



RATINGS (JUNE 2011)

FOUNDATION POWER COMPANY (DAHARKI) LIMITED (FPCDL)

NEW

ENTITY

Long Term	AA-
Short Term	A1+

ANALYSTS

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PROFILE

- FPCDL, was established in 2005 with the primary objective of electricity generation, under the Power Policy 2002. The plant is situated at 8km, Dad Laghari Road, Daharki, District Ghotki, Sindh.
- FPCDL is wholly owned by a Special Purpose Vehicle (Daharki Power Holdings Limited), which in turn is owned 81% by Fauji Foundation (FF) and 19% by Asian Development Bank (ADB). FPCDL has seven members Board comprising five representatives from FF and two from ADB. Lt. Gen Waseem Ahmad Ashraf (Retd) is the Managing Director/ CEO of FPCDL. He is supported by an experienced senior management team.

RATING RATIONALE AND KEY RATING DRIVERS

- The ratings reflect strong financial profile and demonstrated support of key sponsor - Fauji Foundation (FF), also having experience of running another IPP. Given the current structure of power policy, the financial risk is low owing to guaranteed cash flow stream by GoP, subject to adherence to agreed performance parameters under PPA. The operational risk is mitigated through outsourcing of O&M to an international O&M operator - Korean Power Services (KPS). Although KPS possesses extensive international experience in running power plants, given limited previous exposure in Pakistan, its ability to ensure effective O&M operations remains to be seen. The fuel supply risk is mitigated by entering into long-term gas supply contract with Mari Gas. The key sponsor of FPCDL is also a major shareholder in Mari Gas. Nevertheless, weak financial discipline of the sole power purchaser and prevailing circular debt remains a concern.
- The plant has lately been commissioned, after experiencing significant delays. The tariff is yet to be finalized. In this regard, favorable outcome of ongoing negotiations with stakeholders including EPC contractor, insurance company and the regulator would remain important. Furthermore, external factors such as any adverse changes in the regulatory framework and/or inability to adequately manage working capital requirements may impact the ratings.

ASSESSMENT

- The power industry in Pakistan is characterized by inadequate infrastructure and unattainable full capacity levels. This is mainly due to inefficient flow of requisite funds to the sector. This is mainly an outcome of sizeable gap between the volume of electricity generated and eventually billed. The situation is worsened by a misdirected subsidy structure. These factors have created sizeable financial mismatch, being filled by the GoP. However, the government, with limited fiscal space, is constrained in fully meeting the needs. This has led to creation of “circular debt”, where the difference between cost of electricity produced and recovered from the consumer is floating throughout the power sector. The impact subsides with sporadic injection of money by GoP, but it recreates soon as the gap between electricity cost and consumer widens. The implication of the foregoing on IPPs is piling up of huge receivables from power purchaser and, in turn, distressed cashflows. This, at times lead to delays in timely meeting of financial obligations towards lenders.
- FPCDL – a 177MW thermal power plant – has lately started its commercial operations (Required COD: Oct-09; Actual COD: May-11). In this regard, sponsor cost overrun support was available to the company. Meanwhile, the pass through costs are to be adjusted in the tariff structure. These overruns are expected to have material impact on final tariff adjustment which could in turn impact investors return (reduced project IRR). Meanwhile, the management has also identified the overruns attributable to its EPC contractor, DOOSAN Heavy Industries Limited (DOOSAN).
- The key source of earnings for FPCDL would be the generation tariff from the power purchaser, National Transmission and Dispatch Company (NTDC). The reference generation tariff comprises a capacity charge component and an energy charge component. The former is based on dependable capacity and constitutes a minimum tariff guaranteed to the IPP which covers the fixed Operations and Maintenance (O&M) costs, insurance charges, debt, working capital funding costs, and return on equity. The latter is a function of actual electricity dispatched. Project tariff is yet to be finalized (Reference tariff: Sep-08: US\$ 7.28/KWh).
- FPCDL has negotiated the Gas Supply Agreement (GSA) with MGCL, for supply of 65mmcf/d of Low BTU Gas to the plant all year round, which is different from industry norm where annual fuel supply is not promised. FPCDL’s fuel supply risk is low as the allocated gas cannot be diverted to any other use, the case for other IPPs, due to low BTUs. The contract is for a period of 25 years. In case of MGCL’s inability to supply gas, the damages imposed by the power purchaser, would be passed on to MGCL. Meanwhile, MGCL, incorporated in mid-1980’s, is majority owned by Fauji Foundation (40%), followed by GOP (20%) and Oil & Gas Development Company Limited (20%).
- In order to manage its working capital effectively, working capital line of PKR 476mln is available to the company. In case of delay in payments by power purchaser, the company may delay the gas payments to the supplier; thereby reducing the overall working capital requirement.
- FPCDL entered into a long-term (18 years) Operations & Maintenance (O&M) agreement with KEPCO Plant Service and Engineering Company Limited (KPS) a reputable organization to operate and maintain the power plants. The O&M contractor will perform three major overhauls of the power plant during its period of contract. KPS, established since 1974, has a track record of providing operation and maintenance for various power and industrial facilities in Korea and overseas. Currently, the company is acting as O&M of various plants (cumulative capacity: 4,441MW). However, it has limited exposure in Pakistan.
- The project company’s capital structure comprises 25% equity and 75% debt. Equity of PKR 3,804mln has been injected and debt financing in the form of a syndicate term finance facility of PKR 11,565 mln has been fully availed for the project, priced at 6-month KIBOR + 2.93% p.a. The tenor of the facility is ten-years. The principal is to be repaid in 20 unequal semi-annual installments. Despite facing significant delay in commissioning and cash flow constraints, the company has timely serviced payments that commenced in Dec 2010, mainly with the support of sponsor.