The Pakistan Credit Rating Agency Limited

Rating Report

Sapphire Electric Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
26-Feb-2021	AA-	A1+	Stable	Maintain	-
28-Feb-2020	AA-	A1+	Stable	Maintain	-
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. The ratings stemmed from the fact that the long-term debt of the company was fully paid successfully in September-2020 and now the only debt on the financial statements of Sapphire Power is short-term debt. The Company's financial risk profile is dependent on the timely receipt of receivables from the power purchaser. The ratings draw comfort from the sponsors’ demonstrated support to the Company. SECL has recently signed an agreement with Govt. actual impact of executed agreement is yet to be seen.

Upholding operational performance in line with agreed performance levels would remain a key rating driver. 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. However, the management ably supported by sponsors’ remains committed to sustain improvement in management of commercial obligations and timely debt repayments.

Disclosure

Name of Rated Entity	Sapphire Electric Company 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-21)
Rating Analysts	Saadat Mirza | saadat.mirza@pacra.com | +92-42-35869504

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 20.0947 PKR/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-Jun20, while drawing attention to the matter of recoverability of certain trade debts.

Management

Organizational Structure Sapphire Electric's has a lean management structure. 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 Owing to newly installed plants, Pakistan's energy mix is shifting towards Solar/Gas/and coal from Furnace Oil and other expensive sources. As on June-20, installed capacity of electricity reached 38,719 MW, which was 38,995 MW at end June-19, decline of 0.7%.(276MW)in FY20, due to the expunge of 784MW of GTPS-Kotri (144MW) and TPS Guddu (640MW). There was an increase of 508MW new power projects including CPEC from coal and renewable sources and this will increase further in coming years. Although electricity generation varies due to availability of inputs and other constraints, generation decreased from 136,532 GWh to 134,745 GWh, posting a decline of 1.3% in FY20 as compared to FY19.

Generation Electricity produced during FY20 is 299GWh (FY19: 809GWh) owing to the lower power demand by CPPA-G. This decrease in generation is owing to the decrease in power demanded by CPPA-G.

Performance Benchmark The required availability for Sapphire Electric Company under the PPA is 88%. During FY20, average plant availability has been maintained according to agreed parameters. Sapphire Electric's net income improved to PKR 3,595mln during FY20 in comparison to the corresponding period last year (FY19: PKR 3,182mln, FY18: PKR 2,243mln) on account of an increased tariff rate during the respective period. Moreover, decrease in finance cost to PKR 964mln (FY19: PKR 1,011mln) augmented the bottom line.

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 588mln as at end June-20. The debt servicing is mainly funded from capacity payments.

Liquidity Profile As at end June-20, total receivables of the company stood at PKR 10,534mln (FY19: PKR 10,635mln, FY18: PKR 7,706mln). 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 During FY20, Sapphire Electric Company working capital requirements, represented by net cash cycle (net working capital days) – a function of receivables and payables – increased to 336days (end-Jun-19: 199days) due to increase in receivable days. The company meets working capital requirements through a mix of internal cashflows and STBs.

Cash Flow Analysis Sapphire Electric coverage shown a stable trend in debt coverage ratio [FCFO pre WC / Gross Interest +CMLTD] to 3.4x during FY20 (FY19:1.3x, FY18:1.4x), mainly owing to stable internal free cash flow generation.

Capitalization Sapphire Electric's leveraging for FY20 remained moderate at ~26% (FY19: 39%, FY18: 47%). STD comprised 74% and LTD stood 26% of total debt financing.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

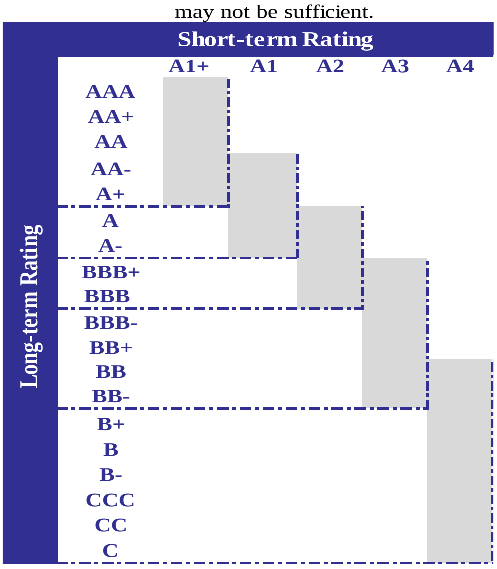
Sapphire Electric Company Ltd	Jun-20	Jun-19	Jun-18
Power	12M	12M	12M
A BALANCE SHEET			
1 Non-Current Assets	11,990	12,581	13,173
2 Investments	-	-	-
3 Related Party Exposure	158	127	65
4 Current Assets	12,128	12,143	8,649
a Inventories	*118*	*162*	*201*
b Trade Receivables	*10,534*	*10,635*	*7,706*
5 Total Assets	24,277	24,851	21,887
6 Current Liabilities	1,918	1,610	1,308
a Trade Payables	*1,402*	*1,225*	*1,259*
7 Borrowings	5,826	9,031	9,551
8 Related Party Exposure	-	-	-
9 Non-Current Liabilities	-	-	-
10 Net Assets	16,533	14,210	11,028
11 Shareholders' Equity	16,534	14,210	11,028
B INCOME STATEMENT			
1 Sales	10,225	14,873	13,198
a Cost of Good Sold	*(5,542)*	*(10,629)*	*(10,028)*
2 Gross Profit	4,684	4,244	3,170
a Operating Expenses	(94)	(70)	(125)
3 Operating Profit	4,590	4,174	3,045
a Non Operating Income or (Expense)	*(31)*	*20*	*(26)*
4 Profit or (Loss) before Interest and Tax	4,559	4,194	3,019
a Total Finance Cost	*(964)*	*(1,011)*	*(776)*
b Taxation	*(0)*	*(1)*	*(0)*
6 Net Income Or (Loss)	3,595	3,182	2,243
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*5,170*	*4,756*	*3,606*
b Net Cash from Operating Activities before Working Capital Changes	*4,103*	*3,895*	*2,847*
c Changes in Working Capital	*142*	*(2,947)*	*(2,045)*
1 Net Cash provided by Operating Activities	4,245	948	803
2 Net Cash (Used in) or Available From Investing Activities	(31)	(60)	(30)
3 Net Cash (Used in) or Available From Financing Activities	(4,465)	(400)	(715)
4 Net Cash generated or (Used) during the period	(251)	488	57
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	-31.2%	12.7%	-4.9%
b Gross Profit Margin	45.8%	28.5%	24.0%
c Net Profit Margin	35.2%	21.4%	17.0%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	51.9%	12.2%	11.8%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	21.5%	23.8%	20.8%
2 Working Capital Management			
a Gross Working Capital (Average Days)	383	230	198
b Net Working Capital (Average Days)	336	199	159
c Current Ratio (Current Assets / Current Liabilities)	6.3	7.5	6.6
3 Coverages			
a EBITDA / Finance Cost	5.4	4.8	4.8
b FCFO / Finance Cost+CMLTB+Excess STB	3.4	1.3	1.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.1	0.9	1.6
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	26.1%	38.9%	46.4%
b Interest or Markup Payable (Days)	36.1	72.0	0.0
c Entity Average Borrowing Rate	13.5%	11.1%	8.2%

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

Disclaimer: PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information. Contents of PACRA documents may be used, with due care and in the right context, with credit to PACRA. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

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
(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent