The Pakistan Credit Rating Agency Limited

Rating Report

Sindh Engro Coal Mining Company

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Jul-2019	AA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Sindh Engro coal mining company's ownership structure- owned by the Government of Sindh and financially sound business groups of the country. The rating also incorporates the fact that indigenous coal is expected to play a dominant role in meeting the country's future energy requirement. The Policy for Coal Tariff Determination Rules 2014 offers a guaranteed internal rate of return, cost indexation and pass-through tariff structure for SECMC. SECMC has leased Block-II (out of 12 blocks) of Thar, for the period of thirty (30) years, which has a cumulative capacity of ~1.57bln tonnes of coal which could be used to produce 5,000 MW for fifty (50) years. The rating favorably factors in successful commissioning of 3.8mln TPA (Phase-I) mine on 10th July 2019, three months earlier than the Scheduled COD. Subsequently, it will be ramped up to 7.6mln TPA in phase II. Block-II has four phases. Comfort is drawn from China Machinery Engineering Corporation (CMEC) – the O&M operator – having significant experience of International EPC Projects in Power Plants. Business risk is considered low, exhibited by demand risk coverage as SECMC has signed a Coal Supply Agreement with its associated company, Engro Powergen Thar Limited (EPTL), incorporated to operate mine-mouth coal-fired Power Plant (2x330MW), for phase-I. Total project cost (3.8mln TPA) which is funded through 75% debt and 25% equity and is supported by back-to-back Sovereign Guarantee, which is a huge comfort. SECMC has in place insurance arrangements against risk related to property and business continuity. This amply covers SECMC for its own risks and risks arising from its customer.

Adherence to good financial discipline towards both financial and commercial obligations is considered a strength. Meanwhile, upholding strong operational performance in line with agreed performance levels remain important. Effective management of the project, favorable regulatory regime, and consistency in related policies remain critical for the ratings.

Disclosure	
Name of Rated Entity	Sindh Engro Coal Mining Company
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Corporate_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Coal Mining and Trading(Jul-19)
Rating Analysts	Faizan Arif | faizan.sufi@pacra.com | +92-42-35869504

Profile

Legal Structure Sindh Engro Coal Mining Company Limited is a public unlisted company, incorporated in Pakistan on October 15, 2009. The Company has its registered office at, The Harbor Front Building, Clifton, Karachi.

Background The Company had commenced an initial feasibility study of the project in November 2009 through a team of International Consultants and local experts to confirm the technical, environmental, social and economic viability of the Project. The study was carried out on an area of 79.6 sq. km allocated to the Company in Thar Coalfield which was approved by the Technical Committee of the Government of Sindh on August 31, 2010.

Operations The Company was formed under a Joint Venture Agreement, dated September 8, 2009, between the Government of Sindh (GoS), Engro Energy Limited (EEL) [formerly Engro Powergen Limited (EPL)] and Engro Corporation Limited for the development, construction and operations of an open-cast lignite mine in Block-II of Thar Coal Field, Sindh

Ownership

Ownership Structure The company's ordinary shares, ~95% of the total equity, are owned by Government of Sindh (~54.70%), Engro Energy Limited (~11.90%), Thal Limited (~11.90%), Habib Bank Limited (~9.50%), HUBCO (~8%), and CMEC Thar Mining Investments LTD (~4%). While preference shares, ~5% of the total equity, are owned by Huolinhe Open Pit Coal (HK) Investment Co. Ltd (100%).

Stability The entity is overseen by Government of Sindh that provides support to stability of the company. Comfort is also drawn as the country's biggest conglomerate, Engro Corporation Limited (ECorp), has its stake in the company through its subsidiary company, Engro Energy Limited, and Mega Conglomerate Private Limited through its subsidiary company HUBCO. Stability of the entity is also drawn from the agreements signed between the company and power producer of Phase-I i.e. Engro PowerGen Thar (Private) Limited. Therefore stability factor is considered strong.

Business Acumen Government of Sindh holds SECMC as its strategically vital asset, whereas more technical knowledge flows in from Engro, HUBCO & CMEC. The business acumen of sponsors of the company is considered strong.

Financial Strength Joint ownership from the Government of Sindh (GoS) and association of financially sound conglomerates provide absolute financial strength to the company. Given the strategic importance of SECMC to the GoS, in terms of its socio-economic policies and its quest of reducing the import bill, the probability of sovereign support, in case the company requires it, remains high.

Governance

Board Structure The board of SECMC comprises twelve experienced professionals, five members represents Government of Sindh, two nominees are from Engro, two members appertaining to Thal Limited, while Habib Bank Limited, HUBCO and Huolinhe Investment company represent one member each.

Members' Profile Mr. Khurshid Anwar Jamali is the Chairman of the board, with more than ~30 years of experience in his portfolio. He has worked extensively on energy projects in many countries around the globe. Most of the board members have engineering background while some are qualified in the domain of Business and Finance. Moreover, diversification in terms of knowledge and experience is considered good.

Board Effectiveness During CY18, the board held four meetings to address the strategic decisions of the company. There are four committees at the Board level, namely i) Audit Committee, ii) Risk Management committee, iii) Human Resource Committee and iv) Procurement committee.

Financial Transparency A.F.Ferguson & Co., a member firm of PWC, is the auditor of the company. They expressed an unqualified opinion on the company's financial statements at end-Dec18. The auditor is having satisfactory QCR Rating from the Institute of Chartered Accountants of Pakistan and classified in category "A" on the panel of auditors maintained by the State Bank of Pakistan. Though the company is non-listed, still financial statements have been being prepared in a timely fashion to maintain financial transparency intact.

Management

Organizational Structure Company's organization is structured around the effective functioning of seven major departments. Each department is headed by an experienced professional, reporting directly to the CEO. The departments comprise: a) Finance, b) HR & Admin, c) Site Operations, d) Mine Tech & Expansion, e) Water Resources, f) Commercial Operations, & g) Audit.

Management Team Mr. Syed Abul Fazl Rizvi is the Chief Executive officer of the company, a mechanical engineer by profession. He is associated with the group for ~21 years with overall ~22 years of experience in his portfolio. His expertise lies in project management, strategic management & execution of large, industrial complexes. Mr. Muhammad Saqib is the CFO of the company, a qualified Chartered Financial Analyst. His association with the group for ~12 years, however, he got an overall experience of ~17 years.

Effectiveness To oversee the management of the company, SECMC has constituted an internal management committee comprising of executives from SECMC and of all subsidiaries Engro Energy Limited. The purpose of the committee is to drive the strategic decision making for the company and formulates new strategies to deal with developments that the company encounters.

MIS SECMC uses SAP as its Enterprise Resources Planning (ERP) Software specifically the FICO (Finance Module) for maintaining its financial database. SAP FI is made up of submodules. The sub-modules that are often used to generate reports of accounts receivables, accounts payables, asset accounting, general ledger accounting, and bank accounting. All the submodules are interlinked and integrate in real-time.

Control Environment SECMC maintains an effective control environment with defined policies and procedures. Company's internal audit function performs regular reviews on the financial, operational and compliance controls and reports directly to the audit committee for all critical issues.

Business Risk

Industry Dynamics Pakistan's total coal reserves stood at ~185,175mln tonnes and is ranked 7th amongst the lignite (coal) rich countries of the world. Of all the reserves ~99% of the reserves are present in Sindh province, while Punjab, and Baluchistan shares ~0.1% each to the total reserves. The country's largest coal reserves are located at Tharparkar District in the south-eastern province of Sindh, where about ~175,506mln Tonnes is identified, which is ~94% of the total reserves and ~95% of the reserves in Sindh Province.

Relative Position SECMC project is being developed in Block II which has four phases. Block II has the total reserves of ~1,584mln Tonnes which is ~1% of the total reserves in Thar region of Sindh. It is estimated that exploitable reserves of 1,584mln tons can be used to produce 5,000 MW for 50 years.

Revenues Company's revenue source is a component of i) Tariff that will be being charged to its customer, and ii) coal that will be supplied. Levelised tariff, for phase-I, that is determined at the time of financial close is $58.03 per tons, while ~3.8mln Tonnes per annum coal will be supplied to the customer of Phase-I.

Margins Company's cost components are pass-through items and margins are achieved through an internal rate of return. USD denominated Equity IRR for 3.8mln Tonnes per annum is ~20%, as agreed with Thar Coal and Energy Board.

Sustainability Coal is mostly imported in Pakistan to meet domestic demand and, although imported coal is a cheap source of fuel compared to imported oil. With the development of Pakistan's huge coal reserves at Thar, the country will be able to substitute its use of imported oil and, through the use of affordable and sustainable energy sources, can mitigate the negative price impact and redress its unfavorable standing in the power sector.

Financial Risk

Working Capital Company's working capital requirement will be emanating from 30 days inventory build-up of coal, 30 days receivables because of billing in arrears and further time for payment of invoice and 21 days inventory buildup of HSD; Spares amount to USD 4.7mln and one-month advance for O&M amounts to USD 7.8mln.

Coverages Company's cash flows will primarily be the function of its profitability. It is expected that the company will be generating ample cash flows to cover its debt obligations.

Capitalization The total project cost of phase I was ~USD 845mln which is being financed with a debt to equity ratio of 75:25. Debt portion is a mix of local and foreign financing.

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

SINDH ENGRO COAL MINING COMPANY LIMITED (SE(	Mar-19	Dec-18	Dec-17	Dec-16
Coal	3M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	65,800	62,510	39,322	22,087
2 Investments	-	-	-	-
3 Related Party Exposure	206	206	206	206
4 Current Assets	3,519	2,132	1,170	2,154
a Inventories	-	-	-	-
b Trade Receivables	-	-	-	-
5 Total Assets	69,525	64,848	40,699	24,447
6 Current Liabilities	5,138	7,377	5,583	4,732
a Trade Payables	-	-	-	-
7 Borrowings	48,742	43,419	24,984	12,148
8 Related Party Exposure	539	539	366	314
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	15,106	13,513	9,766	7,253
11 Shareholders' Equity	15,106	13,513	9,766	7,253
B INCOME STATEMENT				
1 Sales	-	-	-	-
a Cost of Good Sold	-	-	-	-
2 Gross Profit	-	-	-	-
a Operating Expenses	(7)	(32)	(25)	(32)
3 Operating Profit	(7)	(32)	(25)	(32)
a Non Operating Income or (Expense)	*44*	*15*	*16*	*19*
4 Profit or (Loss) before Interest and Tax	37	(16)	(9)	(13)
a Total Finance Cost	*(0)*	*(1)*	*(1)*	*(1)*
b Taxation	*(1)*	*(0)*	*(1)*	*(2)*
6 Net Income Or (Loss)	36	(18)	(10)	(16)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*24*	*(35)*	*(29)*	*(24)*
b Net Cash from Operating Activities before Working Capital Changes	*24*	*(35)*	*(29)*	*(24)*
c Changes in Working Capital	*(1,402)*	*1,254*	*581*	*4,550*
1 Net Cash provided by Operating Activities	(1,377)	1,218	553	4,526
2 Net Cash (Used in) or Available From Investing Activities	(4,065)	(20,182)	(17,892)	(15,926)
3 Net Cash (Used in) or Available From Financing Activities	6,713	19,901	16,305	13,110
4 Net Cash generated or (Used) during the period	1,270	938	(1,034)	1,710
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	N/A	N/A	N/A	N/A
b Gross Profit Margin	N/A	N/A	N/A	N/A
c Net Profit Margin	N/A	N/A	N/A	N/A
d Cash Conversion Efficiency (EBITDA/Sales)	N/A	N/A	N/A	N/A
e Return on Equity (ROE)	N/A	N/A	N/A	N/A
2 Working Capital Management				
a Gross Working Capital (Average Days)	N/A	N/A	N/A	N/A
b Net Working Capital (Average Days)	N/A	N/A	N/A	N/A
c Current Ratio (Total Current Assets/Total Current Liabilities)	0.7	0.3	0.2	0.5
3 Coverages				
a EBITDA / Finance Cost	N/A	N/A	N/A	-25.4
b FCFO / Finance Cost+CMLTB+Excess STB	0.1	0.0	0.0	0.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	519.6	-1392.1	-1035.4	-607.1
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	76.5%	76.5%	72.2%	63.2%
b Interest or Markup Payable (Days)	N/A	N/A	N/A	0.0
c Average Borrowing Rate	0.0%	0.0%	0.0%	0.0%

Credit Rating Scale & Definitions

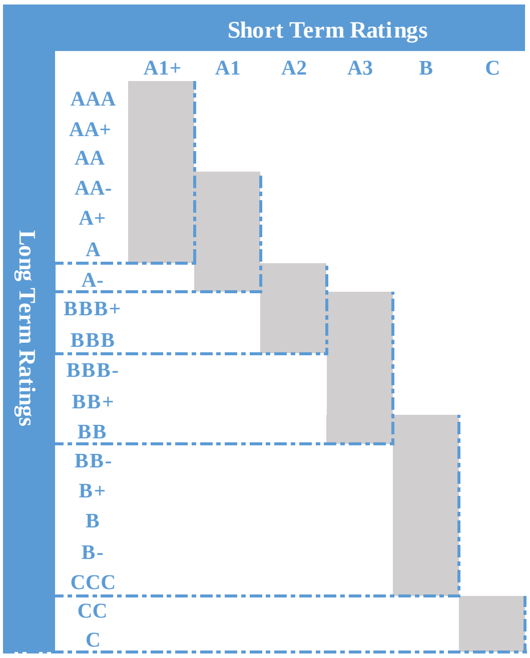
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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

Short Term Ratings

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



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

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

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

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

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

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.

(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