RATING REPORT

Engro Powergen Qadirpur Limited

REPORT DATE:
June 5, 2020

RATING ANALYSTS:
Narendar Shankar Lal

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	AA-	A-1	AA-	A-1
Rating Date	*June 5, 2020*		*April 23, 2019*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirm		Initial	

COMPANY INFORMATION	
Incorporated in 2006	**Chairman of the Board:** Ahsan Zafar Syed
Public Listed Company	**Chief Executive Officer:** Shahab Qader
Key Shareholders (with stake 5% or more):	**External Auditors:** Messers A.F. Ferguson & Co, Chartered Accountants
Engro Energy Limited – 68.89%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (April 2019)   https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

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 29 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 22 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

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 7 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. 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).

<u>Operations & Maintenance Contractor</u>

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.

<u>Power Purchase Agreement and Implementation Agreement</u>

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.

<u>Gas Supply</u>

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

Engineering from UET. He joined the EPQL board in March 2017.

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 & O&M contractor

EPQL is majority owned (68.89%) by EEL, which in turn is a wholly subsidiary of Engro. Engro is a renowned business group with diversified business interests and strong financial profile. The group has presence in fertilizer, dairy, telecom infrastructure, energy & mining, petrochemical and chemical storage and handling sectors. VIS expects sponsor support to materialize in case a need arises in future. Ratings also 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 since inception

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, EQPL 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, which may affect energy payments from the purchaser.

Fuel Supply and Raw Material 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 envisaged in the IA, EPQL is currently 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. The contract contains the provisions for conversion to alternate fuel. Furthermore, the IA mandates that the Government of Pakistan (GoP) is liable to reimburse EPQL for fuel conversion costs and subsequent operations on alternate fuel as a gas depletion mitigation option. 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.

Profitability has depicted improvement on timeline basis

Sales revenue of the company was reported at Rs. 13.2b (2018: Rs. 11.8b) in 2019. The increase in sales revenue was primarily attributable to a higher USD indexation and higher gas price vis-à-vis the preceding year. Increase in sales revenue coupled with lower salaries and wages expense contributed to higher gross profit (2019: 3.6b; 2018: Rs. 3.0b). Finance cost was also reported lower due to repayment of two senior lenders' installments amounting to USD 21.4 million (USD 20.2m was principal payment) and recovery of delayed payment charges from the government. Resultantly, net profit also increased to Rs. 3.4b (2018: Rs. 2.6b). Gross and net margins were reported at 27.5% (2018: 25.6%) and 25.8% (2018: 22.1%), respectively.

Sales revenue was recorded at Rs. 2.8b (Q1'2019: Rs. 3.3b) in Q1'2020. The decrease in sales was primarily a function of lower power dispatch. With the addition of new power plants that either operate out of merit order or rank above EPQL in the merit order, EPQL's dispatch has been affected. Gross and net profit amounted to Rs. 877m (Q1'2019: Rs. 792m) and Rs. 895m (Q1'2019: Rs. 713m). Increase in gross profit was due to higher capacity payments due to indexation.

Cash flows are adequate for servicing outstanding debt obligations. Growing circular debt remains a challenge for the industry and may translate to liquidity problems for the company

During 2019, Funds from Operations (FFO) amounted to Rs. 4.3b (2018: Rs. 3.5b), which was sufficient to service the outstanding debt obligations for the year. DSCR of the company was reported at 1.44x (2018: 1.59x), thereby indicating satisfactory debt servicing ability. FFO to total debt and FFO to long term debt were reported at 0.94xx and 5.0x respectively at end-2019.

Due to inefficiencies in the system, circular debt continues to pose a challenge to the industry with total overdue receivables to the energy sector increasing to 1,051 billion (2018: Rs. 808b) at end-2019. Overdue receivables to the energy sector have continued to increase during the ongoing year as well. At end-Q1'2019, total overdue trade receivables of EPQL from NTDC amounted to Rs. 10.9b (2019: Rs. 9.2b; 2018: Rs. 6.0b). Such a scenario creates a liquidity drag on the company. Comfort is drawn from recent issuance of Rs. 200b circular debt Sukuk will result in reduction in outstanding receivables, thereby providing partial relief to the company. However, due to the impact of COVID-19, recoveries from end consumers are expected to be further impacted and contribute to higher circular debt going forward. Hence, liquidity challenge is expected to persist going forward.

Leverage indicators remain within manageable limits

Total equity of EQPL has increased to Rs. 14.9b (2019: Rs. 14.0b; 2018: Rs. 11.5b) at end-Q1'2020 owing to higher accumulated profits. Debt carried on balance sheet at end-Q1'2020 amounted to Rs. 7.2b (2019: Rs. 4.6b; 2018: Rs. 7.3b) translating into gearing ratio of 0.49x (2019: 0.33x; 2018: 0.63x). Increase in debt in Q1'2020 was on account of higher short term borrowings for working capital requirements. Going forward, with repayment of long term debt, leverage indicators are expected to remain a function of utilization of short term borrowings; however, the same are expected to remain manageable. Dividend payout ratio was 29% (2018: 18%) in 2019.

FINANCIAL SUMMARY (Rs. in millions)				Appendix I
BALANCE SHEET	**2017**	**2018**	**2019**	**Mar'20**
Property, Plant & Equipment	13,169.2	13,664.2	13,299.5	13,192.9
Trade Debts	5,571.6	7,601.7	9,806.7	11,354.8
Cash & Bank Balances	7.4	12.7	12.4	523.5
Total Assets	21,290.6	24,173.6	27,541.3	32,036.3
Short Term Debt	3,208.7	3,758.5	3,712.8	6,314.7
Current Maturity of Long Term Debt	2,051.9	2,804.5	857.0	923.8
Long Term Debt (inc. Current Maturity)	4,871.2	3,563.1	857.0	923.8
Total Debt	8,079.9	7,321.6	4,569.9	7,238.5
Trade and Other Payables	3,367.0	5,241.4	8,406.8	9,786.0
Total Liabilities	11,477.8	12,640.8	13,578.1	17,178.0
Share Capital	3,238.0	3,238.0	3,238.0	3,238.0
Total Equity	9,812.8	11,532.8	13,963.2	14,858.3
INCOME STATEMENT	**2017**	**2018**	**2019**	**Mar'20**
Net Sales	11,589.5	11,874.4	13,201.1	2,801.6
Gross Profit	2,711.6	3,010.1	3,624.4	877.0
Admin & Other expenses	161.5	213.5	162.4	43.1
Other income	110.2	1.8	1.6	0.5
Finance cost/(income)	269.2	196.0	57.7	(61.8)
Profit before tax	2,391.1	2,628.7	3,406.0	896.3
Profit after Tax	2,390.6	2,627.6	3,402.7	895.4
RATIO ANALYSIS	**2017**	**2018**	**2019**	**Mar'20**
Gross Margin (%)	23.4%	25.6%	27.5%	31.3%
Net Margin (%)	20.6%	22.1%	25.8%	32.0%
Dividend Payout (%)	44%	18%	29%	-
FFO	3,256.5	3,525.8	4,287.6	1,144.0
FFO to Long Term Debt (x)	0.67	0.99	5.00	4.95
FFO to Total Debt (x)	0.4	0.48	0.94	0.63
Debt Servicing Coverage (x)	1.66	1.59	1.44	3.75
Gearing (x)	0.82	0.63	0.33	0.49
Leverage (x)	1.42	1.73	2.97	2.37
Current Ratio (x)	0.92	0.87	1.04	1.09

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure I

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	Engro Powergen Qadirpur Limited
Sector	Power
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.
Due Diligence Meetings Conducted	

Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
5/6/2020	AA-	A-1	Stable	Reaffirm
23/4/2019	AA-	A-1	Stable	Initial

Due Diligence Meetings Conducted:

	Name	Designation	Date
1	Saad Shiwani	Treasury Officer	May 12, 2020