR 8.40 with 3% annual escalation on base tariff for 8 years from COD. Power generated by the project is to be evacuated from the switchyard at the power house through a 45 km long, 132 kVA transmission line to proposed new 132 kVA Marsyangdi substation of NEA at Aabukhaireni. Timely completion of the NEA's transmission line facilitating the evacuation of energy generated by the project, will have a bearing on the financial profile of API.

API is also developing 8 MW Upper Naugarh Gad HEP, upstream of the current operational project. The project is expected to be developed at a cost of NPR 1,440 million to be funded in a debt:equity of 70:30. Feasibility study for the project was completed in 2015, IEE (Initial Environmental Examination) approval has been received and grid connection agreement has been entered into. Power generated by the project is to be evacuated through a 7 km long, 33 kV transmission line to NEA Balanch substation at Darchula. The 132 KVA Balanch substation and transmission line is expected to be ready in few months.

With the new projects in very initial stages, ability of the company to mobilize funds for the same, timely completion within the budgeted time and cost estimates and also timely commissioning of transmission line by NEA will have a bearing on the returns of the project. Typically, hydro-power projects entail significant project execution risks as they are located in difficult terrain and hence adverse climatic conditions during the construction period and also geological surprises can disrupt construction schedule of any project. Additionally, time overruns could limit the potential benefits of higher tariff escalations and also could subject the company to penalties. Nevertheless, the promoters have substantial experience in construction and operation of hydro power projects and presence of experienced promoters and management personnel mitigates this risk to some extent.

API posted profit of NPR 15.40 million over gross sales of NPR 85.16 million and OPBDITA of NPR 62.31 million for 9MFY16⁸. The company had NPR 757 million of outstanding term loan payable to the consortium banks as on mid-April 2016 and the gearing ratio of the company stood at 0.43 times as on same date.

⁸ Based on provisional financials of mid-April 2016.



Company Profile

API was established in 19th June 2003 as private limited company being subsidiary of South Asia Engineering Pvt. Ltd. under Company Act 2053. Later on, the company converted into public limited company with major restructuring in the shareholding pattern on Jul-2013. The company was established by the promoters of Arun Hydropower Group⁹, one of the leading private sector hydropower group with the first project of the group getting operational in 2003. The projects are being developed on Build Own Operate Transfer (BOOT) basis where generation license are usually of 35 years including the period of construction.

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⁹ Arun Hydropower Group is one of the established Group in Nepal owned majority of the shareholding by Guru Prasad Neupane including his relatives.