The Pakistan Credit Rating Agency Limited

Rating Report

Narowal Energy Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
22-Jun-2022	AA-	A1+	Stable	Maintain	-
23-Jun-2021	AA-	A1+	Stable	Maintain	-
25-Jun-2020	AA-	A1+	Stable	Maintain	-
27-Dec-2019	AA-	A1+	Stable	Maintain	-
27-Jun-2019	AA-	A1+	Stable	Maintain	-
27-Dec-2018	AA-	A1+	Stable	Maintain	-
11-Jul-2018	AA-	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the strong business profile of Narowal Energy Limited (Narowal Energy or the Company) emanating from the demand risk coverage under the Power Purchase Agreement (PPA) signed between CPPA-G and the Company. Meanwhile, the Implementation Agreement provides a sovereign guarantee for cash flows, given adherence to agreed performance benchmarks (Availability: 96%, Efficiency: 45%). The Company continues to meet its performance benchmarks. The ratings incorporate low operational risk, a result of in-house O&M undertaken by Hub Power Services Limited (HPSL) – an associated company and adequate insurance coverages. During the period, 9MFY22 Narowal Energy provided ~634GWh (9MFY21 ~349GWh) of electricity to the national grid and recorded sales revenue of PKR ~18,089mln (9MFY21 PKR ~11,113mln) generation and revenue witnessed an increase on account of better off-take from RFO based IPPs. In accordance with the MoU signed with the Government of Pakistan (GoP), the Company's received 40% of trade debts outstanding as of Nov'20 and remaing 60% is ecpected to receive in few months time. Nevertheless, despite the settlement, the Company continues to face the issue of receivables build up, which had increased to PKR. 21bln as of March'22. The buildup of receivables is a concern, as the same may translate the pressure on Company's working capital requirements, going forward; however, the rating incorporates very low risk on receivables from GoP. Furthermore, The Company has also secured a long-term finance facility of PKR 25mln under the salary refinancing scheme by SBP. The loan is repayable in eight equal quarterly installments and the repayments have already started from Jan 2021, providing the much needed comfort. The Company's project related debt has been paid off in full and going forward, the Company had no plans to raise any additional debt; accordingly the balance sheet is likely to remain debt-free.

The sound financial profile of Hubco; the holding company, provides comfort to the ratings. Adherence to good financial discipline towards both financial and commercial obligations would remain important. Meanwhile, upholding strong operational performance in line with agreed performance levels remains essential.

Disclosure

Name of Rated Entity	Narowal Energy Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Independent Power Producer Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Power(Jan-22)
Rating Analysts	Muhammad Mubashir Nazir | mubashir.nazir@pacra.com | +92-42-35869504

Profile

Plant Narowal Energy Limited (Narowal Energy) is a 225MW (gross) combined cycle thermal power plant, comprising 11 generating engines from MAN Diesel and one steam turbine from Dresser Rand.
Tariff The tariff has been finalized with National Electric Power Regulatory Authority (NEPRA) at the time of Commercial Operations Date in June 2012. The applicable tariff is US 10.77cents/ KWh. The tariff is adjusted as per PPA.
Return On Project The ROE is 15% based on NEPRA's approved equity and indexed on a quarterly basis as per PPA.

Ownership

Ownership Structure Narowal Energy Limited is 100% owned subsidiary of The Hub Power Company Limited (HUBCO).
Stability Stability in the IPPs is drawn from the agreements signed between the company and power purchaser. However, sponsors association with HUBCO.
Business Acumen Sponsor groups have significant experience in the energy, cement, dairy, real estate, and finance sector.
Financial Strength The financial strength of the sponsors is considered strong as the sponsors have well diversified profitable businesses.

Governance

Board Structure Narowal Energy's Board of Directors comprises of 6 Directors, including the CEO. The members of the Board are also Board members of HUBCO. Mr. Kamran Kamal, CEO of the Company, is also the chairman of Narowal Energy and HUBCO who joined on 1 July 2021.
Members' Profile HUBCO's strong professional profile assists the management in terms of strategic guidance and implementation of strong control framework.
Board Effectiveness The experiences of board will help guiding the management in developing effective operational and financial policies. No Board Committee is formed by the Board.
Financial Transparency PWC A.F.Ferguson & Co. is the external auditor of Narowal Energy and the auditor has given an unqualified report on the financial statements for the year ending June 2021.

Management

Organizational Structure Narowal Energy has a lean organizational structure with an efficient management team. The management control of Narowal Energy vests with Mr. Kamran Kamal, the CEO since 1 July 2021.
Management Team Mr. Kamran Kamal, the CEO throughout his 20 years in career has been responsible for large capital projects, building organizational capabilities and for overall business delivery in both management, executive, and Board roles.
Effectiveness Narowal Energy's management effectiveness plays a significant role in empowering the organization through positive results, which has made the decision-making process systematic. No board committee is formed as the company/board's size is small.
Control Environment Narowal Energy has in place an efficient MIS reporting system named Avanceon for its operations. The system generates real-time plant production data, enabling efficient monitoring and timely decision-making.

Operational Risk

Power Purchase Agreement Narowal Energy's key source of earnings is the revenue generated through the 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 Power Purchaser. Due to increasing fuel cost, revised energy charged became PKR/kWh 21.7842 at March 2022.
Operation And Maintenance O&M of Narowal Energy has been outsourced to Narowal Energy's associate Hub Power Services Limited (HPSL). Hub Power Service is a 100% owned subsidiary of Hubco incorporated to manage the O&M of HUBCO's group power plants.
Resource Risk Bakri Trading Company is the fuel supplier for Narowal Plant. The agreed credit period is 30 days, but owing to better supplier relationships the company can avail credit period of more than 60 days if required.
Insurance Cover Narowal Energy Limited has adequate insurance coverage for property damage and business interruption. The insured values for damages include a property damage cover (up to USD 303mln) & business interruption cover (up to PKR 66mln).

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-21, installed capacity of electricity reached 39,772 MW, which was 38,719 MW at end June-20, increased to 2.7% (1,053MW) in FY21. The share of renewable energy has steadily increased over the years. The government is also taking measures to increase the shares of Hydel and Renewables in energy-mix. There will be increasing 9,703MW new power projects including CPEC from coal and renewable sources and this will increase further in coming years. Pakistan's overall electricity consumption was recorded at 121,206 GWh during FY21 (112,069 GWh in FY20), up 8.2% YoY basis. This is equivalent to 85% of the total electricity generated in FY21(143,090GWh).
Generation The company has dispatched 634GWh of electricity in 9MFY22 as compared to the previous financial years (FY21: 349GWh; FY20:338GWh). Resultantly, the load factor remained at 31% as against 21%. Two engines at Narowal Plant unavailable for power at March 2022 due to fault which has engines 38MW.
Performance Benchmark The plant's availability (FY21: 92%; FY20: 94%) remained well above the required level (95% as per PPA). Company's profitability decreased in generation (9MFY22: PKR 3,052, FY21: PKR 5,870mln, FY20: PKR 4,782mln; FY20: FY19: PKR 3,650mln).

Financial Risk

Financing Structure Analysis Narowal plant's capital structure comprised 78% equity and 22% debt. Narowal Energy has fully paid its project debt in July 21 without any delay in scheduled repayments. The company has also secured a long-term finance facility of PKR 17.7mln under the salary refinancing scheme by SBP. The loan is repayable in eight equal quarterly installments starting from Jan 2021.
Liquidity Profile Receivable days decreased (9MFY22: 335days; FY21: 501days; FY20: 461, FY19: 328days). As the Company started receiving payments under the MoU signed. Consequently, the liquidity requirements from short-term borrowings are expected to reduce.
Working Capital Financing Narowal Energy's receivables stood at PKR 21,677mln as of 9MFY22 (Jun21:PKR 22,645mln, Jun20: PKR 19,459mln) out of which 79% are overdue by more than 90 days. Further, in order to meet operational needs, the Company has arranged working capital lines of PKR 7,700mln at the end-March -22, (utilized up to 91%).
Cash Flow Analysis The availability of cash flows to repay the debt depends on timely conversion of receivables due from CPPA-G. The coverages of the company slight decrease due to tariff discounts (Pre-Working Capital FCFO/Interest + Current Maturity: 9MFY22: 3.7x; FY21: 4.3x; FY20: 2.3x FY19: 1.5x,).
Capitalization The Company is moderately leveraged, its capital structure stood at 9MFY22: 22%; (FY21: 26%, FY20:36%, FY19: 46.1%). The major portion of the debt comprises short-term borrowing lines.

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Financial Summary
PKR mln

30-Jun-22	Mar-22	Jun-21	Jun-20	Jun-19
Power	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	12,704	13,409	14,361	15,352
2 Investments	-	-	-	-
3 Related Party Exposure	4,565	-	-	-
4 Current Assets	26,085	27,119	22,412	20,193
a Inventories	*1,066*	*1,192*	*380*	*1,269*
b Trade Receivables	*21,677*	*22,645*	*19,459*	*15,479*
5 Total Assets	43,354	40,529	36,773	35,545
6 Current Liabilities	2,562	1,830	1,110	1,790
a Trade Payables	*2,398*	*1,657*	*775*	*1,385*
7 Borrowings	8,911	9,870	12,703	15,574
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	31,881	28,829	22,960	18,180
11 Shareholders' Equity	31,881	28,829	22,960	18,180
B INCOME STATEMENT				
1 Sales	18,090	15,335	13,838	16,191
a Cost of Good Sold	*(14,481)*	*(8,444)*	*(6,943)*	*(10,709)*
2 Gross Profit	3,609	6,891	6,896	5,482
a Operating Expenses	(52)	(96)	(95)	(106)
3 Operating Profit	3,556	6,795	6,801	5,376
a Non Operating Income or (Expense)	*4*	*10*	*(17)*	*0*
4 Profit or (Loss) before Interest and Tax	3,561	6,805	6,784	5,376
a Total Finance Cost	*(509)*	*(935)*	*(2,002)*	*(1,726)*
b Taxation	*(1)*	*(1)*	*(1)*	*(2)*
6 Net Income Or (Loss)	3,052	5,869	4,780	3,649
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*4,311*	*7,821*	*7,828*	*6,361*
b Net Cash from Operating Activities before Working Capital Changes	*3,796*	*6,732*	*5,778*	*4,890*
c Changes in Working Capital	*(2,664)*	*(3,445)*	*(3,755)*	*(3,243)*
1 Net Cash provided by Operating Activities	1,132	3,287	2,024	1,647
2 Net Cash (Used in) or Available From Investing Activities	(31)	(54)	(37)	(72)
3 Net Cash (Used in) or Available From Financing Activities	6,358	(2,835)	6,176	(4,323)
4 Net Cash generated or (Used) during the period	7,459	399	8,164	(2,748)
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	57.3%	10.8%	-14.5%	-11.1%
b Gross Profit Margin	19.9%	44.9%	49.8%	33.9%
c Net Profit Margin	16.9%	38.3%	34.5%	22.5%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	9.1%	28.5%	29.4%	19.3%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sl*	13.2%	21.3%	21.2%	20.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	352	520	483	349
b Net Working Capital (Average Days)	322	491	454	319
c Current Ratio (Current Assets / Current Liabilities)	10.2	14.8	20.2	11.3
3 Coverages				
a EBITDA / Finance Cost	8.5	8.4	3.9	3.7
b FCFO / Finance Cost+CMLTB+Excess STB	3.7	4.3	2.3	1.5
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.4	0.4	0.7	1.4
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	21.8%	25.5%	35.6%	46.1%
b Interest or Markup Payable (Days)	88.4	67.3	61.2	85.6
c Entity Average Borrowing Rate	7.3%	8.5%	14.3%	11.4%

#	Notes

Credit Rating

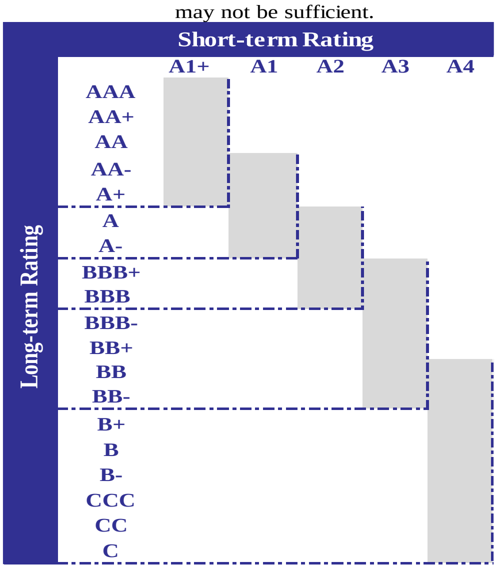
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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 | Clause 11-(A)(p).
(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