

RATING REPORT

Kot Addu Power Company Limited

REPORT DATE:

January 08, 2024

RATING ANALYST:

Husnain Ali

husnain.ali@vis.com.pk

RATING DETAILS				
Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	AA	A-1
Entity Rating Action	Downgrade		Downgrade	
Outlook/Rating Watch	Rating Watch Developing		Stable	
Entity Rating Date	Jan 08, 2024		Jan 12, 2023	

COMPANY INFORMATION

Incorporated in 1996	External auditors: A. F. Ferguson & Co. Chartered Accountants
Public Listed Company	Chairman: Lt. General (Retd.) Sajjad Ghani CEO: Mr. Aftab Mahmood Butt
Key Shareholders (with stake 5% or more):	
WAPDA – 40.3%	
KAPCO Employees Empowerment Trust – 5.5%	

APPLICABLE METHODOLOGIES

Corporates (May 2023)

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

Government Supported Entities (July 2020)

<https://docs.vis.com.pk/docs/Meth-GSEs202007.pdf>

Rating Scale & Definitions

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

Kot Addu Power Company Limited

OVERVIEW OF THE INSTITUTION

Kot Addu Power Company Limited ('KAPCO' or 'the company') was incorporated 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 at Kot Addu, a corporate office located in Lahore and registered office located in Islamabad.

Profile of the Chairman

Lt General (Retd.) Sajjad Ghani was appointed a Director on August 17, 2022. General Ghani is a professional engineer with four decades of experience. He obtained Bachelor of Engineering Degree from Military College of Engineering in 1984. He was awarded Master's Degree in Civil Engineering from University of Engineering and Technology, Lahore in 1990. He has served Commander of Corps Engineers and Quarter Master General Pakistan Army where numerous mega construction projects were executed under his supervision.

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 & LSE Financial Services. 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 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 15 generating units, featuring a nameplate capacity of 1,600 MW in Kot Addu, District Muzaffargarh, Punjab, Pakistan. The rating takes into account ownership profile of the company, with majority shareholding being held by WAPDA (Water and Power Development Authority). While the company's PPA (Power Purchase Agreement) with the Government of Pakistan (GoP) has expired in Oct'22, NEPRA has indicated in its IGCEP (Indicative Generation Capacity Expansion Plan) 2022-31, that KAPCO will partially remain part of the system till FY26 mainly to cater to the system constraints.

Expiry of PPA and Auditors note on going concern assumption:

The PPA which was initially for a term of 25 years was due to expire on June 26, 2021, however, the company signed a Master Agreement and the Third Amendment to the Power Purchase Agreement (PPA) on February 11, 2021, gaining an extension that has also expired on October 24, 2022. The company sought an interim tariff while it has applied to the National Electric Power Regulatory Authority (NEPRA) for a new tariff in order to supply electricity to Central Power Purchasing Agency (CPPA-G) for a span of 5 years. NEPRA approved the Provisional Tariff of the Company on August 4, 2023 for 500 MW capacity on Take-and-Pay basis. The company is in process of finalizing the Interim PPA with the Power Purchaser subject to legal formalities. The Final Tariff Determination by NEPRA is also in process and it is expected to be issued in due course after public hearing. Thereafter, the Final PPA is expected to be executed with the Power Purchaser by May 2024. The company's generation license was renewed for a period of 3 years, which will expire on September 21, 2024, considering the remaining useful life and critical importance of the complex in the system. The pending renewal / extension of the PPA indicates the existence of material uncertainty that may cast significant doubt on the company's ability to continue as a going concern and, therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business, according to the external auditors.

Ongoing Litigation Matters and Contingencies:

During FY23, NEPRA issued a show cause notice dated July 21, 2022, to the company alleging prima facie violation of NEPRA Interim Power Procurement (Procedures and Standards) Regulations, 2005 in respect of the extension of the company's PPA for 485 days. Being aggrieved, the company filed an appeal, against the show cause notice before the NEPRA Appellate Tribunal in accordance with NEPRA Regulations. The company also simultaneously filed stay with the Lahore High Court against the said notice, which was granted. The NEPRA Appellate tribunal remanded the case back to NEPRA vide order dated April 13, 2023, which is pending hearing.

The company had provided bank guarantees in favor of SNGPL on account of payment of dues against gas sales etc., amounting to Rs 2.5b in prior years, which was due to expire on June 09, 2023. During FY23, SNGPL issued encashment notice for the bank guarantee on June 07, 2023 for recovery of outstanding late payment surcharge balances. Subsequently, the company obtained stay order from the Civil Court against the said encashment notice based on the premise that late payment surcharge is disputed and is not covered in the said bank guarantee.

Rating Drivers

Given expiry of the PPA, power generation was limited to 588 GWh units in FY23. The plant also temporarily came online during a country-wide blackout on January 23, 2023 and provided emergency power to the system. The plant's operational metrics are as follows:

	FY21	FY22	FY23
Load Factor	30%	42%	16%
Energy Dispatched (GWh)	3,562	4,980	588
Annual Dependable Capacity (MWh)	11,756	11,756	11,756
Availability	86%	90.0%	97%
Thermal Efficiency	44%	43%	42%

Going forward, in the Integrated Generation Capacity Expansion Plan 2022-31, NEPRA has indicated that KAPCO 3 (300 MW) would be fully retired, while KAPCO 1 (400MW) and KAPCO2 (900MW) would remain operational, with capacity utilization expected at 35.3% and 11.9% respectively. As per NEPRA assumptions, minimum dispatch of 500 MW from Existing KAPCO CCPP (Block-I and Block-II) in the months of May to September up till year 2025 has been considered, beyond its PPA expiry, owing to network requirements/constraints, whereas, the remaining capacity (Block-III) has been retired as per PPA expiry.

Asset base mostly comprises investments, trade debts and inventories: Operating fixed assets decreased to Rs. 1.9b (FY23: Rs. 1.9b, FY22: Rs. 2.2b) by end-1QFY24 on account of depreciation charges. KAPCO has gradually shifted to using imported low sulfur oil, requiring advance procurement due to long import lead times. This led to a significant rise in stock-in-trade end-FY23, while reduced demand from the power purchaser hindered its utilization for power generation. Stock-in-trade thereby increased to Rs. 11.6b (FY23: Rs. 11.6b, FY22: Rs. 6.3b) by end-1QFY24.

KAPCO's short-term investments, comprising government bonds, stood at Rs. 50.2b (FY23: Rs. 50.1b, FY22: Rs. 54.1b) at end-1QFY24. Trade debts decreased to Rs. 22.5b (FY23: Rs. 26.6b, FY22: Rs. 62.1b) by end-1QFY24 as the company received intermittent payments against receivables while power generation remained low in FY23 and nil during 1QFY24. While aging of trade debts indicates larger proportion in older brackets, their ultimate recovery is considered good as these are backed by a GoP guarantee and are receivable from the related party – CPPA-G. Aging of trade debts is as follows:

<i>(Rs. in b)</i>	FY22	FY23	1QFY24
Not yet due	24%	17%	22%
90 days overdue	73%	5%	4%
180 days overdue	0%	2%	5%
300 days overdue	1%	45%	3%
More than 300 days overdue	2%	31%	66%

Profitability primarily based on investment income and interest on late payment: The plant remained partially operational during FY23 and sold electricity between July and October 2022 and became operational again on January 23, 2023 due to country-wide blackout. NEPRA, CPPA-G and the GoP requested KAPCO to provide emergency generation for system restoration notwithstanding the PPA expiry. The black start facility available at the power plant was energized to support and stabilize the system.

Given notable reduction in units sold, net sales decreased to Rs. 25.5b (FY22: Rs. 136.6b) during FY23. KAPCO did not record any sales during 1QFY24. The company incurred a gross loss during FY23 and 1QFY24. The cost of sales increased as insurance was pass-through in initial PPA and since its expiry, insurance cost is now being borne by KAPCO that has increased in FY23 and 1QFY24. While administration expenses decreased to Rs. 842.6m (FY22: Rs. 976.7m), other operating expenses increased to Rs. 1.36b (FY22: Rs. 277.5m) mainly on account of increase in fair value loss on investments (FY23: Rs. 1.0b, FY22: Rs. 260.0m).

Other income increased to Rs. 15.8b (FY22: Rs. 12.6b) on account of higher interest on short-term investments while interest on late payment – CPPA-G also remained a major portion of other income. Despite lower average borrowings, financial charges increased to Rs. 6.2b (FY22: Rs. 4.4b) during FY23 owing to hike in policy rate. Net profit decreased to Rs. 4.0b (FY22: Rs. 9.9b) during FY23 owing to loss at the gross level, higher other operating expenses and financial charges. During 1QFY24, profitability was primarily a function of income from investments and interest on late payment.

Stressed cash flow though adequate liquidity on the balance sheet: Current ratio increased to Rs. 3.3x (FY23: 3.0x, FY22: 2.0x) on account of lower trade payables by end-1QFY24. Trade payables to SNGPL became nil (FY22: Rs. 9.7b) by end-FY23. Overall trade payables decreased to at Rs. 8.6b (FY23: Rs. 9.6b, FY22: Rs. 21.5b) in 1QFY24.

FFO has been negative during FY22, FY23 and 1QFY24, therefore, coverages remain meaningless. Although trade debts declined considerably, these as a percentage of net sales increased during FY23 on account of lower sales. The company is managing its liquidity requirement primarily from investment income. Moreover, favorable working capital changes have impacted positively on CFFO. According to the management, despite below-par liquidity ratios, the company maintains a sizable investment portfolio, adequate cash reserves, enabling it to meet short-term obligations and dividend payouts.

Equity dominated capital structure: The company's profit retention is subdued on account of dividend payouts, therefore, some fluctuation in Tier-1 equity is noticeable. The company's Tier-1 equity decreased to at Rs. 66.1b (FY22: Rs. 68.6b) on account of higher payment of dividend compared to profit retention during FY23. Dividend payout ratio was 188.9% (FY22: 71.2%) in FY23. Tier-1 equity stood at Rs. 67.3b at end-1QFY24.

KAPCO's short-term borrowings comprised conventional and Islamic facilities utilized for working capital requirements, particularly due to intermittent payments from CPPA-G. Short-term borrowings decreased on timeline basis to Rs. 19.4b (FY23: Rs. 22.1b, FY22: Rs. 37.4b) by end-1QFY24. Gearing and debt leverage decreased to 0.3x and 0.5x (FY22: 0.5x and 1.0x) respectively by end-FY23 on account of lower borrowings and trade payables.

Kot Addu Power Company Limited
Annexure I

FINANCIAL SUMMARY				(PKR in m)
<u>BALANCE SHEET</u>	<u>FY21</u>	<u>FY22</u>	<u>FY23</u>	<u>1QFY24</u>
PPE	3,068.2	2,237.4	1,931.2	1,929.0
Staff retirement benefits	435.3	722.0	1,011.9	1,041.0
Stores and spares	3,181.4	3,698.1	3,927.5	3,947.4
Stock-in-trade	5,921.9	6,236.0	11,565.5	11,565.5
Trade debts	104,622.4	62,154.5	26,611.4	22,464.6
Investments at fair value	25,670.4	54,067.3	50,101.5	50,235.6
Other receivables	6,528.7	6,603.0	4,752.0	7,807.4
Advance income tax refundable	1,504.4	-	18.2	-
Cash & bank balances	1,283.5	1,018.2	1,919.8	1,063.6
Other assets	17.4	25.1	9.3	8.1
Total Assets	152,233.6	136,761.4	101,848.3	100,062.7
Deferred liabilities	9,223.8	1,882.2	2,939.6	3,379.1
Contract liability (inc. current portion)	19,128.3	4,613.1	-	-
Short-term borrowings	36,257.3	37,370.3	22,153.7	19,403.3
Total Debt	36,257.3	37,370.3	22,153.7	19,403.3
Trade and other payables	17,177.9	21,470.1	9614.95	8652.91
Unclaimed dividend	810.8	971.2	1,056.1	1,053.1
Unpaid dividend	4,401.3	-	-	-
Provision for taxation	-	1,858.6	-	308.9
Other liabilities	10.5	-	-	-
Total Liabilities	87,010.0	68,165.5	35,764.4	32,797.3
Paid Up Capital	8,802.5	8,802.5	8,802.5	8,802.5
Tier-1 Equity	65,223.6	68,595.9	66,083.7	67,265.4
<u>INCOME STATEMENT</u>	<u>FY21</u>	<u>FY22</u>	<u>FY23</u>	<u>1QFY24</u>
Net Sales	50,349.0	136,599.6	25,435.3	-
Gross profit	5,251.0	8,532.1	(568.8)	(805.7)
Operating expenses	(952.6)	(1,254.2)	(2,202.9)	(320.9)
Other income	13,220.6	12,618.8	15,843.9	4,382.9
Finance cost	(3,108.2)	(4,373.1)	(6,252.9)	(1,319.1)
Profit before tax	14,410.7	15,523.6	6,819.3	1,937.3
Profit after tax	10,229.4	9,893.6	3,958.8	1,181.7
<u>RATIO ANALYSIS</u>	<u>FY21</u>	<u>FY22</u>	<u>FY23</u>	<u>1QFY24</u>
Gross margin	10.4%	6.2%	-	-
Net margin	20.3%	7.2%	15.6%	-
ROAA	7.1%	6.8%	3.3%	*4.7%
ROAE	16.3%	14.8%	5.9%	*7.1%
Trade debt/sales	208%	46%	105%	-
Current ratio (x)	2.0	2.0	3.0	3.3
Stock+Trade Debts/STD (x)	3.0	1.8	1.7	1.8
Cash conversion cycle (days)	695	185	544	-
FFO	25,581.3	(13,654.4)	(8,597.6)	(1,609.0)
FFO/Total Debts	70.6%	-	-	-
DSCR (x)	4.0	-	-	-
Gearing (x)	0.6	0.5	0.3	0.3
Leverage (x)	1.3	1.0	0.5	0.5

*Annualized

REGULATORY DISCLOSURES					Appendix II
Name of Rated Entity	Kot Addu Power Company Limited				
Sector	Power				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History		Medium to Long Term	Short Term	Outlook/ Rating Watch	Rating Action
	RATING TYPE: ENTITY				
	01/08/2024	A+	A-1	Rating Watch Developing	Downgrade
	01/12/2023	AA	A-1	Stable	Downgrade
	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	N/A				
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.				
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Copyright 2024 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.				
Due Diligence Meeting Conducted	Name		Designation		Date
	Mr. Zubair Aslam		Financial Controller		22-Dec-2023
	Mr. Nabeel Ahmed		Manager Treasury		