

## Universal Power Company Limited

### Rating

Facility/Instrument	Amount (Rs. in Million)	Rating	Rating Action
Long Term Bank Facilities	1,538.00	CARE-NP BB+ [Double B Plus]	Reaffirmed
Total Bank Facilities	1,538.00 (One Billion Five Hundred and Thirty-Eight Million Only)		

\*Details of Facilities in Annexure – 1.

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

### Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of UPCL continues to remain constrained by operations stabilization risk associated with its hydropower project in its initial year of operations, where stabilization and streamlining of production over a sustained period remains to be seen. The rating also factors in execution risk and long gestation period of under construction projects in which UPCL has invested in, hydrology risk associated with run-of-river power generation, exposure to regulatory risk and volatile interest rate.

The rating, however, derives strength from UPCL's experienced promoters and management team backed by institutional promoters, presence of Power Purchase Agreement (PPA) with sufficient period coverage, and government support for the power sector. The rating takes cognizance of the improved power generation of the project in 5MFY23 (refers to the five-month period ended mid-December 2022), however sustained power generation at envisaged levels over a reasonable period remains to be seen.

*Going forward, the ability of the company to reduce the gap between operational and contracted plant load factor (PLF) along with the timely receipt of payments from Nepal Electricity Authority (NEA) are the key rating sensitivities. Furthermore, any substantial investments/capital commitment that could lead to material deterioration in the company's capital structure will also be critical from analytical perspective.*

### Detailed description of the key rating drivers

#### Key Rating Weaknesses

#### Project stabilization risk, albeit satisfactory PLF levels so far in FY23

The project commenced commercial operations on December 21, 2021 and the plant operated for around 7 months in FY22 (Unaudited; FY refers to the twelve-month period ended mid-July). The final project cost was Rs 2,913.93 Mn, which has been funded by debt and equity in the ratio of 53:47. During FY22, the plant's PLF was modest at around 84.43% of contracted energy, impacted mainly due to low hydrology issues. However, during 5MFY23, the plant's PLF has improved to 94.5% of contracted energy. Since the project is still in its initial years of operations, stabilization and streamlining of production over a sustained period leading to operational PLF at envisaged levels remains to be seen.

#### Execution risk of Equity commitments and long gestation period of its investments

Till mid-July 2022, UPCL has invested Rs 144 Mn in Rapti Hydro and General Construction Limited and Rs 441.31 Mn in Kasuwa Khola Hydropower Limited. Rapti Hydro and General Construction Limited has 5 MW Rukum Gad Hydropower Project which is expected to come into operation by January end, 2023. Similarly, Kasuwa Khola Hydropower Limited has 45 MW Kasuwa Khola Hydropower Project which is in initial stage of construction having obtained Generation license, signed PPA,

completed financial closure and land acquisition along with access road being under construction and contractor bids being in-progress having the overall physical progress of ~25% as on mid-July 2022.

As both the projects are in project stage, these remain exposed to project execution and stabilization risk, leading to possibility of long gestation period of investments. UPCL's income on investments will be dependent upon the satisfactory performance of these projects. Furthermore, as of now there are no major regulations for the investment / holding companies, which remains a cause of concern from analytical perspective.

#### **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 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 m<sup>3</sup>/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.

#### **Exposure to volatile interest rate**

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy, with substantial upward pressure on interest rates in the last few quarters. A contractionary monetary policy for FY23 coupled with increasing inflation has only added to the upward pressure on interest rates, resulting in the rate hikes taken by BFIs in the first quarter of FY23. Any further significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

#### **Exposure to regulatory risk**

GoN has recently 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. Policies and 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 Strength**

##### **Experienced management team backed by the institutional promoters**

UPCL is promoted by Radhi Bidyut Company Limited and CEDB Hydropower Development Company Limited (CHDCL) [CARE NP BB (Is)]. CHDCL is an investment company, established to develop & promote hydropower projects and provide project management services to hydropower companies. CHDCL directly and indirectly, has invested in operational and under construction hydropower projects having combined installed capacity of more than 100 MW.

UPCL has 6 board of directors chaired by Mr. Uttam Bhlon Lama, has more than 15 years of work experience in various sectors including hydropower sector. He is also associated with NMB Bank Ltd in the capacity of director. The day-to-day operations of the company is managed by Mr. Vinay Kumar Bhandari, managing director, who is also the CEO of CHDCL and has more than two and half decades of experience in hydropower sector. He is supported by other experienced management team.

### Power purchase agreement with sufficient period coverage

UPCL had entered into a PPA with NEA as on February 4, 2013 for sale of 8.26 MW power to be generated from the project which was upgraded to 11 MW 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, December 2020 4 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. As against PPA period of 30 years, the tenure of project debt is 13 years. The PPA is under the take-or-pay modality, which eliminates the risks related to tariff and offtake of the energy to be generated by the project.

### Moderate financial risk profile during initial year of operations

UPCL is generating revenue by selling of power generated through its 11 MW Tallo Khare Khola Hydropower Project (TKKHPP). The company was operational for seven months (Mid December-Mid July) in FY22. During FY22, the company reported total sales revenue of Rs 137.36 Mn. Similarly, UPCL's PBILDT was Rs 98.79 Mn during FY22 with PBILDT margin of 75.10%. Furthermore, PAT stood at 9.88% during FY22.

Similarly, Capital structure of the company was moderate with Debt equity ratio and overall gearing ratio at 0.66x and 0.70x at the end of FY22. The interest coverage ratio of the company was at 1.29 during FY22. However, Total Debt/GCA was high at 44.56x during FY22. As the project was completed at a relatively higher cost of Rs 264.9 Mn per MW, the debt service coverage indicators of the company is likely to remain moderate in the initial years of operations owing to higher interest expense.

### Favorable Government policies towards power sector

Government of Nepal (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 for such person/entity who starts commercial operation, transmission and distribution of electricity up to mid-April 2026. 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.

### About the Company

UPCL is a listed public company, incorporated on December 3, 2002 as a private limited company and later it was converted into public limited company on March 30, 2011. It has developed a 11 MW, run-of-river, Tallo Khare Khola Hydropower Project (TKKHPP) in Dolakha district of Nepal. The project has come into operation on December 21, 2021 under BOOT (Build, Own, Operate and Transfer) mechanism.

### Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	1,538.00	CARE-NP BB+
<b>Total</b>		<b>1,538.00</b>	

## Contact Us

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