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 (January 2019)
Rights issue (equity)	NPR 2,268 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 4**", indicating below average fundamentals to the proposed rights issue (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 22,680,000 equity shares of face value NPR 100 each, to be issued to existing shareholders at par.

The grading is constrained by the significant execution and funding risks for the company's proposed projects, which are much larger in capacity, compared to the operational project. Financial closure for all proposed projects remains to be achieved and there have been limited physical development so far, which accentuates these concerns. Further, typical project implementation risks such as natural calamities/geological surprise can result in time and cost overruns. ICRA Nepal also 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 solar project construction and maintenance. Additionally, the tariffs for proposed solar projects have also been reduced. Hydrological risks also remain high, given the fact that all existing and proposed hydro-electric projects (HEPs) under Api are in the same basin. Since the revenues are directly linked to unit sales and the tariff fixed as per the power purchase agreement (PPA), any loss of generation on account of hydrology/radiation can negatively impact the project earnings and return indicators. The grading is also constrained by the likely dilution in the profitability indicators arising from proposed sizeable equity enhancement amid uncertainty about the revenue streams from proposed projects. Grading concerns further emanate from the interest rate volatility in the market and the counterparty credit risks arising out of exposure to the Nepal Electricity Authority (NEA), which has weak financial indicators. Going forward, the company's ability to achieve timely financial closure and complete its projects within the expected cost/time, as well as its ability to achieve design operating parameters, would all have a major bearing on overall return indicators.

Nonetheless, the grading factors in the rich experience of the promoter group and management in the field of hydropower (Group has four operational HEPs totalling 14.4 MW and 10 HEPs totalling 205.6 MW in various stages of development). The grading also considers the company's track record of timely project execution so far. However, the ability to reflect similar performance in proposed larger projects remains to be seen. The grading action also notes the low evacuation risks for proposed HEPs (totalling 48 MW) and solar projects (totalling 18 MW), to be developed under Api, as the evacuation structures are already available. The proposed HEPs would be evacuating the energy through the same transmission line to which the operational 8.5 MW project is connected. With the recent strengthening of this line, the quantum of transmission losses has reduced significantly, and this remains a positive factor for operational as well as proposed HEPs.

Api's first project, an 8.5-MW run of the river HEP at Naugarh river (Naugarh Gad HEP) in Darchula district, has been operational since August 2015. The project was commissioned at a cost of NPR 1,454 million, funded in a debt-to-equity ratio of ~53:47. The electricity generated from this project is being evacuated through the 132-kVA Balanch-Syaule-Attariya transmission line. The Syaule sub-station was recently added (in July 2018) to the long stretch of the transmission line (~131 km), which has helped lower the transmission losses for the project. Prior to this development, the project supplied only ~50-55% of contract energy, which has since improved to ~77% for 5M FY2019. As per the PPA, the agreed tariff for the wet season (corresponding to 79% of annual contract energy) is NPR 4 per kWhr and for the dry season, it is NPR 7 per kWhr with 3% annual escalation on the base tariff for nine years.

The under construction 8-MW Upper Naugarh Gad HEP lies upstream of the current operational project. The project is now expected to be completed at a cost of NPR 1,649 million (~15% cost overrun over initial estimates) to be funded in a debt-to-equity ratio of ~69:31. Of the NPR 1,566 million costs incurred till mid-October 2018, NPR 985 million (~63%) has been funded through debt and the rest from equity and contractor payables. The contract for civil and hydro-mechanical works for 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 ~95% progress had been achieved in project execution as of mid-October 2018, and hence the project is expected to commission ahead of the required commercial operation date (RCOD) of July 2020. As per the PPA, the agreed tariff for the wet season (corresponding to 77% of annual contract energy) is NPR 4.8 per kWhr and for the dry season, it is NPR 8.4 per kWhr with 3% annual escalation on the base tariff for five years. Power generated by the project is to be evacuated through a 7-km long, 33-kV transmission line to the NEA Balanch sub-station at Darchula.

Api will also be constructing eight solar projects totalling 18 MW (project size ranges from 0.5 MW to 8 MW) in different locations along Nepal's east-west highway. These would be located within a 2-5 km radius of the NEA sub-stations to which the power is to be evacuated. PPA for four of these projects (totalling 14 MW) have been executed and tariff rates finalised at NPR 7.30 per unit with no escalation clauses. The PPA for the remaining projects is yet to be finalised. The tariff has been lowered as against the earlier agreed tariff ranging from NPR 8.35 to NPR 9.25 per unit. The radiation studies are based on Meteonorm data from the nearest weather monitoring stations (either Gorakhpur or Patna). Their detailed project reports (DPRs) have been completed, but financial closure is yet to be achieved. The expected cost for these projects is NPR 1,440 million and the debt financing ratio is yet to be finalised. Hence, the quantum of investment in these projects, out of the proposed issue proceeds, also remains uncertain. Additionally, physical progress so far has remained mostly limited to land acquisition, with contractor mobilisation yet to begin. Given the limited time frame remaining for RCOD as per the PPA (June 11, 2019), any potential delays could subject the project to late COD penalties. The Group also lacks experience in operation and maintenance of solar projects, which also remains an area of concern.

The company further proposes to construct a 40-MW Upper Chameliya HEP at Chameliya river in Darchula district. The estimated cost of the project is NPR 7,225 million that is planned to be financed at a debt-to-equity ratio of 70:30. The feasibility study for the project has been completed and draft PPA has been agreed with NEA. As per the terms of the draft PPA, RCOD is during mid-October 2022 and the agreed tariff for the wet season (corresponding to 63% of annual contract energy) is NPR 4.8 per kWhr and for the dry season, it is NPR 8.4 per kWhr with 3% annual escalation on the base tariff for 8 years. Given the moderate cost expectations and high share of dry energy, this project could add up to revenue potentials for the company. However, considering the multiple projects in pipeline with PPA already locked for most of them, Api's ability to prioritise this project, in terms of funding, remains to be seen. In addition, the draft PPA has multiple conditional off-take clauses that create uncertainty over revenue streams and could also have a bearing over Api's ability to achieve financial closure for the project. Evacuation risks, nonetheless, remains lower on account of the existing transmission line being utilised by the operational project.

The largest of the proposed projects, the 75-MW Trishuli Galchhi HEP, is being developed by a special purpose vehicle (SPV), Siddhakali Power Limited (SPL), with RCOD of May 2020. As per the PPA, the tariff rates for the wet season (corresponding to 83% of annual contract energy) is NPR 4.80 and for the dry season is NPR 8.40 with 3% annual escalation on the base tariff for eight years from COD. Given the nascent stages of physical progress with financial closure to be achieved and contracts yet to be awarded, it is likely that the project would be delayed from its RCOD. This would expose the project to cost overrun risks in addition to late COD penalties and loss of tariff escalation. The current budgeted project cost is NPR 14,044 million, which is planned to be funded by a debt-to-equity ratio of 70:30. Api plans to invest NPR 1,000 million equity in the SPV (NPR 22 million invested so far); and the remaining equity is to be raised from other promoters as well as IPO of the SPV (49% of equity requirements). Only ~40% of promoter equity requirements (NPR 863 million) have been raised so far. With a firm PPA in place, the tariff and off-take risks are reduced considerably. Nonetheless, the PPA has 10% reserve margin clauses for five months in a year (most of which coincides with the wet season); the reserve margin clause would be applicable for FY2021-FY2025 and this energy would be subject to conditional off-take. Power generated by the project is to be evacuated through a 45-km long, 132-kVA transmission line to the proposed new 132-kVA Marsyangdi sub-station 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 return metrics that Api can expect from this investment.

Api posted net profit of NPR 30 million over gross sales of NPR 60 million during Q1 FY2019 as against net profit of NPR 59 million over gross sales of NPR 128 million during FY2018. The reported profits are, however, benefitted by the ballooning depreciation method adopted by the company (auditors qualified their opinion on financial statements of FY2018 over this matter). The company had NPR 1,630 million of outstanding term loan payable to the consortium banks as on mid-October 2018 (including drawdown for the under-construction project) and the gearing ratio of the company stood at 1.60 times for the same date.

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

Links to applicable criteria:

IPO Grading Methodology

About the company

Established in June 2003 as a private limited company, Api began as a subsidiary of South Asia Engineering Private Limited. In July 2013, the company was converted into a public limited company with major restructuring in its shareholding pattern. The company was established by the promoters of Arun Valley Hydropower Group, one of the leading private sector hydropower group of Nepal. The first project of the Group has been operational from 2003. The chairman of API, Mr. Guru Prasad Neupane, and his family have controlling interest across the Group companies. As of mid-October 2018, promoters held 60% stake in Api, while 40% was held by the general public. Api plans to utilise proposed issue proceeds in constructing proposed projects under the company and also to invest in the associate company that would be developing the 75-MW Trishuli-Galchhi HEP.

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