Bhujung Hydropower Limited: Long-term rating downgraded; short-term rating reaffirmed

January 9, 2023

Summary of rating action

Instrument* (NPR Million)	Previous Rated Limits	Current Rated Limits	Rating Action
Long-term loan limits; fund based	1,100	1,100	[ICRANP] LB+; downgraded from [ICRANP] LBB-
Long-term loan limits; fund based (proposed)	-	100	
Short-term loan limits; non-fund based (within long-term loan limits)	(1,350)	(1,350)	[ICRANP] A4; reaffirmed
Total	**1,100**	**1,200**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has downgraded the long-term ratings assigned to Bhujung Hydropower Limited (BHL or the company) to [ICRANP] LB+ (pronounced ICRA NP L B plus) from [ICRANP] LBB- (pronounced ICRA NP L double B minus). ICRA Nepal has reaffirmed the company's short-term loan rating at [ICRANP] A4 (pronounced ICRA NP A four).

Rationale

The rating downgrade mainly factors the increase in project cost following recent cost escalation of ~11% on the initial budgeted cost (revised cost is ~NPR 213 million per MW). Given the relatively fixed tariff and escalation regime, the increase in cost is likely to weaken the company's return indicators and coverage ratios vis-à-vis previous estimates. Moreover, the cost escalations have also given rise to debt funding gap while ~15% of project equity is yet to be raised through the proposed initial public offering. The assigned ratings are also limited by the moderate project execution risks amid approaching required commercial operation date (RCOD)[1] and limited prior experience of the promoters in the hydropower sector. Similarly, rating concerns also arise from hydrological risks owing to the absence of a deemed generation clause in the power purchase agreement (PPA) and hence there would be no compensation to the project by the NEA in case of an adverse flow in the river. ICRA Nepal also takes note of the stringent dry-energy short-supply penalty provisions in the power purchase agreement (PPA), which can impact the company's revenue profile in case of fluctuations in hydrology.

Nonetheless, the assigned ratings consider the relatively high dry energy mix of ~30% in the contract energy (eligible for higher tariff) under the PPA executed for the project. This, along with the presence of eight annual tariff escalations on the base rate, are expected to support the revenue profile and the return indicators, assuming timely commissioning and no tariff loss due to delayed commissioning. The ratings also factor in the relatively lower evacuation risk for the project with the already operational Nepal Electricity Authority's (NEA) Bhorletar sub-station. The ratings also draw comfort from the low tariff and offtake risks, amid the already signed PPA with the NEA, the sole purchaser and distributor of electricity in Nepal, at pre-determined tariff rates and escalations. Additionally, the ratings factor in the positive demand outlook for the energy sector owing to the supply-demand gap in the Nepalese power sector, increasing energy consumption in the nation and improving energy export prospects.

Going forward, the company's ability to timely raise remaining equity and tie up additional debt, commissioning of the project within the budgeted cost/timeline estimates, as well as interest rate volatility in the market will be the key rating drivers for the company.

[1] RCOD of the project is 14th May 2023.

Key rating drivers

Credit strengths

High dry energy mix – The 7.5-MW project's PPA has been executed under a six-month dry season and six-month wet season modality with a relatively high dry energy mix of ~30% in the contract energy table. This, along with presence of eight tariff escalations in the base tariff, is expected to support the project's levelized tariff. However, the project commissioning date would determine the eligibility for all tariff escalations as per the PPA and hence timely project completion would remain crucial.

Lower evacuation risk – The power to be generated from the project is planned to be evacuated via 33 kV bus bar at NEA's Bhorletar sub-station. The required 24-km long 33 kV Damauli-Bhorletar transmission as well as the associated NEA's Bhorletar sub-station is already operational. The project is required to develop 26-Km transmission line from project to the grid-connection point, which is in middle stage of development.

Low tariff and off-take risk, however, provision of 10% reserve margin clause in the PPA – The tariff and off-take risks are low as the company has a 30-year PPA with the NEA at predetermined tariffs and escalations for its entire project capacity of 7.5 MW. The pre-defined, base tariff rates are NPR 4.8 per kWh for the wet season (June to November) and NPR 8.4 per kWh for the dry season (December- May) with a 3% annual escalation on the base tariffs for eight consecutive years (escalations applicable after 12 months from the COD). However, a reserve margin clause in the PPA empowers the NEA to offtake 10% energy during five wet months (mid-June to mid-November) based on its requirements, without any compensation to BHL for non-offtake of the same.

Credit challenges

Moderate project execution risk – The 7.5-MW project has achieved physical progress of ~70-75% till mid-December 2022; with ongoing construction on various project fronts simultaneously. However, amid near approaching required commercial operation date of May 2023 as well as limited prior hydropower experience of promoters remain a concern for timely development of the 7.5MW project.

Relatively higher project development cost with moderate funding risk – The project has been planned to be developed at a relatively higher budgeted cost of ~NPR 213 million per MW, following the latest cost revision. The higher budgeted project cost could impact the company's return indicators as well as coverage ratios amid fixed tariff and tariff escalations regime. The loan requirement of NPR 1,100 million as per the initial budget has already been tied-up while the additional loan of ~NPR 100 million for the escalated project cost is yet to be finalized. Also, on the equity front, ~NPR 327 million i.e., ~82% of the project's total equity requirement has already been infused till mid-December 2022. However, with the company planning to raise ~15% of project equity from IPO, the timely conclusion of IPO process as well as tying up of remaining debt component would remain crucial for development of project on time.

High hydrological risk amid lack of deemed generation clause with stringent penalty terms – Lack of a deemed generation clause in the PPA exposes the project to high hydrology risk in case of any adverse river flow scenarios without receiving any compensation for such losses. However, the source river is partially snow supported, which somewhat lowers the concerns. Hydrological risks are further accentuated as the PPA has stringent penalty terms, in case the project fails to supply minimum 30% energy in the dry months. In such an event, the supplied dry energy would be assumed to be 30% of the deemed annual energy and the additional energy supplied in the wet months would not be paid.

Link to the previous detailed rating rationale
Rationale_Bhujung-Hydropower-Private-Limited_June-2021

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

Bhujung Hydropower Limited was incorporated in June 2015 as a private limited company and converted to public limited company on 13th February 2022 to facilitate local public participation. Bhujung Hydropower Limited (BHL) is developing a 7.5-MW Upper Midim Hydropower Project in Lamjung district, Gandaki Province of Nepal.

The project is a run-of-the-river (RoR) type and is being developed at a 42% probability of exceedance (Q_{42}). The PPA for the project has been entered under six-months dry energy and six-months wet energy modality with a dry energy mix of ~30%. The budgeted cost of the project is ~NPR 1,600 million which has been planned to be funded in a D:E ratio of 75:25.

The project is in the advance stages of development with physical progress of ~70-75% and financial progress of ~74% as of mid-December 2022. As on the same date, the company's paid-up capital was ~NPR 327 million, which is 100% promoter held.

Annexure-1: Instrument details

Instrument (NPR Million)	Previous Rated Amount	Current Rated Amount	Rating Action
Long-term limits (A)	**1,100**	**1,200**	[ICRANP] LB+; downgraded from [ICRANP] LBB-
Long-term loan limits; fund based	1,100	1,100	
Proposed Long-term loan limits; fund-based	-	100	
Short-term limits (B)	**-**	**-**	[ICRANP] A4; reaffirmed
Fund-based; Bridge gap loan (within the term loan)	(450)	(450)	
Non-fund-based; Letter of credit (within the term loan)	(900)	(900)	
Total (A+B)	**1,100**	**1,200**	

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About ICRA Nepal Limited

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