The Pakistan Credit Rating Agency Limited

Rating Report

Engro PowerGen Thar (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Oct-2019	A	A1	Stable	Maintain	-
29-Apr-2019	A	A1	Stable	Maintain	-
27-Dec-2018	A	A1	Stable	Maintain	-
27-Jun-2018	A	A1	Stable	Maintain	-
22-Dec-2017	A	A1	Stable	Maintain	-
21-Jun-2017	A	A1	Stable	Maintain	-
30-Dec-2016	A	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Engro Energy Limited (EEL) along with China Machinery & Engineering Corporation (CMEC) has set up first Thar coal based (2 x 330 MW) power plant (Complex) - Engro Powergen Thar (Pvt.) Limited (EPTL). The project achieved financial close (FC) in Apr-16 and COD in July-19. RCOD was June-19 as per PPA and delay LDs may apply for which the company is in discussion with CPPA as this date is exceeded. These LDs will be paid through shareholders' ROE. The primary fuel is Thar Coal; however, the plant can accommodate imported coal. A 30-year coal supply agreement is signed with Sindh Engro Coal Mining Company (SECMC), which is constructing a coal mine in Thar Block-II. The coal mine’s COD was July-19. Company's both units were successfully connected to and are providing electricity to the grid. The company has successfully provided 903GWh of electricity to the grid from COD to end-Sep 19. The financial strength and experience in the energy chain of the sponsoring companies – EEL and CMEC – is positive to the ratings. The onshore EPC contract is with CERIECO and offshore EPC contract is with CMEC. Comfort is drawn from the experience of these contractors and the involvement of Pakistan and Chinese governments, as this project comes under CPEC. Going forward, the Company’s main focus would be to keep the plant operational. Offtake agreement is with NTDC, which will, upon plant’s availability as per contract, provide capacity payments even if no purchase order is placed. The Government of Pakistan has given payment guarantee against dues from NTDC. The business risk of the company is mitigated as the company has successfully produced electricity on the specifications of Thar coal, which is being used for the first time. Furthermore, the use of CFB Boiler by the Company largely covers the risk of varying lignite quality.

The management’s ability to effectively manage EPC risks and COD provides comfort. Trend in operational profitability would bode well for rating. The availability of Thar Coal is critical. External factors such as any adverse changes in the regulatory framework may impact the ratings.

Disclosure

Name of Rated Entity	Engro PowerGen Thar (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | IPP(Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | Power(Jan-19)
Rating Analysts	Mubasher Bhatti | mubasher.bhatti@pacra.com | +92-42-35869504

Profile

Plant Engro PowerGen Thar (Pvt.) Limited is operating 2 x 330 MW Coal-based Power Plant. The Company is a special purpose vehicle under Engro Energy Limited (EEL). The project, which comes under the CPEC corridor will be the first indigenous coal based Power Plant of Pakistan in Thar Block–II, Sindh.

Tariff EPTL has been provided a levelized tariff of 8.5015 US¢ per KWh. The tariff is divided into two components; Capacity Payments and Energy Payments. The tariff is indexed to the Pakistan Rupee-US Dollar exchange rate, Pakistan CPI inflation, LIBOR, KIBOR and US CPI inflation. Principal and interest repayments, ROE, Insurance, Fixed and Variable O&M costs are part of the escalable (adjustable) component.

Return On Project EPTL's key source of earnings would be the revenue generated through sale of electricity to the Power Purchaser, NTDC. The IRR of the project, as agreed with NEPRA, is 20%. The ROE of the project is at 30.65%.

Ownership

Ownership Structure EPTL's majority ordinary shares are owned by Engro Energy Limited (EEL) (50.1%) and China Machinery Engineering Company (CMEC) (35%). The remaining stake is owned by Habib Bank Limited (HBL) (9.5%) and Liberty Mills Limited (LML) (5.4%). In addition to ordinary shares, $85mln preference shares are all subscribed by CMEC.

Stability Stability in the IPPs is drawn from the agreements signed between the company and power purchaser. However, Company's association with Engro group, China Manufacturing & Engineering Company and Habib Bank Limited will continue to provide comfort.

Business Acumen Sponsor groups have significant experience in the power, coal mining, textile, banking and engineering contracting solutions and services.

Financial Strength Company’s sponsors have the ability and showed the willingness to support the entity both on a continuing basis, and support in times of crisis. Additionally, the financial strength of the sponsors is considered strong as the sponsors have well diversified profitable businesses.

Governance

Board Structure EPTL's Board of Directors (BoD) comprises nine members, including the CEO. Four members represent EPL, three CMEC and one HBL. The board members have diverse experience from different industries.

Members’ Profile The board members have diversified experience with CEO having experience of the company. Mr. Ahsan Zafar Syed is the Chairman of BoD with over 22 years of professional experience in different functions and designations.

Board Effectiveness The BOD has two sub-committees called Audit committee and Board Compensation Committee.

Financial Transparency A.F Ferguson & Co. is the external auditor of the company. The auditor has given an unqualified opinion on the half year financial statements as at 30th June 2019.

Management

Organizational Structure IPPs are generally featured by a flat organizational structure, mainly comprising finance and technical staff, while the engineering, construction and operations of the plant are outsourced.

Management Team The management team is headed by Mr. Syed Manzoor Hussain Zaidi appointed as CEO on 1st August 2019. Mr. Manzoor is associated with Engro group since 2014. He has over ten years of experience as an Investment Banker before joining Engro Powergen Thar (Pvt) Limited as General Manager in 2014. He played a vital role in achieving the Financial Close of EPTL in 2016. The CFO and the GM-Technical report to the CEO.

Effectiveness The management of Engro Powergen is mostly engaged in the finance related activities. The operations and maintenance of the plant have been outsourced to O&M contractor, Engro Energy Services Limited, which is a 100% owned subsidiary of Engro Energy Limited for a period of 5 years. The management has hired site engineers who maintain correspondence with the O&M team to ensure smooth operations of the plant.

Control Environment The company maintains an adequate MIS which helps management to keep track of all operations and liaison with O&M operator.

Operational Risk

Power Purchase Agreement The electricity generated will be sold to National Transmission and Despatch Company Limited (NTDC) under a 30 year Power Purchase Agreement (PPA). Further, the obligations of the power purchaser are guaranteed by the Government of Pakistan. Moreover, a stable revenue stream is also ensured through the minimum guaranteed capacity charge (the component of the tariff received irrespective of electricity production).

Operation And Maintenance Engro Powergen has an O&M contract with Engro Energy Services Limited which is a 100% owned subsidiary of Engro Energy Limited for a period of 5 years. The O&M operator ensures adherence of the plant to meet minimum performance benchmarks (Availability: Actual:84%; Benchmark:82.5% during first five years and 85.5% for next 25 years, Efficiency : Actual 37% ; Bench Mark: 37%) during 3QCY19.

Resource Risk The Coal Supply Agreement of Engro Powergen is with Sindh Engro Coal Mining Company for 30 years where SECMC will provide 350,000 tonnes coal per month. The Agreement is an exclusive contract by which EPTL will be allowed to use the substitute coal (Indonesian coal) only in case of nonavailability of coal by the Supplier.

Insurance Cover The Company has attained reasonable insurance cover for operational period for Property, Plant & Equipment physical damage, third party liability, and business interruption affecting the profits. Additionally, Marine, Terrorism/Political Voilence, and Excess Third Party Liability Insurances are also held.

Performance Risk

Industry Dynamics Pakistan total power generation is increasing on the back of new power projects under CPEC. Owing to newly installed plants, Pakistan’s energy mix is shifting towards Solar/Gas/RLNG and coal from Furnace Oil and other expensive sources. Pakistan total power generation is increasing on the back of new power projects under CPEC. During July - March FY2019, installed capacity of electricity reached 34,282 MW, which was 33,433 MW in corresponding period last year, thus, posting a growth of 2.5 percent. Although electricity generation varies due to availability of inputs and other constraints, the generation increased from 82,011 GWh to 84,680 GWh, posting a growth of 3.3 percent during the period under discussion.

Generation The company achieved COD on 10 July 2019. The electricity generation stood at 904 GWh in 3QCY19.

Performance Benchmark The required availability for Engro Powergen under the PPA is 82.5% during first five years and 85.5% for next 25 years. Meanwhile, the required efficiency of the plant is 37%. The company's required availability and efficiency remained above the required percentage.

Financial Risk

Financing Structure Analysis Debt financing constitutes 75% of the project cost i.e. USD 831mln. The USD facility between the China Development Bank and Engro Powergen Thar is for USD 621mln with a tenure of 14 years with semiannual payments. The local debt facility is between a consortium of multiple local banks, with HBL as the lead arranger, and Engro Powergen Thar for USD 210mln with a tenure is of 14 years with semiannual payments. A Historic DSCR of 1.1 has to be maintained. Ratio of foreign to local financing is 75:25.

Liquidity Profile EPTL will meet its debt repayment and mine capacity payments at 67% of availability, which translates to 3.5 GWh of electricity (8 months). Hence, ETPL can generate ample revenue to cover its financial obligations. EPTL, in its off-take agreement with NTDC will receive capacity payments, given the plant meets contract availability, even if no purchase order is placed.

Working Capital Financing EPTL has successfully issued a Sukuk of PKR 3bln in August-2019 to secure first of its working capital financing from a consortium of investors, led by Meezan Bank Limited.

Cash Flow Analysis During 1HCY19, free cash flows from operations (FCFO) stood at PKR -39mln (FY18: PKR -74mln, FY17: PKR -59mln).

Capitalization The Company has a moderately leveraged capital structure. The debt to equity ratio excluding exchange loss on foreign debt is 71%

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Financials (Summary)

PKR mln

Engro Powergen Thar (Pvt.) Limited

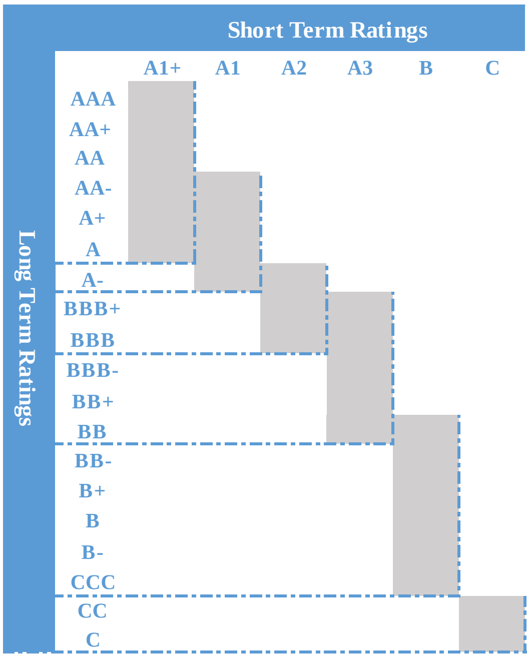
BALANCE SHEET	30-Jun-19	31-Dec-18	31-Dec-17	31-Dec-16
	1HCY19	CY18	CY17	CY16
Non-Current Assets	**136,937**	**104,221**	**56,985**	**31,497**
Investments (Others)	-	-	-	-
Current Assets	**15,876**	**4,718**	**3,870**	**1,336**
Trade Receivables	-	-	-	-
Other Current Assets	1,306	215	124	55
Cash & Bank Balances	13,493	4,502	3,746	1,282
TOTAL ASSETS	**152,813**	**108,939**	**60,855**	**32,833**
Debt	**102,859**	**82,345**	**38,634**	**14,440**
Short-term	-	-	-	-
Long-term (Inlc. Current Maturity of long-term debt)	102,859	82,345	38,634	14,440
Other Short term liabilities (inclusive of trade payables)	18,542	2,514	1,162	2,165
Other Long term Liabilities	-	-	-	-
Shareholder's Equity	**31,412**	**24,080**	**21,059**	**16,228**
TOTAL LIABILITIES & EQUITY	**152,813**	**108,939**	**60,855**	**32,833**
INCOME STATEMENT				
Admin Expenses	(23)	(38)	(25)	(36)
Other Income	-	-	-	21
Financial Charges	-	-	-	(0)
Taxation	(2)	(1)	(0)	(1)
Net Income	**(25)**	**(39)**	**(25)**	**(16)**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	(37)	(72)	(57)	(19)
Net Cash changes in Working Capital	13,433	335	(1,355)	1,810
Net Cash from Operating Activities	9,804	(3,585)	(1,413)	1,792
Net Cash from InvestingActivities	(19,129)	(33,171)	(25,004)	(22,950)
Net Cash from Financing Activities	18,319	37,516	28,883	22,145
Net Cash generated during the period	8,991	756	2,464	994
Ratio Analysis				
Capital Structure (Total Debt/Total Debt+Equity)	76.5%	77.3%	64.7%	47.0%

Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings	
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings	
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information