Api Power Company Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Long Term Bank Facilities	**5,322.27**	**CARE-NP BB+ [Double B Plus]**	**Revised from CARE-NP B+ [Single B Plus]**
Short Term Bank Facilities	**1,850.00**	**CARE-NP A4+ [A Four Plus]**	**Revised from CARE-NP A4 [A Four]**
Total Facilities	7,172.27 (Seven Thousand One Hundred Seventy-Two Million and Two Hundred Seventy Thousand Only)		
Issuer Rating	NA	**CARE-NP BB+ (Is) [Double B Plus (Issuer)]**	**Revised from CARE-NP B+(Is) [Single B Plus (Issuer)]**

The issuer rating is subject to overall gearing ratio of the company not exceeding 1.75x at the end of FY23.
Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has revised the issuer rating assigned to Api Power Company Limited (APC) to 'CARE-NP BB+(Is)' from 'CARE-NP B+(Is)'. Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations, in Nepal.
CRNL has also revised the rating assigned to the long term bank facilities of APC to 'CARE-NP BB+' from 'CARE-NP B+' and the rating assigned to its short term bank facilities to 'CARE-NP A4+' from 'CARE-NP A4'.

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to APC factors in successful commencement of operations of its two solar power projects during the review period and satisfactory operations thereafter coupled with improving trend of Plant Load Factor (PLF) of the already operational hydropower projects leading to improved financial risk profile of the company in FY22 (Audited, FY refers to the twelve-month period ending mid-July). The revenue base of the company has subsequently improved with two operational hydropower projects and three operational solar projects.
The ratings, however, continue to be constrained by project implementation risk associated with APC's under construction 40 MW hydropower project, which is considerably larger than the currently operational projects of the company. Furthermore, the ratings also factor in the still modest operating performance of operational hydropower projects, despite improving trend in FY21-FY22, and hydrology risk associated with run-of-the-river power generation, geological and risk of natural calamities in hydropower projects. The ratings also take note of the exposure of solar projects to climatic conditions and associated technological risks, exposure to volatile interest rate risk and regulatory risk.
Furthermore, the ratings continue to derive strengths from experienced board members and management team with long track record in operating power projects, presence of power purchase agreement (PPA) with sufficient period coverage, and favorable government policies towards power sector. The ratings also factor in the reduced funding risk for its under-construction hydropower project after the successful collection of the earlier envisaged right proceeds in FY22.
Going forward, the ability of the company to timely execute the under-construction project within the required commercial operation date (RCOD) avoiding time or cost overrun, continued reduction in the gap between operational PLF and contracted PLF, availability of sufficient hydrology and timely receipt of payment from Nepal Electricity Authority (NEA) will be the key rating sensitivities.

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

Detailed description of the key rating drivers

Key Rating Weaknesses

Project implementation risk related to under-construction hydropower project

The estimated cost of under construction 40 MW Upper Chameliya Hydroelectric project (UCHP) is Rs. 7,400 Mn which is proposed to be funded through debt-to-equity ratio of 70:30. The total debt amount has already been tied up and the company has also raised the equity amount from the proceeds of right issue, alleviating the funding risk related to the project. As on January 20, 2023, ~76.80% of the total project cost has been incurred. The power from the project is proposed to be evacuated to operational NEA's Balanch substation. The Required Commercial Operation Date (RCOD) of project has been extended till February 25, 2024. The commencement of operations within RCOD would remain critical in determining the number of tariff escalations that the project would avail as well as implications of any late COD penalty. The company's project completion track record in case of hydropower project prior to the RCOD in the earlier two operational projects provides comfort, though capacity remains to be tested for the bigger project. The project's ability to commission within the budgeted cost and expected timeline will be key monitorable aspect.

Modest operating performance of operational hydropower projects

The company has two operational hydro power projects - 8 MW Naugarh Gad Small Hydroelectric Project (NGHP) which came into operation in August, 2015 and 8.5 MW Upper Naugarh Small Hydroelectric Project (UNSHP) which came into operation in October, 2019. Although PLF of NGHP improved to 82.35% of the contracted capacity in FY22 (FY21: 74.91%) and that for UNSHP improved to 83.81% (FY21: 70.39%), these remain modest compared to other hydropower projects during FY22. The improvement in power generation in FY22 was on account of better hydrology during FY22. However, relatively modest PLF levels otherwise is on account of challenges regarding power evacuation, particularly during the high supply wet season. However, upgradation of existing single circuit 132kv Balanch- Syale - Attariya transmission line to double circuit is expected to be completed by third quarter of FY23. When completed, this is expected to further smoothen the power evacuation and improve the PLF of the hydropower projects going forward.

In contrast, the power generation from the three operational solar projects have been relatively better at over 90% of the contracted capacity. The company's ability to continue to reduce the gap between operational PLF and contracted PLF, on a sustained basis, remains to be seen and will remain a key monitorable aspect.

Hydrology risk associated with run-of-the-river power generation

Run-of-the-river power is considered an unsteady source of power, as a run-of-the-river project has little or no capacity for water storage and therefore is dependent on the flow of river water for power generation. It, thus, generates much more power during wet season when river flows are high (June to November) and less during the dry season (December to May). The energy generated by operational hydropower projects depends upon the hydrology of the river and are also prone to geological risk and risk of natural calamities majorly flood. NGHP utilized discharge from Naugarh Gad, UNSHP utilize discharge from Naugarh Gad & Gaddi Gad and UCHP utilizes discharge from Chameliya Khola having catchment area of 192 sq. kms, 148 sq. kms and 656.3sq. kms respectively based on Perennial River. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/ Khola. Since there is no minimum commitment on revenue in PPA in case of adverse river flows scenario, the company is exposed to hydrology risk of the power project for the generation of revenue.

Solar project operations exposed to climatic conditions and technological risks

The company has used mono-crystalline technology in solar projects although expensive than poly- crystalline technology suffers relatively lower degradation, requires lesser land and draws maximum sunlight in the areas of lower sunlight with high heat tolerance thus are more efficient than poly panels. However, achievement of desired Capacity Utilization Factor (CUF) going forward would be subject to change in climatic conditions, amount of degradation of modules as well as technological risks.

Exposure to regulatory risk

Government of Nepal (GoN) has established Electricity Regulatory Commission (ERC) for regulating generation, transmission and distribution of electricity in Nepal. ERC will be the regulator under the GoN which will be responsible for regulating hydropower companies in Nepal. Polices and the directives issued by ERC like approval process for IPO issuance, PPA approval through ERC poses a new challenge to hydropower companies. Hence, sector is prone to regulatory risk and changes in other policies by GoN.

Key Rating Strengths

Experienced board members and management team

APC is managed under the overall guidance of the company's Board of Directors (BoD), who possesses wide experience in the Power sector. Mr. Satish Neupane is the Chairperson of the company, he is also founder director of Arun Valley Hydropower Development Company Limited [AHPC, CARE-NP BBB-], and managing director of API Hydro Mechanical Pvt. Ltd. Mr. Neupane has more than a decade of experience in hydro power sector. Mr. Sanjeev Neupane is the Managing Director who looks after day-to-day operation of APC since 2012. He was also director of Arun Kabeli Power Limited and People Investment Company Limited. Currently he is also one of the directors of AHPC.

Improving financial risk profile

APC has a diversified revenue base with two operational hydropower projects and three operational solar projects. The risk of revenue concentration is significantly lower as compared to other companies in the power industry, which usually generate revenue from a single project. APC revenue through sale of electricity increased by 41% to Rs. 519 Mn during FY22. Consequently, PBILDT of the company increased by 39% to Rs. 434 Mn during FY22. Gross Cash Accruals (GCA) improved to Rs. 239 Mn during FY22 from Rs. 165 Mn during FY21. However, net profit declined to Rs. 106 Mn during FY22 (FY21: Rs. 113 Mn in FY21) mainly on account of higher depreciation (following adoption of NFRS) and increased interest expense. Overall gearing ratio was stable at 1.15x at the end of FY22 (FY21: 1.10x), with increased borrowings pertaining to the under construction hydro project being offset by accretion in net worth.

The tangible net worth of the company improved during FY22 aided by issuance of right shares amounting to Rs. 1,108 Mn, collection of share premium of Rs. 152 Mn on auction of its rights shares on premium coupled with accretion of profit from its operational projects. Furthermore, the company has already obtained the preliminary approval from Electricity Regulatory Commission (ERC) for issuing the right shares amounting to Rs. 1,653.31 Mn, the proceeds of which will be utilized for deleveraging the loans related to operational projects (NGHP, UNSHP, CSP, DSP and SSP), which is expected to significantly improve the returns, debt coverage and capitalization profile of the company.

Power purchase agreement with sufficient period coverage

APC had entered into a long term PPA with NEA for sale of power to be generated from different projects. The period of the PPA is 30 years from the date of COD (25 years in case of solar project) or till validity of Generation License, whichever is earlier. The tariff rate of the hydropower projects ranges from Rs 4.00 per kWh to Rs 8.40 per kWh with clause of escalation in base tariff over the period. In case of solar projects, the tariff rate is fixed at Rs. 7.30 per KWh. For two operational hydropower projects, NGHP and UNSHP, the wet/dry season is under 8/4 months modality. However, for under construction hydropower, UCHP with 40 MW capacity, the wet/dry season is under 6/6 months modality, thus providing avenues for higher revenue in case of better power generations as the tariff rate in dry season are double the rate in wet season.

Favorable government policies towards power sector

Government of Nepal (GoN) considers power generation as priority sector and intends to maximize private sector participation in generation of electricity by offering different exemptions and facilities on power sector. GoN has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years for such person/entity who starts commercial operation, transmission and distribution of electricity up to mid-April 2027. Also, with government focus more toward reservoir-based hydropower projects; Monetary Policy FY23 has provided full tax exemption for first 15 years and 50% tax exemption for next 6 years to reservoir and semi- reservoir projects whose capacity is higher than 40 MW, completing financial closure within mid-April 2029. As per various directives from NRB whereby all the banks (type A, B C, D) have to allocate minimum share of their total advances to energy sector which argues well for the sector. Also, increasing trend of cross border energy trade and its prospect in upcoming days with bilateral agreements with the neighboring nations shows positive outlook on long- term demand for the power sector.

About the Company

API Power Company Limited (APC) is a public limited company promoted by business persons having long experience in the hydropower and other sectors for setting up Hydroelectric Project (HEP) in the territory of Nepal. The company was established as on June 19, 2003 as a private limited company and later converted to public limited company by reorganizing the shareholding pattern of the company as on July 21 2013. The company has two operational hydropower projects, three operational solar projects and one under construction hydropower project, Upper Chameliya HPP (UCHP).

Brief Financial Performance of the company during last 3 years is given below:

(Rs. In Million)

For the year ended Mid July	FY20(A)	FY21(A)	FY22(A)
Period of operation	**12 months**	**12 months**	**12 months**
Income from power sales	324	367	519
PBILDT Margin (%)	87.01	84.78	81.98
Overall Gearing (times)	1.44	1.10	1.15
Interest coverage (times)	1.91	1.71	2.30
Current Ratio (times)	0.73	19.78	25.79
Total Debt/ Gross Cash Accruals (times)	14.65	18.51	19.92

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	**Term Loan**	**5,315.40**	**CARE-NP BB+**
Long Term Bank Facilities	**Hire Purchase Loan**	**6.87**	**CARE-NP BB+**
Short Term Bank Facilities	**Fund Based Loan**	**600.00**	**CARE-NP A4+**
Short Term Bank Facilities	**Non-Fund Based Loan**	**1,250.00**	**CARE-NP A4+**
Total		**7,172.27**	

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