RATING REPORT

Engro Powergen Qadirpur Limited

REPORT DATE:
July 14, 2022

RATING ANALYSTS:
Maham Qasim
maham.qasim@vis.com.pk

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	*July 13, 2022*		*June 23, 2021*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirm		Reaffirm	

COMPANY INFORMATION	
Incorporated in 2006	**Chairman of the Board:** Yusuf Jamil Siddiqui
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: Corporates (August 2021)   https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Engro Powergen Qadirpur Limited (EPQL)

RATING RATIONALE

The assigned ratings to Engro Powergen Qadirpur Limited (EPQL) take into account low business risk profile of the Company underpinned by inking of 25-year long a power purchase agreement (PPA) with 'take or pay' provision with Central Power Purchasing Agency (CPPA-G) from Commercial Operations Date (COD). Moreover, the Implementation Agreement (IA) was signed between the Islamic Republic of Pakistan (GoP) through Private Power Infrastructure Board (PPIB) and EPQL in 2007. Presence of long-term PPA with guaranteed capacity payments mitigates off-take risk as obligations of the power purchaser are backed by sovereign guarantee. The ratings incorporate sound financial profile and sizable experience of the sponsor, Engro Energy Limited (EEL). The ratings take note that the Operations and maintenance (O&M) was discontinued with Engro Energy Services Limited (EESL) and from ongoing year's start will be done in house. Further, fuel supply and price risks are mitigated due to supply contract and cost recovery mechanism built in the tariff. Performance of the plant has remained compliant with normative parameters as laid down in the PPA. Going forward, upholding operational performance in line with agreed performance levels would remain a key-rating driver. As projected in the IA, EPQL has been facing gas curtailment from Qadirpur gas field as it is depleting therefore the plant is made available on mixed mode i.e. combination of gas and high speed diesel.

Assessment of financial risk profile incorporates sound debt coverage metrics and healthy cash flows in relation to outstanding debt repayments. Further the ratings take comfort from master agreement signed with the GoP leading to improved liquidity indicators as a sizeable amount of outstanding trade debts were received during the rating review period. Liquidity profile also remained well managed through effective working capital management. The ratings reflect long-term debt free balance sheet of the company as all long-term borrowings matured in FY20 in line with completion of 10-year term. Subsequently, the margins have trended downwards in line with lower capacity payments received due to discontinuation of debt servicing component. Leverage indicators have increased slightly on a timeline basis owing to higher utilization of short-term funding to meet working capital requirements during the rating review period. The cash coverages and leverage indicators are expected to improve during the rating horizon on account of sizable profit generation; the projected improvement in the aforementioned is captured in the assigned rating. Going forward, ratings remain dependent on sustained efficiency levels and corresponding profitability indicators.

Company & Project Details:

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 was 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 COD. However, after signing of master agreement with the government all NTDC agreements have been novated to CPPA-G. In 2014, EPQL was listed on Pakistan Stock Exchange (PSX). Engro Corporation Limited (Engro) has majority shareholding in the company with 68.9% ownership via its wholly owned subsidiary, EEL. Remaining stake is held by general public.

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 24 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.

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 backup fuel. Project cost was funded through a debt-to-equity ratio of 75:25. For debt financing, EPQL obtained foreign currency loan (repaid fully in FY20) 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 Contract

Previously, EPQL had outsourced its Operations & Maintenance (O&M) services to Engro Energy Services Limited (EESL). The operator was responsible for operation and maintenance of facility and submitting performance updates. However, EPQL finalized the terms of Termination and Settlement Agreement (TSA) with EESL during the outgoing year. Under the TSA, the Company and EESL have agreed to terminate the O&M Agreement with effect from 31st Dec, 2021. The company will now operate on self-operations and maintenance mode from the ongoing year.

Power Purchase Agreement and Implementation Agreement

EPQL has entered into a PPA with NTDC for a term of 25 years from COD. The (IA) was signed between the GoP through PPIB and EPQL in 2007. However, all agreements initially signed with NTDC are now novated to CPPA-G.

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.

Amendment of PPA involving tariff adjustment and recovery of outstanding receivables:

On 12th Aug, 2020, EPQL along with other Independent Private Power Producers (IPPs) representing the 2002 Power Policy projects signed a Memorandum of Understanding (MoU) with the Committee for negotiations with IPPs. In line with the understanding reached in the MOU, EPQL and CPPA entered into a Master Agreement on February 11, 2021, based on the terms of the MOU, including that all undisputed outstanding amounts due and payable to the Company under the PPA, as on 30th Nov'20, will be paid in two instalments, each instalment comprising of one-third cash and two-thirds government issued Pakistan Investment Bonds (PIBs) and Sukuks. Further, the Company also accepted a reduction in the tariff component, whereby the Return on Equity (RoE) and the Return on Equity During Construction (RoEDC) will be fixed at 17% per annum in rupee terms on NEPRA's approved equity at COD for RoE and RoEDC, calculated at USD/PKR exchange rate of PKR 148/USD, with no future USD indexation. However, the existing RoE and RoEDC, together with the applicable indexations, will be applied until the date when the applicable exchange rate under the present tariff reaches Rs. 168/USD and instalments are received by the Company, whereupon the

Revised RoE and RoEDC shall become applicable and will apply for the remainder of the term of the PPA.

In addition to this, fuel and operations and maintenance have been considered as single consolidated item and any savings, if determined, from 1st July, 2021 will be shared in the ratio of 60:40 between CPPA and the Company. EPQL has received the first installment amounting to Rs. 3.3b which is equivalent to 40% of the agreed amount in one-third cash and two-thirds government issued PIBs and Sukuks. Given, the first tranche of overdue receivables was received by the company in Jan'22, the recording of revenues under the new tariff regime started in the ongoing year. In addition, the second tranche of receivables was also received in June'22.

Key Rating Drivers

Strong sponsor profile & experienced management team

EPQL is majority owned (68.9%) by EEL, which in turn is a wholly subsidiary of Engro. Engro is a renowned business group with diversified business interests and strong financial muscle. The group has presence in fertilizer, dairy, telecom infrastructure, energy & mining, petrochemical and chemical storage and handling sectors. VIS expects that financial and technical support will be extended by sponsor, if need be, in the future. Ratings also draw comfort from significant experience of EEL/Engro in executing similar projects.

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 mitigated due to inbuilt take or pay tariff provision and 25-year PPA with power purchaser

In case electricity is not purchased, EPQL 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 impact 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). Moreover, 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. 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.

Increase in revenues on account of higher quantum of energy delivered to national grid. However, profitability metrics depicted downward trajectory in line with lower capacity payments received due to discontinuation of debt servicing component. Profitability indicators are projected to remain subdued, going forward due to ROE adjustment in the tariff and merit order at similar levels.

In line with increase in electricity generated and delivered to national grid to 851,197 MWh (FY20: 550,415 MWh), EPQL's revenue was recorded higher at Rs. 10.2b (FY20: Rs. 8.1b) during FY21. The revenue comprised of higher energy purchase price (EPP) payments recorded at Rs. 8.8b (FY20: Rs. 5.6b) from combined cycle operations meanwhile capacity purchased price (CPP) decreased to Rs. 2.7b (FY20: Rs. 3.3b) during FY21. The increase in sales revenue is attributable to higher energy dispatch during the year which was partly offset by lower capacity payments due to debt servicing component no longer being applicable as the long-term loan fully matured in FY20. Subsequently, the contribution of EPP payments, to sales revenue increased, therefore the gross margins of the company declined to 13.6% (FY20: 21.5%) during FY21. The company's load factor also increased to 45.7% during FY21 as opposed to 29.5% in the preceding year primarily due to higher merit order ranking and consequently higher dispatch. The administrative expenses increased to Rs. 168.0m (FY20: Rs. 103.7m) owing to annual salary adjustments made during the year. On the other hand, net finance income declined to Rs. 433.5m (FY20: 445.7m) during FY21. Moreover, as per the IA the company is not liable to taxation on its income from the power project as provided under the Income Tax Ordinance, 2001 while tax is payable on income from other sources, therefore, provision for tax on income from other sources was charged minimal at Rs. 1.9m (FY20: 15.1) during FY21. Due to absence of debt servicing component in topline, , EPQL's bottom line was recorded lower at Rs. 1.6b during FY21 vis-à-vis Rs. 2.1b in the preceding year.

The EPQL plant demonstrated a billable availability factor of 99.9% and total Net Electrical Output of 124 Gwh to the national grid with a load factor of 27% as compared to 41% (1QFY21: 41%) during 1QFY22. The lower load factor is on account of ongoing scheduled maintenance outage due to major overhaul, which is done after every six years. Moreover, sales revenue was also recorded lower at Rs. 1.4b during 1QFY22 as opposed to Rs. 2.3b in the corresponding quarter last year; the decrease in sales revenue is attributable to lower Period Weighing Factor (PWF) applicable on capacity payments, during the period along with lower dispatch on account of maintenance outage. Consequently, gross margins also declined during the relevant period. On the back of lower capacity payments emanating from reduced PWF leading to depressed revenues and margins, EPQL's profit after tax for 1QFY22 was reported lower at Rs. 151.0m (1QFY21: Rs. 399.3m); this will be offset on annual basis by a higher PWF in subsequent months.

Cash flows are adequate for servicing outstanding debt obligations. Moreover, with the first tranche of receivables due from CPPA-G received during the ongoing year has given boost to liquidity.

Liquidity profile of the company is supported by healthy cash flows generation. In line with reduction in margins for FY21, funds from operations (FFO) decreased to Rs. 2.5b (FY20: Rs. 2.6b) at end-HY22. However, despite reduction in FFO, FFO to total debt was adequate at 0.53x (FY20: 0.70) at end-FY22. The FFO for 1QFY22 was recorded lower; however, the same was an outcome of a one-off event planned once every six years. Moreover, the company has a long-term debt free balance sheet given the long-term borrowing was retired in full in FY20. Therefore, sizable increase was manifested in debt service coverage which was recorded higher on a timeline basis at 6.66x (FY21: 8.98x; FY20: 2.32x) at end-1QFY22. The energy sector continues to be gripped by growing circular debt in the country which reached Rs. 2.5 trillion mark at end-April'22, translating into liquidity constraints for the power producers. Going forward, given the circular debt situation of the country, regular collections from the power purchaser are expected to remain under pressure in the medium term. However, with the second tranche of receivables serviced in June'22, liquidity indicators of the company are projected to improve in the short-term.

Leverage indicators increased on a timeline basis in line with higher utilization of short-term borrowing to finance working capital requirements coupled with sizable dividend payout during the rating review period:

Total equity of EQPL decreased on a timeline to Rs. 14.4b (FY21: Rs. 16.2b; FY20: Rs. 15.6b) at end-1QFY22 owing to sizable final dividend of Rs. 6.0/share amounting to Rs. 1.9b paid for the outgoing year during the review period. Moreover, short-term debt carried on the balance sheet increased to 5.5b (FY21: Rs. 4.8b; FY20: 3.6b) by end-1QFY22 in line with higher working capital requirements. Subsequently, as combined impact of reduction in equity base along with higher utilization of short-term funding, gearing and leverage trended upwards slightly to 0.38x (FY21: 0.29x; FY20: 0.23x) and 0.71x (FY21: 0.70x; FY20: 0.63x) respectively at end-1QFY22; however, despite the increase the leverage indicators still remain within the benchmark range for the assigned rating. 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.

FINANCIAL SUMMARY	*(amounts in PKR millions)*			
BALANCE SHEET	**2019**	**2020**	**2021**	**1Q22**
PP&E	13,299	12,686	11,815	11,736
Long term loans and advances	35	23	14	13
Stock in Trade	863	853	544	534
Trade Debts	9,807	7,040	11,843	9,774
Short term investment	50	49	49	50
Advances, Deposits, Prepayments and Other Receivables	3,339	4,748	2,872	2,213
Cash & Bank Balance	12	13	44	85
Other Assets	136	97	263	258
Total Assets	**27,541**	**25,510**	**27,445**	**24,663**
Trade & Other Payables	8,407	5,191	6,432	4,669
Accrued Markup	93	55	61	69
Short-term Borrowings	3,713	3,618	4,752	5,518
Long-Term Borrowings *(Inc. current maturity)*	857	0	0	0
Total Debt	4,570	3,618	4,752	5,518
Other Liabilities	509	1,009	21	20
Total Liabilities	13,578	9,874	11,267	10,277
Paid Up Capital	3,238	3,238	3,238	3,238
Tier-1/Total Equity	**13,963**	**15,637**	**16,178**	**14,386**
INCOME STATEMENT	**2019**	**2020**	**2021**	**1Q22**
Net Sales	13,201	8,098	10,204	1,387
Gross Profit	3,616	1,739	1,383	109
Operating Profit	3,464	1,649	1,163	24
Profit Before Tax	3,406	2,094	1,597	152
Profit After Tax	3,403	2,079	1,595	151
FFO	4,288	2,646	2,510	362
RATIO ANALYSIS	**2019**	**2020**	**2021**	**1Q22**
Gross Margin (%)	27%	21%	14%	8%
Net Margin (%)	26%	26%	16%	11%
Net Working Capital (Rs. millions)	558	3,851	4,121	2,415
FFO to Long-Term Debt (x)	5.00	NA	NA	NA
FFO to Total Debt (x)	0.94	0.73	0.53	0.26
Debt Servicing Coverage Ratio (x)	1.44	2.32	8.98	6.66
ROAA (%)	13%	8%	6%	1%
ROAE (%)	27%	14%	10%	1%
Gearing (x)	0.33	0.23	0.29	0.38
Debt Leverage (x)	0.97	0.63	0.70	0.71
Current Ratio (x)	1.04	1.43	1.37	1.23
Inventory + Receivables to Short-term Borrowings (x)	2.87	2.18	2.61	1.87

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.

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
14/7/2022	AA-	A-1	Stable	Reaffirm
23/6/2021	AA-	A-1	Stable	Reaffirm
5/6/2020	AA-	A-1	Stable	Reaffirm
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.
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. 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

	Name	Designation	Date
1	Anum Irfan	Manager Finance & Planning	June 27, 2022