The Pakistan Credit Rating Agency Limited

Rating Report

The Hub Power Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2019	AA+	A1+	Stable	Maintain	-
27-Jun-2019	AA+	A1+	Stable	Maintain	-
27-Dec-2018	AA+	A1+	Stable	Maintain	-
29-Jun-2018	AA+	A1+	Stable	Maintain	-
22-Dec-2017	AA+	A1+	Stable	Maintain	-
20-Apr-2017	AA+	A1+	Stable	Maintain	-
20-Apr-2016	AA+	A1+	Stable	Maintain	-
29-Jun-2015	AA+	A1+	Stable	Maintain	-
27-Jun-2014	AA+	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The rating reflects the holding company character of Hubco with an exclusive focus on the different dimension of the energy sector. In addition to the investment book, Hubco itself is a large RFO based power plant. Hubco aims to expand generation capacity to boost the country's power generation by utilizing Pakistan's indigenous natural resources. China Power Hub Generation Company (CPHGC) - A joint venture with China Power International Holdings Limited (CPIHL): 2x660MW coal fired power plant at Hub achieved COD as on 17 August 2019. This is indeed a crucial development. Hubco is setting up two more coal power plants (i) Thar Energy Limited (TEL): 330MW mine-mouth coal fired power plant at Thar and (ii) Thalnova Power: 330MW mine-mouth coal fired power plant at Thar. Hubco also has investment in Sindh Engro Coal Mining Company (SECMC). These investments are being funded through a mix of short term and long term debt. Hubco has working capital related borrowing as well. The overall debt quantum in the wake of fresh investment is huge. The cash flows of the company can sustain the burden, which will be complemented by expected dividend inflows.The cash flows are taking positive benefit for the enhanced capacity payments, emanating from quarterly indexation. The management has forecasted sizable net cash position,reflecting dividend inflow from subsidiaries; materialization of same is crucial. Receivables keep surging due to circular debt issue however pressure on cashflows can be eased through early settlement of receivables. Hubco has used short term debt instruments and privately placed short term sukuk to meet its working capital requirement for some time now and meeting its obligations regarding repayment of principal and interest.These streams are already accounted for in the funding plan.

Cash flow streams of Hubco's plants are guaranteed by GoP under the Power Purchase Agreement (PPA), subject to adherence to the agreed upon performance benchmarks; this provides comfort to the ratings. Timely completion of new projects, settlement of receivable and payable and maintaining healthy debt service coverages are important.

Disclosure

Name of Rated Entity	The Hub Power Company 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-19)
Rating Analysts	Saadat Mirza | saadat.mirza@pacra.com | +92-42-35869504

Profile

Plant The Hub Power Company Limited (Hub Power) consists of four generating units, each comprises of 323 MW gross outputs, with an oil-fired single re-heat boiler. Company has submitted a plan in May-19 to the government to convert furnace oil-fired plant into a coal-fired power plant prior to expiry of Power Purchase Agreement (PPA) in 2027.

Tariff The company negotiated revision in generation tariff with National Electric Power Regulatory Authority (NEPRA) in June 2012. Generation reference tariff (levelized tariff for years 1-25) is US 18.6-cents/ KWh as approved by NEPRA.

Return On Project The policy IRR of Hub Power, as agreed with NEPRA is 12%.

Ownership

Ownership Structure Mega Conglomerate Private Limited (19.5%) is the single largest shareholder, followed by Allied Bank Limited (9%), Fauji Foundation (8.5%), National Bank Pakistan (3.6%) . The remaining shareholding is held by various Financial Institutions, Joint Stock Companies and general public.

Stability Stability in the IPPs is drawn from the agreements signed between the company and power purchaser. However, sponsors association with Mega Conglomerate and Fauji Foundation group will continue to provide comfort.

Business Acumen Mega Conglomerate having a diversified experience with presence in shipping, logistics, real state development, cement, energy and food sector.

Financial Strength Mega Conglomerate has a strong financial position with diversified business.

Governance

Board Structure The Company’s Board of Directors comprises of eleven Directors, The Board’s efficacy is strengthened by the presence of an executive director, the CEO.

Members’ Profile Directors having strong professional profile along with diversified experience assists the management in terms of strategic guidance and implementation of strong control framework.

Board Effectiveness For effective oversight of the matters the board has formed three board committees. (i) Board audit Committee (ii) Board Investment Committee and (iii) Board Compensation Committee. The company displays relevant information on website, stock exchange and financial reports in proper way.

Financial Transparency A.F Ferguson & Co is the external auditor of the company. The auditor has given unqualified opinion on company's financial statement as at 30th June 2019.

Management

Organizational Structure Hub Power deploys a lean organizational structure. Six functions including Finance, Corporate services, Operations, and Audit report directly to CEO. The company’s department – Manufacturing Excellence (MAX) – is responsible for improving the efficiency of the organization.

Management Team Mr. Khalid Mansoor is appointed as the CEO of the company, in May 2013 carrying 37 years of experience in Energy & Petrochemical Sectors. He is assisted by a team of experience professionals.

Effectiveness Hub Power management effectiveness plays a significant role in empowering the organization through positive results, which has made decision making process systematic.

Control Environment Hub Power has in place an efficient MIS reporting system for its operations. The system generates real-time plant production data, enabling efficient monitoring and timely decision making.

Operational Risk

Power Purchase Agreement Hub Power’s key source of earnings is the revenue generated through sale of electricity to the power purchaser, CPPA-G. The Company will receive the capacity payments if it is at the benchmark availability and is ready to provide electricity, even if no purchase order is placed by Power Purchaser.

Operation And Maintenance Hub Power has established a wholly owned subsidiary – Hub Power Services Limited (HPSL) – incorporated to manage the O&M in 2015.

Resource Risk Pakistan State Oil (PSO) is responsible for supplying RFO under the Fuel Supply Agreement (FSA) for 30 years. HUBCO is protected from fuel transportation issues as the company receives fuel directly from PSO.

Insurance Cover Hub Power has adequate insurance coverage for property damage and business interruption. The insured values for damages include a property damage cover (upto USD 1,733mln) & business interruption cover (up to USD 398mln).

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/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. Although electricity generation varies due to availability of inputs and other constraints, the generation increased from 82,011 GWh to 84,680 GWh, posting a growth of 3.3 percent during the period under discussion.

Generation During FY19, electricity generation decreased by 84% FY19: 827GWH; (FY18: 5,201GWH, FY17: 6,793GWH) with average load factor of 7.87% (FY18: 49.48%). Generation was lower due to the facet of lower power demand on the back of improving energy mix. Hubco is receiving capacity payments despite having zero or minimal generation in the months of Jul, Aug, Sep and Oct 2019.

Performance Benchmark During FY19, net profit has decreased owing to higher financing costs partly offset by depreciation of Rupee against USD (FY19: PKR 8,037mln; FY18: PKR 8,565mln; FY17: PKR 8,256mln). Plant availability during FY19 stood at 84% with load factor of 8% and thermal efficiency of 32%.

Financial Risk

Financing Structure Analysis The Hub Power total project cost was $1.5bln; with US $175mln from international and local equity investors, US $689mln from international banks, and the bulk of the rest coming via US $589mln subordinated loan provided by the World Bank, JEXIM and ECAs. The project debt remained fully paid by the Company.

Liquidity Profile At FY19, total receivables of the company stood at PKR 66,629mln (FY18: PKR 82,684mln; FY17: PKR 73,662mln). Reduction in receivables is due to recently issued sukuk by GoP for the power sector.

Working Capital Financing Receivable days have surged to 675 days in FY19 (FY18: 394 days) a facet of delayed payments recovery from CPPA-G. Receivables days as of 3MFY20 stood at 880days. Hubco has used short term debt instruments and intends to raise borrowing through a retail bond. Short term debt instruments would act as bridging short-term facility to cover the timing difference between investments and cashflow from government. As of FY19 company's long term equity investment stood at PKR 48bln (FY18: PKR 20bln), company through its wholly owned subsidiary Hub Holdings Limited has made an equity investment of PKR 22bln in China Power Hub Generation Company (CPHGC) and Thal Nova Power Ltd. During the period under review company holds 47.5% equity stake in CPHGC, 38.3% stake in Thal Nova, 60% Thar Energy ltd and 8% Sindh Engro Coal Mining Company Ltd.

Cash Flow Analysis During the review period, despite improvement in Free cash flows of the company, the debt coverage ratio has declined significantly (FY19: 0.8x; FY18: 2.1x; FY17: 1.5x) on account of increased interest expense. Free cash flows as of FY19 stood at PKR 12,545mln (FY18: PKR 10,478mln; FY17: PKR 13,381mln).

Capitalization Hub Power leverage increased on the back recently issued commercial papers to finance equity investment in coal based power plants (Debt: equity; FY19: 67%; FY18: 65%; FY17: 59%). Further draw-down from availed facility to invest equity in its subsidiary may cause leveraging to increase further.

The Hub Power Company Limited (Hubco)

PKRmln

BALANCE SHEET	30-Sep-19	30-Jun-19	30-Jun-18	30-Jun-17
	3M	Annual	Annual	Annual
Non-Current Assets	**13,387**	**13,741**	**15,477**	**17,440**
Investments (Others)	**55,089**	**48,355**	**20,679**	**11,174**
Current Assets	**87,901**	**91,631**	**100,462**	**86,369**
Inventory	5,722	6,427	7,643	4,746
Trade Receivables	69,980	66,629	82,684	73,662
Other Current Assets	11,894	11,264	9,708	6,737
Cash & Bank Balances	305	7,312	427	1,223
Total Assets	**156,377**	**153,728**	**136,617**	**114,983**
Debt	**64,098**	**64,355**	**36,424**	**27,867**
Short-term	34,214	41,112	21,776	20,091
Long-term (Incl. Current Maturity of long-term debt)	**29,885**	**23,243**	**14,648**	**7,777**
Other Short term liabilities (inclusive of trade payables)	58,426	57,110	80,367	67,630
Other Long term Liabilities	-	-	-	-
Shareholder's Equity	**33,853**	**32,263**	**19,827**	**19,486**
Total Liabilities & Equity	**156,377**	**153,728**	**136,617**	**114,983**

INCOME STATEMENT	30-Sep-19	30-Jun-19	30-Jun-18	30-Jun-17
Turnover	**7,252**	**36,029**	**76,676**	**78,590**
Gross Profit	4,109	11,733	9,803	9,317
Other Operating Expense	(170)	(872)	(900)	(615)
Other Income	39	2,375	2,119	1,480
Financial Charges	(2,360)	(4,961)	(2,248)	(1,784)
Taxation	(12)	(239)	(209)	(142)
Profit from discontinued operations	-	-	-	-
Net Income	**1,607**	**8,037**	**8,565**	**8,256**

Cashflow Statement	30-Sep-19	30-Jun-19	30-Jun-18	30-Jun-17
Free Cashflow from Operations (FCFO)	4,379	12,545	10,478	13,381
Net Cash changes in Working Capital	(2,261)	(8,129)	(1,385)	(7,321)
Net Cash from Operating Activities	144	117	6,939	3,317
Net Cash from Investing Activities	(6,747)	(24,720)	(7,305)	(224)
Net Cash from Financing Activities	(404)	31,489	(430)	(8,709)
Cash transferred to NEL	-	-	-	3,558
Net Cash generated during the period	**(7,007)**	**6,885**	**(796)**	**(2,058)**

Ratio Analysis	30-Sep-19	30-Jun-19	30-Jun-18	30-Jun-17
Performance				
Turnover Growth	-32.2%	-53.0%	-2.4%	-9.1%
Gross Margin	56.7%	32.6%	12.8%	11.9%
Net Margin	22.2%	22.3%	11.2%	10.5%
ROE	38.0%	27.0%	46.9%	39.1%
Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD	1.7	2.0	2.5	3.2
Interest Coverage (X) (FCFO/Gross Interest)	1.9	2.5	4.7	7.5
FCFO post WC / Gross Interest +CMLTD	0.8	0.7	2.1	1.5
Liquidity				
Short Term Borrowings Coverage	0.5	0.4	0.4	0.6
Net Cash Cycle	-669.6	-101.7	-11.0	22.3
Capital Structure (Total Debt**/Total Debt+Equity)	65.4%	66.6%	64.8%	58.9%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

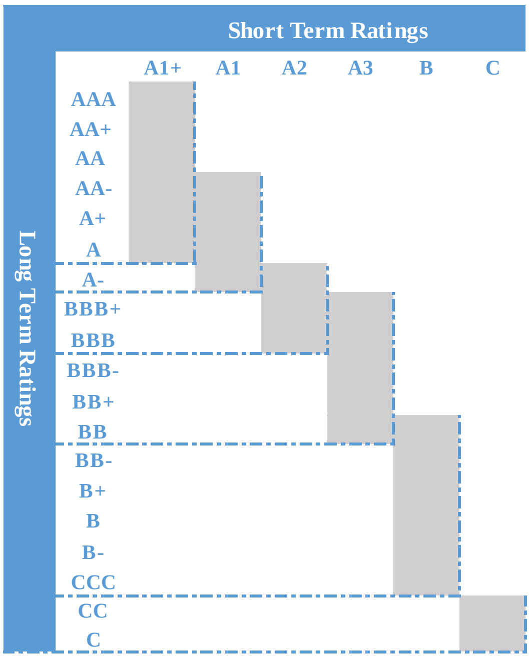
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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