RATING REPORT

Zephyr Power Limited

REPORT DATE:
April 18, 2024

RATING ANALYST:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
Entity	A+	A-1	A+	A-1
Rating Date	*April 18, 2024*		*Feb 02, 2023*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Upgrade	

COMPANY INFORMATION	
Incorporated in 2005 as Private Limited Concern	**External Auditors:** A. F. Ferguson & Co. – Chartered Accountants
Public Unlisted Company (Conversion in 2021)	**Chief Executive Officer:** Mr. Kumayl Khaleeli
Key Shareholders (with stake 5% or more):	
• CDC Pakistan Power Projects Limited – 46.3% • Sadek Nissar Dossa – 13.1% • Kumayl Khaleeli (CEO) – 8.0% • Danish Iqbal – 5.2% • Saad Iqbal – 5.2% • Natasha Iqbal – 5.2% • Jawaid Iqbal – 5.2%	

APPLICABLE METHODOLOGY
Applicable Rating Criteria: Corporates
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

APPLICABLE RATING SCALE
VIS Issue/Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

Zephyr Power Limited (ZPL)

OVERVIEW OF THE INSTITUTION

Zephyr Power Limited was incorporated as a private limited company in July 2005, and then converted into public unlisted company in June 2021. The principal activity of the company is to build, own and operate wind power plant with a net capacity of 50MW in Gharo area, located in Thatta, Sindh.

Profile of CEO

Mr. Khaleeli has over a decade of experience in institutional investment management and investment banking experience, along with over 10 years of experience in project acquisition, development and finance fields in the renewable energy sector. He holds a B.A. from Bates College and an M.B.A. from The Fuqua School of Business at Duke University.

RATING RATIONALE

The assigned ratings of Zephyr Power Limited (ZPL or 'the Company') factor in the robust profile of the primary sponsor, represented by foreign investment by a Development Finance Institution (DFI) wholly owned by the UK Government. The remaining sponsors comprise a consortium of local partners contributing through equity and management. The ratings also draw comfort from the presence of Debt Service Reserve Account (DSRA) and CPPA-G's commitment of timely payment of receivables for debt servicing. In addition, presence of long-term Energy Purchase Agreement (EPA) with CPPA-G mitigates off-take risk while adequate insurance coverage is also in place. Moreover, operational risk remains minimal given O&M contractor's track record of international experience, and fulfillment of obligations towards the company till date.

The ratings take into consideration temporary closure of two wind turbines during FY23 which impacted operational performance; however, recovery amounting to expected loss of output is anticipated from the O&M contractor. Nonetheless, the topline continued to depict growth over the rating review period owing to tariff rate adjustments with gross and net margin levels rebounding to FY22 levels during the ongoing year. The liquidity profile remains sound given adequate debt-servicing capacity and cash flow coverages. Moreover, capitalization indicators exhibited timeline improvement given expansion of equity base; the same are expected to further enhance given projected internal capital generation coupled with repayment of financial obligations and limited capital expenditure plans, going forward.

Corporate Profile

Incorporated as a private limited company in 2005 with conversion into a public unlisted company in June 2021, ZPL principally operates a Wind Independent Power Project (IPP) with a total capacity of 50 MW employing 25 Wind Turbine Generators (WTGs) located at Gharo, Thatta, Sindh. The IPP interconnection is maintained and operated by the National Transmission Despatch Company (NTDC).

The Company has signed an Energy Purchase Agreement (EPA) with the Central Power Purchasing Agency (Guarantee) Limited (CPPA-G). The EPA is based on the 2006 Renewable Energy Policy and the 2015 Upfront Tariff as awarded by the National Electric Power Regulatory Authority (NEPRA).

The Company has a Debt: Equity financial structure of 75:25. Both equity and debt structures encapsulate ~ 50:50 compositions from local and foreign financing. The debt financing is from Netherlandse Financierings-Maatachappij voor Ontwikkelingslanden N.V (FMO) and British International Investment (BII) (formerly CDC Group PLC (CDC)) at 3M LIBOR plus 4.75% spread, while local financing is utilized under Rupee Facility Agreement with United Bank Limited (UBL), Soneri Bank Limited (SBL) and Pak Kuwait Investment Company (PKICL) at 3M KIBOR plus 3.0% spread.

Rating Drivers

Strong sponsor profile
Assigned ratings continue to draw comfort from strong sponsor profile which comprises foreign investment by a Development Finance Institution (DFI) wholly owned by UK Government and experienced local equity shareholders.

Minimal operational risk given O&M contractor having track record of international experience
The Company has entered into short term warranty period (2 years) and, thereafter, long term period (8 years) O&M contracts with Siemens Gamesa Renewable Energy Technology (China) Co. Ltd (formerly Gamesa Wind (Tianjin) Co. Ltd.). The O&M contractor exhibits track record of introducing wind power to new markets as per market demands, and operates in Asia since 1980's. The current Long-Term Operations and Maintenance (LT-O&M) Contract has a term of 8 years, that will expire by end-Oct'29. As per agreed terms, the O&M contractor has guaranteed maintenance of 98% plant availability over the term of the Contract.

Operating performance deteriorated as output decreased in FY23
The IPP has been designed to exceed the 35% base net plant capacity factor as defined under the 2015 Upfront Tariff and as awarded to the Company by NEPRA on May 13, 2016. Due to variable nature of the wind resource the generation output of the IPP will vary based on the availability and quality of the wind resource. As per management, impact of curtailments from NTDC coupled with closure of two turbine generators during April-May'23 on account of lack of availability of spare parts due to supply chain issues in FY23, resulted in overall production of the Company decreasing to 115,268 MWH compared to 193,180 MWH in FY22. Likewise, the average capacity factor and availability declined to 28.75% and 95.44% during FY22 (FY22: 46.86%, 98.73%) which falls below the thresholds outlined in the EPA and O&M agreements, respectively. Consequently, as per management, the Company is expected to recover the loss in revenue generation amounting to the difference between the actual and stipulated availability. On the flipside, average capacity factor and availability increasing during the ongoing year to 30.22% and 98.31%, respectively; however, offtake remained below stipulated requirements on account of limited wind resource and ongoing curtailment issues. Moreover, operating fixed assets stood higher at Rs. 12.1b at end-Dec'23 (FY23: Rs. 12.2b, Rs. 11.3b) mainly on account of capitalization of foreign exchange loss granted by SECP

Long-term Energy Purchase Agreement (EPA) with CPPA-G alleviates off-take risk
The EPA with CPPA-G is for twenty years commencing from the Commercial Operations Date (COD) dated March 28, 2019. Revenue measurements are in accordance with the mechanism stipulated in EPA at the quarterly tariff rates approved by NEPRA. Revenues are recognized as per EPA on the basis of Net Delivered Energy and Non-Project Missed Volume (NPMV) in case the network is not available to evacuate power.

Revenue from CPPA-G is invoiced on a monthly basis as per tariff structure, and any differences in amounts are re-submitted. In case of delayed payments, interest is recognized on an accrual basis at 3M KIBOR plus 2% per annum based on 365 days per year convention. Ratings also draw comfort from payments being secured under guarantee issued by the Government of Pakistan (GoP).

Satisfactory profitability performance despite rising financing burden

The Company's topline performance increased by 6.7% to Rs. 4.4b during FY23 (FY22: Rs. 4.2b) despite decline in energy production by 40.3% YoY due to quarterly adjustments in tariff rates in accordance with changes in US CPI, LIBOR/KIBOR and currency exchange rate. However, gross margins depicted downward movement over the outgoing year to 67.3% (FY22: 72.7%) largely on account of heightened inflationary pressure, particularly manifested in operations and maintenance expenses which increased to Rs. 494.3m (FY22: Rs. 352.9m). Moreover, net margin levels also dropped to 35.9% (FY22: 50.2%) in tandem with decline in gross margins coupled with sizeable increase in finance costs to Rs. 1.4b (FY22: Rs. 797.0m) owing to increase in policy rates both domestically and internationally. Additionally, impact of sharp currency depreciation over the rating review period further increased financing costs on foreign loans.

During 1HFY24, profitability indicators witnessed improvement with the topline to Rs. 3.6b due to higher volumetric offtake alongside tariff rate revisions. Resultantly, gross margin levels depicted an increase to 77.7% which was reflected in uptick in net margin to 55.3% despite much higher financing costs. Additionally, the bottom-line was supported by appreciable uptick in other income to Rs. 129.6m (FY23: Rs. 149.8m, FY22: Rs. 44.7m) largely on the back of interest income generated from savings accounts.

Sound liquidity profile

Funds from Operations (FFO) amounted to Rs. 1.4b during 1HFY24 (FY23: Rs. 2.4b, FY22: Rs. 2.8b) resulting in FFO-to-total debt remaining relatively stable over the rating review period at 0.28x (FY23: 0.23x, FY0.29x). However, debt-servicing coverage ratio (DSCR) trended downwards on a timeline basis to 1.37x (FY23: 1.53x, FY22: 2.14x) mainly on account of higher principal repayments in local currency terms; nonetheless, the same is considered adequate and is expected to stabilize with adjustments in revenue.

The overall liquidity profile of the Company remains sound with the current ratio standing at 2.44x at end-Dec'23 (FY23: 2.56x, FY22: 3.11x); however, downtrend exhibited in the same is largely on the account of increase in current portion of long-term financing in tandem with higher debt levels coupled with unpaid dividend remittance of Rs. 186.6m (FY23: Rs. 218.9m, FY22: nil) awaiting approval from the SBP for disbursement at end-1HFY24. On the other hand, cash balances depicted an increase over the rating review period to Rs. 3.3b (FY23: Rs. 3.4b, FY22: Rs. 2.0b), the majority of which is parked in foreign currency saving accounts. Trade debts amounted to Rs. 3.3b (FY23: Rs. 3.4b, FY22: Rs. 3.8b); nonetheless, internal cash remains adequate for working capital management, providing coverage for payment delays from CPPA-G. Going forward, liquidity indicators are expected to remain satisfactory provided timely payment of trade debts by CPPA-G.

Timeline improvement in capitalization levels

The Company's equity base augmented to Rs. 7.9b by end-Dec'23 (FY23: Rs. 7.6b, FY22: Rs. 6.9b) on account of sizeable profit retention despite cash dividend and full repayment of the outstanding shareholders' interest-free loans (payable at the Company's discretion). Given that internal cash generation is sufficient to meet working capital requirements, the overall debt profile constitutes exclusively of long-term financing amounting to Rs. 9.8b (FY23: Rs. 10.5b, FY22: Rs. 9.6b); the same comprises largely of foreign currency-denominated loans with interest rates of 3M LIBOR + 4.75% whereas domestic loans have terms of 3M KIBOR + 3%. With expansion of Tier-1 equity size, debt leverage and gearing levels depicted a downtrend over the rating review period, standing at 1.39x and 1.25x, respectively (FY23: 1.53x, 1.38x; FY22: 1.51x, 1.40x). Going forward, with projected profitability and minimal expected capex, capitalization indicators are expected to improve further.

Financial Summary (PKR in mln)				(Annexure I)
Balance Sheet	**FY21**	**FY22**	**FY23**	**1HFY24**
Operating fixed assets	10,800	11,270	12,255	12,089
Trade debts	2,691	3,808	3,394	3,297
Cash and bank balances	1,791	2,029	3,375	3,314
Other assets	143	174	292	180
Total assets	**15,425**	**17,281**	**19,316**	**18,879**
Long-term borrowings (inc. current portion)	9,142	9,642	10,534	9,849
Total borrowings	9,142	9,642	10,534	9,849
Trade payables	314	540	529	587
Other liabilities	169	226	630	544
Total liabilities	**9,625**	**10,408**	**11,693**	**10,980**
Paid up capital	1,968	1,968	1,967	1,968
Shareholder's loan	1,721	702	328	-
Tier 1 equity	**5,801**	**6,872**	**7,623**	**7,898**
Income Statement	**FY21**	**FY22**	**FY23**	**1HFY24**
Net sales	2,972	4,164	4,442	3,576
Gross profit	1,889	3,026	2,990	2,780
Finance cost	(748)	(797)	(1,355)	(759)
Net profit	1,025	2,091	1,594	1,978
Ratio analysis	**FY21**	**FY22**	**FY23**	**1HFY24**
Gross margin (%)	63.6	72.7	67.3	77.7
Net margin (%)	34.5	50.2	35.9	55.3
ROAA* (%)	6.3	12.8	8.7	20.7
ROAE* (%)	18.0	33.0	22.0	51.0
Current ratio (x)	3.34	3.11	2.56	2.44
FFO	1,596	2,769	2,427	1,393
FFO to long-term debt* (x)	0.17	0.29	0.23	0.28
FFO to total debt* (x)	0.17	0.29	0.23	0.28
DSCR* (x)	1.41	2.14	1.53	1.37
Trade debts/Sales* (%)	90.5	91.4	76.4	46.1
Gearing (x)	1.58	1.40	1.38	1.25
Leverage (x)	1.66	1.51	1.53	1.39

**Annualized*

REGULATORY DISCLOSURES — Annexure II

Name of Rated Entity	Zephyr Power Limited
Sector	Power
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
18/04/2024	**A+**	**A-1**	**Stable**	**Reaffirmed**
02/02/2023	A+	A-1	Stable	Upgraded
31/12/2021	A	A-2	Stable	Reaffirmed
26/11/2020	A	A-2	Stable	Upgraded
26/08/2019	A-	A-2	Stable	Reaffirmed
16/08/2017	A-	A-2	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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Due Diligence Meetings Conducted

Names	Designation	Date
Mr. Kumayl Khaleeli	CEO	
Mr. Farhan Baig	Head of Finance	15th March, 2024
Mr. Waqar Ahmad	Project Manager	
Mr. Azeem Iqbal	Head of Operations	