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
25-Sep-2020	AA-	A1	Stable	Upgrade	-
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. Since its COD, EPTL is running its operations smoothly and sustainably and exceeding operational benchmarks. 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 operating 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 2,175GWh of electricity to the grid in 1HCY20 as compared to 1,999 GWh in 2HCY19 showing a growth of ~8% in generation. The financial strength and experience in the energy chain of the sponsoring companies – EEL and CMEC – is positive to the ratings. EPTL has build its own financial strengths in a short span of time by adding to its equity base, consistent profitability and improved FCFOs support the timely repayment of debt. Strong cash position and un-utilized short term borrowing lines depicts healthy financial position of the company. 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. Power purchase agreement is with CPPA-G, which will, upon plant's availability as per contract, provide capacity payments even if no off take by power purchaser. The Government of Pakistan has given payment guarantee against dues from CPPA-G. 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 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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Power(Jan-20)
Rating Analysts	Saadat Mirza | saadat.mirza@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 is 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 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, CPPA-G. 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, Preference shares equivalent to USD 85mln all are 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. Five members represent EEL including CEO, 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 financial statements year ending as at 31st December 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 EPTL 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.

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 Central Power Purchasing Agency - (CPPA-G) 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 EPTL 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: 85.3% in 1HCY20; Benchmark: 82.5% during first five years and 85.5% for next 25 years, Efficiency : Actual 37.4% ; Bench Mark: 37%).

Resource Risk The Coal Supply Agreement of EPTL is with Sindh Engro Coal Mining Company for 30 years where SECMC will provide 320,000 tonnes coal per month. The Agreement is an exclusive contract by which EPTL will be allowed to use the substitute coal (Imported coal) only in case of non-availability 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 ~2,175 GWh in 1HCY20 as compared to 1,999 GWh from Jul19-Dec19 since COD.

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 actual availability and efficiency remained above than the benchmarks.

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. Ratio of foreign to local financing is 75:25.

Liquidity Profile At end June20, total receivables of the company stood at PKR 34,530mln (CY19: PKR 29,849mln). As circular debt continues to be an issue for companies operating in power sector. Consequently, IPPs have to manage their liquidity requirements from short-term borrowings. EPTL, in its power purchase agreement with CPPA-G will receive capacity payments, given the plant meets contract availability, even if no off take by the power purchaser.

Working Capital Financing Despite increase in receivables EPTL has mantain it's cash cycle at 23days by managing its trade payable days in line with trade receivable days. EPTL has successfully issued a Sukuk of PKR 3bln in August-2019 to meet its working capital financing from a consortium of investors, led by Meezan Bank Limited.

Cash Flow Analysis The company's debt service coverage [FCFO pre WC / Gross Interest +CMLTD] stood at 1.3x at 1HCY20. During 1HCY20, free cash flows from operations (FCFO) stood at PKR 14,014mln (CY19: PKR 13,472mln, CY18: PKR -74mln).

Capitalization The Company has a moderately leveraged capital structure. The debt to equity ratio is 73%.

PKR mln

Engro Powergen Thar (Pvt.) Limited

BALANCE SHEET	30-Jun-20	31-Dec-19	31-Dec-18	31-Dec-17
	1HCY20	CY19	CY18	CY17
Non-Current Assets	**144,801**	**140,293**	**104,221**	**56,985**
Investments (Others)	-	-	-	-
Current Assets	**48,168**	**42,163**	**4,718**	**3,870**
Inventory	266	246	-	-
Trade Receivables	34,530	24,952	-	-
Other Current Assets	6,154	9,489	1,439	124
Cash & Bank Balances	7,218	7,476	3,279	3,746
TOTAL ASSETS	**192,969**	**182,456**	**108,939**	**60,855**
Debt	**119,557**	**107,009**	**82,345**	**38,634**
Short-term	3,000	5,010	-	-
Long-term (Inlc. Current Maturity of long-term debt)	116,557	101,999	82,345	38,634
Other Short term liabilities (inclusive of trade payables)	29,206	37,892	2,514	1,162
Other Long term Liabilities	-	-	-	-
Shareholder's Equity	**44,206**	**37,555**	**24,080**	**21,059**
TOTAL LIABILITIES & EQUITY	**192,969**	**182,456**	**108,939**	**60,855**

INCOME STATEMENT				
Turnover	**39,300**	**36,436**	-	-
Gross Profit	**12,357**	**11,644**	-	-
Admin Expenses	(281)	(281)	(38)	(25)
Other Income	607	658	-	-
Financial Charges	(6,026)	(5,894)	-	-
Taxation	(5)	(5)	(1)	(0)
Net Income	**6,651**	**6,124**	**(39)**	**(25)**

Cashflow Statement				
Free Cashflow from Operations (FCFO)	14,014	13,472	(72)	(57)
Net Cash changes in Working Capital	(13,516)	894	335	(1,355)
Net Cash from Operating Activities	(5,669)	5,867	(3,585)	(1,413)
Net Cash from InvestingActivities	(658)	(26,301)	(34,395)	(25,004)
Net Cash from Financing Activities	6,065	24,631	37,516	28,883
Net Cash generated during the period	(261)	4,197	(467)	2,464

Ratio Analysis				
Performance				
Turnover Growth	7.9%	N.A.	N.A.	N.A.
Gross Margin	31.4%	32.0%	N.A.	N.A.
Net Margin	16.9%	16.8%	N.A.	N.A.
ROE	15.0%	16.3%	N.A.	N.A.
Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD)	3.8	4.2	N.A.	N.A.
Interest Coverage (X) (FCFO/Gross Interest)	2.3	2.3	N.A.	N.A.
FCFO Pre-WC/Gross interest+CMLTD	1.29	0.43	N.A.	N.A.
FCFO POST-WC/Gross interest+CMLTD	0.05	0.46	N.A.	N.A.
FCFO+change in WC+Change in STB/Gross Interest+CMLTD	2.33	2.29	N.A	N.A
Liquidity				
Short Term Borrowings Coverage (Adjusted Quick Assets/STB)	0.3	0.1	N.A.	N.A.
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	22.9	-50.5	N.A.	N.A.
Capital Structure (Total Debt/Total Debt+Equity)	73.0%	74.0%	77.4%	64.7%

Credit Rating

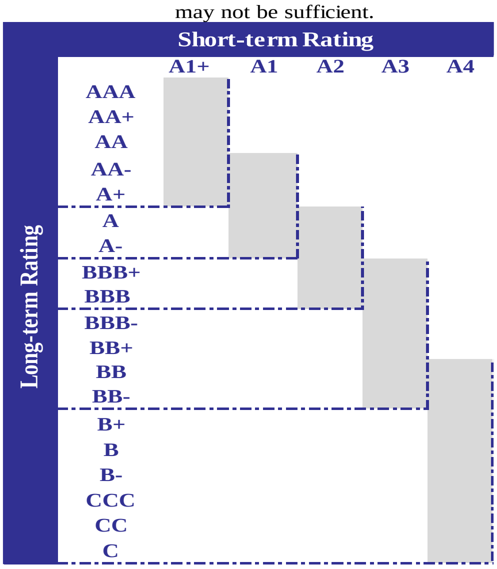
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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

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(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.
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(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)

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(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)
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(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)
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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)
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