



## The Pakistan Credit Rating Agency Limited

### Rating Report

## Sapphire Electric Company Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Aug-2019	AA-	A1+	Stable	Maintain	-
20-Mar-2019	AA-	A1+	Stable	Maintain	-
06-Nov-2018	AA-	A1+	Stable	Maintain	-
29-Mar-2018	AA-	A1+	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect strong business profile of Sapphire Electric Company Limited (Sapphire Electric) emanating from the demand risk coverage under Power Purchase Agreement signed between CPPA-G (Central Power Purchasing Agency) and the company. Meanwhile, the Implementation Agreement provides sovereign guarantee for cashflows, given adherence to agreed performance benchmarks. Nevertheless, delayed payments from the power purchaser remained a challenge. The ratings incorporate low operational risk, a result of the performance of General Electric - the O&M operator. Primary fuel of the plant is Regasified Liquefied Natural Gas (RLNG) which is supplied by Sui Northern Gas Pipeline Limited (SNGPL). Thus fuel supply risk is considered adequate, pertaining to meaningful addition of RLNG in Pakistan's fuel mix. Although there are delays in payments from power purchaser, the company manages the impact by aligning the payments to fuel supplier with its receipts. This keeps working capital needs under check. Short-term borrowing lines are available and mainly used to fund any short-fall in working capital requirements. As of Mar-19, short term lines utilization stood at 64%. Moreover, lately Sapphire Electric has been repaying its debt repayments (Principal and Markup) on time without availing benefit of forbearance period and committed to continue this practice till maturity. Sapphire Electric has outstanding long term debt of PKR 2,726mln as at end-June-19 payable till September-2020. The company's association with Sapphire Group provides comfort to the ratings.

Sustained good financial discipline and upholding strong operational performance in line with agreed performance levels remain important. Accumulation of circular debt would pose threat to the company's ability to continue with this practice. However, the management ably supported by sponsors' remains committed to sustain improvement in management of commercial obligations and timely debt repayments.

#### Disclosure

<b>Name of Rated Entity</b>	Sapphire Electric Company Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	PACRA_Methodology_IPP_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
<b>Related Research</b>	Sector Study   Power(Jan-19)
<b>Rating Analysts</b>	Taimoor Ahmad   taimoor.ahmad@pacra.com   +92-42-35869504

## The Pakistan Credit Rating Agency Limited

### Profile

**Plant** Sapphire Electric Company Limited (Sapphire Electric) is operating a Combined Cycle thermal power plant on a build-own-operate (BOO) basis, with gross capacity of 225 MW.

**Tariff** Sapphire Electric's key source of earnings is the generation tariff from the power purchaser, Central Power Purchasing Agency (CPPA-G). The reference generation tariff comprises a capacity charge component and an energy charge component. Levelized Tariff on Gas as per NEPRA determination is 5.32 Cents/KWH and 18.51 Cents/KWH on HSD fuel.

**Return On Project** The dollar IRR of Sapphire Electric, as agreed with NEPRA, is 15%.

### Ownership

**Ownership Structure** Sapphire Electric's is majority owned by Sapphire Group with 70% holding, while Xenel Saudi Arabia (20%), Meezan Bank (5%), and high net worth individuals (5%) are other shareholders respectively.

**Stability** Stability in the IPPs is drawn from the agreements signed between the company and power purchaser. However, sponsors affiliation with Sapphire group will continue to provide comfort.

**Business Acumen** Sapphire Group is engaged in the business of manufacturing and selling of yarn & fabric and home textile products.

**Financial Strength** The financial strength of the sponsors is considered strong as the sponsors have well diversified profitable businesses.

### Governance

**Board Structure** The seven-member Board of Directors (BoD) is majorly composed of representatives from Sapphire Group, including the CEO, while Xenel is represented by one member. Due to dominance of the Sapphire Group on the board, the board has limited diversification. All the board members are seasoned professionals having interests in various sectors of the industry.

**Members' Profile** Board members are qualified and have relevant experience in their portfolio reflecting strong management profile.

**Board Effectiveness** The experiences of board will help guiding the management in developing effective operational and financial policies. The board has formulated two committees, i) Audit, & ii) HR and Remuneration Committee, to ensure smooth and effective monitoring of operations. Participation of all board members during board meetings remained satisfactory.

**Financial Transparency** M/s A.F Ferguson is the external auditor of the company. They have expressed an unqualified opinion on the company's financial statements at end-Jun18.

### Management

**Organizational Structure** Sapphire Electric's has a lean management structure. It has separate teams at head office and at plant site. The CEO is supported by a team of qualified and experienced professionals.

**Management Team** The management control of the company vests with Sapphire Fibres Limited being largest shareholder. Mr. Shahid Abdullah, the CEO, has been spearheading the company as he carries with him over three decades of experience in various fields of industry.

**Effectiveness** The management of Sapphire Electric is mostly engaged in the finance related activities. The operations and maintenance of the plant have been outsourced to GE by way of the O&M contract. In this regard, Company has built up a team of senior technicians at the plant site, whom are conducting bi-weekly and monthly meetings with GE personnel to further enhance and fortify their knowledge of operating the power plant.

**Control Environment** Sapphire Electric take advantage of advanced I.T. solutions delivered comparatively better on many fronts. Moreover, quality of the I.T. infrastructure and the breadth and depth of activities performed has remained well satisfactory.

### Operational Risk

**Power Purchase Agreement** Sapphire Electric's key source of earnings is the revenue generated through sale of electricity to the power purchaser, CPPA-G. The Company will receive the capacity payments if it is at the benchmark availability and is ready to provide electricity, even if no purchase order is placed by the Power Purchaser. The company has a power purchase agreement of 30 years with CPPA-G.

**Operation And Maintenance** Sapphire Electric has negotiated an O&M contract with GE for a period of 18 years, which commenced from the COD in October 2010.

**Resource Risk** Sapphire Electric's power plant is fueled by Pipeline Quality Gas supplied by Sui Northern Pipelines Limited (SNGPL). SECL has signed an interim agreement in 2018 with SNGPL for supplying RLNG due to acute shortages of gas in the country. In case of non-availability of RLNG, company runs its plant on HSD.

**Insurance Cover** Sapphire Electric has significant insurance coverage for property damage and business interruption. The insured values for damages include a property damage cover (upto PKR 23.31bln) & business interruption cover (up to PKR 6.026bln). Local insurance is covered by Adamjee Insurance Co and foreign insurance is covered by Lockton (MENA) Limited.

### Performance Risk

**Industry Dynamics** Pakistan' total power generation is increasing on the back of new power projects under CPEC. 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 2.1 percent during the period under discussion

**Generation** Electricity produced during 9MFY19 is 490GWh (9MFY18: 435GWH, FY18: 815GWh) owing to the increase in power demanded by CPPA-G, due to the improving energy mix via inclusion of RLNG and coal based projects. However, for Nov-Dec18 and Feb-19 the plant was not operational due to the gas shortage

**Performance Benchmark** The required availability for Sapphire Electric Company under the PPA is 88%. During 9MFY19, average plant availability has been maintained according to agreed parameters. Sapphire Electric's net income improved to PKR 2,275mln during 9MFY19 in comparison to the corresponding period last year (9MFY18: PKR 1,783mln, FY18: PKR 2,243mln, FY17: PKR 2,383mln) on account of increase in electricity dispatched during the respective period. Moreover, increase in other income to PKR 5.32mln (9MFY18: PKR 0.67mln) augmented the bottom line. Other incomes consists of interest on bank deposits.

### Financial Risk

**Financing Structure Analysis** Sapphire Electric's project capital structure comprises 25% equity (US\$ 61mln) and 75% debt (US\$ 183mln). The total outstanding balance of debt stood at PKR 2,726mln as at end June-19. The Company has repaid thirty five installments by end-June 19, the debt servicing is mainly funded from capacity payments.

**Liquidity Profile** As at end June-19, total receivables of the company stood at PKR 9,678mln (FY18: PKR 7,706mln, FY17: PKR 6,202mln), an increase of around ~26%. 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.

**Working Capital Financing** Cash cycle days stood at 213days for 9MFY19 (FY18: 175days, FY17: 116days). During 9MFY19, Sapphire Electric has available working capital lines of PKR 8,376mln (FY18: PKR 8,360mln) of which ~53% (FY18: 60%) has been utilized.

**Cash Flow Analysis** Sapphire Electric coverage shown a stable trend in debt coverage ratio [FCFO pre WC / Gross Interest +CMLTD] to 1.5x during 9MFY19 (FY18: 1.4x, FY17: 1.6x ), mainly owing to stable internal free cash flow generation.

**Capitalization** Sapphire Electric's leveraging for 9MFY19 remained moderate at ~38% (FY18: 46%, FY17: 47%). STD comprised 86% and LTD stood 14% of total debt financing.



Power

## The Pakistan Credit Rating Agency Limited

Financials (Summary)

### Sapphire Electric Company Limited

PKRmln

BALANCE SHEET	31-Mar-19	30-Jun-18	30-Jun-17	30-Jun-16
	9M	FY18	FY17	FY16
<b>Non-Current Assets</b>	<b>12,733</b>	<b>13,173</b>	<b>13,783</b>	<b>14,357</b>
Investments (Others)	124	65	-	-
<b>Current Assets</b>	<b>10,002</b>	<b>8,649</b>	<b>7,090</b>	<b>5,004</b>
Inventory	161	201	241	168
Trade Receivables	9,061	7,706	6,202	4,016
Other Current Assets	373	263	223	313
Cash & Bank Balances	407	478	424	507
<b>Total Assets</b>	<b>22,858</b>	<b>21,887</b>	<b>20,873</b>	<b>19,362</b>
<b>Debt</b>				
Short-term	5,056	4,990	2,910	1,015
Long-term (Incl. Current Maturity of long-term debt)	3,211	4,561	6,136	7,493
Other Short term liabilities (inclusive of trade payables)	1,288	1,308	1,771	1,908
Other Long term Liabilities	-	-	-	-
<b>Shareholder's Equity</b>	<b>13,303</b>	<b>11,028</b>	<b>10,057</b>	<b>8,946</b>
<b>Total Liabilities &amp; Equity</b>	<b>22,858</b>	<b>21,887</b>	<b>20,873</b>	<b>19,362</b>

### INCOME STATEMENT

<b>Turnover</b>	<b>9,692</b>	<b>13,198</b>	<b>13,876</b>	<b>12,742</b>
Gross Profit	3,050	3,170	3,255	3,294
Other Income	5	1	1	(7)
Financial Charges	(728)	(776)	(789)	(1,013)
<b>Net Income</b>	<b>2,275</b>	<b>2,243</b>	<b>2,383</b>	<b>2,214</b>

### Cashflow Statement

Free Cashflow from Operations (FCFO)	3,433	3,606	3,746	3,808
Net Cash changes in Working Capital	(1,475)	(2,045)	(2,108)	1,819
Net Cash from Operating Activities	1,276	803	659	4,520
Net Cash from Investing Activities	(62)	(30)	(8)	(211)
Net Cash from Financing Activities	(1,350)	(763)	(733)	(4,313)
Net Cash generated during the period	(136)	57	(82)	(5)

### Ratio Analysis

#### Performance

Turnover Growth	18.4%	-4.9%	8.9%	6.2%
Gross Margin	31.5%	24.0%	23.5%	25.9%
Net Margin		17.0%	17.2%	17.4%
ROE	22.8%	20.3%	23.7%	24.7%

#### Coverages

Debt Service Coverage (X) (FCFO/Gross Interest+CMI)	1.5	1.4	1.6	1.6
Interest Coverage (X) (FCFO/Gross Interest)	4.7	4.7	4.7	3.8
FCFO Pre-WC/Gross interest+CMLTD	1.5	1.4	1.6	1.6

#### Liquidity

Short Term Borrowings Coverage (Adjusted Quick Asse)	1.8	1.6	2.2	4.1
Net Cash Cycle (Inventory Days + Receivable Days - Pa)	213.3	174.6	115.8	60.6

#### Capital Structure (Total Debt/Total Debt+Equity)

	38.3%	46.4%	47.4%	48.7%
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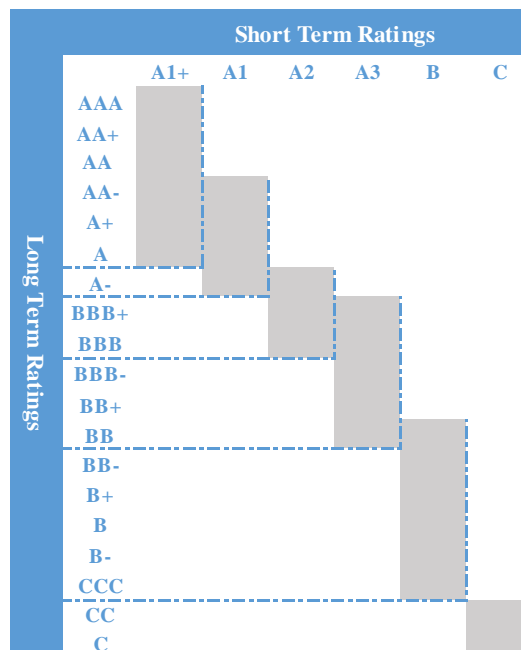
### Sapphire Electric Company Limited

Aug-19

## 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		Short Term Ratings	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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.	<b>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	Obligations are currently in default.		



**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 surveil the opinion due to lack of requisite information.

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

**Disclaimer:** PACRA’s ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA’s opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security’s market price or suitability for a particular investor.

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(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)
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- (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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- (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)

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- (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)
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- (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)

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- (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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