RATING REPORT

Kot Addu Power Company Limited

REPORT DATE:
December 10, 2021

RATING ANALYSTS:
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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*		*Maintained*	
Rating Outlook	*Rating Watch-Developing*		*Rating Watch-Developing*	
Entity Rating Date	*Dec 9, 2021*		*Dec 14, 2020*	

COMPANY INFORMATION

Incorporated in 1996	**External auditors:** A. F. Ferguson & Co. Chartered Accountants
Public Limited Company	**Chairman:** Lt. General (R) Muzammil Hussain **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: Corporate Rating Methodology (August, 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Kot Addu Power Company Limited

OVERVIEW OF THE INSTITUTION

KAPCO was incorporated in Pakistan on April 25, 1996 as a public limited company under the Companies Ordinance, 1984 (now Companies Act, 2017). The Company was listed on April 18, 2005 on Pakistan Stock Exchange Limited. The Company has a plant site, a corporate office and a registered office. The Company has a plant site at Kot Addu, a corporate office located in Lahore and registered office located in Islamabad.

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 Guarantee 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

Kot Addu Power Company Limited (KAPCO or 'the Company'), was incorporated in Pakistan on April 25, 1996 as a public limited company under the Companies Ordinance, 1984 (now Companies Act, 2017). The Company was listed on April 18, 2005 on Pakistan Stock Exchange Limited. The principal activities of the Company are to own, operate and maintain a multi-fuel fired power station with fifteen generating units with a nameplate capacity of 1,600 MW in Kot Addu, District Muzaffargarh, Punjab, Pakistan and to sell the electricity produced therefrom to a single customer, Pakistan Water and Power Development Authority (WAPDA) under a Power Purchase Agreement (PPA), which has been extended by 16 months during the current year and is due to expire on October 24, 2022. WAPDA has irrevocably transferred all of its rights, obligations and liabilities under the PPA to Central Power Purchasing Agency Guarantee Limited (CPPA-G) (Power Purchaser) thereunder via Novation Agreement which became effective on May 21, 2021 after approval from the relevant authorities

<u>Business Update</u>

Update on PPA & Generation License

- The existing PPA which was initially for a term of 25 years was due to expire on June 26, 2021. Followings discussions between GoP-led negotiation committee and IPPs, a MoU was signed in August 2020. In view of the MoU, a Third Amendment to the Master Agreement was signed in February 2021. Salient features of the changes to the previous master Agreement are as follows:
    - IPPs will have the option to participate on GoP's Competitive Trading Arrangement (CTA), once CTA is implemented and becomes fully operational.
    - CPPA-G and IPPs resolved the dispute of Liquidated Damages (LDs) levied by CPPA-G
        - In case of KAPCO, it was decided to treat the outages due to fuel shortage, as Other Force Majeure Event (OFME) under the PPA and consequently, existing Term of PPA has been extended by 485 days (16 months) ending October 2022. Amounts previously received as Capacity Purchas Price (CPP) during the outage periods, would be treated as CPP revenue for the OFME period. So the Company has reversed the income booked of Rs. 19.3b, while creating a contract liability, which will be amortized fully by October 2022.
    - GoP related outstanding receivables of KAPCO (Rs. 99b), as Nov'20, would be paid in two-installments of 40% and 60% respectively. The payment will be made in equal parts of cash, PIBs & Ijarah Sukuk.
        - In this regard, the first tranche of Rs. 39.6b was received on June 4, 2021.
        - Furthermore, the second tranche has also been recently cleared by GoP Committee on November 29, 2021.
    - Subsequent to the receipt of installment, KAPCO agreed to tariff reduction on escalable portion, which would affect KAPCO's revenue for the period June 4 – June 26, 2021.
- The Company's generation license with NEPRA has expired in September 21, 2021. KAPCO's management strongly believes that the PPA will be extended for an additional term, given the Power Purchaser has agreed to consent to this, albeit the terms & conditions are yet to be negotiated for the same. Management's view on renewal of generation license and extension of PPA is based on following factors:
    - KAPCO's significance to the Power Purchaser due to its certain distinct capabilities such as being a multi-fuel power plant, having a black start facility, providing an extensive fuel storage facility and its contribution to the national power grid;
    - KAPCO's strategic location in mid of the country and being a major feeding source for distribution companies of central and lower Punjab; and
    - Remaining useful life of the plant is at least 10 years as per the life assessment study carried out by an independent foreign consultant in the month of June 2021

Operational Update

Table 1: Operational Metrics

	FY18	FY19	FY20	FY21	Q1'FY22
Average Annual Load Dispatched (%)	63%	42%	30%	30%	58.5%
Energy Dispatched (GWH)	7,437	4,961	3,477	3,562	1,737
Annual Dependable Capacity (MWH)	11,756	11,756	11,788	11,756	NA
Availability	86%	91.80%	88.90%	95.2%	93.7%
Thermal Efficiency	44.00%	44.00%	44.40%	44.5%	NA

- Load factor of the Company has declined in the last few years given availability of new cheaper power producers, which outranked KAPCO in the economic merit order. As per management, KAPCO's system is mainly utilized by the GoP during peak seasons.

Table 2: Balance Sheet (Extract)

	Jun'20	Jun'21	Sep'21
Assets	**134,523**	**152,234**	**146,396**
- **Non-Current Assets**	4,145	3,521	3,284
- **Stock in Trade**	2,701	5,922	5,966
- **Trade Debts**	119,904	104,622	113,767
- **Investments**	-	25,670	15,635
- **Cash & bank Balances**	835	1,284	887
- **Others**	6,938	11,215	6,857
Liabilities	**74,172**	**87,010**	**78,893**
- ***Debt***	44,088	36,268	35,639
- **Contract Liability**	-	19,128	15,470
- **Trade Payables**	20,785	17,178	19,874
- **Others**	9,299	14,436	7,910
Equity	**60,351**	**65,224**	**67,503**

- In view of the Third Amendment to PPA, the Company created a Contract Liability of Rs. 19.3b, which is treated as advance against future Capacity Purchase Payment. This amount will be amortized in full by end of OFME period i.e. by October 2022.
- Despite settlement of 40% receivable (Rs. 39.6b) in June 2021, receivables continued to pile up and comprised 79% of the Company's asset base and 1.6x of equity as of September 2021. Part of the reasoning is the uptick in energy pricing, being driven by higher fuel costs. Accordingly, despite the trade receivables being sizable, cash conversion cycle has reduced from 480 days as of end-June 2020 to 265 days as of end-September 2021. This likely to recede notably by end-1H'FY22, given that trade debts of Rs. 59.6b have been released by CPPA-G in November 2021.
- The debt on the balance sheet remains almost entirely short term in nature, and has declined during the period in review. Given the decline in debt utilization in combination with growth in equity, the Company's gearing has reduced from 0.73 as of June 2020 to 0.53 as of September 2021.
- Following clearance of sizable part trade debts in November 2021, the Company's debt utilization is likely to recede further.

Table 3:Profitability Margins

	FY19	*FY20*	*FY21*	*Q1'FY22*
Sales	**84,831**	**71,543**	**50,349**	**34,238**
Less: Cost of Sales	**70,625**	**50,065**	**45,098**	**32,937**
- *Energy Purchase Revenue (net of Sales Tax)*	64,693	45,894	41,694	31,853
- *Capacity Purchase Price – net*	20,138	25,650	27,943	2,385
Gross Profit	**14,205**	**21,478**	**5,251**	**1,301**
Gross Margin	**16.7%**	**30.0%**	**10.4%**	**3.8%**
Net Margin	**15.5%**	**33.0%**	**20.3%**	**6.7%**

- Profitability margins of the Company have come under pressure during the period under review. In FY21, this was mainly on the back of LD settlement of Rs. 19b, which has been netted off from the energy purchase receipts from CPPA-G.
- In the interim period, the profitability margin remained depressed given lower Capacity Purchase Price revenue (previously based on annual dependable capacity and indexation factors) and True-up Income. Going forward, the profitability margin is likely to persist at similar level until October

2022, subsequent to which the financial performance will depend on renewed PPA negotiated with GoP.

	FY19	*FY20*	*FY21*	*Q1'FY22*
FFO	**18,608**	**27,489**	**25,581**	**(2,190)**
FFO to Debt	**34%**	**62%**	**71%**	**(25%)**

- Given depressed profitability metrics, FFO for interim period was negative, as a result for which cash flow coverage indicators has gone negative.

Rating Drivers

Expiry of existing PPA; extension may be given at different terms
The extended PPA is set to expire in October 2022, and 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. Accordingly, given potential changes to the Company's business risk profile during the rating horizon, VIS continues to maintain the ratings while keeping the outlook as 'Rating Watch – Developing'.

Company's Profitability Margins have remained depressed, with a similar outlook for the future
The Company's profitability margin remained depressed during the rating horizon, which is expected to persist up till October 2022. The impact on business risk profile of the Company has been noted and factored. Comfort is derived from sizable receipt of trade debts by CPPA-G in June and November 2021. Even though VIS had always treated these receivables as highest credit quality, given attached sovereign guarantee. Nevertheless, factoring in the receipt of Rs. 59.4b in November 2021, net debt of the Company would essentially nullify, with sizable liquidity buffer available on the balance sheet.

Rating is supported by Conservative Capital Structure
Over the years, KAPCO has entirely repaid its long term debt, and the debt on the books is essentially short term in nature used for financing working capital requirements, which stand on the higher side particularly because of delayed release of payments from Power Purchaser. Even though the same does not affect KAPCO's profitability, as the Company also books interest income on these receivables. However, it results in inflating the trade debt and debt utilization of the Company, thus impacting the gearing ratio, given release of sizable liquidity (Rs. 99b) in the last 5 months, the Company's net debt is projected to be nil by end-December 2021, which is factored into the assigned rating.

Kot Addu Power Company Limited Annexure I

FINANCIAL SUMMARY					*(amounts in PKR millions)*
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**Q1'FY22**
Fixed Assets	8,565	6,337	4,106	3,068	2,824
Long term Investments	-	-	-	-	-
Stock-in-Trade	6,718	9,466	2,701	5,922	5,966
Trade Debts	115,472	115,798	119,904	104,622	113,767
Cash & Bank Balances	685	1,350	835	1,284	887
Total Assets	138,446	139,267	134,523	152,234	146,396
Trade and Other Payables	49,755	40,139	20,785	17,178	19,874
Long Term Debt	54	38	25	11	9
Short Term Debt	49,875	54,180	44,062	36,257	35,630
Total Debt	49,929	54,218	44,088	36,268	35,639
Paid Up Capital	8,803	8,803	8,803	8,803	8,803
Total Equity	35,093	41,161	60,351	65,224	67,503
	FY18	**FY19**	**FY20**	**FY21**	**Q1'FY22**
INCOME STATEMENT					
Net Sales	91,916	84,831	71,543	50,349	34,238
Gross Profit	13,379	14,205	21,478	5,251	1,301
Operating Profit	21,995	27,269	41,412	17,519	3,938
Profit Before Tax	15,808	18,963	32,954	14,411	3,208
Profit After Tax	10,617	13,112	23,613	10,229	2,280
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21**	**Q1'FY22**
Gross Margin (%)	14.6%	16.7%	30.0%	10.4%	3.8%
Net Margin (%)	11.6%	15.5%	33.0%	20.3%	6.7%
Net Working Capital	29,178	36,193	64,722	75,543	71,588
Trade debts/Sales	126%	137%	168%	208%	83%
FFO	17,014	18,608	27,489	25,581	(2,190)
FFO to Total Debt (%)	34%	34%	62%	71%	(25%)
Debt Servicing Coverage Ratio (x)	5.4	3.7	3.4	4.0	NA
Current Ratio (x)	1.3	1.4	2.0	2.0	2.0
Stock+ Trade Debts/STD	245%	231%	278%	305%	336%
Gearing (x)	1.42	1.32	0.73	0.56	0.53
Leverage (x)	2.95	2.38	1.23	1.33	1.17
ROAA (%)	8%	9%	17%	7%	6%
ROAE (%)	31%	34%	47%	16%	14%

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				
12/9/2021	AA+	A-1+	Rating Watch Developing	Maintained
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	Financial Controller	November 24, 2021