# RATING REPORT

# Kot Addu Power Company Limited

**REPORT DATE:**
December 14, 2020

**RATING ANALYSTS:**
Asfia Aziz
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## RATING DETAILS

| | Latest Rating | | Previous Rating | |
|---|---|---|---|---|
| Rating Category | Long-term | Short-term | Long-term | Short-term |
| **Entity** | AA+ | A-1+ | AA+ | A-1+ |
| **ICP/STS** | A-1+ | | A-1+ | |
| **Entity Rating Action** | *Maintained* | | *Reaffirmed* | |
| **Rating Outlook** | *Rating Watch-Developing* | | *Stable* | |
| **Entity Rating Date** | *Dec 14, 2020* | | *Dec 02, 2019* | |

## COMPANY INFORMATION

| | |
|---|---|
| **Incorporated in 1996** | **External auditors:** Deloitte Yousuf Adil, Chartered Accountants |
| **Public Limited Company** | **Chairman:** Lt. General (R) Muzammil Hussain<br>**CEO:** Mr. Aftab Mahmood Butt |
| **Key Shareholders (with stake 5% or more):** | |
| WAPDA – 40.3% | |
| United Bank Limited – 7.9% | |
| KAPCO Employees Empowerment Trust – 5.5% | |

## APPLICABLE METHODOLOGY(IES)

**VIS Entity Rating Criteria: Corporates (May 2019)**
*https://www.vis.com.pk/kc-meth.aspx*

# Kot Addu Power Company Limited

## OVERVIEW OF THE INSTITUTION

KAPCO owns, operates and maintains a multi-fuel (gas, furnace oil and high speed diesel) fired power plant in District, Muzaffargarh, Punjab with a nameplate capacity of 1600MW and dependable capacity of 1342MW (on gas). The Company is listed on Pakistan Stock Exchange (PSX). For FY20, Deloitte Yousuf Adil – Chartered Accountants – have been appointed as external auditors.

**Profile of the 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). His other Directorships are on the Board of Directors on Neelum Jhelum Hydroelectric Company Limited, Diamer Basha Dam Company, Pakistan Cricket Board and Private Power Infrastructure Board.

**Profile of the CEO**

Management team is headed by Mr. Aftab Mahmood Butt who is the Chief Executive Officer. Mr. Aftab is a chartered accountant by profession and previously served on the boards of Central Power Purchasing Limited & Lahore Stock Exchange Limited. His other professional experience includes the position of Member Finance & Secretary Board in the Corporate and Industrial Restructuring Corporation, Ministry of Finance, Government of Pakistan.

## RATING RATIONALE

The ratings assigned to Kot Addu Power Company Limited (KAPCO) take into account its strong ownership profile being majority owned by Government of Pakistan (GoP) through its representative Water and Power Development Authority (WAPDA). The ratings draw strength from the company's strong business profile with demand risk mitigated under Power Purchase Agreement (PPA) signed with WAPDA. The ratings also draw comfort from government guaranteed cash flow stream under the agreement upon meeting certain performance benchmarks. Moreover, upholding operational performance in line with agreed performance levels would remain a key rating driver. Given the expiry of PPA in June'2021, the ratings depend on the company's negotiation regarding operational terms and conditions with the government.

**Operational Highlights**

| Load Factor and Capacity | FY18 | FY19 | FY20 |
|---|---|---|---|
| Average annual load dispatched (%) | 63% | 42% | 30% |
| Energy dispatched (GWH) | 7,437 | 4,961 | 3,477 |
| Annual dependable capacity (MWH) | 11,756 | 11,756 | 11,788 |
| Availability | 86% | 91.80% | 88.90% |
| Thermal Efficiency | 44.00% | 44.00% | 44.40% |

Load factor of the company has been declining on a timeline basis owing to new cheaper power producers that commenced operations over the last couple of years which have outranked the company in the economic merit order. As per management, KAPCO's system is largely utilized by the GoP during peak seasons. The company sold 3,477 GWh of electricity to the GoP representing a load factor of 29.5%, availability of 96.8%, and thermal efficiency of 44.4% during FY20. Fuel generation mix noted a shift towards RLNG contributing 72.6% (FY19: 71%) in the mix given higher avaialbility of the same, followed by 27.2% on low sulphur furnace oil and 0.2% on HSD. During winters of the ongoing year, the plant shall operate on FO as the GoP has specifically allowed import of 200,000MT of FO. This exception has been allowed as KAPCO's plant acts as a substitute to the hydel power plants that do not operate during winters.

**Rating Drivers**

**Expiry of existing PPA; extension may be given at different terms**

The existing PPA is set to expire in June 2021, the management is of the view that there is a strong likelihood of government extending the PPA. However, the same is expected to materialize on rather different terms entailing take & pay terms; leading to reduction in ROE component of tariff. As per management, given large installed capacity, the only multi-fuel operated plant in the country, decent throughput, absence of debt component in the tariff, and ability to assist in regulating voltage frequency; probability of PPA extension is higher, though at different terms and conditions. Meanwhile, due to outset of some relatively newer and more efficient thermal power plants, KAPCO has been shifted downward on the merit list. Consequently, sales of the company have witnessed a downward trend over the past two years.

**Impact of MOU signed with the GoP**

Recently, in August'20, the GoP has signed an MOU with certain Independent Power Producers of the country to enhance its savings and consequently reduce the circular debt of the power sector that was recorded at Rs. 2.1tr at end-Oct'20. In lieu of the same, following are the implications of the same on KAPCO:

- Existing capacity payments and variable O&M shall be reduced by 11%
- $ exchange rate and US CPI indexation shall be discontinued on 50% of the reduced capacity payment (rate of Rs. 168)
- The company will participate in the Competitive Trading Arrangement when the same is implemented and fully operational.

**Despite decline in sales revenue, profitability profile of the company improved during FY20 and 1QFY21 due to declining fuel prices, higher efficiency with the plant running on RLNG, and interest income on late payments by WAPDA.**
Revenue of the company was recorded at Rs. 71.5b (FY20: Rs. 84.8b) during FY20 due to lower quantum of energy dispatched. Decline in energy purchase price was off-set by higher capacity payments in the outgoing year. Sales revenue was reported higher at Rs. 23.4b during 1QFY21 due to higher output with load factor reported at 56.8%. Gross margins improved significantly to 30% (FY19: 16.7%) during FY20 mainly on account of higher proportion of CPP component, lower fuel & power cost and higher efficiency due to the plant running majorly on RLNG. Increase in administrative expense to Rs. 873m (FY19: Rs. 708m) was primarily a function of cost related to arbitration proceedings owing to dispute over amount of liquidated damages. Overall profitability of the company was supported by other income amounting Rs. 20.9b (FY19: Rs. 13.8b) majorly encompassing interest receivable on late payment from WAPDA (penal interest) and higher realized true-up income resulting from change in USD-PKR exchange rate exceeding the limit defined in PPA and its difference with the rates used for dollar indexation of relevant CPP invoices. Accounting for taxation, the company recorded higher net income of Rs. 23.6b (FY19: Rs. 13.1b) during FY20. Net profit after tax for 1QFY21 was reported at Rs. 6.2b.

**Liquidity damages – Arbitration proceedings:** On March 29, 2018, the company commenced arbitration proceedings in Singapore against WAPDA and Central Power Purchasing Agency (Guarantee) Limited (CPPA-G) under the arbitration rules of International Chamber of Commerce (ICC) to nullify the liquidated damages of Rs. 27.7b imposed by WAPDA/CPPA-G, and to enforce its right to claim Rs. 2.4b comprising the company's net losses not otherwise covered by penal interest. The GoP was also made a party to the arbitration proceedings pursuant to the Facilitation Agreement and it issued guarantee in favor of the company. The ICC Tribunal, in its Partial Award (received on June 10, 2019), dismissed the challenge by WAPDA to the jurisdiction of the ICC Tribunal. The ICC Tribunal further held that it has no jurisdiction over CPPA-G and GoP. The arbitration proceedings will continue between WAPDA and the company, going forward. According to the legal advice, there are sufficient grounds to defend any claim by WAPDA as these conditions were imposed on the company due to circumstances beyond its control. Resultantly, no provision has been made for such liquidated damages in the financial statements.

**Liquidity indicators remained intact conforming to healthy cash flows and strong debt servicing**
The trade debts of the company accumulated to Rs. 125.4b by the end-1QFY21 (FY20: Rs. 119.9b). These include an overdue amount of Rs. 106.8b (FY20: Rs. 99.4b) receivable from WAPDA due to delay in payments. However, these are secured by sovereign guarantee from the GoP under the Facilitation agreement and are in normal course of business. Albeit these are interest free, a late payment surcharge of Discount rate plus 4% per annum is charged in case the amounts are not cleared within due dates. In line with higher profits, funds from Operation (FFO) amounted higher at Rs. 27.5b and Rs. 7.6b (FY19: Rs. 18.6b) during FY20 and 1QFY21. Healthy cash flow coverages to total debt and DSCR at comfortable levels indicate strong liquidity profile of the company.

**Sound capitalization profile as evident from healthy internal capital generation and long-term debt free balance sheet**
Equity base of the company increased to Rs. 66.5b (FY20: Rs. 60.3b, FY19: Rs. 41.2b) by end-1QFY20. Retention ratio of the company during FY20 and 1QFY21 were reported at 94% and 79%, respectively resulting in healthy equity growth. KAPCO funds its working capital requirements, mainly trade debts, through short-term borrowings, trade payables and internally generated cash flows. The company has to pay relatively higher interest on trade payables to suppliers (SNGPL and PSO). However, financing of trade payables with relative low-cost short-term borrowings provides a positive arbitrage for the company vis-à-vis interest received on accumulated trade debts. Subsequent to issuance of Pakistan Energy Sukuk (PES) II of Rs. 200b by Power Holding Limited (PHL), KAPCO has received Rs. 12b against overdue receivables in June'20. Resultantly, the company has reduced the utilization of short-term financing during FY20 and 1QFY21. As a result of improved liquidity, the company repaid payables to PSO & SNGPL (impact of decline was partially offset by increase in deferred liabilities) and a decline in utilization of short term debt was noted. Consequently leverage and gearing indicators of the company improved to 1.08x (FY20: 1.23x, FY19: 2.38x) and 0.60x (FY20: 0.73x, FY19: 1.32x), respectively at end 1QFY20.

## Kot Addu Power Company Limited Annexure I

| FINANCIAL SUMMARY *(amounts in PKR millions)* | | | | | |
|---|---|---|---|---|---|
| **BALANCE SHEET** | **FY17** | **FY18** | **FY19** | **FY20** | **1QFY21** |
| Fixed Assets | 10,813 | 8,565 | 6,337 | 4,106 | 3,570 |
| Long term Investments | - | - | - | - | - |
| Stock-in-Trade | 5,914 | 6,718 | 9,466 | 2,701 | 1,731 |
| Trade Debts | 89,987 | 115,472 | 115,798 | 119,904 | 125,386 |
| Cash & Bank Balances | 630 | 685 | 1,350 | 835 | 800 |
| Total Assets | 116,001 | 138,446 | 139,267 | 134,523 | 138,175 |
| Trade and Other Payables | 34,169 | 49,755 | 40,139 | 20,785 | 21,468 |
| Long Term Debt | 476 | 54 | 38 | 25 | 22 |
| Short Term Debt | 46,133 | 49,875 | 54,180 | 44,062 | 39,750 |
| Total Debt | 46,609 | 49,929 | 54,218 | 44,088 | 39,773 |
| Paid Up Capital | 8,803 | 8,803 | 8,803 | 8,803 | 8,803 |
| Total Equity | 32,503 | 35,093 | 41,161 | 60,351 | 66,552 |
| | | | | | |
| **INCOME STATEMENT** | | | | | |
| Net Sales | 81,847 | 91,916 | 84,831 | 71,543 | 23,400 |
| Gross Profit | 14,180 | 13,379 | 14,205 | 21,478 | 5,803 |
| Operating Profit | 18,498 | 21,995 | 27,269 | 41,412 | 9,634 |
| Profit Before Tax | 14,073 | 15,808 | 18,963 | 32,954 | 8,741 |
| Profit After Tax | 9,447 | 10,617 | 13,112 | 23,613 | 6,202 |
| | | | | | |
| **RATIO ANALYSIS** | | | | | |
| Gross Margin (%) | 17.3% | 14.6% | 16.7% | 30.0% | 24.8% |
| Net Margin (%) | 11.5% | 11.6% | 15.5% | 33.0% | 26.5% |
| Net Working Capital | 23,658 | 29,179 | 36,193 | 64,722 | 72,543 |
| Trade debts/Sales | 110% | 126% | 137% | 168% | 134% |
| FFO | 11,439 | 17,014 | 18,608 | 27,489 | 7,619 |
| FFO to Total Debt (%) | 25% | 34% | 34% | 62% | 77% |
| FFO to Long Term Debt (%) | 2404% | 31249% | 48863% | 108426% | 136155% |
| Debt Servicing Coverage Ratio (x) | 3.4 | 5.4 | 3.7 | 3.4 | 6.8 |
| Current Ratio (x) | 1.3 | 1.3 | 1.4 | 2.0 | 2.2 |
| Stock+ Trade Debts/STD | 208% | 245% | 231% | 278% | 320% |
| Gearing (x) | 1.43 | 1.42 | 1.32 | 0.73 | 0.60 |
| Leverage (x) | 2.57 | 2.95 | 2.38 | 1.23 | 1.08 |
| ROAA (%) | 10% | 8% | 9% | 17% | 18% |
| ROAE (%) | 31% | 31% | 34% | 47% | 39% |

# 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 DISCLOSURES — Appendix III

| | |
|---|---|
| **Name of Rated Entity** | Kot Addu Power Company Limited |
| **Sector** | Power |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Ratings |

**Rating History**

| Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
|---|---|---|---|---|
| **RATING TYPE: ENTITY** | | | | |
| 12/14/2020 | AA+ | A-1+ | Rating Watch Developing | Maintained |
| 12/02/2019 | AA+ | A-1+ | Stable | Reaffirmed |
| 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 |
| 5/03/2012 | AA+ | A-1+ | Stable | Reaffirmed |
| 2/21/2011 | AA+ | A-1+ | Stable | Reaffirmed |
| **RATING TYPE: CP/STS** | | | | |
| 09/09/2020 | | A-1+ | | Preliminary |

| | |
|---|---|
| **Instrument Structure** | KAPCO is issuing a series of rated, privately placed, Islamic Commercial Paper (ICP) / Short-term Sukuk (STS) of up to Rs. 15.0b, inclusive of green-shoe option of Rs. 3.0b. The instrument will be issued in three tranches, with each tentatively amounting to Rs. 5.0b inclusive of green-shoe option of Rs. 1.0b. The proceeds of the issue will be utilized by the company to meet its 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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**Due Diligence Meetings Conducted**

| Name | Designation | Date |
|---|---|---|
| Mr. Zubair Aslam | Manager Treasury | Nov-12-2020 |
| Mr. Rabnawaz Anjum | CFO | Nov-12-2020 |