Liberty Energy Company Limited: [ICRANP] LBB-/ A4 (Assigned)

March 13, 2019

Summary of rated instruments:

Instrument*	Rated Amount (NPR Million)	Rating Action
Fund-based - Long-term loans	2,774.00	[ICRANP] LBB- (Assigned)
Fund-based - Short-term loans	50.00	[ICRANP] A4 (Assigned)
Non-Fund based- Short-term loans	15.00	[ICRANP] A4 (Assigned)
Total	**2,839.00**	

**Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP] LBB- (pronounced ICRA NP L double B minus) to the NPR 2,774-million long-term loans of Liberty Energy Company Limited (LECL). ICRA Nepal has also assigned the short-term rating of [ICRANP] A4 (pronounced ICRA NP A Four) to the NPR 65-million short-term loans of LECL.

Rationale

The assigned ratings factor in the relatively high project cost and the high gearing level of LECL, which is developing the 25-MW Upper Dordi 'A' hydroelectric project (HEP) in the Lamjung district of western Nepal. High project cost under a relatively fixed tariff regime (that doesn't compensate for higher capex incurred), results in modest debt coverage and return indicators; especially if the project is unable to achieve its design operating parameters. LECL's project is also exposed to a funding gap, because of the cost escalation vis-à-vis an earlier estimate; albeit mitigated through an in-principle commitment from the bankers for increased credit limit and adequate equity-raising plans vis-à-vis project equity requirement. Timely raising of funds will be essential for project completion within the time and cost estimates. At the same time, any further cost overruns or timeline delays compared to the company's plans could further deteriorate the overall financial metrics. The rating also remains constrained by the hydrological risk due to the absence of the deemed generation clause in the power purchase agreement and the power evacuation risk, given the absence of NEA's transmission line to the proposed connection point (Kirtipur Besi sub-station). The interest rate volatility in the banking sector also remains a rating concern.

Nonetheless, the ratings factor in the presence of the long-term power purchase agreement (PPA) with pre-defined tariffs, which mitigates the offtake and tariff risk. The rating also takes into consideration the positive demand outlook for renewable energy in Nepal. The assigned rating also factors in the advanced stage of project development (~60% of estimated cost incurred till mid-Jan 2019), which reduces the execution risk to a large extent, which, though present, is relatively moderate due to the short span of the NEA's transmission line to be developed (~10 km from Udipur to Kirtipur Besi substation). Availability of long-term flow data for Dordi also remains a comforting factor for the project's hydrology.

Key rating drivers

Credit strengths

Presence of long term power purchase agreements with fixed tariff structure results in low off-take risk

LECL has executed a PPA with the NEA for its entire capacity, at a pre-determined energy tariff. Tariff rates are standard at NPR 4.8 and NPR 8.4 per unit during the wet and dry seasons, respectively, with 5 times 3% annual escalation on base tariff. A firm PPA with pre-defined tariff mitigates off-take and tariff risk. Moreover, the counterparty credit risk also remains low, given the sovereign support of the Government of Nepal (GoN) to the NEA, and the NEA's past track record of timely payment of energy bills to private hydropower developers.

Supply-demand gap to result in healthy offtake

Nepal is a net importer of electricity, even with limited electrification across the country and current suppressed demand (per capita power consumption of <150 KW as per 2015 study, among the lowest in Asia). In the fiscal year (FY) 2017/2018, the peak power demand in the Integrated Nepal Power System (INPS) surged to 1,508 MW, while the installed operational capacity was only 1,074 MW. The shortfall was met through import. As per the NEA, the power demand is expected to grow at the rate of ~15% over the next 22 years (driven by increase in electrification, per capita consumption and higher industrial demand) and hence the supply-demand gap is expected to persist.

Project in advanced stage of development

The 25-MW project under the company is at an advanced stage of construction. As per the information provided by the management, ~80% physical progress (corresponding to ~60% of financial progress) had been achieved till mid-Jan 2019, reducing execution risks to a larger extent.

Credit challenges

High project cost and gearing result in modest return and weak debt coverage indicators

LECL's management estimated project cost is ~NPR 4,600 million[1], which is ~70% debt-funded. This results in relatively higher commissioning cost for the 25-MW project (~NPR 185-190 million per MW) and sizeable debt burden on the project, resulting in modest debt coverage indicators. A contract plant load factor (PLF) for the project as per the PPA at ~62% also remains on a slightly lower side, compared to most Q40 projects. A low contract PLF would result in relatively lower revenue. Hence, return and debt coverage indicators could further come under pressure in case the project is unable to achieve the designed operating parameters.

Evacuation risk remains a concern given the early stages of TL development by NEA

The power generated from the project is to be evacuated through the proposed Kirtipur substation of the NEA, which has begun the development of ~10 km span of the 132-KV transmission line from the Udipur hub to the Kirtipur substation, whose timely commissioning will be essential for the 25-MW project, helping it meet its required commercial operation date (RCOD) of August 31, 2019. Any delay in the construction of evacuation infrastructure could have an impact on the project timeline and the cost estimate.

Hydrological risk and absence of deemed generation clause in the PPA

Although the availability of the long-term flow data for Dordi river is a comfort, the PPA arrangement does not provide for compensation in case of inadequate generation going forward. Hence the availability of water to sustain long-term energy generation remains a concern. This is a major risk for the project earnings, since the PPA with the NEA does not contain the provision for deemed generation.

Annexure-1: Instrument details

Instrument	Rated Amount (NPR Million)	Rating Assigned
Fund-based - Long-term loans (I)	2,774.00	[ICRANP] LBB-
Fund-based – Short-term loans	50.00	[ICRANP] A4
Non-fund based- Short-term loans- BG	15.00	[ICRANP] A4
Total	**2,839.00**	

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

Links to applicable criteria:

[1] *Increased marginally to NPR 4,760 million by bank appointed consultant*

Corporate Credit Rating Methodology

About the company

Liberty Energy Company Limited (LECL) was incorporated in December 2009 as a private limited company and was converted to a public limited company on March 2016 to facilitate public participation. The company is promoted by 402 promoters with ~9% holding each by Mr. Kush Kumar Joshi and Dr. Atmaram Ghimire, ~6% holding by Mr. Ram Bahadur Pandey, ~5% holding by Mr. Kumar Keshar Bista and a ~3% holding by Mr. Sushil Thapa, among others. The company is developing the 25-MW Upper Dordi 'A' HEP (Required Commercial Operation Date-RCOD: 31st August 2019) in Faleni and Dhodeni VDC, Lamjung district of western Nepal. Till mid-Jan 2019, the project achieved ~60% financial progress (based on the estimated project cost of ~NPR 4,600 million).

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About ICRA Nepal Limited:

ICRA Nepal Limited, the first Credit Rating Agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was incorporated on November 11, 2011 and granted licence by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a Technical Support Services Agreement, which envisages ICRA helping ICRA Nepal in such areas as rating process and methodologies, analytical software, research, training, and technical-and-analytical skill augmentation.

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