

**Rating Rationale**  
**Universal Power Company Limited**

**Rating**

| Facility/ Instrument      | Amount<br>(Rs. In Million) | Rating <sup>1</sup>         | Rating Action |
|---------------------------|----------------------------|-----------------------------|---------------|
| Long Term Bank Facilities | 1,300.00                   | CARE-NP BB+ [Double B Plus] | Reaffirmed    |
| <b>Total Facilities</b>   | <b>1,300.00</b>            |                             |               |

*Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of ‘CARE-NP BB+’ to the long-term bank facilities of Universal power Company Limited (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 relatively high cost of project, 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 majority of project cost. The rating also factors in moderate counter party risk, current demand & supply gap however expected increase in supply in future. 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 Nepal Electricity Authority (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 relatively high cost of project***

The revised estimated cost of the project was Rs. 2,047 Mn at the time of initial rating (initial budgeted amount Rs. 1,870 Mn). However, the same has been further escalated to Rs. 2,141 Mn (i.e. Rs. 195 Mn per MW). Project cost escalated mainly due to increase in cost of civil works and Interest during Construction (IDC) as compared to the earlier budgeted amount. IDC cost increased due to the delay in the completion of the project on account of delay in the completion of the transmission line and the pandemic impact of COVID-19 on the project construction. Required Commercial Operation date (RCOD) of the project was December 31, 2017 for initial 8.26 MW (extended from initial RCOD of Jan 1, 2017) and July 19, 2019 for additional 2.74 MW. UPCL was not able to execute the project within

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com)

revised RCOD due to social issues, difficult geographical conditions, and delayed project's construction work on account of delay in completion of NEA transmission line. The company is in process of extension of RCOD. The commercial operation of the project is expected to be Mid-March, 2021. 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 ~84% financial progress as on Mid July 2020 and ~98% physical progress has been completed. All the components including turbine and generators and main inlet valve has been installed. Additionally, all the hydro mechanical components in headworks are completed. The erection of 12 power transmission towers out of 15 has been completed. Although, major part of the project 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. Timely completion of the project within the revised cost and time and satisfactory operations thereafter are the key rating sensitivities.

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

At present, company has Rs 2,100 Mn paid up capital. It had issued Rs 966 Mn equity share capital to public during FY19 with the purpose of repayment of loan however, the loan has not been repaid till date as it is planning to invest excess amount of equity share capital into other hydropower project (i.e. Kasuwa Khola Hydropower Ltd.) subject to approval from Board of Directors, consortium bank and regulatory authorities. Till Mid July, 2020, it has invested Rs 144 Mn into Rapti Hydro and General Construction Ltd. and has placed Rs 910 Mn into fixed deposit. UPCL has committed to invest Rs 1,500 Mn into Kasuwa Khola Hydropower Ltd.

Rapti Hydro and General Construction Ltd. has 5 MW Rukum Gad Hydropower Project of which ~ 68% physical progress was achieved till Mid-August, 2020 and has achieved financial closure for proposed debt. Similarly, Kasuwa Khola Hydropower Ltd. has 45 MW 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's income on investment will be dependent upon the timely completion and satisfactory performance of these projects.

***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 is under-construction 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, 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). UCPL 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.

**Key Rating Strengths**

***Promoters, directors and management having prior experience in hydropower sector***

Radhi Bidyut Company Ltd. (RBCL) and CEDB Hydropower Development Company Ltd. (CHDCL), [rated CARE NP BB (Is)], are major promoter shareholders of the company. RBCL has 4.4MW (operational) run of river Radhi Small Hydropower project, commercial operation of which started on 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 (84.30%) subsidiary companies related with generation of hydroelectricity. CHDCL directly and indirectly, has invested in five companies among which combined capacity of 4.58 MW hydropower projects are under operation, 28 MW hydropower projects are under construction phase and 70.04 MW hydropower projects are under pipeline.

UPCL has 6 board of directors chaired by Mr. Uttam Bhlon Lama, has more than 15 years of work experience including 3 years in hydropower sectors. He is currently director of NMB Bank Ltd. 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. 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,

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.

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. The company has applied for the extension of RCOD with NEA on the ground of the delay in the construction of transmission line from Singati to Lamosangu by NEA. However, as per the company the expected COD of the project is Mid-March 2021. If RCOD is not extended till expected COD, the company is bound to pay penalty to NEA as per the PPA. Further, number of escalations in tariff rate will be reduced if there is delay in COD of the project than RCOD by more than 6 months.

#### ***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 FY16. However, as per the annual report published by NEA, during FY20 (provisional), NEA earned profit of Rs 11,056 Mn (Rs. 9,812 Mn during FY19) and achieved gross cash accrual of Rs 16,056 Mn (Rs 14,664 Mn in FY19). 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.

#### ***Financial closure achieved for majority of the project cost***

The total estimated cost of the project was 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). However, the total cost of the project is revised to Rs. 2,141 Mn to be funded through the debt amount of Rs. 1,499 Mn and remaining through equity in debt equity ratio of 70:30. The financial closure for debt amount of Rs. 1,300 Mn was completed on July 1, 2013. The financial closure for the additional Rs. 199 Mn project cost is yet to be achieved. However, as on Mid July 2020, UPCL has Rs 50 Mn cash and bank balance and Rs 910 Mn fixed deposit which provides the comfort to large extent. Till July 15, 2020, Rs 1,253 Mn term loan has been utilized. Further, as on July 15, 2020, it has Rs 2,100 Mn equity share capital contributed by shareholders.

#### ***Current demand & supply gap however expected increase in supply in future***

As per the NEA's Annual Report for FY20, the current peak electricity demand is 1,408MW. The total domestic installed capacity stands at 1,328 MW which includes 632 MW owned by NEA and 696 MW by private sector IPPs. Overall, during FY20, total energy demand was 7,894 GWh which was met by import of 1,720 GWh (~22% of total demand) from India whereas balance was met by domestic generation.

However, considering under construction projects which are expected to generate electricity in next 2-3 years and electricity demand which has not increased substantially in past few years could create a

situation of oversupply in near future in wet season. This could put pressure on NEA’s payment capabilities which is sole counter party with majority of PPA signed on take or pay basis.

**Government support for the power sector**

GoN 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 2024. Furthermore, GoN has declared to provide grant of amount equivalent to Rs. 5 Mn per MW installed capacity after receiving evidence of formal COD of complete 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.

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**Annexure 1: Details of the Facilities rated**

| S. N. | Name of Bank              | Type of the Facility | Amount (Rs. in Million) | Rating      |
|-------|---------------------------|----------------------|-------------------------|-------------|
| 1     | Long Term Bank Facilities | Term Loan            | 1,300.00                | CARE-NP BB+ |
|       | <b>Total</b>              |                      | <b>1,300.00</b>         |             |

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