

RATING REPORT

K-Electric Limited

REPORT DATE:

October 18, 2019

RATING ANALYSTS:

Talha Iqbal

talha.iqbal@vis.com.pk

Asfia Aziz

asfia.aziz@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA	A-1+	AA	A-1
Sukuk – 5 (Rs. 25b)	AA+		AA+	-
Sukuk – 4 (Rs. 22b)	AA+		AA+	-
Rating Outlook	Stable October 14, 2019		Rating Watch- Developing February 25, 2019	
CP-3 (Rs. 8b)	A-1+ October 14, 2019		- A-1 July 31, 2019	

COMPANY INFORMATION

Incorporated in 1913

External auditors: M/s. A.F. Ferguson & Co, Chartered Accountants and M/s. BDO Ebrahim & Co, Chartered Accountants

Public Limited Company

Chief Executive Officer: Syed Moonis Abdullah Alvi**Key Shareholders (with stake 5% or more):****Chairman:** Mr. Ikram Sehgal

KES Power Limited – 66.40%

Government of Pakistan – 24.36%

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria : *Industrial Corporates (October 2003)*<http://www.vis.com.pk/images/IndustrialCorp.pdf>*Rating The Issue (September 2014)*http://vis.com.pk/Images/criteria_instrument.pdf

K-Electric Limited

OVERVIEW OF THE INSTITUTION

RATING RATIONALE

K-Electric Limited (KE) was incorporated as a limited liability company in 1913. It is a vertically integrated power utility responsible for generation, transmission and distribution of electricity in Karachi and its adjoining areas. KES Power is the major shareholder of the company.

Profile of Chairman
With more than 40 years of business experience, Ikram Sehgal is Chairman Pathfinder Group Pakistan, employing several thousand people in 50 towns and cities across Pakistan. Ikram Sehgal has served on many Boards, including Bank Alfalah for 16 years.

Profile of CEO
Mr. Moonis Alvi was appointed CEO of K-Electric in June 2018. Mr. Alvi has more than 28 years of diversified experience in the finance industry, with a focus towards driving operational efficiencies, financial planning and capital restructuring. Mr. Alvi joined K-Electric in 2008 and has served as K-Electric’s Chief Financial Officer and other key positions and has played an integral role in the transformation of K-Electric. He is a Fellow member of the Institute of Chartered Accountants of Pakistan.

Shareholding
K-Electric Limited (KE) is a vertically integrated power utility responsible for generation, transmission and distribution of electricity in Karachi and its adjoining areas including Dhabeji and Gharo in Sindh and Hub, Uthal, Vindar and Bela in Balochistan. KES Power is the major shareholder of the company. KES Power is a consortium of Abraaj Group of United Arab Emirates, Al-Jomaih of Saudi Arabia and National Industries Group (NIG) of Kuwait which holds majority in KEL. Shanghai Electric Power (SEP) intends to acquire up to 66.4% stake in KEL. The transaction is subject to receipt of requisite regulatory and other approvals including National Security Clearance (NSC) Certificate from the GoP. KE has received fresh public announcement of intention (PAI) to acquire 66.4% stake from SEP on 30th September 2019.

Generation
KE operates with an installed power generation capacity of 2,267MW (Average gross dependable Capacity for FY19 2,008MW). Units generated have increased at a CAGR of 4.26% over the last 5 years. All gas engines/gas turbine plants in KE are now in Combined Cycle Operation while around 45% of the installed capacity is less than 10 years old. Given completion of several rehabilitation projects at the company’s existing power plants, average fleet efficiency was maintained at 37% in FY19. Fleet efficiency of the generation portfolio is expected to remain at similar levels till new plants come online which should result in significant improvement in overall fleet efficiency of the generation portfolio.

Plant	Installed Capacity (MW)	GDC (MW)
BQPS 1	1,260	1,061
BQPS II	560	526
KPC	247	229
KGT	100	96
SGT	100	96
	2,267	2,008

The company also receives power from National Grid of upto 800MW and also has an arrangement with multiple IPPs. These represent 44% of the units sent out in FY19. During the last three years, four new IPPs were added to the company’s system comprising FFBL Power Company Limited’s 52 MW coal power plant, Sindh Nooriabad (I and II) 101 MW gas power plants and Oursun Solar’s 50 MW solar power plant. However, aggregate power supplied by KE remained below peak demand of 3,530MW during FY19.

Going forward, management will be pursuing a strategy of enhancing existing power generation and addition of IPPs in order to cater to growing demand of electricity. Key future projects for enhancing power generation include the following:

- 900 MW (2 x 450) RLNG based combined cycle power plant at Bin Qasim Power Station located at Port Qasim which is expected to operate at an efficiency level of 60%. EPC contract valuing \$425million is under finalization. The plant is expected to commence operations in 2021.
- 700 MW Coal fired power plant at Port Qasim which will facilitate in diversifying generation mix. This project is being developed under an IPP mode structure, with KE as the single off-

taker. KE will hold majority equity share in this IPP whereas China Machinery Engineering Corporation is both an equity partner and EPC (Engineering, Procurement and Construction) contractor. Land has been acquired and the project is expected to start commercial operations in 2022.

The management is also under the planning phase for other power generation projects and including power through other solar and nuclear based IPPs.

Multi-Year Tariff (MYT)

KE filed for a new integrated MYT in March 2016 (the previous MYT expired in June 2016). NEPRA determined the new MYT in March 2017 (for July 01, 2016 to June 30, 2023) significantly lower than requested along with change in tariff structure. KE contested the same (through a review petition) and upon reconsideration request filed by the Ministry of Energy (Power Division) the tariff was finalized at Rs. 12.82Kwh. Following withdrawal of the case in Sindh High Court by KE, the tariff was notified by the Ministry of Energy in May 2019. VIS believes that notification of MYT has resulted in much needed clarity and will allow the company to forge ahead with its investment plans. However, KE plans to continue contesting the same in Appellate tribunal once it is constituted.

	Rs. KWh
Previous Tariff	15.6
Tariff sought by KE in Review Petition	16.2
Revised Tariff (Mar'17)	12.07
Revised Tariff – After Review Petition (Oct 2017)	12.77
Revised Tariff – After Reconsideration request (July 2018)	12.82
Tariff Notified (May 2019)	12.82

Key rating drivers

Strategic importance of KE as a vertically integrated power utility is a key rating consideration

The assigned ratings predicate the strategic importance of KE as a vertically integrated power utility having exclusive rights to distribute electricity in the largest metropolitan city of Pakistan. The company's monopoly status and protection from direct competition is a key rating consideration.

Growing demand of electricity and increasing tariff should result in healthy revenue growth

Business risk profile draws support from growing demand for electricity. Units sold have increased at a CAGR of 4.6% over the last 5 years. This, along with increasing tariff post entry in the IMF Programme is expected to result in healthy growth in revenues over the rating horizon. Revenues are projected to grow at a CAGR of 11.6% over the period FY19-FY23

Continuous improvement across various operational performance metrics

Continuous improvement across various operational metrics including further reduction in transmission & distribution losses and aggregate technical and commercial losses and improvement in recovery ratio is a key rating determinant.

KPIs	FY17	FY18	FY19
T&D Loss	21.7%	20.4%	19.1%
Recovery Ratio	90.0%	91.1%	92.6%
Aggregate Technical and Commercial Loss (%)	29.5%	27.5%	25.1%
Fleet Efficiency	36.7%	37.4%	37.1%

Generation: Management is pursuing a strategy of enhancing existing power generation and addition of

IPPs in order to cater to growing demand of electricity. Significant capacity addition over the next 3 years is projected to bridge the gap between peak demand and power supplied. Once new plants come online, fleet efficiency of generation portfolio is expected to depict noticeable improvement.

Transmission: The company is currently undergoing its \$450m transmission enhancement plan (TP-1000). Around 800MVA of transmission capacity has been added to the network. The Company has also installed power transformers to curb overloading. Remaining work on this project is expected to be completed by the end of the ongoing calendar year. Resultantly, fault response on power transformers and transmission lines has declined. Going forward, KE plans to invest in TP-2 project which is expected to enhance transmission capacity by 1,500 MVA, cost and timelines for the same are being finalized.

Distribution: Over the last few years, KE has been working on initiatives such as Aerial Bundled Cables (ABC), Technical Loss Reduction, and System Improvement Projects to reduce distribution losses. KE has also added new feeders for improving system capacity and reliability. Resultantly, T&D loss of 19.1% during FY19 (FY18: 20.4%; FY17: 21.7%, FY16: 22.2%, FY15: 23.7%) has continued to decline over the years but was slightly higher than NEPRA benchmark of 18.75%. T&D losses are projected to be lower than NEPRA benchmark in later years.

Recovery Ratio: Cash flows of the company are dependent on KE's recovery ratio. Various recovery initiatives undertaken by the company have resulted in improved collection from residential consumers and public sector entities along with adjustment of Electricity Duty against KWSB receivables. Recovery of old but recently verified dues from KWSB will enhance recovery ratio.

Financial Risk Profile

Given the decline in tariff, profitability to be lower vis-à-vis historical levels in the earlier years. Profitability to depict strong growth over the MYT period on the back of higher unit sent out and continuous reduction in T&D losses. Quantum of improvement will depend on growth in units sent out, extent of reduction in T&D losses and amount of write-off claims.

Revenues of KE are projected to grow at a CAGR of 11.6% over the period FY19-FY23. Growth in revenues will be a function of higher units sold and increase in tariff on the back of tariff variations allowed in the MYT. KE's sizeable revenue base is a key rating consideration. Residential customers comprise the largest segment of the overall revenues. Overall units sold to industrial customers has continued to grow but proportion of revenues has declined partly due to industrial support package announced by the government. Going forward, management expects proportion of revenues from industrial customers to increase.

Customer Segment (% of revenues)	FY17	FY18	FY19
Residential	44%	44%	44%
Commercial	11%	14%	15%
Industrial	32%	30%	30%
PSC	13%	12%	11%
Total	100%	100%	100%

Given the sizeable debt being undertaken to fund capacity and efficiency enhancement projects, finance cost is projected to depict noticeable increase over the rating horizon. However, overall profitability to depict strong growth over the MYT period on the back of higher unit sent out and continuous reduction in T&D losses. Quantum of improvement will depend on growth in units sent out, extent of reduction in T&D losses and amount of write-off claims. Management expects other operational and tariff related improvements/adjustments to result in increase in profitability beyond projected levels.

While remaining within manageable levels, leverage indicators are expected to continue to increase given the significant capital expenditure being incurred and planned over the rating horizon. Debt servicing coverage ratio is expected to be satisfactory at around 1.5(x) over the rating horizon.

Debt levels of the Company have witnessed an increasing trend over the last two years due to higher working capital requirements and debt being undertaken for capital expenditure projects. Going forward, debt levels and leverage indicators are projected to increase over the rating horizon as additional debt is being undertaken. Gearing levels are likely to peak at around 1.27 (x) end-FY22 but are then projected to decline to 0.81(x) by end-FY24. Cash flow coverage of outstanding debt will decline but remains within manageable levels, and debt servicing coverage ratio is expected to be satisfactory at around 1.5(x) over the rating horizon.

RATIO ANALYSIS	FY20E	FY21E	FY22E	FY23E
FFO to Total Debt (%)	29%	20%	17%	22%
FFO to Long Term Debt (%)	43%	24%	20%	27%
CFO to Total Debt (%)	33%	23%	14%	20%
Debt Servicing Coverage Ratio (x)	2.5	2.3	1.65	1.4
Gearing	0.95	1.22	1.27	1.11

Working capital cycle expected to improve significantly with the release of funds from tariff differential claims (TDC)

KE's working capital requirements have increased manifold due to significant increase in receivables in lieu of TDC. TDC receivable have increased by nearly 3.5 times over the last 2 years majorly due to dispute over tariff. With the notification of tariff and expected release of TDC claims post verification by NEPRA, working capital cycle is expected to improve. Receivable from KWSB have remained stagnant indicating current dues being recovered during the last 2 years. Similarly, there has been no addition in payables to Sui Southern Gas Company over the last 3 years.

Proposed Sukuk

KE plans to issue a Sukuk amounting to Rs. 25b (inclusive of a green shoe option of Rs. 5b) to finance ongoing capital and operating expenditures of the company arising from higher natural gas cost, swapping cost of natural gas to RLNG, and addition of new IPPs. Tenor of the instrument is 7 years (inclusive of a grace period of 2 years).

Ratings to the proposed Sukuk draw comfort from sizeable and growing cash flows that will be routed through the new Master Collection Account (MCA).

KE will route collection from specific bank collection account(s) into the MCA. MCA will be signed by KE, identified collection bank(s) and specified lenders whose debt service payments are secured through this arrangement. The collection agent appointed will retain (on monthly basis) the required amount of funds (one-third of the quarterly installment) for payment on due date and any excess amount will be released to KE. Ratings draw comfort from sizeable and growing cash flows that will be routed through the collection account. KE will undertake to cover any shortfall in the debt servicing amount. Sizeable and growing cash flows (increased at a CAGR of 13.6% over the last 5 years) that will be routed through the new Master Collection Account (MCA) is a key rating strength and provides strong coverage for debt payments planned to be undertaken through the MCA.

KE's existing Sukuk

The assigned ratings to Sukuk issued by KE incorporate adequate debt servicing capacity and structure of the Sukuk. The entire Sukuk issue has repayment linked to specific receivables from 495 identified

customers, which have an extended history of timely payments with the Company. Other structural features of the Sukuk include retention of amount equivalent to one-third of the quarterly installment by the collection agent from the revenues of these 495 customers to meet the upcoming installment while excess proceeds after meeting the retention requirement is being released to KE each month.

K-Electric Limited
Appendix I

FINANCIAL SUMMARY <i>(amounts in PKR billions)</i>			
BALANCE SHEET	FY16	FY17	FY18
Fixed Assets	223.5	237.7	277.4
Investments	-	-	-
Stores, spares and loose tools	7.9	9.4	11.5
Trade Debts	101.0	103.4	115.4
Cash & Bank Balances	2.2	2.1	1.1
Total Assets	377.8	395.9	473.7
Trade and Other Payables	106.3	117.1	140.5
Long Term Debt <i>(*incl. current maturity)</i>	32.0	29.0	31.5
Short Term Debt	23.9	20.4	41.3
Total Debt	55.9	49.4	72.8
Total Equity <i>(*excluding surplus)</i>	121.3	136.7	153.2
Total Equity <i>(*including surplus)</i>	171.3	184.3	207.3
INCOME STATEMENT	FY16	FY17	FY18
Revenue	188.6	183.9	217.1
Gross Profit	57.2	39.5	44.9
Operating Profit	30.1	12.3	17.0
Profit After Tax	31.8	10.4	12.3
RATIO ANALYSIS	FY16	FY17	FY18
Gross Margin (%)	30.3%	21.5%	20.7%
FFO	52.6	39.0	44.0
CFO	41.1	27.8	19.3
FFO to Total Debt (%)	94.2%	78.9%	60.5%
FFO to Long Term Debt (%)	164.3%	134.6%	139.9%
CFO to Total Debt (%)	73.5%	56.3%	26.6%
Debt Servicing Coverage Ratio (x)	6.8	7.0	4.1
Gearing	0.5	0.4	0.5
ROAA (%)	8.4%	2.7%	2.8%
ROAE (%)	30.8%	8.1%	8.5%

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC

A high default risk

C

A very high default risk

D

Defaulted obligations

Short-Term

A-1+

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURE		Appendix III			
Name of Rated Entity	K-Electric Limited				
Sector	Power				
Type of Relationship	Solicited				
Purpose of Rating	Entity and Sukuk Ratings				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	RATING TYPE: ENTITY				
	14-Octo-2019	AA	A-1+	Stable	Reaffirmed
	25-Feb-2019	AA	A-1	Rating Watch -Developing	Reaffirmed
	03-Mar-2018	AA	A-1	Rating Watch -Developing	Maintained
	30-Dec-2015	AA	A-1	Stable	Reaffirmed
	1-Dec-2014	AA	A-1	Stable	Upgrade
	2-Jan-2014	A+	A-2	Positive	Reaffirmed
	25-Nov-2013	A+	A-2	Positive	Initial
	Rating Date	Medium to Long Term		Rating Outlook	Rating Action
	RATING TYPE: SUKUK-4				
	14-Oct-2019	AA+		Stable	Reaffirmed
	25-Feb-2019	AA+		Rating Watch - Developing	Reaffirmed
	03-Mar-2018	AA+		Rating Watch - Developing	Maintained
	30-Dec-2015	AA+		Stable	Reaffirmed
	26-Mar-2015	AA+		Stable	Final
	29-Jan-2015	AA+		Stable	Preliminary
	Rating Date	Medium to Long Term		Rating Outlook	Rating Action
	RATING TYPE: SUKUK-5				
	14-Oct-2019	AA+		Stable	Preliminary
	Instrument Structure	<p>Sukuk 4: Sukuk 4 was issued by KE in FY15 and funds raised from this Sukuk amounted to Rs. 22b. It possesses a tenor of 7 years, with a grace period of 2 years. It is structured as a diminishing musharaka arrangement and carries an interest rate of 3 month KIBOR plus 1%.</p> <p>Sukuk 5: KE plans to issue a Sukuk amounting to Rs. 25b (inclusive of a green shoe option of Rs. 5b) to finance ongoing capital and operating expenditures of the company arising from higher natural gas cost, swapping cost of natural gas to RLNG, and addition of new IPPs. Tenor of the instrument is seven years (inclusive of a grace period of two years).</p>			
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not				

	a recommendation to buy or sell any securities.
Probability of Default	VIS ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2019 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.