

## RATING REPORT

### KotAddu Power Company Limited (KAPCO)

**REPORT DATE:**
8<sup>th</sup> January, 2019
**RATING ANALYSTS:**

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#### RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA+	A-1+	AA+	A-1+
Rating Outlook	Stable		Stable	
Rating Date	12/31/2018		12/18/2017	
Rating Action	Reaffirmed		Reaffirmed	

#### COMPANY INFORMATION

Incorporated in 1996	External Auditors: Deloitte Yousuf Adil, Chartered Accountants
Public Limited Company	Chairman: Lt. General (R) Muzammil Hussain
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Mr. Aftab Mahmood Butt
WAPDA- 40.3%	
Allied Bank Limited- 10.0%	
United Bank Limited- 9.0%	
KAPCO Employees Empowerment Trust- 5.5%	

#### APPLICABLE METHODOLOGY

Rating Methodology: Industrial Corporate (May 2016)

<http://www.jcrvis.com.pk/kc-meth.aspx>

## KotAddu Power Company Limited (KAPCO)

### OVERVIEW OF THE INSTITUTION

KAPCO owns, operates and maintains a multi-fuel fired power plant in District, Muzaffargarh, Punjab with a nameplate capacity of 1600MW and dependable capacity of 1342MW. The Company is listed on Pakistan Stock Exchange (PSX). For FY19, Deloitte Yousaf Adil – Chartered Accountants have been appointed as external auditors.

#### Profile of Chairman

Lt. General Muzammil Hussain (Retd.) is a reputed ex-army person and has served army for 31 years. He has been appointed chairman of Pakistan Water & Power Development Authority (WAPDA).

#### Profile of CEO

Management team is headed by Mr. Aftab Mahmood Butt who is the Chief Executive Officer. Mr Aftab is a chartered accountant and previously served on the boards of Central Power Purchasing Limited & Lahore Stock Exchange Limited.

#### Financial Summary

**Assets:** 1QFY19: Rs. 148.2b, FY18: Rs. 138.5b, FY17: Rs. 116.0b  
**Equity:** 1QFY19: Rs. 38.2b, FY18: Rs. 35.1b, FY17: Rs. 32.5b  
**PAT:** 1QFY19: Rs. 3.1b, FY18: Rs. 10.6b, FY17: Rs. 9.4b

### RATING RATIONALE

The ratings assigned to KotAddu Power Company Limited (KAPCO) take into account its strong ownership profile being majority owned by Government of Pakistan (GoP) through their representative Water and Power Development Authority (WAPDA). The ratings draw strength from the company's strong business risk profile with demand risk mitigated under Power Purchase Agreement (PPA) signed with WAPDA. The company has a distinct advantage of having sovereign as the major shareholder, power purchaser and supplier. The ratings also draw comfort from government guaranteed cash flow stream under the agreement upon meeting certain performance benchmarks. However, the mounting inter-corporate debt is a challenge for maintaining the financial risk profile of the company. Given the expiry of PPA in June, 2021, the ratings will depend on the company's negotiation regarding operational terms and conditions with the government.

#### Rating Drivers

##### **Improved profitability owing to higher energy dispatch and forex exchange gain:**

Positive impetus in earnings was witnessed during FY18 on account of higher power dispatch. However, gross margins declined in line with two major overhauls and increase in fuel prices. The administrative expenses were largely rationalized; however, other operating expenses stood higher as a result of charges associated to acquisition process, which was shelved subsequently. Moreover, as an outcome of increased utilization of short-term borrowing, financial expense was recorded higher in FY18.

Other income stood higher at Rs. 9.5b (FY17: Rs. 5.0b) as a result of higher interest income received/receivables from WAPDA on account of late payment on average receivable balance related to inter-corporate debt along with true-up income realized in line with considerable change in USD parity with Pak Rupee. Subsequently, with higher other income offsetting the impact of reduced margins and higher finance cost, the profit after taxation was recorded higher during FY18 as compared to preceding year. The positive momentum in sales continued during the ongoing year as a result of which profit for 1QFY19 was reported higher than the corresponding period. With the recent inclusion of some relatively more efficient thermal power plant and hydel projects coming online, KAPCO has been shifted downward in merit list. Resultantly, sales of the company may get hampered, however, upholding operational performance in line with agreed performance levels would remain a key rating driver.

**Liquidity profile is supported by healthy cash flows and strong debt servicing:** The receivables of the company increased by end-1QFY19 on account of deterioration of

payment behavior of the power purchaser. Resultantly, receivable days increased to 459days (FY17: 329days) by end-FY18. Around two-thirds of the receivables were overdue for more than two months at end-FY18. Given a sizeable proportion of asset base of the company is tied up in receivables, liquidity position of the company continues to remain stressed. However, the trade debts are secured by the guarantee from Government of Pakistan (GoP) under the facilitation agreement. The receivables are incurred in the normal course of business and are interest free. However, a penal mark-up of SBP discount rate plus 4 percent per annum is charged in case the amounts are not cleared within due dates. Further, in line with increase in scale of operations, Funds from Operations (FFO) of the company exhibited an improving trend on a timeline basis. Subsequently, debt service coverage ratio improved during the review period and exhibits strong capacity of the company to timely service debt repayments falling due in the medium to long-term horizon.

**Arbitration proceedings initiated against WAPDA related to liquidity damages imposed on the company:** WAPDA has raised invoices for liquidated damages against the company amounting Rs. 27.9b as of end-FY18. The company rejects these claims on the premise that its failure to dispatch electricity was due to WAPDA's nonpayment of dues on timely basis. By end-1QFY18, the company initiated arbitration proceedings in Singapore under the arbitration rules of the international Chamber of Commerce. GoP has also been made a party to the arbitration as it has issued a guarantee in favor of the company. The arbitration has commenced pursuant to the provisions of the PPA. KAPCO has requested to nullify the liquidated damages wrongly imposed on them and enforced its right to claim Rs. 2.4b comprising the net losses incurred which were not covered by interest payment. Therefore, the company has not booked any provision against the liquidated damages.

**Capitalization related indicators improving due to periodic repayment of long-term and debt and profit retention:** Paid-up capital of KAPCO amounted to Rs. 8.8b at end-1Q19 while total equity witnessed modest increase owing to higher accumulated profits. The company continues to pay regular cash dividend to its shareholders. To bridge its working capital requirements, the company has to finance through a mix of short term borrowings and increased payables to PSO. During FY18, the company fully discharged its obligation to WAPDA in accordance with the provisions of the Note Agreement; the long term loan now stands fully paid. As a result of repayment of long-term debt, gearing and debt leverage declined on a timeline basis by end-1QFY19.

<b>KotAddu Power Company Limited</b>				Appendix I
<i>(Amounts in PKR Millions)</i>				
<b><u>BALANCE SHEET</u></b>	<b>30-Jun-16</b>	<b>30-Jun-17</b>	<b>30-Jun-18</b>	<b>30-Sept-18</b>
Fixed Assets	12,759	11,047	8,663	8,079
Other Assets	6,344	8,424	6,908	5,904
Stock in Trade	3,135	5,914	6,718	3,446
Trade Debts	69,377	89,987	115,472	130,107
Cash & Bank Balances	598	629	685	656
Total Assets	92,213	116,001	138,446	148,192
Trade and Other Payables	16,397	34,169	49,755	54,218
Long Term Debt (*incl. current maturity)	1,003	475	54	50
Short Term Debt	41,346	46,133	49,875	51,716
Other Liabilities	2,512	2,721	3,669	4,000
Total Equity	30,955	32,503	35,093	38,208
<b><u>INCOME STATEMENT</u></b>	<b>30-Jun-16</b>	<b>30-Jun-17</b>	<b>30-Jun-18</b>	<b>30-Sept-18</b>
Revenue	64,178	81,846	91,916	31,595
Gross Profit	13,408	14,180	13,379	3,617
Operating Profit	16,920	18,498	21,995	6,513
Profit After Tax	9,071	9,447	10,617	3,116
FFO	10,028	11,439	17,014	5,192
<b><u>RATIO ANALYSIS</u></b>	<b>30-Jun-16</b>	<b>30-Jun-17</b>	<b>30-Jun-18</b>	<b>30-Sept-18</b>
Gross Margin (%)	20.9	17.3	14.6	11.5
FFO to Total Debt (x)	0.24	0.25	0.34	0.40
FFO to Long Term Debt (x)	10.0	24.0	312.0	414.0
Debt Servicing Coverage Ratio (x)	3.7	3.5	5.4	6.4
ROAA (%)	9.6	9.1	8.4	9.2
ROAE (%)	29.9	29.8	31.4	34.0

<b>Gearing (x)</b>	1.37	1.43	1.42	1.35
<b>Debt Leverage (x)</b>	1.98	2.57	2.95	2.88

**ISSUE/ISSUER RATING SCALE & DEFINITIONS**

**Appendix II**

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:** JCR-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.jcrvis.com.pk/images/criteria\\_watch.pdf](http://www.jcrvis.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.jcrvis.com.pk/images/criteria\\_outlook.pdf](http://www.jcrvis.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.

**'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.jcrvis.com.pk/images/policy\\_ratings.pdf](http://www.jcrvis.com.pk/images/policy_ratings.pdf)

**'SD' Rating:** An 'SD' rating is assigned when JCR-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.

<b>REGULATORY DISCLOSURES</b>		<b>Appendix III</b>			
<b>Name of Rated Entity</b>	KotAddu Power Company Limited (KAPCO)				
<b>Sector</b>	Power				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	12/31/2018	AA+	A-1+	Stable	Reaffirmed
	12/18/2017	AA+	A-1+	Stable	Reaffirmed
	11/28/2016	AA+	A-1+	Stable	Reaffirmed
	11/20/2015	AA+	A-1+	Stable	Reaffirmed
	12/29/2014	AA+	A-1+	Stable	Reaffirmed
	9/20/2013	AA+	A-1+	Stable	Reaffirmed
	5/3/2012	AA+	A-1+	Stable	Reaffirmed
	2/21/2011	AA+	A-1+	Stable	Reaffirmed
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