RATING REPORT

Engro Powergen Qadirpur Limited

REPORT DATE:
June 23, 2021

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
Rating Date	*June 23, 2021*		*June 5, 2020*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirm		Reaffirm	

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:** 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 Energy Limited. Mr. Ahsan has a combined professional experience of over 30 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 23 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. He joined the EPQL board in March 2017.

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 operates a 217.3 MW (net) combined cycle power plant which 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 68.89% ownership via its wholly owned subsidiary, Engro Energy Limited (EEL). Remaining stake is held by general public.

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 funded through a debt to equity ratio of 75:25. For debt financing, EPQL obtained foreign currency loan (matured in 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).

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 and submitting performance updates.

Power Purchase Agreement and Implementation Agreement

EPQL has entered into a power purchase agreement with National Transmission and Dispatch Company (NTDC) 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.

Gas Supply

The gas supply agreement (GSA) had been signed between the Sui Northern Gas Pipelines Limited (SNGPL) and EPQL. The term of this agreement is for a period of 25 years, subject to availability of permeate gas.

Master Agreement signed with CPPA

Under the committee for negotiations with IPPs and GoP, EPQL has signed a master agreement on February 11, 2021 encompassing alterations in the existing contractual arrangements as well as setting up mechanism for clearance of undisputed outstanding amounts due and payable to EPQL. The Tariff Adjustment Application submitted to NEPRA has been approved. Consequently, revised tariff shall be applicable when the payment has been made by the GoP to EPQL and the applicable exchange rate reaches Rs. 168/$. The following are the key terms of the agreement:

1. Return on Equity (RoE) and the Return on Equity during Construction (RoEDC) will be fixed at 17% per annum in PKR with no future USD indexation. However, the existing RoE and RoEDC, together with the applicable indexations, shall continue to be applied until the date when the applicable exchange rate under the present Tariff reaches Rs. 168/$, post which the revised RoE and RoEDC shall apply for the remainder of the term.
2. Withholding tax on dividends shall be adjusted in accordance with the revised ROE and RoEDC components.

Under the agreement, payment mechanism of outstanding receivables at end-Nov'20 entails payment to be made in 2 installments with 40% being paid in the first installment and the remaining 60% to be paid within six months from the date of the first disbursement. Each installment to comprise 1/3rd in cash and 2/3rd government issued PIB and Sukuks.

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 the 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 power purchaser.

In case electricity is not purchased, EQPL is eligible for guaranteed capacity payments from power purchaser. In addition, the IA guarantees repayment of receivables of the Company in case the power purchaser defaults on its payments. The GoP also pays interest on delayed 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 dispatch and hence energy payments.

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. Fuel cost is a part of the tariff which mitigates the risk to company's margins.

The company is facing gas curtailment from Qadirpur gas field as it depletes. EPQL has made its plant available on mixed mode (gas and HSD). The company has submitted a gas depletion mitigation plan to the PPIB to pursue alternate fuel arrangements. Under the IA, once the gas curtailment reaches a certain point, EPQL is allowed a one-time conversion to an alternate fuel; the cost of this conversion being fully recoverable from the Power Purchaser. In the meanwhile, EPQL is entitled to recover full capacity payments while making the plant available on mixed mode.

The company has submitted a gas depletion mitigation plan to the PPIB to pursue alternate fuel arrangements. Development in this regard will be monitored by VIS closely. In case of conversion to any alternate fuel, profitability is not expected to be impacted given that fuel cost component will be adjusted accordingly.

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.

Profitability indicators of the company declined on account of lower capacity and energy payments due to full repayment of the debt component and lower dispatch to the grid, respectively. Profitability indicators are projected to remain subdued, going forward due to ROE adjustment in the tariff and merit order at similar levels.

Sales revenue of the company was reported at Rs. 8.1b (2019: Rs. 13.2b) in 2020. The decrease in sales revenue was primarily attributable to lower capacity and energy payments as a result of full repayment of the debt component and lower dispatch to the grid, respectively. Lower dispatch was on account EPQL being lower on the merit order due to new plants coming online. Given higher reduction in revenues, gross profit declined to Rs. 1.7b (2019: Rs. 3.6b) during 2020. Overall profitability profile in 2020 was supported by one-off re-measurement gain on GIDC payable to the tune of Rs. 102.6m and higher interest income on overdue trade debts amounting Rs. 1.35b (2019: Rs. 1.13b). Finance cost was also reported lower due to repayment long term debt. Net profit after tax was reported at Rs. 2.1b (2019: Rs. 3.4b) during 2020. Given lower capacity payments on the back of debt servicing component being unavailable during 1Q21, gross and net profit of the company were reported lower at Rs. 311m (1Q20: Rs. 877m) and Rs. 399m (1Q20: Rs. 895m) , respectively.

Cash flows are adequate for servicing outstanding debt obligations. Moreover, recent MOU signed with the GoP is expected to provide liquidity relief once new mechanism is released.

During 2020, Funds from Operations (FFO) amounted to Rs. 2.6b (2019: Rs. 4.3b), which was sufficient to service the outstanding debt obligations for the year. DSCR of the company was reported at 2.32x (2019: 1.44x), thereby indicating satisfactory debt servicing ability. FFO to total debt were reported at 0.74x at end-2020. Cash flow coverages and DSCR improved substantially during 1Q21 on account of full re-payment of long term debt.

The energy sector continues to be gripped by growing circular debt in the country which reached Rs. 2.3 trillion mark as at end Jan'21, translating into liquidity constraints for the power producers.. In order to reduce the same, the GoP has been undergoing negotiations with the IPPs. In pursuant to the master agreement discussed above, liquidity profile of the company is expected to improve going forward, once the GoP clears EPQL's outstanding dues in two tranches.

Leverage indicators improving on a timeline basis on account of debt repayments.

Total equity of EQPL was reported at Rs. 15.5b (2020: Rs. 15.6b; 2019: Rs. 13.96b) at end-Q1'2021 owing to profit retention. Debt carried on balance sheet at end-Q1'2021 amounted to Rs. 2.9b (2020: Rs. 3.6b; 2019: Rs. 4.6b) translating into gearing ratio of 0.19x (2020: 0.23x; 2019: 0.33x). Debt comprises short term borrowings for working capital requirements. Going forward, given full 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 46.7% (2019: 29%) in 2020.

FINANCIAL SUMMARY *(amounts in PKR millions)*					*ANNEXURE I*
BALANCE SHEET	**2017**	**2018**	**2019**	**2020**	**1Q21**
PP&E	13,169	13,664	13,299	12,686	12,495
Long term loans and advances	39	100.057	35	23	22
Stock in Trade	881	895.149	863	853	852
Trade Debts	5,572	7,602	9,807	7,040	8,801
Short term investment	50	50	50	49	50
Advances, Deposits, Prepayments and Other Receivables	1,428	1,712	3,339	4,748	3,634
Cash & Bank Balance	7	13	12	13	20
Other Assets	144	137.671	136.144	97.287	96.372
Total Assets	**21,291**	**24,174**	**27,541**	**25,510**	**25,970**
Trade & Other Payables	3,367	5,241	8,407	5,191	6,368
Accrued Markup	31	54	93	55	60
Short-term Borrowings	3,209	3,758	3,713	3,618	2,946
Long-Term Borrowings *(Inc. current maturity)*	4,871	3,563	857	0	0
Total Debt	8,080	7,322	4,570	3,618	2,946
Other Liabilities	0	24	509	1,009	1,127
Total Liabilities	11,478	12,641	13,578	9,874	10,501
Paid Up Capital	3,238	3,238	3,238	3,238	3,238
Total Equity	**9,813**	**11,533**	**13,963**	**15,637**	**15,469**
INCOME STATEMENT	**2017**	**2018**	**2019**	**2020**	**1Q21**
Net Sales	11,590	11,874	13,201	8,098	2,332
Gross Profit	2,712	3,036	3,624	1,739	311
Operating Profit	2,660	2,825	3,464	1,649	276
Profit Before Tax	2,391	2,629	3,406	2,094	399
Profit After Tax	2,391	2,628	3,403	2,079	399
FFO	3,256	3,526	4,288	2,646	618
RATIO ANALYSIS	**2017**	**2018**	**2019**	**2020**	**1Q21**
Gross Margin (%)	23%	26%	27%	21%	13%
Net Margin (%)	21%	22%	26%	26%	17%
Net Working Capital (Rs. millions)	-656	-1,546	558	3,851	3,430
FFO to Long-Term Debt (x)	67%	99%	500%	NA	NA
FFO to Total Debt (x)	40%	48%	94%	73%	84%
Debt Servicing Coverage Ratio (x)	1.66	1.59	1.44	2.32	49.45
ROAA (%)	12%	12%	13%	8%	2%
ROAE (%)	26%	25%	27%	14%	3%
Gearing (x)	0.82	0.63	0.33	0.23	0.19
Debt Leverage (x)	1.17	1.10	0.97	0.63	0.68
Current Ratio (x)	0.92	0.87	1.04	1.43	1.34
Inventory + Receivables to Short-term Borrowings (x)	201%	226%	287%	218%	328%

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Annexure 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.

<table>
<tr><th>REGULATORY DISCLOSURES</th><th colspan="5">Appendix III</th></tr>
<tr><td>Name of Rated Entity</td><td colspan="5">Engro Powergen Qadirpur Limited</td></tr>
<tr><td>Sector</td><td colspan="5">Power</td></tr>
<tr><td>Type of Relationship</td><td colspan="5">Solicited</td></tr>
<tr><td>Purpose of Rating</td><td colspan="5">Entity Rating</td></tr>
<tr><td rowspan="4">Rating History</td><td>Rating Date</td><td>Medium to Long Term</td><td>Short Term</td><td>Rating Outlook</td><td>Rating Action</td></tr>
<tr><td>23/6/2021</td><td>AA-</td><td>A-1</td><td>Stable</td><td>Reaffirm</td></tr>
<tr><td>5/6/2020</td><td>AA-</td><td>A-1</td><td>Stable</td><td>Reaffirm</td></tr>
<tr><td>23/4/2019</td><td>AA-</td><td>A-1</td><td>Stable</td><td>Initial</td></tr>
<tr><td>Instrument Structure</td><td colspan="5">N/A</td></tr>
<tr><td>Statement by the Rating Team</td><td colspan="5">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.</td></tr>
<tr><td>Probability of Default</td><td colspan="5">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.</td></tr>
<tr><td>Disclaimer</td><td colspan="5">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. 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.
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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Saad Shiwani	Treasury Officer	April 21, 2021
2	Javed Kasbati	Manager, Treasury	April 21, 2021
3	Ali Athar	CFO	April 21, 2021
4	Anum Irfan	Business Analyst	April 21, 2021