The Pakistan Credit Rating Agency Limited

Rating Report

K-Electric Limited | ICP-A

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
29-Aug-2019	AA	A1+	Developing	Initial	YES
09-Aug-2019	AA	A1+	Developing	Preliminary	YES

Rating Rationale and Key Rating Drivers

K-Electric has lately published the annual report for the year ended 30th June, 2017. The company’s net profit took dip during FY17 as compared to last year owing to significant reduction in tariff level along with the change in tariff structure. The operational parameters and the related data reflect improved performance going forward. The number of consumers have taken a growth of ~10% during FY19 as compared to FY18. The recovery ratio of the company, which reflect, amount received against amount billed, has taken almost percentage point improvement during FY19. Hence, the profitability and cashflow position of the company are expected to take a positive impact. The challenge faced by the industry is prevailing circular debt. As of May, 2019 the Company’s gross receivables from various Federal and Provincial public sector entities stand at PKR 177bln and are nearly two times the Company’s payables which total PKR 99bln. The company has not accrued markup on its payable to government controlled entities. The management view is that the markup on these outstanding liabilities will be payable only when it receives markup on its own outstanding receivable balance on account of tariff differential claims and energy dues of the company’s public sector consumers. This has resulted in an increase in the company’s borrowings. The overall leverage indicators reflect manageable position. The external settlement of the pending issues is important, going forward. The company is creating different avenues to fund it’s enhanced needs of its working capital, the recent leg of which is ICP-A (amounting to PKR 8bln). In application to PSX dated May 28th 2019, K-Electric informed that following the withdrawal of case before the Sindh High Court, Ministry of Energy (MoE) has notified long standing MYT on May 22nd, 2019 for the period of seven years applicable from July 1st, 2016 to June 30th, 2023. However, the AGM for approval of accounts for the year ended 30th June, 2018 to be held, with SECP's direction.

Disclosure	
Name of Rated Entity	K-Electric Limited | ICP-A
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_Debt Instrument_FY19(Jun-19),PACRA_Methodology_Sukuk_FY19(Jun-19),PACRA_Methodology_IPP_FY19(Jun-19)
Related Research	Sector Study | Power(Jan-19)
Rating Analysts	Faizan Arif | faizan.sufi@pacra.com | +92-42-35869504

K – ELECTRIC LIMITED PROFILE	
Incorporated	1913
Major business lines	Vertically-integrated power utility
Legal status	Public Limited (Listed)
Installed Capacity	2,267MW
No. of Consumers	3,301,969
Head Office	Karachi

INDUSTRY SNAPSHOT

- Pakistan total power generation is increasing on the back of new power projects under CPEC
- Pakistan's energy mix is shifting towards Gas/RLNG and coal from Furnace Oil and other expensive sources
- Gas fired power plants have lowest per unit cost among all fossil fuel power plants.

PROFILE & OWNERSHIP

- K-Electric Limited, a vertically-integrated power utility, has been in operations for over a century.
- Total installed capacity of K-Electric Limited power generation plants is 2,267MW as at end-June19. K-Electric Limited has an arrangement with external power producers for 1,362 MW including 800 MW from the National Grids.
- The company is ~66% owned by KES Power Limited, while GoP holds ~24% stake. However, KES Power Limited is majority owned (~54%) by Abraaj with the balance held by a group of investors (Al Jomiah, Saudi Arabia and NIG, Kuwait). 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 against a consideration of US$ 1.77bln. The transaction will close once customary closing conditions and requisite regulatory approvals are obtained.

GOVERNANCE

- The company's board of directors comprises of thirteen directors. Mr. Ikram Sehgal is elected as the new Chairman of the Board of Directors with effect from January 2019. All the board members are seasoned professionals having interests in various sectors of the industry.
- The CEO – Mr. Moonis Alvi – is a K-Electric veteran. He is supported by a team of experienced professionals; management quality is considered strong.
- There are five committees at the board level, namely i) Audit, ii) Finance, iii) Human Resource & Remuneration iv) Strategy & Projects Committee and v) Risk Management & Safety. This ensures effective oversight of the company's affairs and strengthening the board's governance role.
- Lately the company has appointed A.F. Ferguson & Co, Chartered Accountants and M/s. BDO Ebrahim & Co, Chartered Accountants as external auditors. GOP has notified on 22 May 2019, Multiyear Tariff (MYT) for K-Electric Limited for the period of seven (7) years applicable from 1 July 2016 to 30 June 2023. The audit for FY18 is in progress and the company is expecting to hold AGM by the end of 3QCY19.

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 K-Electric 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 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 AND OPERATIONAL RISK

- During FY17, the operational indicators showed sustained progress. However, the net profit reduced to PKR 10,419mln (FY16: PKR 31,807mln), decrease of around 67% compared to the last year. This is mainly due to the significant reduction in tariff level along with a change in tariff structure.
- K-Electric Limited has a registered customer base of ~3.30mln at end-June 19 (FY18: ~3.02mln), of which 78.5% constitute residential consumers, 20.4% commercial, Industrial 1%, and remaining comprises the agriculture sector and public consumers.
- K-Electric Limited internal power generation is dependent on the gas feed and furnace oil received; supply of gas remained volatile on account of continuing gas shortages in the country. However, SSGC is supplying RLNG in addition to natural gas to mitigate this risk. The company also has a long term oil purchase agreement with Pakistan State Oil.
- TP-1000 is a transmission enhancement project by K-Electric Limited of over USD 450mln which will enable the utility to enhance transmission capacity by 1000 MVs through a total of additional seven new grid stations and new transmission lines. Generation projects amongst others include 900 MW RLNG Project, coal based IPP of 700MW in which K-Electric Limited has an equity stake are still in progress.
- Effective and timely execution of project is likely to further uplift company's profile in medium to long term.

PERFORMANCE

- Units billed has seen growth on an annualized basis (FY19: 14,318GWh; FY18:13,860GWh). The same increasing trend is seen in case of amount billed (FY19: PKR 230,402mln; FY18: PKR 222,703mln).
- Recovery ratio improved to 91.9% during FY19 (FY18: 90.8%). Furthermore, the management is anticipating improvement in public sector recoveries on account of settlement of old recoveries from KWSB.

FINANCIAL RISK

- During FY17, total receivables of the company have increased to PKR 103,42mln (FY16: PKR 101,044mln) owing to delay in public sector recoveries and the prevailing circular debt crisis in the country.
- The company has strong cash generation ability. Cashflow stream is healthy and provides strong coverage, against liabilities. The leverage is in the comfortable range, particularly in the context of equity base. The equity base itself is strong.

ABOUT THE INSTRUMENT

- K-Electric Limited issued an unsecured Islamic commercial paper of PKR 8,000mln which will be issue at a discount to the face value to finance the ongoing working capital requirements. The tenor of the instrument will be 6 months starting from the issuance, carrying a mark-up rate of 6 months KIBOR plus 1.3%. The instrument will be redeemed at face value on the maturity date. This will be for six months and may be rolled over for next two same terms on a best effort basis.

K-Electric Limited

BALANCE SHEET	30-Jun-17	30-Jun-16	30-Jun-15
	Annual	Annual	Annual
Non-Current Assets	**237,981**	**223,576**	**214,039**
Current Assets	**157,962**	**154,222**	**166,762**
Trade Receivables	103,420	101,044	91,331
Others	54,542	53,178	75,431
Total Assets	**395,943**	**377,798**	**380,801**
Debt	**46,259**	**55,394**	**67,844**
Short-term	17,278	23,352	36,743
Long-term (Inlc. Current Maturity of long-term debt)	28,981	32,042	31,101
Other shortterm liabilities	131,693	119,699	135,307
Other Longterm Liabilities	33,675	31,417	38,091
Shareholder's Equity	184,316	171,288	139,559
Total Liabilities & Equity	**395,943**	**377,798**	**380,801**
INCOME STATEMENT			
Turnover	**183,855**	**188,607**	**194,755**
Interest Expense	(3,891)	(5,100)	(9,760)
Net Income	**10,419**	**31,807**	**32,413**
OPERATIONAL PERFROMANCE			
Recovery Ratio	91.0%	90.4%	90.4%
T & D Losses	21.7%	22.2%	23.7%
Fleet Efficiency	37.3%	37.3%	37.3%
CASHFLOW STATEMENT			
Free Cashflow from Operations (FCFO)	42,144	57,889	45,130
Net Cash from Operating Activities	27,836	41,097	18,585
Net Cash from InvestingActivities	(19,593)	(28,654)	(14,847)
Net Cash from Financing Activities	(11,849)	(10,795)	(7,023)
RATIO ANALYSIS			
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD)	3.3	7.2	3.5
Interest Coverage (x) (FCFO/Gross Interest)	10.8	11.4	4.6
Debt Payback (Years) (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	0.8	0.6	0.9
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	25	-9	11
Capital Structure (Total Debt/Total Debt+Equity)	20.1%	24.4%	32.7%

Debt Instrument Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying 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.

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.

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

Regulatory and Supplementary Disclosure

Nature of Instrument	Size of Issue (PKR)	Tenor	Security	Quantum of Security	Musharakah Assets	Issuing and Paying Agent	Book Value of M-Assets (PKR mln)
Islamic Commercial Paper	PKR 8,000mln	Six Months from the Issue Date	Unsecured	N/A	Transformer & Switchgear	Faysal Bank Limited	PKR 9,813,888,862

K-Electric Limited | Islamic Commercial Paper	
Name of Issuer	K-Electric Limited
Issue size	PKR 8,000mln
Issue Date	Date of Full drawdown
Tenor	Upto Six Months
Maturity	In Six Months from the Issue Date
Profit Rate	6 months KIBOR plus 130 bps per annum
Principal Repayment	The instrument will be redeemed at face value on the maturity date
Security	Unsecured

K-Electric Limited | Islamic Commercial Paper | Redemption Schedule

Sr. No	Month	Principal as at start of the period	Principal Repaid	Profit	Cumulative amount to be paid	Balance as at end of period
						-
1	1	7,424,373,098			-	7,424,373,098
2	2	7,424,373,098			-	7,424,373,098
3	3	7,424,373,098			-	7,424,373,098
4	4	7,424,373,098			-	7,424,373,098
5	5	7,424,373,098			-	7,424,373,098
6	6	7,424,373,098		575,626,902	8,000,000,000	8,000,000,000