RATING REPORT

Gharo Solar Limited

REPORT DATE:
September 6, 2022

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity			A	A-1
Rating Date	*6 September'22*		*27 October'21*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Upgrade	

COMPANY INFORMATION

Incorporated in 2016	**External auditors:** KPMG Taseer Hadi & Co. Chartered Accountants
Public Unlisted Company	**Chairman:** Rana Nasim Ahmed **CEO:** Rana Uzair Nasim
Key Shareholders (with stake 5% or more):	
Rana Nasim Ahmed – 55%	
Windforce (Private) Ltd – 30%	
Norsk Solar – 10%	
Mohammad Khaqan Babar Cheema – 5%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Gharo Solar Limited

OVERVIEW OF THE INSTITUTION

Gharo Solar Limited was incorporated in June, 2016, as a private limited Company under the repealed Companies Ordinance, 1984 (now Companies Act, 2017). Subsequently, the Company changed its legal status from private to public limited company on January 01, 2019. The Company owns and operates a solar power plant of 50 MW generation capacity.

Profile of CEO:
Rana Uzair Nasim is also the CEO of Harappa Solar (Pvt) Ltd and has led the project from inception through commissioning and operations. He has previously worked as a management consultant in New York with Oliver Wyman and Dalberg Global Development Advisors. He holds a BA degree in Economics and and MS degree in Management Sciences & Engineering, both from Stanford University, California, USA.

RATING RATIONALE

Incorporated in 2016, Gharo Solar Limited (GSL) is engaged in the generation and supply of electricity to K-Electric through a 50 MW solar PV power plant near Gharo, District Thatta, Sindh. The plant was constructed at a total cost of ~ Rs. 6.3b with debt to equity ratio of 75:25. The ROE of the project was determined at 15%. The Company has opted for cost-plus tariff structure. The project sponsors include local and international players having considerable expertise operating renewable energy projects.

Key Rating Drivers

Sound sponsor profile

The ratings incorporate sound profile of local and international sponsors having considerable experience in setting up green-field projects in power and industrial sectors. Chairman, Mr. Rana Ahmed holds major stake at ~55% is also the main sponsor of Harappa Solar, an 18MW solar PV power plant under operation near Sahiwal. Other significant shareholder, Windforce Pvt Ltd (~30%) is a leading private sector power producer in Sri Lanka with diversification into wind, solar, and hydro power across various countries in the world. Apart from Pakistan, Windforce has plants established in Uganda and Ukraine as well and is conducting feasibility studies to expand further across the globe. Norsk Solar that holds ~10% stake, is a Norwegian based vertically integrated IPP and focuses on building solar projects in emerging markets.

Leveraging their experience in solar power, sponsors plan to invest in three new projects in Balochistan. In this regard, bids are expected to be placed soon.

Sound operating performance observed on a timeline basis

The solar power plant started commercial operations in December 2019. The Annual Benchmark electricity generation for GSL based on 22.21% capacity factor is 97,279.8 MWh. However, the plant has been performing well above the NEPRA laid performance parameters and produced a higher output than the benchmark level in each year of operation with a capacity factor hovering above an average of 24%. Under the EPA, GSL will further reap the benefit from producing electricity beyond the benchmark capacity factor in the form of higher tariff payments.

in MWh	FY20	FY21	FY22
Installed capacity – Kilowatts	50,000	50,000	50,000
Annual benchmark energy-kWh	51,032,026	97,279,800	97,279,800
Actual energy delivered- kWh	64,679,000	108,626,026	102,644,000

To effectively utilize solar energy, the company has installed PV solar plant for the first time in Pakistan. It has a bi-facial solar technology and single axis trackers, along with sun tracking technology, which helps in absorbing the maximum amount of solar radiation to convert it into power. Also, the Company has installed dual glass technology to avoid abrasion and cope up with the variance in temperature levels.

Actual energy delivered declined to 102.6 kWh in FY22 on account of one-off incremental energy accounted for in FY21 after finalization of true-up. With reference to the production benchmarks, the company has been consistently producing in excess of the same.

Presence of long-term Energy Purchase Agreement with K-Electric and O&M contract with experienced operator mitigates operational risk.

The electricity generated is purchased by K-Electric under the Energy Purchase Agreement (EPA) dated September 26, 2018 which is valid for 25 years from the Commercial Operations Date. In case K-Electric is unable to accept all energy delivered, this will constitute as Non Project Event (NPE) and GSL will continue to receive the payments from K-electric under Non-Project Missed Volume (NPMV) which is compensation of loss of revenue. Furthermore, even if the plant remains non-operational for a period due to any reason, K-Electric is liable to pay GSL for those days on the basis of expected units determined by an independent valuator. Probability of the same is on the lower side since the plant is classified as a must-run plant in the merit order.

Revenue from K-Electric is invoiced monthly and the payment mechanism is executed through an escrow account where K-Electric is required to pay within 30 days once the invoice is received. The escrow mechanism allows direct transfer to GSL's revenue account before K-electric can access its account for other transactions. In case of delayed payment, the K-Electric is liable to pay markup at the rate of KIBOR plus 2% on prorated basis for the delayed period. To-date all payments have been received on time.

As per initially agreed terms, the Company has signed a 3 year O&M contract with OMS (Pvt.) Ltd. As per management, upon completion of assigned term ending in Dec'22, the contract is expected to be renewed with the same operator. OMS (Pvt.) Ltd has a sound track record and extensive experience in renewable energy sector with notable clients including Orient Power Company Limited, Packages Limited, JDW Power (Private) Ltd., K-Electric, Punjab Thermal Power Limited, and Northern Power Generation Company Limited. This, coupled with the fact that the entity operates and maintains other power plants of the group as well provides comfort against operational risk.

Topline and profitability indicators depicted a slight fall, as routine indexation of tariff resumed.

Topline of the company for FY22 was reported at Rs. 1.1b (FY21: Rs. 1.3b, FY20: Rs. 427m) being lower than FY21 due to the fact that revenue for last year comprised an amount of Rs. 213m that pertained to energy delivered in FY20. The reason for that was the delay in true-up decision by NEPRA, which resulted in tariff adjustment for two years at once. Since July'21, tariff indexation takes place on a quarterly basis, with the latest rate being approved at Rs. 12.365/kWh (for Jul-Sep'22) against a levelized tariff awarded of Rs. 8.7/kWh.

As direct costs and operating expenses remained at similar levels, accounting fall in revenue also impacted quantum of net profitability. Gross margins and net margin for the year were reported at 65% (FY21: 71.3%, Fy20: 57.4%): and 36.7% (FY21: 44.4%, FY20: 2.3%), respectively. Currently, the management is working on enhancing the efficiency of the plant by making some technical adjustments, which will help to achieve an even higher output going forward.

Sound liquidity profile.

In line with lower profits, Funds from Operations (FFO) decreased to Rs. 658m (FY21: Rs. 816m, FY20: Rs. 197m) in FY22. However, the relevant liquidity indicators remained at reasonable levels with Debt service coverage ratio (DSCR) and FFO to Total Debt were reported at 1.39x (FY21: 1.61x, FY20: 1.69x) and 12% (FY21: 17%, FY20: 4%), respectively at end-June'22. Current ratio stood at a comfortable level of 2.0x (FY21: 3.4x, FY20: 2.6x) at end-FY22. Comfort is drawn from the presence of Debt Service Reserve Account for debt repayments. GSL has invested Rs. 541m of excess cash accumulation in mutual funds against the minimum requirement of Rs. 300m. Consequently, portfolio of short-term investments also provides support to the liquidity profile of the company.

Leverage indicators have increased in the review period due to a rise in the value of dollar based debt and a significant dividend payout.

Equity base of GSL fell to Rs. 2.0b at end-FY22 (FY21: Rs. 2.3b, FY20: Rs. 1.7b) due to dividend payout to the tune of Rs. 650m (which was higher than the yearly profit). This quantum of dividend payout is not sustainable as per management as it was paid as a compensation for a period of three years. Going forward, management foresees quantum of dividends amounting around Rs. 300m in accordance with the profit earned over the year. Due to a depreciation of local currency against USD, quantum of foreign debt in rupee terms increased. As per accounting standards, the company is not allowed to adjust dollar based equity in the same manner as debt. Consequently, gearing and leverage ratios were reported higher at 2.7x (FY21: 2.2x, FY20: 3.2x) 2.8x (FY21: 2.2x, FY20: 3.3x) at end-June'22. Going forward, considering no further drawdown of debt is planned, the projected increase in equity on the back of higher profit retention is expected to bring leverage indicators down.

Gharo Solar Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY20**	**FY21**	**FY22**
PP&E	6,062	5,762	6,464
Trade Debts	192	237	299
Cash & Bank Balance	698	241	205
Short Term Investments	201	421	541
Total Assets	**7,345**	**7,270**	**7,625**
Trade & Other Payables	94	45	112
Short-term Borrowings	0	0	0
Long-Term Borrowings *(Inc. current maturity)*	5,521	4,937	5,479
Total Debt	5,521	4,937	5,479
Total Liabilities	5,619	4,986	5,595
Paid Up Capital	169	1,002	1,002
Total Equity	1,726	2,285	2,031
INCOME STATEMENT	**FY20**	**FY21**	**FY22**
Net Sales	427	1,260	1,078
Gross Profit	245	899	701
Profit Before Tax	12	565	411
Profit After Tax	10	559	396
FFO	197	816	658
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**
Gross Margin (%)	57.4%	71.3%	65.0%
Net Margin (%)	2.3%	44.4%	36.7%
FFO to Total Debt (x)	4%	17%	12%
Debt Servicing Coverage Ratio (x)	1.69	1.61	1.39
ROAA (%)	0.2%	7.6%	5.3%
ROAE (%)	0.6%	27.9%	18.4%
Gearing (x)	3.20	2.16	2.70
Debt Leverage (x)	3.25	2.18	2.76
Current Ratio (x)	2.63	3.42	1.98

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	Annexure III				
Name of Rated Entity	Gharo Solar Limited				
Sector	Power				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	RATING TYPE: ENTITY				
	09/06/2022	A	A-1	Stable	Reaffirmed
	27/10/2021	A	A-1	Stable	Upgrade
	11/08/2020	A-	A-2	Stable	Reaffirmed
	03/05/2019	A-	A-2	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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Due Diligence Meetings Conducted	Name	Designation	Date		
	Mr. Husnain Arif	CFO	August 18, 2022		
	Mr. Kamil Munir	Assistant Manager Finance	August 18, 2022		
	Mr. Muhammad Sahal	Assistant Manager Finance	August 18, 2022		
	Mr. Usman Amjad	Assistant Manager Commercial	August 18, 2022		