RATING REPORT

K-Electric Limited –Sukuk-6

REPORT DATE:
December 29, 2022

RATING DETAILS	Final	Preliminary
	Long-Term	**Long-term**
K-Electric Limited – Sukuk 6 (6.7b)	AA+	AA+
Rating Date (Sukuk 6)	*December 29, 2022*	*April 29, 2022*
Rating Action	*Final*	*Preliminary*
Outlook	*Stable*	*Stable*

RATING ANALYSTS:
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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)

Applicable Rating Criteria: Industrial Corporate (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Rating The Issue (July 2020)
https://docs.vis.com.pk/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 Chairman

Mark Skelton is a Managing Director with Alvarez & Marsal's (A&M) Advisory practice in London. He brings more than 20 years of experience in corporate finance and advisory. His primary areas of concentration are cross boarder assignments, many of which involve complex stakeholder groups crossing different legal jurisdictions and waterfall classes. Mr Skelton has undertaken senior roles on numerous major UK, US, European, Emerging Markets, and Australian projects across a range of industries, including energy, power, industrials, mining, financial services, automotive, retail, property and telecommunications. Prior to joining A&M, Mr. Skelton's held senior positions in a leading independent restructuring advisory and a Big 4 firm. Mr. Skelton is a member of the Institute of Chartered Accountants in Australia

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 Al-Jomaih Group of KSA, NIG of Kuwait and IGCF, a private equity fund comprising several Middle East institutional investors. Shanghai Electric Power (SEP) intends to acquire up to 66.4% stake in KEL. The transaction is subject to receipt of requisite regulatory and government approvals including National Security Clearance (NSC) Certificate from the GoP.

Sukuk 6 Issuance

- KE has issued a privately placed DSLR listed Sukuk on November 23, 2022 to the tune of Rs. 6.7b against proposed amount of Rs. 12b.
- The purpose of the Sukuk is to meet the permanent working capital requirements of the business and to fund routine capital and operating expenditures of the Issuer and shall reduce short-term debt post issuance.
- Tenor of the instrument is seven years (inclusive of a grace period of two years). The instrument carries profit rate of 3 month KIBOR plus 1.7%. Profit will be payable quarterly in arrears calculated on a 365 day year basis on the outstanding principal amount. The first such profit payment will fall due three (03) months from the Issue date and subsequently every three (03) months thereafter.
- Assigned ratings of the instrument incorporates the MCA (Master Collection Account) in place. Company's 250 consumers deposit their bill proceeds in accounts maintained with HMBL, SCB and HBL. KE has issued irrevocable instructions to HMBL and HBL to transfer funds in SCB. A new Master Repayment Account (MRA) for amount retention for Sukuk and for future lenders/beneficiaries has been formed. As of now, this MRA will service only Sukuk-6 repayments. Irrevocable instructions have been given to SCB to ensure all consumer proceeds are transferred in MRA at end of each business day. Funds equivalent to 1/3rd of quarterly installment is retained on a monthly basis, and excess funds will be released to the company. One day prior to the quarterly installment date, the retained funds will be transferred into the Sukuk Payment Account for onward payments to the Sukuk holders.
- The Sukuk Issue shall be secured by:
  - A first pari passu charge over the Hypothecated Properties, in favour of the Investment Agent for
  - the benefit of Sukuk holders with a 25% margin over the outstanding Issue Amount.

and New Zealand (CAANZ)

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.

- A first pari passu hypothecation charge over the Hypothecated Collections, Accounts and Deposits in favor of the Investment Agent for the benefit of Sukuk holders.
- A first charge by way of letter of lien over the balances available in the Sukuk Payment Account in favor of the Investment Agent for the benefit of Sukuk holders.
- A lien and right of set-off by way of letter of lien over the balances available in the MRA in favor of the Collection agent for the benefit of the Sukuk holders.

Financial Risk Profile

- Revenues & profitability indicators for FY22 depicted improvement post revival in overall economy post relaxations in lockdown amidst COVID-19.
- However, during 1QFY23, the same were comparatively on the lower side due to the following:
    - Recovery ratio went down to 88.9% (1QFY22: 93.2%) due to increase in consumer tariff, high Fuel cost adjustment, imposition of taxes and current economic conditions
    - Units sent out reduced by 8.9% due to challenging macroeconomic environment, surging inflation and reduction in economic activity.
    - Increase in impairment loss to the tune of Rs. 4b against doubtful debts due to weak capability of the consumer to pay
    - Increase in foreign exchange loss amounted Rs. 2.6b
    - Finance cost increased by Rs. 3.4b due to higher borrowing rates along with higher quantum of debt to finance elevated working capital needs
    - In view of the above, the company reported a net loss of Rs. 16b in 1QFY23.
- Although the company reported losses, comfort to the financial risk profile is garnered from positive cash flow coverages.
- As per management's projections, cash flows that will be generated from operations of the company in FY23 are estimated at Rs. 103b against debt obligations of Rs. 73b. Cash generated from operations includes adjustment of Tariff Differential Claim (TDC) with CPPA-G payables. Furthermore, as per management, in coming months, the monthly TDC is going to be lower than the monthly payable of CPPA-G consequently reducing the net TDC balance by the end of FY23 as compared to FY22.
- Furthermore, comfort is drawn from financing of long term debt servicing including the interest payments through Master Collection Account (MCA) through which consumer collections are trapped and retained to service the debt first before releasing the funds to the Company for other operational uses.
- Improvement in financial risk profile is considered important.
- Capitalization indicators of the Company have continued to swell due to higher working capital needs along with capex to finance planned investments for enhancing capacity and operational efficiencies, indicating higher debt utilization.

As of Sep'22, gearing stood at 1.78x (FY22: 1.57x, FY21: 1.10x). Improvement in the same is considered critical.

K-Electric Limited Appendix I

FINANCIAL SUMMARY *(amounts in PKR billions)*						
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Fixed Assets	277.4	326.5	361.0	424.1	489.2	494.3
Investments	-	-	3.0	3.0	2.9	2.9
Stores, spares and loose tools	11.5	12.1	13.0	16.1	17.1	19.1
Trade Debts	115.4	99.9	99.8	104.7	136.8	106.1
Cash & Bank Balances	1.1	2.7	3.1	2.4	2.8	5.1
Total Assets	473.7	598.9	703.4	835.7	1,060.1	1,108.5
Trade and Other Payables	140.5	190.8	267.6	353.9	439.3	487.8
Long Term Debt *(*incl. current maturity)*	31.5	57.6	83.0	77.3	175.4	187.8
Short Term Debt	41.3	71.9	72.5	107.0	107.5	107.3
Total Debt	72.8	129.5	155.6	184.3	282.9	295.1
Paid Up Capital	96.3	96.3	96.3	96.3	96.3	96.3
Total Equity *(*excluding surplus)*	153.2	148.8	151.4	168.0	180.5	165.6
Total Equity *(*including surplus)*	207.3	214.5	210.7	224.0	250.2	233.8
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Revenue	217.1	289.1	288.8	325.0	518.8	154.5
Gross Profit	45.3	50.7	43.9	59.2	72.4	8.0
Operating Profit	17.0	15.2	17.1	26.5	20.8	(8.8)
Profit Before Tax	13.7	8.9	0.4	15.3	5.7	(15.2)
Profit After Tax	12.3	17.3	(3.0)	12.0	8.6	(16.3)
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**1QFY23**
Gross Margin (%)	20.9%	17.5%	15.2%	18.2%	14.0%	5.2%
FFO	44.0	42.2	25.4	44.6	48.3	33.7
CFO	19.3	(16.9)	21.9	42.3	(26.9)	3.0
FFO to Total Debt (%)	60.5%	32.6%	16.3%	24.2%	17.1%	45.7%
FFO to Long Term Debt (%)	139.9%	73.3%	30.6%	57.7%	27.5%	71.7%
CFO to Total Debt (%)	26.6%	-13.0%	14.1%	22.9%	-9.5%	4.0%
Debt Servicing Coverage Ratio (x)	4.1	3.2	1.6	2.2	1.9	2.6
Gearing (x) (excluding revaluation surplus)	0.48	0.87	1.03	1.10	1.57	1.78
Current Ratio (x)	0.95	0.95	0.92	0.81	0.91	0.90
ROAA (%)	2.8%	3.2%	-0.5%	1.6%	0.9%	-6.0%
ROAE (%)	8.5%	11.4%	-2.0%	7.5%	4.9%	-37.8%

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	Sukuk-6 Issuance
Rating History	

Rating Date	Long Term	Rating Outlook	Rating Action
RATING TYPE: Sukuk-6 (Rs. 6.7b)			
December 29, 2022	AA+	Stable	Final
April 29, 2022	AA+	Stable	Preliminary

Instrument Structure	**Sukuk 6:** KE has issued Sukuk 6 November 23, 2022 which has raised funds to the tune of Rs. 6.7b. It has a tenor of 7 years, with a grace period of 2 years. It is structure as a diminishing musharaka arrangement and will carry profit rate of 3 month KIBOR plus 1.7%.
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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