

RATING REPORT

K-Electric Limited – Short Term Sukuk-26

REPORT DATE:

June 13, 2024

RATING ANALYSTS:

Basel Ali Assad

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RATING DETAILS	Final	Preliminary
	Short-Term	Short-Term
K-Electric Limited – STS-26	A-1+	A-1+
Rating Date	June 13, 2024	May 24, 2024
Rating Action	Final	Preliminary

COMPANY INFORMATION

Incorporated in 1913	External auditors: M/S. A.F. Ferguson & Co, Chartered Accountants.
Public Limited Company	Chairman: Mr. Mark Gerard Skelton
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Syed Moonis Abdullah Alvi
KES Power Limited – 66.4%	
Government of Pakistan – 24.4%	

APPLICABLE METHODOLOGIES

Applicable Rating Criteria: Industrial Corporate

<https://docs.vis.com.pk/docs/CorporateMethodology.pdf>

Rating The Issue

<https://docs.vis.com.pk/docs/Rating-the-Issue-Aug-2023.pdf>

VIS Rating Scale

<https://docs.vis.com.pk/docs/VISRatingScales.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 Limited 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 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 and New Zealand (CAANZ)

Profile of CEO

Mr. Moonis Alvi was appointed CEO of KE 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 KE in 2008 and has served as KE's Chief Financial Officer and other key positions and has played an integral role in the transformation of KE. He is a Fellow member of the Institute of Chartered Accountants of Pakistan.

RATING RATIONALE

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 Limited (KESP) is the major shareholder and holding company of KE. KESP is a consortium comprising Al-Jomaih Group of KSA, National Industries Group of Kuwait and IGC SPV 21, a special purpose vehicle company indirectly owned by Infrastructure and Growth Capital Fund - a private equity fund of several investors. The Government of Pakistan also holds about one-fourth stake in KE.

Short Term Sukuk Issuance:

- KE has raised a rated, unsecured, privately placed Short-term Sukuk (STS-26) amounting up to Rs. 5b (inclusive of green shoe option of Rs. 1b) to finance working capital requirements of the company on June 5, 2024.
- Tenor of the instrument is up to 6 months from the date of drawdown and will be redeemed in bullet at the expiry of tenor.
- Indicative rate on the instrument would be 6M KIBOR + 15 bps per annum.
- Upon review of executed legal documents and issuance of the instrument, rating has been finalized.

Financial Risk Profile:

- Rising socio-political instability, and macroeconomic challenges, including policy rate hike have negatively impacted the revenues and profitability of the Company during FY23. The units sent-out dropped by 7.3% due to overall economic slowdown in FY23. The Company's cash flows and coverages have been adversely impacted in FY23.
- All time high inflation has considerably impacted the consumer's ability to pay which is reflected in sizeable increase in impairment loss booked during FY23.
- Accumulated receivables from Government, continued to strain the working capital of the Company. Increase in fuel prices and non-provision of local gas supply to KE have led to augmentation in Tariff Differential Subsidy (TDS) claims receivables from GoP. Further, increase in effective borrowing rate and higher levels of borrowing due to non-payment from Government entities resulted in net loss for the Company in FY23.
- The Company is focusing on improvements on operational fronts to curtail losses. In addition, the Company remains in continuous engagement with National Electric Power Regulatory Authority (NEPRA) to expedite the determination of pending quarterly tariff variations.
- Amidst uncertain socio-political and macro-economic factors, managing liquidity remained a challenge. However, the Company has managed its cashflow requirements through optimization of working capital and continuous support from banks, capital markets and other financial institutions. Leverage indicators increased considerably on a timeline basis. Going forward, additional loans will be required to fund planned investments in transmission and distribution, being undertaken over the next control period from FY24 to FY30, valued at Rs. 392b.
- KE was awarded an integrated MYT by NEPRA for a control period of 7 years that expired in June 2023. Keeping in view learnings of the MYT 2017-2023 and the ongoing changes in power sector including Distribution (network) and Supply business being separate licensed activities, implementation of Competitive Trading Bilateral Contract Market (CTBCM) model, and the proposed countrywide central economic dispatch, KE is endeavoring for separate tariff determination for each business segment for the period post-June 2023.
- Under the proposed Tariff for the next period i.e., FY24 onwards, KE has proposed indexation mechanism to account for changes in the macroeconomic factors including exchange rate, CPI, KIBOR, LIBOR etc. Accordingly, cost of debt in the proposed tariff will reflect quarterly indexation of KIBOR / LIBOR or SOFR based on actual. Further, KE has requested annual revision in investments due to changes in exchange rate and CPI. With respect to recovery loss, KE has requested recovery loss allowance based on a proposed improvement trajectory. It is to be noted that the proposed structure and salient points under new MYT are in line with existing industry practices and

current tariff structure offered to IPPs, therefore, the company expects that their requests, bar minor adjustments, will be accepted by NEPRA after their due process.

- However, given that the proposed tariff structure is yet to be approved, KE has been unable to finalize quarterly financial statements during the ongoing year. The Company has duly informed apex regulators, namely, SECP and NEPRA of the same.

Company Updates:

- With regards to the latest quarterly tariff adjustment for KE consumers, NEPRA has approved the adjustment till March 2023. NEPRA conducted the hearing in the matter of KE's Quarterly Adjustment for the quarter ending June 2023 on October 19, 2023. The final decision of the Authority is pending. The Company remains in continuous engagement with NEPRA to expedite the determination of pending quarterly tariff variations.
- KE has filed separate tariff petitions for each of its business segments including Generation, Transmission, Distribution & Supply for the period FY24-30. KE's Tariff petition for Generation Segment has been admitted by NEPRA and currently proceedings are in an advanced stage regarding approval of the same. Moreover, KE's investment plan of Rs. 392b has been approved by the regulator. For the Transmission, Distribution and Supply tariff petition, a public hearing is scheduled to take place soon after which the finalization of the said tariffs will begin with the regulator.
- The approved investment plan entails a focus on the utilization of indigenous resources along with renewables (including hydro) which is in line with the National Electricity Policy. The purpose is to add low cost, indigenous fuels-based power projects. Subject to third party studies and regulatory approvals, KE has planned a total addition of 2,272 MW including renewables of approximately 1,282 MW, by FY30. Moreover, the management expects that the overall procedure will be completed by July'24.
- K-Electric's Power Acquisition Programme (PAP) has recently been approved by NEPRA for the period FY 2024-2028. The approved Programme outlines a comprehensive plan to ensure a stable power supply by integrating renewable energy, local fuel, and power off-take from the National Grid.
- The overall control of the Company vests in Board of Directors (BoD) which comprises of thirteen members including the CEO. The majority of the Board is controlled by KES Power Ltd. Where Mr. Mark Gerard Skelton has been appointed by the BOD as Chairman. In October 2022, Mr. Boudewijn Clemens Wentink, Ch. Khaqan Saadullah Khan and Ms. Sadia Khurram resigned from the position of Non-Executive Directors resulting in casual vacancies on the Board. However, KE cannot change its current Board composition in view of (i) an ad-interim order passed by the High Court of Sindh (SHC) in a suit filed by Al Jomaih Power Limited & Denham Investments Limited against IGCF SPV 21 Limited and others; and (ii) a directive issued by Securities and Exchange Commission of Pakistan; restricting the Company to make any change in composition of the Board. However, operations and management of KE continues to operate.
- For distribution and supply of electric power services in its territory, KE's Distribution & Supply Licenses have been renewed by NEPRA for the next 20 years, effective from 19th January 2024.
- Shanghai Electric Power (SEP) had entered into a Sale-and-Purchase Agreement (SPA) with KES Power Limited (holding company), to acquire 66.4% shareholding of KE during Oct'16. SEP issued a fresh Public Announcement of Intention (PAI) for the acquisition during July'23 which was valid for 180 days and was followed by a 90-day extension received during Jan'24. However, the extension expired during April'24 as regulatory approvals pertaining to the transaction remained pending. As per applicable law, SEP is entitled to make a fresh PAI at any time going forward.
- Moreover, during Jan'24, KE signed several agreements with the government to resolve long-standing disputes, particularly related to the a) firm supply of power from the National Grid to Karachi up to the interconnection capacity and b) subsidy to be received from the GoP. Both parties have signed-off on the Tariff Differential Subsidy Agreement (TDA) and the Power Purchase Agency Agreement (PPAA). In addition, the Interconnection Agreement (ICA) has been signed between NTDC and K-Electric in Feb 2024 which aims at providing use of the NTDC Transmission facilities to KE for receiving power through the NTDC Transmission system at various connecting sites. Additionally, a Mediation Agreement (MA) was signed and agreed upon which related to legacy contentions on payables and receivables between the Company and government entities.
- NEPRA granted approval for all three Request for Proposals (RFPs) submitted by the Company related to the addition of 640 MW of renewable power projects under IPP mode. These projects

include 150 MW at Vinder and Bela, 270 MW GOS Solar (in collaboration with Government of Sindh) and 220 MW Site Neutral Hybrid Renewable Project. The above additions in KE's Fleet are aligned with the Company's objectives to achieve 30% renewable generation mix by 2030 through wind, solar and hydel power projects. Building the capacity to evacuate power and meet the growing demand requires sustained investments in grids and interconnection infrastructure including KE's first-ever 500kv network.

- Going forward, materialization of favorable outcomes in terms of operational improvements, tariff petitions and planned energy projects would remain key rating factors.

K-Electric Limited
Appendix I

FINANCIAL SUMMARY			
	<i>(amounts in PKR billions)</i>		
<u>BALANCE SHEET</u>	FY21	FY22	FY23
Fixed Assets	424.1	489.2	580.2
Investments	3.0	2.9	2.9
Stores, spares and loose tools	16.1	17.1	18.7
Trade Debts	104.7	136.8	104.3
Other Receivables	275.0	375.2	239.4
Cash & Bank Balances	2.4	2.8	7.1
Total Assets	835.7	1,060.1	1,024.7
Trade and Other Payables	353.9	438.1	357.9
Long Term Debt <i>(*incl. current maturity)</i>	77.3	175.5	216.8
Short Term Debt	107.0	107.5	92.9
Total Debt	184.3	283.1	309.8
Paid Up Capital	96.3	96.3	96.3
Tier-1 Equity <i>(*excluding surplus)</i>	168.0	180.5	153.7
Total Equity <i>(*including surplus)</i>	224.0	250.2	255.2
<u>INCOME STATEMENT</u>	FY21	FY22	FY23
Revenue	325.0	518.8	519.5
Gross Profit	59.2	68.5	52.8
Operating Profit	26.5	20.8	(7.8)
Profit Before Tax	15.3	5.6	(42.4)
Profit After Tax	12.0	8.5	(30.9)
<u>RATIO ANALYSIS</u>	FY21	FY22	FY23
Gross Margin (%)	18.2%	13.2%	10.2%
Net Margin (%)	3.7%	1.6%	-5.9%
FFO	44.2	52.3	16.6
CFO	42.3	(25.7)	60.8
FFO to Total Debt (%)	24.0%	18.5%	5.3%
FFO to Long Term Debt (%)	57.2%	29.8%	7.6%
CFO to Total Debt (%)	22.9%	-9.1%	19.6%
Debt Servicing Coverage Ratio (x)	2.25	1.96	0.90
Current Ratio (x)	0.81	0.91	0.80
ROAA (%)	1.6%	0.9%	-
ROAE (%)	7.5%	4.9%	-
Gearing (x) (excluding revaluation surplus)	1.10	1.57	2.02
Debt Leverage	3.64	4.49	5.01

REGULATORY DISCLOSURE		Appendix II												
Name of Rated Entity	K-Electric Limited													
Sector	Power													
Type of Relationship	Solicited													
Purpose of Rating	STS-26 Issuance													
Rating History	<table border="1"> <thead> <tr> <th>Rating Date</th> <th>Short Term</th> <th>Rating Action</th> </tr> </thead> <tbody> <tr> <td colspan="3" style="text-align: center;"><u>RATING TYPE: STS-26 (Rs. 5b)</u></td> </tr> <tr> <td>13/June/2024</td> <td>A-1+</td> <td>Final</td> </tr> <tr> <td>24/May/2024</td> <td>A-1+</td> <td>Preliminary</td> </tr> </tbody> </table>		Rating Date	Short Term	Rating Action	<u>RATING TYPE: STS-26 (Rs. 5b)</u>			13/June/2024	A-1+	Final	24/May/2024	A-1+	Preliminary
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Instrument Structure	K ELECTRIC LIMITED – STS-26: KE has raised Rs. 5b (inclusive of green shoe option of 1b) to finance its working capital requirements of the company by way of Short Term Sukuk issuance at a face value of Rs. 1m each or in multiples thereof. Tenor of the STS is 6 months, with repayment by way of a single bullet payment. Indicative rate on the instrument would be 6-month KIBOR + 15 bps p.a.													
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