The Pakistan Credit Rating Agency Limited

Rating Report

K-Electric | PPSTS-14 | PKR 5bln | TBI

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
24-Feb-2023	AA	A1+	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The ratings incorporate the strategic importance of K-Electric Limited, (“the Company” or “KE”) being a vertically integrated power utility, responsible for the generation, transmission, and distribution of electricity in Karachi and adjoining areas of Sindh and Balochistan. The company’s board of directors comprises of ten directors currently. Three vacancies are to be filled soon. However the quorum of all board committees is complete. Support has been drawn from the sustained rather improved performance metrics of the Company, owing to the growing demand for electricity and continuous improvement across various operational metrics including a reduction in T&D losses and a better recovery ratio. KE reported a netloss of PKR (16.3)bln during 1QFY23 (1QFY22: 2.9bln). However, the decline in net profit of the Company was observed on the back ofa significant increase in fuel prices, exponential finance cost, increase in significant rupee devaluation and increase in Tariff differential. Working Capital also remains a challenge becausethe delayed payments from the government resulted in enhanced borrowings ultimately curtailing profitability because of increased finance cost. The Company is pursuing its 900 MW RLNG project on a fast-track basis in unit-I & II of 450 MW each. KE has witnessed the synchronization of 900MW RLNG - fired power project (BQPS-III). Both Units have achieved base load operations. The generation capacity of the Company will increase and being an efficient plant, electricity will be produced at a lower rate which would havea positive impact on the working capital of the Company.

The expected increase in generation fleet efficiency and additional power purchase from GoP, are imperative for the ratings, going forward. At the same time, upholding business and financial metrics is of utmost importance.

Disclosure

Name of Rated Entity	K-Electric | PPSTS-14 | PKR 5bln | TBI
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Debt Instrument Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22),Methodology | Independent Power Producer Rating(Jun-22)
Related Research	Sector Study | Power(Jan-23)
Rating Analysts	Muhammad Atif Chaudhry | Atif.Chaudhry@pacra.com | +92-42-35869504

Issuer Profile

Profile K-Electric Limited, ('KE" or "the Company") a vertically-integrated power utility, has been in operations for over a century. It is the only vertically-integrated power utility in Pakistan, which means the organisation manages all three key areas – Generation, Transmission and Distribution – of producing and delivering energy to consumers. Total installed capacity of K-Electric Limited power generation plants is 2,817MW. K-Electric Limited has an arrangement with external power producers for ~1,650+ MW including 1,100 MW from the National Grid.

Ownership The company is ~66% owned by KES Power Limited, while GoP holds ~24% stake. KES Power is the major shareholder of the Company. However, KES Power is a consortium of Al-Jomaih Group of KSA, NIG of Kuwait and IGCF, a private equity fund of several Middle East institutional investors. KES Power has entered into a Share Purchase Agreement with Shanghai Electric Power Company Limited (SEP) for sale of up to 66.4% shares of K-Electric Limited. The transaction will close once customary closing conditions and requisite regulatory approvals are obtained.

Governance The company's board of directors comprises of ten directors currently. Three vacancies are to be filled soon. However the quorum of all board committees is complete. All the board members are seasoned professionals having interests in various sectors of the industry. There are six committees at the board level, namely i) Audit, ii) Finance, ii) Human Resource & Remuneration iv) Strategy & Projects Committee and v) Risk Management & Safety, vi) Board Regulatory Affairs Committee This ensures effective oversight of the company's affairs and strengthening the board's governance role. GOP has notified on 22 May 2019, Multiyear Tariff (MYT) for KElectric Limited for the period of seven (7) years applicable from 1 July 2016 to 30 June 2023.

Management The management control of the company vests with KES Power Limited, being the largest shareholder. Mr. Moonis Alvi has been spearheading the company since being the CEO in June 2018. He has also previously served as the Chief Financial Officer of KElectric Limited. The organizational structure of K-Electric Limited is divided into three main business areas, namely (i) Generation, (ii) Transmission, and (iii) Distribution. Meanwhile, support functions such as Treasury & Corporate Finance, Marketing, and HR, supply chain etc. are centralized at the company level and are headed by professionals having considerable experience in their respective fields.

Business Risk K-Electric Limited has a registered customer base of ~3.4mln at end-FY22 (FY21: ~3.1mln), of which 83.7% constitute residential consumers, 15.5% commercial, Industrial 0.7%, and the remaining comprises the agriculture sector and public consumers. During FY22, with the drop in consumption by industrial and commercial consumer segments and decline in units sent-out, management was able to reduce the overall T&D losses by 2.2% to stand at 15.3% (FY21: 17.5%; FY 2020: 19.7%; FY 2019: 19.1%). The Company's gross profit in FY22 witnessed an uptick (FY22: 72bln, FY21: 59bln). Further, finance cost in FY22 was around 36% higher than that of the previous year. This was mainly on account of an elevation in KIBOR rates. Unfortunately, the same did not translate into net profitability mainly because of the Pak rupee devaluation. As a result, profitability deteriorated and resulted in a net profit of PKR 8.5bln (FY22: 11.9bln).

Financial Risk Units billed during FY22 have increased to 16,763 GWh as compared to the corresponding period (FY21:16,069 GWh; FY20:14,277GWh; FY19:14,318GWh). Recovery ratio has started to show improvement to 96.7% during FY22 (FY21: 94.9%). Furthermore, the management is anticipating an improvement in public sector recoveries on account of settlement of old recoveries from KWSB. During FY22, total receivables of the company are reported at PKR 136,843 as compared to PKR 104,714mln in FY21, owing to delay in public sector recoveries and the prevailing circular debt crisis in the country. The company has strong cash generation ability. The outstanding receivable balances and tariff differential claims have placed constraints on cashflow streams, and for working capital requirement company is resorting to short term debt avenues. The leverage is in the comfortable range, particularly in the context of equity base. The equity base itself is strong.

Instrument Rating Considerations

About The Instrument KE is in the process of issuing rated, unsecured, privately placed, short-term, sukuk K-Electric | PPSTS-14 | PKR 5bln | TBI ("PPSTS-14") up to PKR 5,000mln in Feb 2023, to finance the Company's working capital requirements, while the existing PPSTS-8 is about to be mature soon. The tenor of PPSTS-14 would be 6 months and will carry a profit rate of 6MK +75bps. Profit and principal will be realized at the time of maturity.

Relative Seniority/Subordination Of Instrument The claim of the certificate holders will rank superior to the claim of ordinary shareholders.

Credit Enhancement The instrument is unsecured

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

K Electric Limited Power	Jun-22 12M	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET				
1 Non-Current Assets	489,791	424,484	361,321	326,857
2 Investments	19,249	2,987	3,048	-
3 Related Party Exposure	275	182	-	-
4 Current Assets	550,813	408,024	339,045	272,008
a Inventories	*4,030*	*3,024*	*647*	*12,078*
b Trade Receivables	*136,843*	*104,714*	*99,832*	*99,928*
5 Total Assets	1,060,128	835,677	703,414	598,865
6 Current Liabilities	476,818	382,145	295,378	215,752
a Trade Payables	*379,069*	*297,613*	*217,625*	*190,795*
7 Borrowings	283,088	184,300	155,574	129,511
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	50,050	45,281	41,795	39,113
10 Net Assets	250,172	223,952	210,667	214,489
11 Shareholders' Equity	250,172	223,952	210,658	214,489
B INCOME STATEMENT				
1 Sales	518,777	325,049	288,807	289,119
a Cost of Good Sold	*(446,362)*	*(265,854)*	*(244,914)*	*(238,413)*
2 Gross Profit	72,416	59,195	43,893	50,706
a Operating Expenses	(27,598)	(25,225)	(21,523)	(43,103)
3 Operating Profit	44,817	33,970	22,370	7,603
a Non Operating Income or (Expense)	*(24,049)*	*(7,511)*	*(5,275)*	*7,564*
4 Profit or (Loss) before Interest and Tax	20,769	26,459	17,096	15,167
a Total Finance Cost	*(15,120)*	*(11,113)*	*(16,737)*	*(6,285)*
b Taxation	*2,875*	*(3,348)*	*(3,318)*	*8,391*
6 Net Income Or (Loss)	8,524	11,998	(2,959)	17,274
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*68,380*	*59,424*	*48,785*	*51,725*
b Net Cash from Operating Activities before Working Capital Changes	*48,261*	*44,556*	*27,160*	*42,190*
c Changes in Working Capital	*(75,117)*	*(2,296)*	*(4,512)*	*(59,074)*
1 Net Cash provided by Operating Activities	(26,857)	42,259	22,648	(16,884)
2 Net Cash (Used in) or Available From Investing Activities	(63,843)	(74,465)	(49,411)	(33,842)
3 Net Cash (Used in) or Available From Financing Activities	84,804	22,061	26,415	52,012
4 Net Cash generated or (Used) during the period	(5,896)	(10,144)	(349)	1,285
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	59.6%	12.5%	-0.1%	30.6%
b Gross Profit Margin	14.0%	18.2%	15.2%	17.5%
c Net Profit Margin	1.6%	3.7%	-1.0%	6.0%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-1.3%	17.6%	15.3%	-2.5%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	3.6%	5.5%	-1.4%	8.2%
2 Working Capital Management				
a Gross Working Capital (Average Days)	87	117	134	143
b Net Working Capital (Average Days)	-151	-172	-124	-36
c Current Ratio (Current Assets / Current Liabilities)	1.2	1.1	1.1	1.3
3 Coverages				
a EBITDA / Finance Cost	5.4	6.6	3.7	7.8
b FCFO / Finance Cost+CMLTB+Excess STB	1.3	0.6	0.9	1.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.4	3.1	3.2	1.6
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	53.1%	45.1%	42.5%	37.6%
b Interest or Markup Payable (Days)	317.6	360.1	228.8	437.2
c Entity Average Borrowing Rate	5.6%	5.3%	9.3%	6.2%

Credit Rating

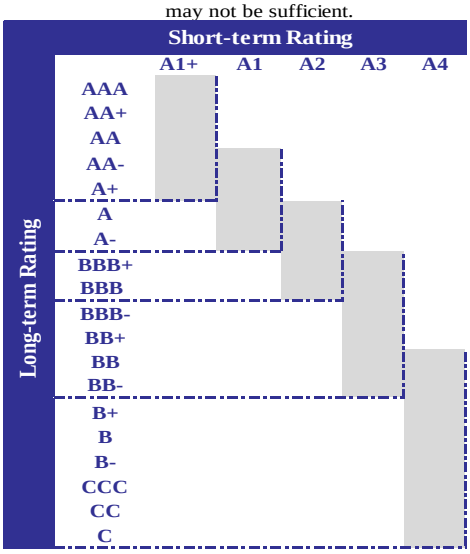
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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.

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Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

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(Credit Rating Companies Regulations,2016)

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

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

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(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).
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(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)
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(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

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(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
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(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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Regulatory and Supplementary Disclosure

Nature of Instrument	Size of Issue (PKR)	Tenor	Security	Book Value of Assets (PKR mln)	Nature of Assets	Lead Advisor
Rated, Privately Placed, Short Term Sukuk (PPSTS-I4)	PKR 5,000mln	6 months	Unsecured	N/A	N/A	Habib Bank Limited

Name of Issuer	K- Electric Limited
Issue Date	Feb-23
Maturity	Aug-23
Profit Rate	6M KIBOR +0.75%

K-Electric | PPSTS-14 | PKR 5bln | TBI | Redemption Schedule

Sr.	Due Date Principal	Opening Principal	6M Kibor	Markup/Profit Rate (6MK + 0.75%)	Markup/Profit Payment	Principal Payment	Total	Principal Outstanding
		PKR (mln)			PKR (mln)			
Issue Date	Feb-23	5,000			-	-	-	5,000
1	Aug-23	5,000	17.95%	18.70%	482	5,000	5,482	-
					482	**5,000**	**5,482**	