



The Pakistan Credit Rating Agency Limited

Rating Report

Chanar Energy Limited

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Rating History

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|--------------------|------------------|-------------------|----------|----------|--------------|
| 29-Jun-2020 | BBB- | A3 | Negative | Maintain | YES |
| 28-Jan-2020 | BBB- | A3 | Stable | Initial | - |

Rating Rationale and Key Rating Drivers

Chanar Energy Limited has a 22MW baggase based power plant which is adding renewable energy to the national grid. The IPP model is designed to creating synergy and higher efficiency gains between IPP and sugar mill. Sustainable business profile of Chanar Energy emanates from the demand risk coverage under Energy Purchase Agreement signed with CPPA-G and 'Bagasse supply and Steam Purchase Agreement' with Chanar Sugar Mills Limited, a related entity. However, procurement of raw material, solely from the associated concern, Chanar Sugar Mills, is posing constraints on generation capability and cash flow stream of the Company. The main risk factor affecting the stability of return is the availability of baggase at a price higher than the assigned fuel component, by NEPRA. The ratings reflect company's average credit quality and liquidity profile. Plant availability during crushing season is reported at 19%, while during off season the same remained unavailable. Below benchmark operational parameters, coupled with restricted supply avenues, impacted the Company's revenues and profitability. Company has project debt of PKR 2,200mln repayable till Feb 2029 in quarterly installments. Uptill now, the due debt obligations are met through energy receivables and short-term credit lines. Likewise, the operational needs are financed by sponsors. The leverage is high in comparison to the equity base. The downward adjustment in the interest rates would add cushion. The management is resorting to deferment appeal for the upcoming principal payments. However, material progress is yet to be seen, as approval from the financing consortium is in process.

Rating Watch and developing outlook signifies the prevailing uncertainty pertinent to company's financial muscles, deferment approval and timely debt servicing. The ratings are dependent on Chanar Energy's ability to sustain its business (Both On and Off sugar season) and financial profile; any deterioration in margins, leading to weak coverages and pressure on liquidity, will have a negative impact on ratings. Financial support from sponsors remains imperative in the long term. However, SBP's initiative of reducing interest rates and deferral of principal repayments for one year will provide relief.

Disclosure

| | |
|------------------------------|--|
| Name of Rated Entity | Chanar Energy Limited |
| Type of Relationship | Solicited |
| Purpose of the Rating | Entity Rating |
| Applicable Criteria | Methodology IPP(Jun-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19) |
| Related Research | Sector Study Power(Jan-20) |
| Rating Analysts | Sana Shameen sana.shameen@pacra.com +92-42-35869504 |

The Pakistan Credit Rating Agency Limited

Profile

Plant Chanar Energy Limited (CEL) has a co-generation bagasse based power plant with a gross generation capacity of 22MW (Net capacity: 20MW). The plant is capable of supplying both electricity and steam to the associated company, Chanar Sugar Mills Limited (CSML). The net exportable electricity to grid during season is ~14.5 MWh and during off season is ~20 MWh.

Tariff Chanar Energy's key source of earnings is the revenue generated through sale of electricity to the power purchaser, CPPA-G and associated company, CSML. The levelized upfront tariff decided by NEPRA is UScents/KWh 10.5601.

Return On Project The dollar ROE of Chanar Energy is 17%.

Ownership

Ownership Structure CEL's majority shareholding is with Mr. Javed Ahmad Kayani (60%). Other shares of the company are held by Ms. Atiya Kiyani (10%), Mr. Murtaza Feroze Kiyani (10%), Mr. Hamza Feroze Kiyani (10%), Ms. Tayyaba Kayani (5%) and Chanar Sugar Mills Limited (5%).

Stability Stability in the IPPs is drawn from the agreements signed between the company and power purchaser. However, sponsors association with Chanar Sugar Mills Limited will continue to provide comfort.

Business Acumen Chanar Group is engaged in the business of sugar mill and power sector. Mr Javed is a seasoned businessman. His numerous articles on sugar industry have appeared in leading newspapers like Business Recorder and daily DAWN.

Financial Strength The foundation of the group was laid with the establishment of Chanar Sugar Mill in 1990. There are 2 companies in the group and are owned by individuals of the chairman's family. Chanar Sugar Mills Limited continue to provide comfort.

Governance

Board Structure CEL's four member board comprises of four family members of the Kayani family, Mr. Javed Ahmad Kayani, Ms. Atiya Kiyani (wife of Mr. Javed Ahmad Kayani), Mr. Murtaza Feroz Kiyani and Mr. Hamza Feroz Kiyani. Mr. Javed Ahmad Kayani, CEO of the company is also the Chairman of the Board.

Members' Profile Mr. Javed Ahmad Kayani is CEO of the group. He has been elected as Chairman of Pakistan Sugar Mills Association 'Punjab Zone' for the sessions 2002-2004, 2008-2010 and 2014-2016 and served as Chairman of Pakistan Sugar Mills Association 'Central Office' for the sessions 2010-2012 and 2016-2018.

Board Effectiveness For effective oversight of the matters of the company, board discussions are held regularly where important matters related to the company are discussed.

Financial Transparency EY Ford Rhodes is the external auditor of the company and has expressed an unqualified opinion on the company's financial statements as at 30 June, 2019.

Management

Organizational Structure IPPs are generally featured by a flat organizational structure, mainly comprising finance and technical staff.

Management Team Mr. Javed Kiyani is the CEO of the company carrying more than 30 years of experience in Sugar & Textile and Power Sectors. He is assisted by a team of experienced professionals.-

Effectiveness Chanar Energy's management effectiveness plays a significant role in empowering the organization through positive results, which has made decision making process systematic.

Control Environment Chanar Energy has an in-house MIS reporting system for monitoring operations and management reporting.

Operational Risk

Power Purchase Agreement Chanar Energy's key source of earnings is the revenue generated through sale of electricity to the power purchaser, CPPA-G, and a related company. The Company, during the season, will receive energy and capacity payments if it is at the benchmark availability and is ready to provide electricity, even if no purchase order is placed by CPPA-G. During off-season, company will receive capacity payments if it produces electricity and remains available

Operation And Maintenance Chanar Energy is handing the O&M function in-house. In this regard, it has built a well experienced O&M team as the Plant is adjacent to the Chanar Sugar Mills Limited (CSML), a related company.

Resource Risk Bagasse is the primary fuel of the co-generative plant. CSML and Chanar Energy has entered in to an agreement of supply of bagasse to the plant. CSML has a cane crushing capacity of 4,800 MT per day. Bagasse is to be procured from Chanar Sugar Mills Limited, for which payment is contingent on meeting all cash commitments as per agreed waterfall.

Insurance Cover CEL has significant insurance coverage for property damage and business interruption.

Performance Risk

Industry Dynamics Pakistan total power generation is increasing on the back of new power projects under CPEC. Owing to newly installed plants, Pakistan's energy mix is shifting towards Solar/Wind/Gas/RLNG and coal from Furnace Oil and other expensive sources. 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. The generation increased from 82,011GWh to 84,680 GWh, posting a growth of 3.3 percent during the period under discussion.

Generation CEL has an installed capacity of 80,810 MWh (based on 4,236 hours). During the review, company produced 28,984MWh (FY19: 8,474MWh) of electricity, out of which 77% was provided to CPPA-G and rest was purchased by CSML.

Performance Benchmark During 9MFY20, plant operated for 70 days; the capacity factor (19%) stood below the benchmark of 45%. The same is attributable to the non-availability of bagasse at profitable price.

Financial Risk

Financing Structure Analysis Chanar Energy's project-related debt is ~ 2,200mln repayable in quarterly installments. The total tenor of the project debt is twelve years including grace period which is earlier of two years or COD. Project debt will be redeemed in 40 consecutive quarterly installments starting from May 2019. The capital structure of the project is 25% equity and 75% debt. Cost overruns have been funded by the sponsors. The company allowed debt by CPPA-G was PKR 1,752mln whereas actual debt was PKR 2,200mln. The difference of PKR 448mln is excess debt, which was incurred to achieve higher efficiency in steam production. As of date, the project related debt stood at PKR 2,081mln. Company is in process of seeking principal payment deferment till Feb21, from lending institutions; approval from banks is pending. However, debt payment for May20, remained unpaid.

Liquidity Profile As of 9MFY20, total receivables of the company stood at PKR 243mln (FY19: PKR 43mln) among the outstanding receipts, 27% are overdue by 60 days. Due to circular debt in power sector, IPPs have to manage their liquidity requirements from short-term borrowings.

Working Capital Financing Cash cycle days stood at -8 days at end March-20 (FY19: -500 days) with the decrease in receivable days (end-March20: 147days, FY19: 157 days) depicting satisfactory payments recovery from CPPA-G. During the review, company does not have any working capital credit facility, and has funded its operational requirements through sponsor's support. As per management, the interest liabilities will be paid from CPPA-G receipts and operational expenses will be financed by sponsors.

Cash Flow Analysis The company has started operations in FY19. As of 9MFY20, free cash flows from operations (FCFO) stood at PKR 188mln (FY19: PKR-39mln). Company's debt service ratio is reported at 0.7x (FY19: -0.2x). After considering outstanding receivables, due debt obligations and operational cash needs; company's cash flow position seems stringent.

Capitalization Chanar Energy's leveraging for 9MFY20 stood at ~76% (FY19: 77%).



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Power Financial Summary

Chanar Energy Limited

PKRmln

| BALANCE SHEET | 30-Mar-20 | 30-Jun-19 | 30-Jun-18 |
|--|--------------|--------------|--------------|
| | 9M | FY19 | FY18 |
| Non-Current Assets | 2,992 | 3,033 | 2,310 |
| Investments (Others) | - | - | - |
| Current Assets | 653 | 530 | 246 |
| Inventory | 5 | - | - |
| Trade Receivables | 243 | 43 | - |
| Other Current Assets | 163 | 142 | 86 |
| Cash & Bank Balances | 243 | 345 | 160 |
| Total Assets | 3,645 | 3,562 | 2,556 |
| Debt | | | |
| Short-term | 64 | - | - |
| Long-term (Inlc. Current Maturity of long-term debt) | 2,095 | 2,156 | 1,592 |
| Other Short term liabilities (inclusive of trade payables) | 551 | 561 | 212 |
| Other Long term Liabilities | 245 | 182 | - |
| Shareholder's Equity | 691 | 663 | 752 |
| Total Liabilities & Equity | 3,645 | 3,562 | 2,556 |

INCOME STATEMENT

| | | | |
|-------------------|-------------|--------------|----------|
| Turnover | 451 | 99 | - |
| Gross Profit | 152 | (9) | - |
| Other Income | 22 | 9 | 2 |
| Financial Charges | (169) | (124) | (0) |
| Net Income | (11) | (141) | 0 |

Cashflow Statement

| | | | |
|--------------------------------------|-------|-------|---------|
| Free Cashflow from Operations (FCFO) | 188 | (39) | (63) |
| Net Cash changes in Working Capital | (221) | 268 | 188 |
| Net Cash from Operating Activities | (185) | 169 | 68 |
| Net Cash from Investing Activities | (21) | (783) | (1,840) |
| Net Cash from Financing Activities | 105 | 798 | 1,625 |
| Net Cash generated during the period | (102) | 184 | (147) |

Ratio Analysis

Performance

| | | | |
|-----------------|--------|---------|-----|
| Turnover Growth | 353.5% | N/A | N/A |
| Gross Margin | 33.7% | -9.3% | N/A |
| Net Margin | -2.5% | -141.9% | N/A |
| ROE | -2.2% | -21.3% | N/A |

Coverages

| | | | |
|---|-----|------|--------|
| Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD) | 0.7 | -0.2 | -0.9 |
| Interest Coverage (X) (FCFO/Gross Interest) | 1.1 | -0.3 | -520.8 |
| FCFO Pre-WC/Gross interest+CMLTD | 0.7 | -0.2 | -0.9 |

Liquidity

| | | | |
|---|------|--------|-----|
| Short Term Borrowings Coverage (Adjusted Quick Assets/Short Term) | -0.3 | N/A | N/A |
| Net Cash Cycle (Inventory Days + Receivable Days - Payable Days) | -8.1 | -499.8 | N/A |

| | | | |
|---|--------------|--------------|--------------|
| Capital Structure (Total Debt/Total Debt+Equity) | 75.7% | 76.5% | 67.9% |
|---|--------------|--------------|--------------|

Chanar Energy Limited

Jun-20

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 | |
|--|---|--------------------|--|
| AAA | Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments | A1+ | The highest capacity for timely repayment. |
| 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. | A1 | A strong capacity for timely repayment. |
| 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. | A2 | A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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. | A3 | An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions. |
| 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 | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. |
| 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. | C | An inadequate capacity to ensure timely repayment. |
| 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. | | |



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.

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) Conflict of Interest

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

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- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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- (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)
- (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)

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