

Bungal Hydro Limited

Rating

Facilities	Amount (Rs. in Million)	Rating	Rating Action
Issuer Rating	NA	CARE-NP B (Is) [Single B (Issuer)]	Assigned

* The issuer rating is subject to total debt of the company not exceeding Rs. 2,350 Mn at the end of FY24 (FY refers to the twelve-month period ending mid-July).

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP B (Is)' to Bungal Hydro Limited (BHL). Issuers with this rating are considered to offer high risk of default regarding timely servicing of financial obligations, in Nepal.

Detailed Rationale & Key Rating Drivers

The rating assigned to BHL is constrained by the significantly high cost of its hydropower project leading to highly leveraged capital structure and increased financial burden towards debt servicing in the initial years of commercial operations owing to high interest outgo considering the project is heavily debt funded. The long-term revenue profile also remains impacted by loss of two (out of five) tariff escalations due to delays of more than eighteen months in commencement of commercial operations from the required commercial operations date (RCOD). In addition, the rating also factors inherent hydrology risk associated with run-of-the-river power generation, risk of natural calamities and exposure to volatile interest rate risk.

The rating, however, derives strengths from BHL's experienced promoters and management team in the hydropower sector, low offtake risk and moderate counter party risk. The rating also takes comfort from BHL's successful commencement of operations and satisfactory power generation during first five months of operations, sustenance of which remains imperative from credit perspective in coming years.

Going forward, the ability of the company to successfully reduce the gap between operational Plant Load Factor (PLF) and contracted PLF and availability of sufficient hydrology with timely receipt of payments from Nepal Electricity Authority (NEA) leading to improved solvency and coverage indicators will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

High project cost leading to increased financial strain in initial years of operations

BHL has set up a 10.7 MW run-of-river Upper Sanigad Hydroelectric Project (USHEP) in Bajhang District of Nepal. The final cost of the project is estimated to be around Rs. 3,043 Mn (~Rs. 284 Mn per MW), which was funded in the debt equity ratio of ~71:29. The project faced multiple hiccups during construction including disruptions amid the COVID-19 pandemic and geological challenges during tunnel excavation. As a result, the commercial operation of the project was substantially delayed. Against the RCOD of December 15, 2021, actual COD was August 19, 2023. The company was liable for late COD penalty of Rs. 28.24 Mn and is eligible for only 3 out of 5 possible tariff escalations attributed to delay in commencement of operations, limiting its revenue profile over the long run. However, BHL has applied for extension of RCOD to Nepal Electricity Authority (NEA) and if approved, BHL will lose only 1 tariff escalation.

USHEP's cost had increased multiple times due to delay in execution of project leading to substantial increase in interest during construction (IDC). Consequently, the relatively high project cost of around Rs. 284 Mn per Megawatt (MW) is likely to lead to a longer payback period coupled with elevated debt servicing requirements in the initial years of operations owing to higher interest outgo. The company's ability to adequately service its debt obligations will therefore hinge on its ability to generate sufficient cash flow from operations, which will be crucial from analytical perspective.

Furthermore, the company has partly funded its project cost by additional loans (Rs. 107.5 Mn) against initial public offering (IPO). This has led to added financial burden on the company in the interim. Timely completion of the proposed public issuance and debt repayment as envisaged will also remain a key monitorable.

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

A Run-of-the-river (ROR) power project is recognized as a variable energy source of generation of power due to its reliance on natural river flow without significant water storage capacity. The dependency on river flow makes the power generation from the project highly responsive to seasonal variations. The project extracts discharge from Sani Gad Khola, covering a catchment area of 64.96 sq. kms, characterized as a perennial river. BHL tends to produce higher electricity output during the wet season, from mid-April to mid-December, when river flows are abundant. Conversely, during the dry season, from mid-December to mid-April, power generation may be reduced due to lower river flows. Consequently, the project's performance will be exposed to the inherent risk associated to the natural hydrological patterns, variability in water discharge and optimized power generation efficiency throughout the year.

Risk of Natural Calamities

In Nepal, hydropower projects are commonly situated in topographically challenging terrains, making them susceptible to the vagaries of nature. The rugged landscapes often expose these projects to the risks of floods and landslides, which can pose significant threats by damaging infrastructure and disrupting operations. BHL's power project is inherently exposed to these natural calamities that have the potential to cause infrastructural, operational, and financial damages to the project.

Exposure to volatile interest rate

BHL's interest rates are based on floating interest rate regime, where a certain premium is added to the monthly base rate and interest rate is changed accordingly on monthly 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 changes in interest rates. Higher interest rates than envisaged could result in squeezed margins of the company, impacting its liquidity profile. Hence, funding sourced from BFIs exposes BHL to interest rate volatility.

Key Rating Strengths

Experienced promoters and management team

BHL has six board of directors having long experience in various sector including both operational and under construction hydropower projects in Nepal. The board is chaired by Mr. Shiva Prasad Ghimire who has been involved in energy sector for an extensive period. He has also been involved in numerous distribution and manufacturing plants related to petroleum, as well as cement industry. Mr. Rajesh Kumar Shrestha, Director, also has wide experience across multiple hydropower projects. Mr. Khageshwar Bohara, Director, has more than a decade of experience in various business domains including hydropower sector. He is also an executive committee member of Independent Power Producers' Association of Nepal (IPAN), which is an umbrella organization of independent power producers in Nepal. Mr. Birendra Bahadur Malla, Director, also has experience of more than a decade in hydropower sector. The directors are also supported by the experienced management team to run the day-to-day activities.

Low offtake risk with moderate counter party risk

BHL had entered into a long term PPA with Nepal Electricity Authority (NEA) as on June 30, 2013 for sale of 10.7 MW power to be generated from the project. The period for the PPA is 30 years from the date of COD or till validity of Generation License, whichever is earlier. PPA period may be extended with mutual consensus during the last six months 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 successive years. The contracted energy for the project is 62.71 million units at PLF of 66.90%. Offtake risk remains low as the company has signed PPA on 'take or pay' basis with NEA which is owned by Government of Nepal and hence counter party default risk is deemed moderate; however, timely realization is critical for the company and from analytical perspective also.

Successful commencement of operations and satisfactory power generation so far

BHL had successfully commenced the operations of USHEP on August 19, 2023. Power is evacuated through a 132kV transmission line to Balanch substation at Darchula district. During its first five months of operations, total energy generated against the contracted PLF was 108.98%. However, the project has been operational for less than a year and streamlining of production in coming years remains to be seen. Ability of the company to sustain its operational PLF close to the contracted levels is critical from revenue generation perspective and will remain critical from analytical perspective particularly given its relatively high debt servicing burden.

Industry Outlook

The industry outlook of Nepalese power sector is likely to remain stable over the long-term with increasing domestic demand for generation backed by growing national demand with an average growth rate of around 11% p.a. over the last five years (2018-2023). The Government of Nepal (GoN) has featured the significance of power generation as a priority sector and encouraging private sector involvement by providing various exemptions within the power generation sector. GoN has also announced a comprehensive tax incentive package, offering full tax exemption for the initial 10 years and a 50% tax exemption for the subsequent 5 years to individuals or entities engaged in the commercial operation, transmission, and distribution of electricity until mid-April 2027. This approach is aimed at promoting investment and growth in the energy sector. Furthermore, directives from the Nepal Rastra Bank (NRB) mandate financial institutions regulated by NRB to allocate a minimum share of their total advances to the energy sector. This strategic initiative is expected to contribute to the financial support and development of projects within the energy sector which argues well for the sector. Additionally, increasing cross-border energy trades coupled with fresh bilateral treaty between Nepal and India for export of 10,000 MW electricity to India over a period of 10 years has further boosted the demand outlook for the power sector in Nepal.

About the Company

Bungal Hydro Limited (BHL) was initially incorporated as a private limited company as on 13 December, 2016 (converted to a public limited company as on July 14, 2021) by a group of individual and institutional promoters for setting up of a 10.7 MW, run-of-river, Upper Sanigad Hydroelectric Project in Bajhang district of Nepal. The project is constructed under BOOT (Build, Own, Operate and Transfer) mechanism.

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