

Universal Power Company Limited

Rating

Facilities	Amount (Rs. in Million)	Rating ¹	Rating Action
Long Term Bank Facilities	1,477.29	CARE-NP BB+ [Double B Plus]	Reaffirmed
Total Bank Facilities	1,477.29 (One Billion Four Hundred Seventy-Seven Million and Two Hundred Ninety Thousand 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 moderate operating performance of its 11MW Tallo Khare Khola Hydropower Project (TKHPP), and execution risk and long gestation period of its investments. The rating also factors in hydrology risk associated with run-of-river power generation, exposure to interest rate, and risk of natural calamities. The rating, however, continues to derive strength from UPCL's experienced promoters and management team backed by institutional promoters, presence of Power Purchase Agreement (PPA) with sufficient period coverage, and moderate financial risk profile with comfortable gearing levels. The rating also factors in government support for the power sector.

Going forward, the ability of the company to reduce the gap between operational and contracted plant load factor (PLF) along with 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

Moderate operating performance in FY23

UPCL generates revenue by selling power generated from its 11 MW Tallo Khare Khola Hydropower Project (TKKHPP). The hydropower project commenced its commercial operations from December 21, 2021 and has been operating moderately since. PLF of the plant increased to 86% of contracted energy during FY23 (Unaudited, FY refers to twelve-month period ending mid-July) from 84% during FY22. Nonetheless, the plant's PLF has remained modest mainly due to low hydrology issues in the catchment of Tallo Khare Khola. The company's ability to achieve actual PLF in line with contracted PLF will be critical from its revenue perspective, particularly given increasingly lumpier repayments in coming years.

Execution risk and long gestation period of its investments

As on mid-July 2023, UPCL has invested Rs. 144 Mn in Rapti Hydro and General Construction Limited (RHGCL) and Rs. 470 Mn in Kasuwa Khola Hydropower Limited (KKHL). The 5 MW Rukum Gad Hydropower Project of RHGCL has come into operation from April 2023 and is exposed to operations stabilization risk. However, the 45 MW Kasuwa Khola Hydropower Project of KKHL is in initial stage of construction having obtained Generation license, signed PPA, and completed financial closure. This exposes the company 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 177.8 sq km 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.

Exposure to volatile interest rate

The company's interest rates are based on 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. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed to volatile interest rate.

Risk of natural calamities

In Nepal, hydropower projects are usually located in terrains that are topographically challenging making their operations vulnerable to adversities of nature. Floods and landslides that tend to occur in these areas pose threat to these power projects damaging their infrastructures. These natural calamities can adversely affect the smooth flow of power generation and distribution, which can impact financial returns of the projects. UPCL is also exposed to such risks of natural calamities that might cause infrastructural, operational and financial damages to the project.

Key Rating Strengths**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.

Moderate financial performance in FY23 although coverage indicators remain suppressed due to high project cost

In its first full year of operations, UPCL reported total operating income of Rs. 291 Mn with gross cash accruals of Rs. 98 Mn in FY23. Furthermore, as on mid-July 2023, UPCL had unencumbered cash and cash equivalent of Rs. 189 Mn in the form of cash and bank balance. While operational cash generation is likely to cover the projected cash outflows of the company over the near term, having a surplus cash reserve could help the company safeguard its liquidity position to cover any contingencies.

Similarly, capital structure of the company was moderate with debt-to-equity ratio and overall gearing ratio at 0.63x and 0.64x at the end of FY23. However, the interest coverage ratio of the company was modest at 1.27x with Total Debt/GCA

relatively high at 15.05x during FY23. 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 are likely to remain comparatively suppressed in the initial years of operations owing to higher interest expense.

Power purchase agreement with sufficient period coverage and moderate counter-party risk

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. 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. Furthermore, NEA is owned by Government of Nepal and hence counter party default risk is moderate; however, timely realization of receivables is critical for the company and remains a key monitorable aspect.

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. As per various directives from NRB, 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 growing prospect in upcoming days supported by new bilateral agreements between Nepal and India for additional export of power to India from Nepal augurs well for the long-term demand prospect for the power sector in Nepal.

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.

Brief financial performance of UPCL is given below:

(Rs. In Million)

For the period	7MFY22 (A)	FY23 (UA)
Income from Operations	137	291
PBILD Margin (%)	71.95	74.21
Overall Gearing (times)	0.69	0.64
Interest coverage (times)	1.29	1.27
Total Debt/Gross Cash Accruals (times)	21.53	15.28

A: Audited, UA: Unaudited

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	1,477.29	CARE-NP BB+
Total		1,477.29	

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