Kot Addu Power Company Limited

Chairman: Mr. Zafar Mahmood; Chief Executive: Mr. Aftab Mahmood Butt

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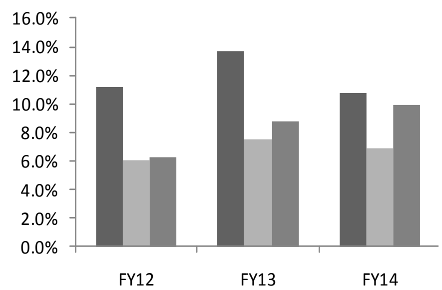
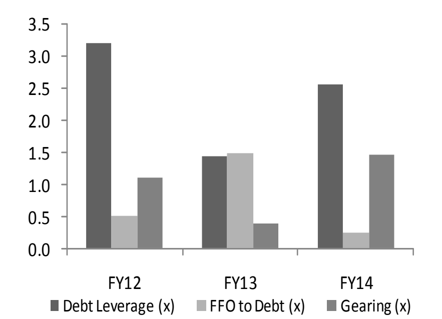
Analysts: Maimoon Rasheed
Syed Adil Hussain

Category	Latest	Previous
Entity	AA+/A-1+	AA+/A-1+
	Dec 29,'13	*Sept 20,'13*
Outlook	*Stable*	*Stable*
	Dec 29,'13	*Sept 20,'13*

Key Financial Trends





(Rs. billion)	FY12	FY13	FY14
Net Sales	100.5	97.5	113.2
Net Profit	6.1	7.4	7.7
Equity	23.7	25.5	26.8
Total Debt	26.1	9.9	39.5
Gearing (x)	1.1	0.4	1.5
Debt Leverage (x)	3.2	1.4	2.6
FFO	13.5	14.7	9.6
FFO/Total Debt (x)	0.52	1.48	0.24
ROAE (%)	25.5	29.9	29.6
ROAA (%)	6.2	9.1	9.8

Rating Rationale

Kot Addu Power Company Limited (KAPCO) is the largest Independent Power Plant (IPP) operating in Pakistan in terms of installed capacity and second largest in terms of generation. The company has a 25 year 'take or pay' power purchase agreement (PPA) with Pakistan Water and Power Development Authority (WAPDA) to provide electricity to the off-taker. Government guarantee on payments from WAPDA remains a key rating factor.

A sizable gap between billing and recovery of electricity has led to accumulation of inter-corporate debt in the power sector. Meanwhile, cost of generation in Pakistan has remained high owing to an expensive fuel mix with oil & gas contributing 64% of the total electricity generated and high transmission and distribution losses. A more permanent solution for reduction in the inter-corporate debt rests in utilizing a cheaper energy mix.

As anticipated, despite the government's preliminary effort on reducing circular debt via lump sum payments to IPPs before end-FY13, inter-corporate debt has started to pile up again. Resultantly, trade debts of the company increased to Rs. 66.1b (end-FY13: Rs. 34.2b) of which Rs. 50.8b (end-FY13: Rs. 21.2b) was overdue by end-FY14. As per PPA, a 25 day credit period is available to WAPDA; failing which WAPDA is charged a penalty on overdue invoices at SBP discount rate + 4%.

The company avails short term credit lines for working capital requirements. Recently, the company has been able to avail short term borrowings at an average markup rate of 1-6 month Kibor + 0.9% vis-à-vis an average rate of 1-6 months Kibor + 1.5% in FY14. As per oil supply agreement, the company's sole fuel supplier 'Pakistan State Oil' (PSO) charges the company markup at 6 month T-bill rate + 6% on outstanding payables. Despite no credit period available from PSO, a certain amount of payments are delayed to fulfill financial commitments like cash dividend payout. Mark-up differential on overdue trade debts and delayed payments to PSO cause an arbitrage loss to the company. However, on account of relatively low magnitude of average PSO payables, the said loss is considered manageable.

In order to finance accumulation in trade debts, short term borrowings increased to Rs. 37.1b (FY13: Rs. 5.5b) by end-FY14. While there is room in credit lines available to the company (Rs. 50b), cushion is kept for unforeseen circumstances. Payables outstanding to PSO increased to Rs. 7b (end-FY13: Rs. 4.4b) by end-FY14. FFO to total debt declined to 0.24 (FY13: 1.48, FY12: 0.52), owing to both; accretion in short term borrowings and lower FFO.

Over the years, WAPDA has raised invoices for Liquidated Damages (LDs) to the company on account of low electricity dispatched than contracted under the PPA. LDs invoiced to the company increased to Rs. 20.5b (end-FY13: Rs. 12.6b) by end-FY14. However, no provision against LDs has been made. As per management, the reason for low electricity dispatch was owing to the company's inability to procure fuel as payments from WAPDA was delayed. The company has been in litigation against these claims.

KAPCO's revenue is derived from two sources namely Energy Purchase Price (EPP) and Capacity Purchase Price (CPP) with the former being a pass through item while the latter being the primary driver of profitability. GoP guarantee on CPP payments, despite the level of off-take by WAPDA, mitigates the company's business risk. During FY14, electricity dispatched by KAPCO increased to 6,479 (FY13: 5,521 GWh, FY12: 6,065 GWh) translating into higher EPP recognized. Gross margins declined to 10.8% (FY13: 13.7%, FY12: 11.2%) owing to a relatively lower proportion of CPP in total revenue. Moreover, finance cost declined to Rs. 4.6b (FY13: Rs. 8b) mainly on account of lower average fuel supplier payables during FY14. Thereby, net profit improved during FY14. KAPCO employs a high dividend payout ratio; given stressed cash flows, the company may need to revisit its dividend policy.

The company is conducting a feasibility study on setting up a 660MW coal based power plant in Bhikki, Punjab. Materialization of the same may take some time as certain issues relating to transportation of coal with Pakistan Railways need to be addressed. The board of directors witnessed some changes as 3 new directors were appointed in FY14. The new board members bring decades of experience in power and banking sector.

Overview of the Institution

KAPCO owns, operates and maintains a multi fuel fired power plant in District Muzaffargarh, Punjab with a nameplate capacity of 1,600MW and dependable capacity of 1,342MW. The company is listed at Karachi, Lahore and Islamabad Stock Exchanges. Financial statements for FY14 have been audited by A. F. Ferguson & Co. – Chartered Accountants JCR-VIS