RATING REPORT

Mughal Energy Limited

REPORT DATE:

July 14, 2021

RATING ANALYSTS:

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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	A-	A-2
Rating Date	*14 July, 2021*	
Rating Outlook	Stable	

COMPANY INFORMATION	
Incorporated in 2012	**External auditors:** Fazal Mahmood & Company, Chartered Accountants
Public (Unlisted) Company	**Chairman:** Mirza Javed Iqbal **CEO:** Mr. Khurram Javed
Key Shareholders (with stake 5% or more): Jamshed Iqbal -- 33.34% Khurram Javaid—16.70% Fazeel Bin Tariq—16.68% Fahad Javaid—16.61% Muhammad Waleed Bin Tariq Mughal—16.61%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (May 2019) ***https://www.vis.com.pk/kc-meth.aspx***

Mughal Energy Limited

OVERVIEW OF THE INSTITUTION

MEL was incorporated in August 19, 2012 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017) in Pakistan with the objective of generating and selling electricity. The registered office of the company is located at 31-A, Shadman-1, Lahore.

Profile of Chairman

Mirza Javed Iqbal has over 40 years of experience of steel sector. He is also on the board of Mughal Iron & Steel Industries Limited.

Profile of CEO

Mr. Khurram Javed is also CEO of Mughal Iron & Steel Industries Limited. He holds an MBA from the Coventry University, UK. He has around 15 years of experience of actively managing and monitoring the parent company.

RATING RATIONALE

Mughal Energy Limited (MEL) is an associated company of Mughal Iron & Steel Industries Limited (MISIL), one of the largest steel manufacturing concern in Pakistan. The majority shareholders (~76%) of MISIL hold 100% stake in MEL. The company is in process of installing a 36.5 MW hybrid power plant for uninterrupted supply of electricity to MISIL. The project is expected to achieve commercial operations by Sep'22.

Total project cost is estimated at Rs. 5.1b to be funded through debt amounting Rs. 3.7b and an equity of Rs. 1.4b. MISIL has issued a cross corporate guarantee in favor of banks to the tune of Rs. 6b for a period of 5 years. The loans have also been secured by way of personal guarantees of all directors.

Key Rating Drivers

Power Purchase Agreement (PPA) is expected to be signed with Mughal Iron & Steel Industries Limited (MISIL) in July 2021: MISIL is one of the largest steel manufacturing concern in Pakistan. MISIL has an estimated power requirement of at least 100 MW at its peak load production capacity, for which it is dependent on Water & Power Development Authority (WAPDA) as a main power source. MEL is in a process of installing a coal fired power plant with a gross capacity of 36.50 MW and net capacity of 32.12 MW. Electricity would be priced at cost-plus pricing model; it is expected to be at a discounted rate than what is being charged by WAPDA.

Total project cost is estimated at Rs. 5.1b to be funded through debt and equity mix of 72:28, with debt amounting Rs. 3.7b and equity amounting Rs. 1.4b. The sponsors have contributed the agreed proportion of the equity through land worth Rs. 1.17b and payment of first installment amounting Rs. 274.2m. Land has been acquired and is adjacent to MISIL plant. Project cost is determined using higher exchange rate of Rs. 165/USD to account for changes in currency rate while rate of markup including spread is determined at 8.50%. Diminishing Musharaka facilities of Rs. 1.7b have been approved by three commercial banks by end-March, 2021 with a tenure of 7 years including 1.5 years of grace period. Murabaha facility of Rs. 0.2b for a tenor of 180 days has also been sanctioned. Approval of remaining financing amounting Rs. 1.7b is currently in process. MISIL has issued a cross corporate guarantee in favour of banks to the tune of Rs. 6b for a period of 5 years. In addition, the loans have been secured by way of personal guarantees of all directors, first *pari passu* charge over present and future fixed assets of the company through equitable mortgage via constructive Memorandum of Deposit of the Title Deed (MODTD) and letter of hypothecation over plant and machinery of the company. Breakup of project cost and other attributes are presented below:

Total Project Cost:	Rs. 5,093.6m
Foreign Component	Rs. 2,310.0m
Local Component	Rs. 2,783.6m
Gross Capacity	36.50 MW
Net Capacity	32.12 MW
Efficiency	31%
Turbine Manufacturer	Siemens, TGM Kanis
Boiler Manufacturer	Sulzur/Stern Muller
Useful Life	20 years
Feedstock Type	Mix of indigenous and imported Coal, and Bark
Annual Feedstock Requirement	119,486 MT

With equity contribution of Rs. 1.4b including revaluation surplus of Rs. 0.7b on land, gearing (calculated on Tier 1 equity) is projected at 4.7x after mobilization of total bank borrowings.

Equipment Purchase Agreement (EPA): MEL has signed equipment purchase agreement with RWV GmbH, Deggendorf, Germany, also referred as 'Karl Group' on April 14, 2021. The contract entailed sale and purchase of inoperative hybrid power plant located in Germany which has to be dismantled from the property, referred to as H-Power plant. The plant had initially been installed in 1983 and has been inoperative since 2011 post refurbishment. MEL is responsible for dismantling, loading, freight and transport of the power plant equipment to the loading port. The dismantling and removal will be carried out in accordance with the relevant regulations and technical rules itself or by the contractors at its own expense and risk. However, the company cannot start dismantling until the first installment has been paid. All relevant regulations such as Technical Rules for Hazardous Substances (TRHS) and technical rules applicable to the dismantling work will be complied by the company and its agent. The dismantling/removal work must be completed and removed by November 30, 2021 at the latest. After this date, all production facilities and parts thereof acquired by the buyer but not dismantled/removed by that date will become the ownership of the seller. The purchase price remains unaffected by the decision of the buyer on the whereabouts and dismantling and removal of certain elements. This period can be extended till January 31, 2022, in case covid-19 restrictions cause the buyer to exceed the deadline. The period can be extended further till March 30, 2022 in case of force majeure. Until March 30, 2022 the right to terminate the purchase agreement because of a force majeure event will be waived.

The company has appointed shipping company namely 7 Worldwide Logistics GmbH, Bermen for transportation of the equipment. The Karl Group is entitled to receive a first installment of USD 1.8m (USD 1.5m for Karl Group; USD 0.3m for forwarding payment for dismantling) after twenty-one days following the receipt of LC. The remaining purchase price shall be paid through further drawdowns under LC installments along with the dismantling progress of the power plant equipment. Purchase price is agreed at USD 9m, out of which USD 6.3m is for purchase of equipment, USD 1.8m for dismantling and USD 0.9m is allocated for shipping. Payment has to be made in seven installments with first installment of USD 1.76m, following five installments of USD 1.27m each and last installment of USD 0.90m. Advance payment guarantee will be reduced automatically by USD 250,000 with each of the further installments received by the seller until it reaches zero.

The bank issued LC of USD 9m in May, 2021 while the company has also paid first installment, which was funded through equity. MEL has finalized dismantling agreement with Pol-Inowex against performance guarantee of EUR 5m as per requirements of EPA. Pol-Inowex is a Polish company having around three decades of experience in innovative dismantling, industrial relocation and reassembly services. Dismantling is underway and the first shipment is expected to be received in July, 2021.

Force Majeure*:* As per agreement, the seller and the buyer are not responsible for any force majeure event. For the purpose thereof, the term force majeure means and include, work stoppages, strikes, epidemic pandemic, act of God, act of terrorism, other disruption or interference with trade, government sanction, prohibition or restraint, civil commotion and any other unforeseen event beyond the reasonable control of either party that renders or is reasonably expected to render performance of a party's obligation hereunder commercially impractical, illegal or impossible to perform. In the event of force majeure circumstances, the party whose performance is impacted will notify the other party in writing in accordance with the notice provision of purchase agreement within five business days of existence of such circumstances. The party claiming the force majeure will also immediately notify the other party in accordance with the notice provision, when the force majeure circumstances have ended. If the notice required under this provision is not given within the stipulated time, the party failing to give such notice will not be entitled to any defenses available for any period of time before giving of such notice. In addition, if a force majeure event continues for a period of more than sixty consecutive days, either party may, upon written notice to the other party, terminate this purchase agreement without penalty.

Descon Engineering Limited (DEL) has been finalized as local contractor: DEL submitted technical proposal for power plant relocation project for the provision of engineering, project management, required procurement, construction & commissioning management on August 04, 2020 which was accepted by MEL. The contractor has started first phase of civil work. The company has made first payment of Rs. 10m to the contractor through own sources. In addition, MEL plans to enter into long-term Operations & Maintenance (O&M) with DEL after the project becomes operational. Scope of work of Descon as a local contractor entails:

- Engineering services including design of existing plant and equipment, new equipment and system design, plant and system integration;
- Procurement services includes requests for quotes (RFQs) preparation; floating inquiries and receipt of quotations; technical bids evaluation and purchase order issuance and post purchase order activities;
- Project management encompassing formation of project management team, project planning, scheduling and monitoring, documentation control, project invoicing, quality control and quality assurance, health safety environment;
- Site mobilization and Tailing Storage Facility (TSF)
- Construction of plant—civil works, mechanical works, electrical and instrumentation works, pre-commissioning of plant;
- Commissioning management services; and,
- Post commissioning activities.

Meanwhile, MEL would be responsible for due diligence of existing power plant, dismantling from existing site and transportation to the project site in Pakistan. The company will be responsible for provision of required quality and quantity of fuels and chemicals for carrying out commissioning of the plant. In addition, the company has hired UJV Rez, a.s., Czech Republic, for design and performance warranty for the first year. UJV has extensive experience spanning over 85 years in providing engineering and advisory services in the field of investment construction of nuclear energy and conventional energy.

Mughal Energy Limited Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY19**	**FY20**	**9MFY21**
Non-current Assets	375.9	467.9	1,173.8
Current Assets	41.7	35.6	49.4
Total Assets	**417.5**	**503.5**	**1,223.2**
Total Liabilities	1.3	0.1	0.3
Paid-Up Capital	451.4	451.4	451.4
Tier-1 Equity	416.2	503.4	517.0
Total Equity	416.2	503.4	1,222.8
INCOME STATEMENT	**FY19**	**FY20**	**9MFY21**
Profit/(Loss) Before Tax	(2.4)	(1.4)	(0.3)
Profit After Tax	(2.4)	(1.4)	(0.3)
RATIO ANALYSIS	**FY19**	**FY20**	**9MFY21**
Current Ratio (x)	32.1	356.0	164.7
Gearing (x)	0.0	0.0	0.0

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix 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	Mughal Energy 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		
	07/14/2021	**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	
	1	Mr. Muhammad Zafar Iqbal	Chief Financial Officer	June 17, 2021	
	2	Mr. Muhammad Fahad Hafeez	Company Secretary	June 17, 2021	