Liberty Energy Company Limited: Ratings reaffirmed

September 7, 2020

Summary of rated instruments:

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

**Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has reaffirmed the long-term rating of [ICRANP] LBB- (pronounced ICRA NP L double B minus) for Liberty Energy Company Limited (LECL) long-term loan. ICRA Nepal has also reaffirmed the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) for the company's short-term loans.

Rationale

The rating reaffirmation factors in the lowering of execution risk for the 25-MW Upper Dordi A hydroelectric project (HEP), given the final stages (~98% physical progress till mid-July 2020) of project construction and adequate headroom for loan repayment, which will only kick in after the project's commissioning. The ratings draw comfort from the industry experience and reputation of the promoters. LECL has raised 100% of the original project equity of NPR 1,500 million after successfully raising NPR 375 million through the IPO in August 2020, which remains a comfort. The rating also factors in low regulatory and offtake risks, given the firm offtake arrangement through a long-term power purchase agreement (PPA) with the Nepal Electricity Authority (NEA). Availability of long-term flow data for Dordi also remains a comforting factor for the project's hydrology. The changes made by the Monetary Policy for FY2021 requiring banks to increase their exposure towards the energy sector could enable companies like LECL with near operational projects to raise cheaper borrowings, which could improve the project economics and provide comfort to the financial profile.

However, the ratings remain constrained by the expected weak debt coverage indicators of LECL, given the high capital cost and fixed energy tariff regime (which does not compensate for high capital cost). The 25-MW project is likely to witness a delay of ~6-9 months vis-à-vis the latest revised commercial operation date of April 2020[1] due to the delay along the NEA's transmission line, which is likely to result in a sizeable cost overrun. The revised project cost is expected to increase by ~18% vis-à-vis earlier estimates of NPR 4,760 million to cover for the interest during construction and additional expenditure identified in civil works; which is likely to give rise to a big funding gap. With the equity portion tied up after the recently-concluded IPO, the funding gap is likely to be met through additional debt, which could result in a sharp rise in the gearing level vis-à-vis an earlier estimate.

The combined effect of the cost overrun, and increased gearing is likely to weaken the debt coverage indicators of LECL significantly vis-à-vis the earlier estimates. LECL's ability to timely secure the additional fund will remain essential for project execution, without any significant delay. Any further delay in project commissioning could further deteriorate the project economics and will be a key rating sensitivity.

Given the higher estimated project cost, generational efficiency of the project will be the key driver for the overall financial profile of the project (and company). Lower generational efficiency, especially in the initial years when the cash build-up is low, could constrain the debt coverage indicators, necessitating further fresh borrowings or equity injection

1 Revised from earlier COD of August 2019 by promoters. The rating also remains constrained by the hydrological risk due to the absence of the deemed generation clause in the power purchase agreement. The interest rate volatility in the banking sector also remains a rating concern, given the long-term repayment schedule of the hydropower projects.

Key rating drivers

Credit strengths

Project in final stage of development

The 25-MW project under the company is at an advanced stage of construction with ~98% physical progress till mid-July 2020. This has significantly lowered the project execution risk.

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 the 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.

Low offtake risk, given current demand-supply gap - Nepal is a net importer of electricity even with limited electrification across the country. For FY2019, Nepal imported ~37%[2] of its energy demand from India. As per the NEA, the power demand is expected to grow at a rate of ~15% over the foreseeable future, driven by an increase in electrification, per capita consumption, and industrial demand. Hence, the supply-demand gap is expected to persist, resulting in the healthy offtake of the energy to be generated by the project.

Credit challenges

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

The project has witnessed significant delays as compared to its original project commissioning date of August 2019 due to the lack of the NEA's transmission line at the grid connection point - NEA's Kirtipur substation. NEA is in in the mid-stages of developing the ~10-KM 132 KV transmission line from its operational Udipur substation to the Kirtipur substation, whose early commissioning will be critical for the 25-MW project, which is witnessing significant cost escalation due to the time overrun. Any delay in the construction of evacuation infrastructure could result in a further deviation from the cost and time estimates and weaken the project economics further.

Funding gap arising from cost escalation

Although LECL had tied up its entire original project fund requirement of NPR 4760 million, the recent cost escalation has given rise to a fund gap of ~NPR 875 million, which remains to be tied up. With the completion of the IPO process, raising equity is likely to be a lengthy process due to the regulatory compliances involved; that could delay the process significantly. Hence the funding gap is likely to be met through debt, either from the promoters or the lender banks. The ability of LECL to tie up the funding gap within the stipulated time will be essential for an early project execution.

High project cost and increased gearing likely to result in weak return and debt coverage indicators

After the recent cost escalation of ~18%, the project cost is likely to reach ~NPR 5,650 million, which will be funded through ~73% debt (assuming debt financing of escalated cost). This results in a high project commissioning cost for the project (~NPR 225 million per MW vs. initial estimate of ~190 million) in addition to a sizeable debt burden. This is expected to result in weak debt coverage indicators. The 25-MW project has a low contract plant load factor (PLF) of

2 NEA's annual report for FY2019

~62% (relatively lower compared to other Q40 projects), which would mean lower billable energy for the project. The return and debt coverage indicators could further come under pressure in case the project is unable to achieve the designed operating parameters.

Hydrological risk and absence of deemed generation clause in the PPA

Although the availability of the long-term flow data for the 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 reaffirmed
Fund-based - Long-term loans	2,774.00	[ICRANP] LBB-
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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

Liberty Energy Company Limited (LECL) was incorporated in December 2009 as a private limited company and was converted into a public limited company in March 2016 to facilitate public participation[3]. The company is promoted by 556 promoters *(402 at the time of last rating)* with major holding by Dr. Atmaram Ghimire (~7%), Mr. Kush Kumar Joshi (4%), Mr. Kumar Keshar Bista (4%), Mr. Sushil Thapa (~4%), Mr. Ram Bahadur Pandey (~3%) among others.

The company is developing the 25-MW Upper Dordi 'A' HEP in Faleni and Dhodeni VDC, Lamjung district of Gandaki Pradesh of Nepal. The project is behind the scheduled commercial operation date (original date of August 31, 2019 later revised to April 12, 2020) because of the unavailability of the transmission line at the proposed connection point (Kirtipur Besi Substation). The project has already achieved ~98% physical progress till mid-July 2020 and is likely to be begin work after the commissioning of the transmission line by the Nepal Electricity Authority (NEA).

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[3] *LECL has concluded the NPR 375 million IPO in August 2020 and its paid up capital currently stands at NPR 1,500 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.

Our parent company, ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

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