

Budhanilkantha Heritage Private Limited: [ICRANP] LB+ (assigned)

May 4, 2020

Summary of rated instruments:

Instrument*	Rated Amount (NPR Million)	Rating Action
Fund-based - Long-term loans	900.00	[ICRANP] LB+ (assigned)
Total	900.00	

*Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP] LB+ (pronounced ICRA NP L B plus) to the NPR 900-million long-term loans (including proposed limits) of Budhanilkantha Heritage Private Limited (BHPL).

Rationale

The rating assigned to BHPL, a special purpose vehicle (SPV) formed to own and operate a proposed medium scale 5-star hotel property, is constrained by the execution and offtake risk associated with the project. The project is in the mid-stage of development and the disruption created by the recent pandemic could result in a time and cost overrun. At the same time, the intensifying competition among high-end hotels is likely to create a supply glut over the medium term unless compensated by improvement in the macroeconomic factors related to the tourism industry. This could intensify competition, erode the industry margins and challenge the viability of new projects. Given the high debt proportion in the total project cost, the debt coverage metrics are likely to remain moderate to weak until the project stabilises.

The project also remains exposed to funding gap as 1/3rd of the project debt and ~50% of project equity is yet to be tied up/raised. This could exacerbate in the event of time and cost overrun. The promoters' ability to infuse equity in a timely manner to expedite project development and cover the possibility of a cost overrun, will be essential to the timely execution and initial offtake of the project. The rating concern also emanates from the limited experience of the promoters in developing and managing a high-end hotel. The hotel's limited segment and geographical diversification and its moderate scale of operation makes the business cash flow vulnerable to any slack in projected occupancy, which also remains a rating concern.

Nonetheless, the rating considers the strong profile of the diversified/knowledgeable promoter group and strategic location of the project. The project execution has moved at a good pace in the last 12-15 months, before being disrupted by the Covid-19 lockdowns in effect from the last week of March 2020, which provides comfort on the project execution capacity to some extent. The rating also favourably factors in the Government of Nepal's (GoN) initiatives to boost the tourism industry.

Key rating drivers

Credit strengths

Strong and diversified promoter group - The promoter group of BHPL consists of established professionals and businesspersons with involvement in various sectors, allowing them to develop traction amongst various stakeholders in the industry. This helps reduce the offtake risk for the hotel to a certain extent. Further, the promoter group itself is large and this eases the company's ability to raise required funds.

Conducive environment for tourism-related ventures notwithstanding recent negative sentiment - The Government of Nepal (GoN) has taken positive steps to encourage private sector involvement in the tourism sector. The GoN has rolled out provisions like a tax holiday for large-scale hotel projects, prescribed a lending floor for banks and financial institutions (BFIs) for tourism-related projects, among others. Although the global and national level lockdowns implemented in the aftermath of the Covid-19 outbreak and cancellation of the Visit Nepal Year (VNY) 2020/21 by the GoN

has created a negative sentiment across the hospitality and tourism sector, the longer-term outlook remains positive and, therefore, the impact on companies such as BHPL with under-construction properties, is expected to remain lower than the currently operational properties.

Credit challenges

Execution risk associated with the project - The construction of the hotel building started in March 2019 and the hotel is in the mid stages of development, with most of the civil work on the main hotel building structure completed. The management plans to commence hotel operations from late 2021 or early 2022. However, with the project development in the early stages, timely commissioning is a concern. Execution of the project before the repayment begins¹ will be critical to ensure timely debt servicing.

Project offtake risk - The hotel sector in the last few years has witnessed a notable rise in the number of high-end properties, some already commissioned and many still under construction. To some extent, this followed the categorisation of tourism and the hotel industry as priority sector lending, which diverted a sizeable portion of banking sector credit to the sector. However, amid modest improvement in tourism infrastructures, spending capacity and foreign tourist arrival/spending in the recent years, this has intensified competition and suppressed the revenues of existing properties which is likely to remain muted as newer properties get commissioned. Therefore, the ability of new properties to achieve their projected revenue, occupancy and debt-servicing ability will remain a major challenge.

Funding gap risk associated with the project - The project cost of ~NPR 1,500 million will be funded in the debt:equity ratio of ~60:30. Almost NPR 300 million out of the total debt requirement of NPR 900 million remains to be tied up as of mid-April 2020. Similarly, ~NPR 300 million out of the project equity of NPR 600 million remains to be infused. Timely arrangement of funds to meet the projected cost estimate as well as to cover the cost overrun will be essential for timely commissioning of the project.

Limited geographical and segment diversification - The proposed project will be a single-property hotel in Kathmandu and thus will remain exposed to the geographical concentration risk. Moreover, given the limited segment diversification, the revenue of the hotel is likely to be driven by high-end tourists. The prospect of the hotel, therefore, will depend on the improvement of foreign tourist arrival and the hotel's ability to compete with others operating in the area

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below:

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

About the company

Budhanilkantha Heritage Private Limited (BHPL) was incorporated in November 2018. It is a special purpose vehicle (SPV) that will own and operate a proposed nine-storied-5-star hotel, under construction in Budhanilkantha, Kathmandu on a plot size of ~5,820 square metres.

The promoter group comprises professionals such as chartered accountants, doctors as well as private entrepreneurs. BHPL, the first hotel project for the promoter group, is currently under construction with targeted commercial operations from December 2021.

Annexure-1: Instrument Details

Instrument	Rated amount (NPR Million)	Rating assigned
Fund-based -Existing Term Loans	600.00	[ICRANP] LB+
Fund-based -Proposed Term Loans	300.00	[ICRANP] LB+
Total	900.00	

¹ After the moratorium of two years from the signing of syndicated loan agreement which is expected soon.

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