RATING REPORT

K-Electric Limited

REPORT DATE:
August 25, 2020

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Short-term**	**Long-term**	**Short-term**
K-Electric Limited – ICP-10 (Rs. 4.5b)		A-1+ (Preliminary)	N/a	
Rating Date (ICP-10)	*August 25, 2020*		*N/a*	
Entity Rating	AA/A-1+		AA/A-1+	
Rating Date (Entity)	*August 25, 2020*		*April 16, 2020*	

COMPANY INFORMATION

Incorporated in 1913	**External auditors:** M/s. A.F. Ferguson & Co, Chartered Accountants
Public Limited Company	**Chief Executive Officer:** Syed Moonis Abdullah Alvi
Key Shareholders (with stake 5% or more):	
KES Power Limited – 66.40%	
Government of Pakistan – 24.36%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria : *Industrial Corporates – April 2019*
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

Rating The Issue (July 2020)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Notchingtheissue202007.pdf

K-Electric Limited

OVERVIEW OF THE INSTITUTION

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 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.

RATING RATIONALE

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.

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. Growth in units sent out is a key rating driver. While growth in units sent out continued in FY20, it was below historical levels due to impact of Covid-19 where economic activities were severely impacted in March, April and May.

Continuous improvement across various operational performance metrics; however, Covid-19 has resulted in various challenges and has impacted improving trajectory of T& D losses. Going forward, based on the planned initiatives, the company remains resolute in recuperating the operational improvements, which will resultantly have a positive impact on the company's financials. Continuity in improvement in various operational performance metrics is considered important from a ratings perspective

Key operational performance metrics have depicted continuous improvement till FY19. While fleet efficiency of the generation portfolio improved in FY20 and recovery ratio has been maintained (despite the significant impact of Covid-19), T&D losses have depicted an increase primarily due to impact of Covid-19 during which zero load-shedding across the city was implemented, even in areas where power theft was high. 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	FY20
T&D Loss	21.7%	20.4%	19.1%	19.7%
Recovery Ratio	90.0%	91.1%	92.6%	92.6%
Aggregate Technical and Commercial Loss (%)	29,5%	27.5%	25.1%	25.5%
Fleet Efficiency	36.7%	37.4%	37.1%	38%

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 $450million transmission enhancement plan

(TP-1000). Around 900 MVAs of transmission capacity has been added to the network. The Company has also installed power transformers to curb overloading and the project is on course for successful completion. Resultantly, fault response on power transformers and transmission lines has declined. Going forward, KE plans to continue and further accelerate investments in Transmission infrastructure upgrade through capacity enhancement as well as to set up new interconnection points with the National Grid for increased reliability and off-take of additional power from the National Grid subject to technical study and required approvals.

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. T&D losses are projected to be lower than NEPRA benchmark over the rating horizon.

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.

Satisfactory 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. 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. KE's working capital requirements have increased significantly due to increase in receivables in lieu of Tariff Differential Claim although amount received in lieu of the same was higher vis-à-vis preceding. These have been offset by sizeable jump in payable to NTDC in FY20. On a net basis, increase in receivable has remained manageable but overall KE has a significant net receiver position. Finance cost is higher during 1HFY20 on account of increase in interest rates and debt levels which have increased significantly over the last 3 years due to additional working capital requirements and capital expenditure being incurred on generation, transmission and distribution front.

Commercial Paper

KE is in the process of issuing an unsecured Islamic Commercial Paper (ICP-10) issue of up to Rs. 4.5billion. The ICP-10 will have bullet repayment at maturity and will have a tenor of 6 months. The proceeds of the issue will be utilized for KE's working capital requirements.

K-Electric Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR billions)*					
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**FY19**	**1HFY20**
Fixed Assets	223.5	237.7	277.4	326.5	NA
Investments	-	-	-	-	NA
Stores, spares and loose tools	7.9	9.4	11.5	12.1	NA
Trade Debts	101.0	103.4	115.4	99.9	NA
Cash & Bank Balances	2.2	2.1	1.1	2.7	NA
Total Assets	377.8	395.9	473.7	598.9	NA
Trade and Other Payables	106.3	117.1	140.5	190.8	NA
Long Term Debt *(*incl. current maturity)*	32.0	29.0	31.5	57.6	NA
Short Term Debt	23.9	20.4	41.3	71.9	NA
Total Debt	55.9	49.4	72.8	129.5	NA
Paid Up Capital	96.3	96.3	96.3	96.3	NA
Total Equity *(*excluding surplus)*	121.3	136.7	153.2	148.8	NA
Total Equity *(*including surplus)*	171.3	184.3	207.3	214.5	NA
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**FY19**	**1HFY20**
Revenue	188.6	183.9	217.1	289.1	158.4
Gross Profit	57.2	39.5	45.3	50.7	24.2
Operating Profit	30.1	12.3	17.0	15.2	12.9
Profit Before Tax	25.0	8.7	13.7	8.9	4.8
Profit After Tax	31.8	10.4	12.3	17.3	2.8
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**FY19**	**1HFY20**
Gross Margin (%)	30.3%	21.5%	20.9%	17.5%	15.3%
FFO	52.6	39.0	44.0	42.2	NA
CFO	41.1	27.8	19.3	(16.9)	NA
FFO to Total Debt (%)	94.1%	78.9%	60.5%	32.6%	NA
FFO to Long Term Debt (%)	164.3%	134.6%	139.9%	73.3%	NA
CFO to Total Debt (%)	73.5%	56.3%	26.6%	-13.0%	NA
Debt Servicing Coverage Ratio (x)	6.8	7.0	4.1	3.2	NA
Gearing (x) (excluding revaluation surplus)	0.46	0.36	0.48	0.87	NA
Current Ratio (x)	1.06	1.00	0.95	0.92	NA
ROAA (%)	8.4%	2.7%	2.8%	3.2%	NA
ROAE (%)	30.8%	8.1%	8.5%	11.4%	NA

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	Commercial Paper
Rating History	see table below
Instrument Structure	**K ELECTRIC LIMITED – ICP-10** KE is in the process of issuing an unsecured Islamic Commercial Paper (ICP-10) issue of up to Rs. 4.5billion. The ICP-9 will have bullet repayment at maturity and will have a tenor of 6 months. The proceeds of the issue will be utilized for KE's working capital requirements.
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.
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Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: Commercial Paper (ICP-10)				
25-Aug-2020		A-1+		Preliminary