Rating Rationale

Universal Power Company Limited

Rating

Facility	Amount (Rs. In Million)	Grading	Rating Action
Long Term Bank Facility	1,300.00	CARE-NP BB+ [Double B Plus]	Assigned
Total Facilities	**1,300.00**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Ltd. (CRNL) has assigned Rating of 'CARE-NP BB+' to the long term bank facilities of Universal Power Company Ltd. (UPCL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of UPCL is constrained by significant cost and time overrun leading to high project cost, residual project implementation and stabilization risk. The rating also noted the execution risk related to under construction projects where UPCL has already invested and planning to invest. The rating is also constrained by exposure to volatile interest rate, power evacuation risk and hydrology risk associated with run of the river power generation. The ratings, however, derives strength from promoters, directors and management having prior experience in hydropower projects, power purchase agreement (PPA) with sufficient period coverage and financial closure achieved for estimated project cost. The rating also factors in moderate counter party risk, shortage of power in the country and government support for the power sector. The ability of the company to timely execution of the project avoiding further time or cost overrun, timely completion of Singati to Lamosangu transmission line by NEA to evacuate power generated from the project and sufficient hydrology and timely receipt of the payments from NEA are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Significant cost and time overrun leading to high cost of project

Estimated project cost has escalated by 9.43% to Rs 2,047 Mn (i.e. Rs 186 Mn per MW) from initial estimated cost of Rs 1,870 Mn (i.e. Rs 170 Mn per MW) despite decrease in cost of Hydro Mechanical (HM), Electromechanical (EM) and transmission line work. Project cost escalated mainly due to increase in cost of civil works (by Rs 237 Mn). Further, pre-operating expenses and project engineering and management cost incurred till Aug 17, 2019 is higher than budgeted cost.

Required Commercial Operation date (RCOD) of the project for initial 8.26 MW is Dec 31, 2017 (extended from initial RCOD of Jan 1, 2017 due to delay in completion of project on account of 2015 earthquake) and for additional 2.74 MW is July 19, 2019. UPCL was not able to execute the project

[1]*Complete definitions of the ratings assigned are available at* www.careratingsnepal.com

within extended RCOD due to social issues, difficult geographical conditions, slowed down of project's construction work on account of delay in completion of NEA Singati to Lamosangu transmission line etc. The company is in process to extend the RCOD to Mid Dec, 2019. The commercial operation of the 8.26 MW capacity is already delayed by ~21.5 month and it is expected to come into operation from Mid Dec, 2020. If RCOD is not extended, the company is bound to pay heavy late COD penalty. Besides this, as per PPA, number of escalation in tariff rate will reduce if the delay in COD is more than 6 months.

Project implementation risk and stabilisation risk

UPCL has achieved ~91.34% financial progress till Aug 17, 2019. Till Aug 17, 2019, most of the civil work at headwork, waterway and powerhouse; HM work at headwork's and penstock pipe erection work (3,250 m completed out of 3,300 m); and EM work at powerhouse has been completed. However, major portion of transmission line work is yet to be done. Although, major part of the project work has been completed, the company continues to remain exposed to the risks associated with project implementation and satisfactory operations thereafter as the plant is being executed in the hilly region where the uncertain geology and adverse climatic conditions of the area plays a major role in timely completion of the planned activities.

Execution risk of under construction project, in which UPCL has invested and planning to invest

The company has Rs 2,100 Mn paid up capital out of which only Rs 747 Mn required for funding equity portion of project cost and there is excess capital of Rs 1,353 Mn. It had issued Rs 966 Mn equity share capital to public during FY2018/19 with the purpose of pre-payment of loan however, the amount is not utilised for prepayment of the loan. Now, the company planning to invest Rs 980 Mn into Kasuwa Khola Hydropower Ltd. (KKHL) subject to approval from consortium bank and the regulatory authorities. Till Mid July, 2019, it has invested Rs 144 Mn into Rapti Hydro and General Construction Ltd. (RHGCL) and has placed Rs 1,062 Mn into fixed deposit. RHGCL has 5 MW Rukum Gad Hydropower Project which has achieved ~ 28% financial progress till Mid Oct, 2019 and also achieved financial closure for proposed debt. Similarly, KKHL has 45MW Kasuwa Khola Hydropower Project which is in initial stage of construction and financial closure for proposed debt is yet to be achieved.

As both the projects are in initial stage of construction, it has high project execution and stabilization risk. UPCL will not receive any income on investments in RHGCL for next 2-3 years and on KKHL for next 5-6 years. Even after execution of these projects, UPCL's income on investment will dependent upon the performance of those projects.

Exposure to volatile interest rate

Nepalese banking sectors are fixing interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate is changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions is changed by change in liquidity position which leads to change in interest rate.

Interest rate has been changing frequently in Nepal market since last 1-2 year. Therefore, funding from Bank and Financial Institutions are exposed to volatile interest rate.

Power evacuation risk

The Power generated from the project will be evacuated by 5.3Km long 132KV Transmission Line to NEA substation at Singati. At present 33 KV line at Singati is operational. 132KV Transmission line from Singati to Lamosangu should be constructed to evacuate the energy generated from the project. Construction of transmission line up to Singati Substation lies with UPCL and construction of transmission line from Singati to Lamosangu lies with NEA. There are many hydropower projects within the corridor (nearing completion) which are dependent upon timely completion of NEA substation and transmission line for power evacuation.

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

Run-of-the-river power is considered an unsteady source of power. It has little or no capacity for water storage and dependent on the flow of river water for power generation. It, thus, generates much more power during summer season when seasonal river flows are high (Mid-April to Mid-December) and less during the winter season (Mid Dec to Mid-April). UPCL is proposed to utilize discharge from Khare Khola having catchment area of 180 sq kms based on perennial river. The project has 10.10 m3/s design discharge at 40% exceedance flow and gross head of 136.70m. Hence, the project is exposed to risk associated with variation in discharge of water from the aforesaid river/khola.

Key Rating Strengths

Promoters, directors and management having prior experienced in hydropower sector

Radhi Bidyut Company Ltd. (RBCL), and CEDB Hydropower Development Company Ltd. (CHDCL), are major promoter shareholders of the company. RBCL has 4.4MW (operational) run of river Radhi Small Hydropower project, commercially operating since June 14, 2014. CHDCL, is public limited company, incorporated on November 30, 2009 with the main objectives to invest in the companies established to develop & promote hydropower project and providing project management services to hydropower companies. CHDCL has four wholly owned and one majorly owned (84.19%) subsidiary companies related with generation of hydroelectricity. CHDCL directly and indirectly has invested in multiple companies among which combined capacity of ~4.58 MW hydropower projects are under operation and ~116MW hydropower projects are under different phases of construction.

UPCL has 6 board of directors chaired by Mr. Uttam Bhlon Lama, who has prior experience in hydropower sector. He is chairperson of NMB Microfinance Bittiya Sanstha Ltd. and also serves as director at CHDCL. Day to day operation of the company is looked after by Mr. Vinay Kumar Bhandari, managing director, who is also CEO of CHDCL and has more than two and half decades of experience in hydropower sector.

Power purchase agreement with sufficient period coverage

UPCL had entered into a PPA with NEA as on February 4, 2013 for sale of 8.26MW power to be generated from the project which was upgraded to 11MW on May 30, 2016. The period of the PPA is 30 years from commercial operation date (COD) or till validity of Generation License (obtained on July 3, 2012 for 35 years), whichever is earlier. PPA period may be extended with mutual consensus during the last six month of validity. The tariff for wet season (Mid-April to Mid-December) is Rs 4.80 per kWh and for dry season (Mid-December to Mid-April) is Rs 8.40 per kWh with 3% escalation on base tariff for 5 times in every year after completion of 12 months from COD date. The contracted energy for the project is 62.73 million units (MU) (i.e. 11.53MU for dry season and 51.20MU for wet season), at PLF of 66%. Required Commercial Operation (RCOD) of the project was December 31, 2017 for initial 8.26 MW and July 19, 2019 for additional 2.74 MW.

Financial closure achieved for estimated project cost

The total estimated cost of the project is Rs. 2,047 Mn to be funded in debt: equity ratio of 63.51:36.49 (i.e. Rs 1,300 Mn debt and Rs 747 Mn equity). Financial closure for debt was completed on July 1, 2013 for Rs 1,300 Mn term loan. Till August 17, 2019, Rs 925 Mn term loan and Rs 68 Mn bridge gap loan has been utilized. Further, as on August 17, 2019, it has Rs 2100 Mn equity share capital contributed by promoter and public shareholders in the ratio of 54:46. As on Mid July 2019, it has Rs 60 Mn cash and bank balance and Rs 1,062 Mn fixed deposit.

Moderate counter party risk

UPCL is exposed to counter party payment risk pertaining to Nepal Electricity Authority (NEA), which has been making consecutive losses in past till FY2016 and carry huge accumulated loss in its book. However, as per the annual report published by NEA, during FY19 (provisional), it has earned profit of Rs 7,205 Mn (Rs 2,897 Mn during FY18). Further, during FY19, it has achieved gross cash accrual of Rs 11,915 Mn (Rs 7,107 Mn in FY18). The counter party payment risk is moderated by the fact that, NEA is fully owned by Government of Nepal, net loss is declining over the period and generating positive gross cash accruals. Further, NEA has been making timely payment to independent power producers (IPPs) in past.

Shortage of power in the country

As per NEA's Annual Report for FY19, the current peak electricity demand is 1320 MW. The total domestic installed capacity stands 1178 MW which includes 617 MW owned by NEA and 561 MW by private sector IPPs. During FY19, overall energy demand was 7,584 GWh which was met by import of 2,813 GWh from India whereas balance was met by domestic generation.

Government support for the power sector

GoN considers hydropower generation as priority sector and intends to maximize private sector participation in generation of hydroelectricity by offering different exemptions and facilities. GoN has announced full tax exemption for first 10 years and 50% tax exemption for next 5 years to those who generate electricity within mid-April 2024. Income tax will be levied only 20% despite the normal tax rate for entity in Nepal is 25%. Also, GoN has declared to provide grant of amount equivalent to Rs. 5 Mn per MW installed capacity after receiving evidence of formal COD of power plant.

About the Company

UPCL is a public company, incorporated on December 3, 2002 as private limited company and converted to public limited company on March 30, 2011. It is developing 11 MW run-of-river, Tallo Khare Khola Hydropower Project (TKKHPP) in Dolakha district of Nepal by utilizing available head and flow from Khare Khola (river).

The project is constructed under BOOT (Build, own, Operate and Transfer) mechanism. As per the Generation License, from Government of Nepal – Ministry of Energy, obtained on July 3, 2012, the project shall be handed, on whatever conditions the project is, to the Government of Nepal after expiry of generation license, which is 35 years. It is promoted by institutional as well as individual promoters from different background. Radhi Bidyut Company Ltd. (2.65%) and CEDB Hydropower Development Company Ltd. (2.26%) are major promoter shareholders of the company.

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Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	1,300.00	CARE-NP BB+
Total Bank Facilities		**1,300.00**	