

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 (August 2017)
Rights Issue (equity)	NPR 2,100 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 200% rights issue of 21,000,000 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 construct the proposed 8 solar projects totalling 18 MW and to invest in equity share of Siddhakali Power Limited which is developing 75 MW Trishuli Galchhi project with required commercial operation date (RCOD) of May 2020 (API will invest ~24% of equity requirements for the project).

The assigned grading factors in the rich experience of the promoters and management in the field of hydropower (group has four operational hydro-electric projects (HEPs) totalling 14.4 MW and five HEPs totalling 157.9 MW in various stages of development). The promoters have strong execution capabilities having commissioned 8.5 MW HEP in August 2015 (under API), and are currently involved in the development of 8 MW Upper Naugarh HEP (~40% complete) and 75MW Trishuli Galchhi HEP (being developed by Siddhakali Power Limited where API will hold ~24% stake). The company has also been awarded 8 solar projects with aggregate capacity of 18 MW.

However, the grading is constrained by the significant execution and funding risks involved in its various projects (75 MW Trishuli HEP and solar projects) which are currently in nascent stages. Additionally, ICRA Nepal draws limited comfort from the proposed solar projects as these would be the first of its kind venture in Nepal with the group companies lacking experience in construction and maintenance of solar projects. The grading is also constrained by poor operating performance of the operational project¹ on account of lack of requisite evacuation structures from NEA. Likely dilution in the profitability indicators of API arising from 200% rights issue and uncertainty about the revenue stream from proposed projects has also 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 sources for the project. The grading is also constrained by power evacuation risk² for proposed 75 MW HEP, 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 which can result in time and cost overrun. Further, since the revenues are directly linked to unit sales and the tariff are fixed as per Power Purchase Agreement (PPA), any loss of generation on account of hydrology/radiation can negatively impact the project earnings and return indicators.

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

¹ 8.5 MW Naugarh Gad hydel project is operating since August 2015 at PLF of ~32% and ~41% for 11MFY16 and 10MFY17 against contract PLF of ~67%.

² Construction of proposed transmission line and substation for 75 MW project has not been started by NEA.

API is operating an 8.5 MW run of the river HEP in Naugarh river (Naugarh Gad HEP) since August 2015 in Dethala VDC of Darchula District in 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. As per the PPA, the agreed tariff for wet season is NPR 4 per kWhr and for dry season is NPR 7 per kWhr with 3% escalation on base tariff for 9 years.

The company is also constructing 8 MW Upper Naugarh Gad HEP, upstream of the current operational project. The project is expected to be completed at a cost of NPR 1,440 million to be funded in a debt:equity of 70:30. The debt component has been tied up with a consortium of banks while the equity requirements are to be met from internal accruals of the company as well as from proposed right issue proceeds. Of the NPR 555 million costs incurred till mid-April 2017, ~NPR 234 million (42%) has been funded through debt and balance from equity, advances from group companies and contractor payables. The contract for civil and hydromechanical works of the project have been awarded to Makalu Developers Limited and API Hydro Mechanical Limited (both are group companies). The electro-mechanical contract has been awarded to Neon Energy Private Limited. Overall ~40% progress has been achieved in project execution as of mid-April 2017 and hence project is expected to commission ahead of Required Commercial Operation Date (RCOD) of July 2020. As per the PPA, the agreed tariff for wet season is NPR 4.8 per kWhr and for dry season is NPR 8.4 per kWhr with 3% escalation on base tariff for 5 years. 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.

API will also be constructing 8 solar projects totalling 18 MW (project size ranges from 0.5 MW to 8 MW) in different locations along the East-West Highway of Nepal within 2-5 km radius of the NEA substations from where the power will be evacuated. Tariff rates for these projects as per bid price accepted by NEA range from NPR 8.35 to NPR 9.25 per unit with no escalation clauses; NPR 8.35 per unit being for the largest of these projects i.e. 8 MW. Detailed project report (DPR) for these projects have been completed and energy table has been agreed upon with NEA. However, PPA and financial closure are yet to be achieved. The radiation studies are based on Meteoronorm data from the nearest Weather Monitoring station (either Gorakhpur or Patna). API plans to invest NPR 1,100 million into these projects from the proposed issue proceeds which will account for ~64% of total project cost NPR 1,719 million.

The proposed 75 MW Trishuli Galchhi HEP (being developed by Special Purpose Vehicle, SPV viz. Siddhakali Power Limited) has RCOD of May 2020 as per the PPA signed with NEA. The budgeted project cost is NPR 14,044 million which will be funded in a debt:equity of 70:30. API will invest NPR 1,000 million equity for the project from the proposed right issue proceeds (NPR 22 million invested so far). Remaining equity is to be raised from other promoters as well as IPO of the SPV³. Following the feasibility study in 2015, the company has received EIA (Environment Impact Assessment) approval and power generation license for the project, entered into grid connection agreement and PPA with NEA. However, only ~36% of promoter equity requirements (NPR 777 million) have been raised so far which along with pending financial closure raises funding risks for the project. API will inject part equity capital requirements through proceeds of proposed issue and will eventually hold ~24% in Siddhakali Power Limited. With a firm PPA in place, the tariff and off-take risks are reduced considerably. Also, the conditional off-take clauses for FY2020-FY2029 have been removed from the PPA through an amendment which provides some comfort. Nonetheless, the same amendment has introduced 10% reserve margin clauses for five months in a year (most of which coincides with rainy season); the reserve margin clause would be applicable for FY2021-FY2025 and this energy would be subject to conditional off take. As per the PPA, the tariff rates for wet season is 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

³ The SPV plans to raise 49% of its equity requirements through its IPO.

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 posted net profit of ~NPR 44 million over gross sales of ~NPR 122 million during 9MFY2017⁴ as against net profit of NPR 81 million over gross sales of ~NPR 106 million during FY2016. The reported profits are however benefitted by ballooning depreciation method adopted by the company⁵. The company had NPR 863 million of outstanding term loan payable to the consortium banks as on mid-April 2017 (including drawdown for under construction project) and the gearing ratio of the company stood at 0.78 times as on same date.

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, the company was converted into public limited company with major restructuring in shareholding pattern in Jul-2013. The company was established by the promoters of Arun Hydropower Group⁶, one of the leading private sector hydropower group with the first project of the group operational from 2003. The HEPs are being developed on Build Own Operate Transfer (BOOT) basis where generation licenses are usually of 35 years including the period of construction and PPA is of 30 years. The solar project is expected to have PPA for 25 years, after which the promoters can continue the project with replaced solar panels, provided the PPA is extended.

August 2017

For further details please contact:

Analyst Contacts:

Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)

kishor@icranepal.com

Mr. Rajib Maharjan, (Tel No. +977-1-4419910/20)

rajib@icranepal.com

Relationship Contacts:

Mr. Deepak Raj Kafle, (Tel. No. +977-1-4419910/20)

drkafle@icranepal.com

All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website (www.icranepal.com) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents.

⁴ Based on provisional financials as of mid-April 2017.

⁵ Auditors qualified their opinion on financial statements of FY16 over this matter.

⁶ Arun Hydropower Group is one of the established hydropower group in Nepal; majority of the shareholding by Guru Prasad Neupane including his relatives.