

RATING REPORT

Engro Powergen Qadirpur Limited

REPORT DATE:

April 23, 2019

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Initial Rating	
	Long-term	Short-term
Entity	AA-	A-1
Rating Outlook	Stable	
Rating Date	April 23, '19	

COMPANY INFORMATION

Incorporated in 2006	
Public Listed Company	Chairman of the Board: Ahsan Zafar Syed
Key Shareholders (with stake 5% or more):	Chief Executive Officer: Shahab Qader
Engro Energy Limited – 68.99%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016)

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

Engro Powergen Qadirpur Limited (EPQL)

OVERVIEW OF THE INSTITUTION

Engro Powergen Qadirpur Limited is a public listed company, incorporated in Pakistan and its shares are quoted on the Pakistan Stock Exchange Limited. The company is a subsidiary of Engro Energy Limited, which is a wholly owned subsidiary of Engro Corporation Limited. Engro Corporation Limited is a subsidiary of Dawood Hercules Corporation Limited.

Profile of Chairman

Ahsan Zafar Syed is the CEO of Engro Powergen Thar Private Limited and the acting CEO of Engro Energy Limited. Ahsan has a combined professional experience of over 28 years. His expertise lies in project management, design, construction and execution of large, complex manufacturing and industrial complexes.

Profile of CEO

Shahab Qader has had more than 21 years of industry experience in the chemical process and power utility industry where his expertise ranges from project development and project execution to Operations & Management. In addition to having worked through project development and execution at a senior level, Mr. Qader has been part of Operations & Management teams in the first twelve years of his career. He holds a Bachelor's in Electrical Engineering from UET.

RATING RATIONALE

Engro Powergen Qadirpur Limited (EPQL) was incorporated in Pakistan in 2006 as a private limited company. In 2008, the company was converted to an unlisted public company. EPQL completed construction and testing of its 217.3 MW (net) combined cycle power plant and commenced commercial operations on March 27, 2010. The electricity generated is transmitted to the National Transmission and Dispatch Company (NTDC) under the Power Purchase Agreement (PPA) dated October 26, 2007 which is valid for a period of 25 years from the Commercial Operations Date (COD). In 2014, EPQL was listed on Pakistan Stock Exchange (PSX). Engro Corporation Limited (Engro) has majority shareholding in the company with 69% ownership via its wholly owned subsidiary, Engro Energy Limited (EEL). Remaining stake is held by general public. The board of directors comprises 9 members and is chaired by Ahsan Zafar Syed.

Project Details

The company has set up a 217.3 MW (net) gas based thermal combined cycle power plant near Qadirpur, District Ghotki, Sindh. This is a 1+1+1 configuration plant with one gas turbine, one heat recovery system generator (HRSG) and one steam turbine. The project converts low British thermal unit (BTU), high sulphur content permeate gas, which was earlier being wasted and flared, into electric power. The plant uses permeate gas as its primary fuel source and high speed diesel (HSD) as the startup and backup fuel. Usage of permeate gas currently makes EPQL one of the lowest tariff power plants as compared to other thermal based power plants in the economic merit order (Rank in economic merit order was 10/130 as per NTDC report). Project cost was US\$ 194m funded through a debt to equity ratio of 75:25. For debt financing, EPQL obtained foreign currency loan amounting to US\$ 144.0m (repayable by 2020) from a consortium comprising international financial institutions. A tariff based on a net output of 217.3 MW (permeate gas) and 212.9 MW (HSD) was approved by National Electric Power Regulatory Authority (NEPRA).

EPC Contractor

China Tianchen Chemical Engineering Corporation was chosen as Engineering and Procurement Contractor (EPC) for the project and China National Construction and Engineering Company was chosen as construction contractor after a competitive bidding process. The plant achieved commercial operations three months before the agreed scheduled date.

Operations & Maintenance Contractor

EPQL has outsourced its Operations & Maintenance (O&M) services to Engro Energy Services Limited (EESL). The operator is responsible for operation and maintenance of facility, unplanned maintenance, parts, consumables and spare parts, sending O&M plan every year to the owners, preparing and submitting weekly/monthly/annual availability forecast, make recommendations to improve the plant, provide personnel management services and capital spares to be retained by the owner.

Power Purchase Agreement and Implementation Agreement

EPQL has entered into a power purchase agreement with National Transmission and Dispatch Company (NTDC) on a take or pay basis (guaranteed capacity payment) for a term of 25 years from COD. The Implementation Agreement (IA) was signed between the Islamic Republic of Pakistan (GoP) through Private Power Infrastructure Board (PPIB) and EPQL in 2007.

He joined the EPQL board in March 2017.

Gas Supply

The gas supply agreement (GSA) had been signed between the Sui Northern Gas Pipelines Limited (SNGPL) and EPQL. SNGPL has a back to back agreement with OGDCL (gas producer) for supply 46,000 MMBTUs of gas from Qadirpur gas field. The term of this agreement is for a period of 25 years, subject to availability of permeate gas. The gas is low BTU with high content of hydrogen sulphide (permeate gas) and was previously being flared at the Qadirpur gas field. The daily contract quantity (DCQ) is 46,000 MMBTU/day.

Water Supply

Raw water to meet normal plant needs is drawn from the Ghotki feeder canal located approximately 7 km south of the project site under a permit from the Sindh Irrigation and Drainage Authority.

Key Rating Drivers

Strong sponsor profile, experienced management team and O&M contractor.

EPQL is majority owned (68.99%) by EEL, which in turn is a wholly subsidiary of Engro. Engro is a renowned business group with diversified operations and strong financial profile. Ratings draw comfort from significant experience of EEL/Engro in executing similar projects. Moreover, ratings incorporate sound operational track record of the O&M contractor, EESL.

Strong operating track record during first eight years of operations.

Performance of the plant has remained compliant with normative parameters as laid down in the PPA with plant availability at ~100% except rotor event of 2013.

Demand Risk limited due to take or pay tariff awarded and 25 year PPA with NTDC.

In case electricity is not purchased, EPQL is eligible for guaranteed capacity payments from NTDC. In addition, the IA guarantees repayment of receivables of the Company in case the power purchaser defaults on its payments. However, in case of conversion to any alternate fuel, EPQL's rank in NTDC's economic merit order list may change.

Fuel Supply and Price Risks are limited due to long-term supply contract and cost pass through mechanism built in the tariff.

The company has a long-term GSA with SNGPL. The term of GSA will extend till the expiry of the PPA. The contract allows specific days of outage allowance for schedule and unscheduled outages of seller and gas producer. Cost of gas is a pass through item as per the tariff which mitigates the risk to company's margins.

As projected in the IA, EPQL is now facing gas curtailment from Qadirpur gas field as it is depleting and has made its plant available on mixed mode i.e. comingling of gas and HSD from September 7, 2018 onwards. Terms of the contract also allows conversion to alternate fuel. In case of conversion to any alternate fuel, profitability will not be impacted given that fuel cost component is pass-through.

Operational Risk is mitigated by performance guarantees in place as part of O&M agreement.

EPQL has an O&M agreement with EESL. As part of this agreement, various performance guarantees are in place to mitigate operational risk of the project as detailed below.

- Reliability guarantee: Equivalent reliability factor to be maintained at 96% or above.

- Outage duration guarantee: As per durations defined in the PPA.
- Heat rate guarantee: Baseline for performance liquidated damages set as per PPA.

Cash flows are adequate for servicing outstanding debt obligations. Persistence of circular debt may translate into some liquidity pressures.

During 2018, Funds from Operations (FFO) amounted to Rs. 3.5b (2017: Rs. 2.6b; 2016: Rs. 1.9b) while debt repayment for the period was Rs. 2.9b, translating into Debt Servicing Coverage ratio of 1.66x indicating satisfactory debt servicing ability. FFO to Total Debt and FFO to Long Term Debt were reported at 0.48x and 0.99x respectively at end-2018. Capex amounted to Rs. 158.8m in 2018 and future capex (mainly maintenance) is planned to be funded by internal cash. Total overdue receivables increased to Rs. 6.1b (2017: Rs. 4.3b) at end-2018. Going forward, recent issuance of Rs. 200b circular debt Sukuk will result in reduction in outstanding receivables. In case problem of circular debt persists, this may translate into liquidity pressures for EPQL going forward.

Leverage indicators stand within manageable limits.

Total equity of EQPL has increased to Rs. 11.5b (2017: Rs. 9.8b) at end-2018 owing to higher accumulated profits. Debt carried on balance sheet at end-2018 amounted to Rs. 7.3b (2017: Rs. 8.1b) translating into gearing ratio of 0.63x (2017: 0.82x). Leverage ratio was 1.73x (2017: 1.42x) at end of the period. Accordingly, leverage indicators stand within manageable limits. Going forward, gearing levels are expected to decline by end-2020 with complete repayment of long term debt and increase in equity base. Dividend payout ratio has reduced to 18% (2017: 44%; 2016: 54%; 2015: 63%) in 2018 on account of increase in receivables.

Financial Summary (Rs. m)		Appendix I		
<u>BALANCE SHEET</u>		2018	2017	2016
Property, Plant & Equipment		13,664.2	13,169.2	13,524.7
Trade Debts		7,601.7	5,571.6	3,896.8
Cash & Bank Balances		12.7	7.4	39.6
Total Assets		24,173.6	21,290.6	20,092.1
Short Term Debt		3,758.5	3,208.7	2,919.0
Current Maturity of Long Term Debt		2,804.5	2,051.9	1,792.4
Long Term Debt (inc. Current Maturity)		3,563.1	4,871.2	6,403.0
Total Debt		7,321.6	8,079.9	9,322.0
Trade and Other Payables		5,241.4	3,367.0	2,290.7
Total Liabilities		12,640.8	11,477.8	11,637.4
Total Equity		11,532.8	9,812.8	8,454.7
<u>INCOME STATEMENT</u>		2018	2017	2016
Net Sales		11,874.4	11,589.5	11,451.8
Gross Profit		3,010.1	2,711.6	2,242.5
Administrative Expenses		182.4	158.7	188.0
Other income		1.8	110.2	98.8
Finance cost		196.0	269.2	361.1
Profit After Tax		2,627.6	2,390.6	1,787.7
<u>RATIO ANALYSIS</u>		2018	2017	2016
Gross Margin (%)		25.3%	23.4%	19.6%
Net Margin (%)		22.1%	20.6%	15.6%
Dividend Payout (%)		18%	44%	54%
FFO		3,529.5	3,256.5	2,723.9
FFO to Long Term Debt (x)		0.99	0.67	0.43
FFO to Total Debt (x)		0.48	0.40	0.29
Debt Servicing Coverage (x)		1.66	1.71	
Gearing (x)		0.63	0.82	1.10
Leverage (x)		1.73	1.42	1.25
Current Ratio (x)		0.87	0.92	0.92

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 moderate 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

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.

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.

(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	Engro Powergen Qadirpur Limited				
Sector	Power				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	23/4/2019	AA-	A-1	Stable	Initial
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.				
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