RATING REPORT

Zhenfa Pakistan New Energy Company Limited (ZPNECL)

REPORT DATE:
Dec 27, 2022

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-2	A-	A-2
Rating Date	*27th Dec '22*		*3rd Nov '21*	
Rating Outlook	*Stable*		Stable	
Rating Action	Upgrade		Initial	

COMPANY INFORMATION

Incorporated in 2014	**Chairman:** Mr. Frahim Ali Khan
Public Limited Company	**Chief Executive Officer:** Mr. Maqsood A. Basraa
Key Shareholders (with stake 10% or more):	
Atlas Power Limited – 60%	
Shirazi Investments (Private) Limited – 20%	
Zhenfa Energy Group Co. Limited – 20%	

APPLICABLE METHODOLOGY(IES)

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

Zhenfa Pakistan New Energy Company Limited (ZPNECL)

OVERVIEW OF THE INSTITUTION

Zhenfa Pakistan New Energy Company Limited (ZPNECL) was incorporated in Pakistan on September 04, 2014 under the repealed Companies Ordinance, 1984 (now Companies Act, 2017) with the object to construct, operate and own a 100MW solar power plant for generation and supply of electricity.

Chairman's Profile:
Mr. Frahim Ali Khan has *over 50 years of experience in General Management, Finance, Investment and Taxation. He joined the Atlas Group in 1967 and has served in different positions. Currently his directorships include Atlas Battery Limited, Atlas Insurance Limited, Atlas Asset Management Limited, Atlas Engineering (Private) Limited, Atlas Power Limited, Atlas Energy Limited, Atlas Autos (Private) Limited, Atlas Metal (Private) Limited, Shirazi Trading Company (Private) Limited and Atlas Foundation. Mr. Frahim Ali Khan is a Law graduate from Karachi University.*

CEO's Profile:
Mr. Maqsood A. Basraa has been the Chief Executive Officer of ZPNECL since October 2019 while Group Director Business Development (GDBD) Power and Member Group Executive Committee (GEC) since April 2017. He is with the Atlas Group since 1989. Prior to this position he has been working as GM and group director in different companies of the group in different area of business

RATING RATIONALE

The ratings assigned to Zhenfa Pakistan New Energy Company Limited (ZPNECL) incorporate the company being a part of 'Atlas Group' which is one the biggest and renowned conglomerates in the country with business interests in automobiles, batteries, insurance, asset management, trading and energy. The ratings take into account the company's low business risk profile underpinned by inking of energy purchase agreement (EPA) with the Central Power Purchasing Agency (Guarantee) Limited (CPPA-G) with the inbuilt 'take or pay' provision for a period of 25 years. Further, given the energy generation of the company is dependent on a renewable source, solar, with the same being one of the cheapest sources of energy, the project is expected to stay high in the merit list. The long-term rating upgrade is underpinned by elimination of construction risk as the project achieved commercial operations on 14th April, 2022.

Completion risk eliminated; the COD was achieved on 14th April, 2022.

The company was granted power generation license by National Electric Power Regulatory Authority (NEPRA) on July 10th, 2017. The project was financed through debt to equity mix of 80:20, where debt matrix comprises around three-fifths of foreign funding while the remaining was contributed by country's leading commercial bank. The Construction Contract (CC) is signed with Hydrochina International Engineering Company Limited (HIECL) as onshore construction contractor while Hangzhou Huachen Electrical Power Control Co. Limited (HHEPCL) is the offshore supplier. HIECL is a subsidiary of 'PowerChina', one of the biggest construction groups in the power sector with engagement in over 100 countries. HIECL is also the O&M contractor for the initial two years of warranty period. Moreover, HIECL as the O&M operator, is also obligated to pay (liquidated damages) LDs if the plant is unable to maintain benchmark availability. The company has adequate insurance coverages for cargo, operations, erection, liability, third party and terrorism. Initially, commercial operations date (COD) was expected to be achieved in December'21; however, due to force majeure claimed due to covid-19 the required COD date was extended till May'22 with no LDs to be paid. On the other hand, the actual COD was achieved well ahead of time on 14th April'22, therefore the risk related to construction has been eliminated. The majority shareholding is vested with Atlas Power Limited (holding company) with 60% shares; whereas, ultimate parent is Shirazi Investments (Private) Limited.

Change in Financial Reporting Period

ZPNECL's year-end for financial reporting has been changed from December to June as per regulatory requirement regarding the year end to be aligned with the holding company's year-end. Therefore, the June'22 numbers are now reported as annual numbers but in actuality the income and cashflow statements only provides for performance of half year.

Project Design:

The solar power plant is constructed and being operated on land leased by the government for 25 years. The electric power generation facility comprises arrays of solar photo-voltaic modules located at the site and the interconnection facilities, having a nominal rated capacity of approximately 100 MW. The financial close of the project was achieved on 18th Feb'21. The inverters are central type with 3125 kW from Sungrow, one of the leading manufacturers of central inverters globally. Further, the module manufacturer has provided 25 years linear performance warranty and 10 years limited product warranty for the modules. As a result of the advanced solar panel technology, with the configuration of full single axis tracking, the capacity factor of the project is higher than other solar power plants commissioned in the country at 21.51%. As per the management, currently the plant is operating at a capacity factor higher than 21.51%. Going forward, upholding operational performance in line with agreed performance levels would remain a key rating driver.

Cost Structure & Drawdowns:

Given delay in COD by around four months, slight cost escalation was evidenced to USD $59.41 as opposed to initially determined at USD $58.3 on account of interest during construction (IDC) component as there was no change in insurance with financial charges and EPC cost capped.

such as finance, commercial & logistics, HR& Administration, IR Business corporate affairs, CEO of Atlas Power for 11 years. He is also CEO of Atlas Energy, another group company which is developing renewable power sale business. Before joining to this group he served State Bank of Pakistan for ten years. He is the Fellow Member of Institute of Cost & Management Accountants of Pakistan.

Spread on the foreign finance is recorded at i.e., 3-M-LIBOR plus 4.25%. The return on equity during construction has been allowed at 14.0%. The savings in the approved spreads shall be shared between the power purchaser and power producer in the ratio of 60:40. Entire debt drawdown and equity injection was completed during the rating review period. Repayment of the company debt (local & foreign) amounting to USD $1.1m in aggregate was extended by one quarter in line with delay in COD; the same was paid at end-June'22 as opposed to initially planned for end-Mar'22. In addition, the September installment of around Rs.129m comprising of local debt of Rs. 44m and foreign debt of Rs. 85m ($0.37m) has also been paid. As per the management, the upcoming December installment amounting to Rs. 69m along with the succeeding two installments of debt will be partially payable from revenue generation coupled with working capital facility.. The salient features of the project as per the company's financial model are tabulated below:

Breakup of Project Cost	**USD (in m)**
Total Project Cost	**59.41**
EPC Cost:	53.55
Project Development Cost	1.70
Insurance During Construction	0.21
Interest During Construction (IDC)	2.8
Financial Charges	1.15
Minimum DSCR	1.32x
Maximum DSCR	1.41x
Average DSCR	1.33x
Allowed Equity IRR	14%
Foreign Loan Spread	3M-LIBOR+4.25%
Local Loan Spread	3M-KIBOR+1.75%

Construction Contract (CC) with HydroChina International Engineering Company Limited (HIECL): ZPNECL (employer) entered into a CC contract with HIECL (Contactor) on 21st January, 2021 amounting to Rs. USD $10m. HIECL is incorporated under the laws of People's Republic of China, with its principal office located in Chaoyang District, Beijing and a registered office in Karachi, Pakistan. HIECL provides energy services through designing, consultations, supervising, developing and operating new energy generation projects

In addition, the Offshore Supply Contract (OSC) for provision of equipment was signed with Hangzhou Huachen Electric Power Control Company Limited (HHEPCL) on 21st January, 2021 amounting to USD $43m. The Offshore Supplier (OS) is responsible for the adequacy, stability and safety of all the supply obligations. In terms of performance guarantees (PGs) and liquidated damages (LDs) resulting from issues pertaining to equipment malfunctioning will be met by HHEPCL while the remaining from construction and installation issues will be met by HIECL.

CC/OSC LDs in view of failing to Achieve Guaranteed Performance: In the event the completed works/supply fails to achieve the performance guarantees (PG), the contractor will have to pay ZPNECL the liquidated damages, calculated in accordance with the detailed formula of performance LDs (mentioned in schedule 4 of CC/OSC of company's agreements). These LDs are cumulative and if there are claims in respect of more than one PG, the LDs payable will be the sum of the applicable amounts. Any failure by the contractors to timely submit any reports, information or certifications required by CC/OSC will not result in the imposition of any LDs. Failure to perform tests on completion also fall under the ambit of failing to achieve guaranteed performance.

Delayed Payment Penalties: If the contractors or the employer do not receive payment on account of delay damages, failure to pass completion tests, failure to remedy defects, timing of payments or any other clause of CC/OSC, the parties will be entitled to receive the outstanding amount together with interest calculated at a default rate of 1M-LIBOR (London Interbank Offered Rate) plus 3% commencing on the day after the due date of the payment. Both the parties, whichever case maybe, will be entitled to delayed payments surcharge without formal notice.

Force Majeure Event (FME) impacting CC/OSC: In an event that is beyond the reasonable control of party including but not limited to war, change in regulations, pandemic, natural calamity, explosion etc., any party, who becomes aware first, should give notice to the other party within 36 hours. The party (contractors or employer) which has given notice will be excused from performance of its obligations for as long as FME prevents it from performing them. However, FME will not apply to obligations of either party to make payments to the other party under EPA.

On the other hand, if ZPNECL at all times since the occurrence of the FME remain complied with the obligations of "Duty to Minimise Delay and Mitigate" clause, then it will not be liable for any failure or delay in performing its obligations (other than an obligation to make a payment, allowing a day for day extension of time and associated costs to the contractor) under the CC/OSC during the existence of such FME. However, if the political force majeure event exceeds consecutive 180 days, ZPNECL can serve the contractors with the termination notice.

Energy Purchase Agreement (EPA) signed with CPPA-G for 25 years with take or pay provision on 29th January, 2021

ZPNECL signed the EPA with CPPA-G on January 29, 2021 for a period of 25 years. The cost overruns until the physical completion date of the project are to be determined at the time of COD and may be partially claimed under the tariff true-up. As per the agreement, CPPA-G should take delivery of and pay for all Net Delivered Energy generated by ZPNECL at the interconnection point. In this regard, ZPNECL should not take any action, which would encumber, impair or diminish its ability to generate, sell and deliver the energy. Further, six months prior to expiry of the EPA contract, both the parties will enter into negotiations for sale and purchase of the electrical output of the complex on terms mutually acceptable to them.

Power purchaser has exclusive right to energy: Except to the extent that electric energy is required for the operation of any part of the complex, the company cannot without the prior written approval of the CPPA-G sell or deliver electric energy produced to anyone other than the power purchaser. Moreover, the company cannot allocate the right to or in the available energy to any other party other than the power purchaser.

EPA LDs due to Reduction of Contract Capacity: In respect of any downward revision of the declared contract capacity by more than 5% and less than 10%, ZPNECL will pay the power purchaser from immediately available funds as liquidated damages an amount equal USD $350,000 multiplied by the MW (prorated for any fraction) of the reduction after five percent (5%) in the contract capacity.

EPA LDs on Energy Output: CPPA-G can invoice the company for liquidated damages for any positive balance of the shortfall energy in the shortfall energy account. ZPNECL will have to pay these liquidated damages to CPPA-G calculated as the product of kilowatt hours representing the positive balance of the shortfall energy and the then-prevailing use of system charge per kWh allowed by NEPRA to CPPA-G for interconnection and use of grid station.

Late Payment Surcharge: Any bill payment not made by the due date by either party will entail late payment surcharge of KIBOR+ 2% per annum, for the actual number of days against which the amount remains unpaid.

Operations & Maintenance (O&M): The O&M agreement was signed with HIECL (operator) on 15th Feburary'2021 for 2 years from COD. The operator has provided warranty for parts and services for the period of the contract; however, the warranty period can be extended up to 36 months from taking over date in case of any extended warranty item.

Tariff: NEPRA has determined the tariff for ZPNECL for 25 years; the proposed annual insurance cost (construction & operation) is calculated at 0.4% of the EPC Cost. Tariff has been computed on 100% foreign financing. The levelized tariff has been decided at Rs. 5.81/ kWh; the following tariff has been proposed:

Components	**(Rs. /kWh)**
O&M Local	**0.7832**
Insurance during Operation	0.1766
Return on Equity	1.3696
Return on Equity during Construction	0.0755
Principal Repayment	2.0661
Interest	1.3354
Levelized Tariff	**5.8085**

Total 1-14 years	6.5982
Total 15-25 years	2.4070

Currently, the billing of the company is being made on reference tariff; however, all components will be adjusted in true-up tariff. The application for finalization of tariff was sent to NEPRA on 1st November, 2022 therefore the tariff is expected to be finalized in the next six to nine months.

Key take-outs from latest financial available: The net investment in lease increased exponentially to Rs. 10.9b (FY21: nil) by end-FY22; the same represents project related expenditures incurred by the company on establishment of 100 MW solar power project. In light of requirements of IFRS-16 Leases, at commencement of lease i.e. 14th April, 2022, the Company derecognized the underlying asset and recognized a finance lease receivable at an amount equal to its net investment in the lease, which comprises the present value of the lease payments and any unguaranteed residual value accruing to the lessor. The present value is calculated by discounting the lease payments and any unguaranteed residual value at the interest rate implicit in the lease. In addition, the company has extended loan to Multan Electric Company to the tune of Rs. 133.4m (FY21: Rs. 133.4m) to meet expenses of grid interconnection at Layyah, Punjab; the loan is interest free and repayable in 36 equal monthly installments starting from Nov'23 onwards including grace period of 18 months. The financial impact of discounting to present value is considered as immaterial. Further, advances, deposits & other receivables were reported lower at Rs. 382.5m (FY21: Rs. 415.8m) at end-FY22 in line with full adjustment of Rs. 190.4m advance extended to EPC contractor. The long-term funding has increased on a timeline basis in line with incremental drawdowns during the review period. In addition, the short-term borrowings have also increased to Rs. 417.2m (FY21: Rs. 142.3m) by end-FY22 in order to meet increased operating expenses. Moreover, ZPNECL reported negative bottom-line profit of Rs. 187.8m during FY22 despite the project becoming operational on account of sizable other operating expenses booked amounting to Rs. 792.8m primarily owing to exchange loss on loan obtained from BII.

Zhenfa Pakistan New Energy Company Limited (ZPNECL) **Annexure I**

Financial Statement (*Amount in Billions)*

BALANCE SHEET	**FY20**	**FY21**	**FY22***
Property, Plant and Equipment	130.4	8,362.1	22.2
Investment in Lease *(Inc. current matu.)*	-	-	10,906.2
Advances, Prepayments & other Receivables	130.9	415.8	385.5
Cash & Bank Balances	15.0	1,731.9	465.7
Total Assets	276.3	10,644.5	11,916.6
Trade and Other Payables	148.8	1,075.6	548.7
Short Term Borrowings	-	142.3	417.2
Long Term Finances *(Inc. current matu.)*	-	7,605.5	9,141.1
Accrued Markup	-	61.8	103.2
Total Liabilities	148.8	8,885.2	10,210.4
Tier-1 & Total Equity	127.6	1,759.2	1,706.3
INCOME STATEMENT	**FY20**	**FY21**	**FY22***
Net Sales	-	-	823.6
Gross Profit	-	-	786.5
Operating Profit	-	-	778.6
Profit/ (Loss) Before Tax	-	(55.9)	(187.8)
Profit/ (Loss) After Tax	-	(55.9)	(187.8)
FFO	-	(55.9)	(914.7)
RATIO ANALYSIS	**FY20**	**FY21**	**FY22***
Gross Margin (%)	-	-	95.5%
Net Margin (%)	-	-	-
FFO to Long-Term Debt	-	-	-
FFO to Total Debt	-	-	-
Debt Servicing Coverage Ratio (x)	-	-	-
Gearing (x)	0.00	4.40	5.60
Debt Leverage (x)	1.17	5.05	5.98
Current Ratio	0.98	1.34	1.96

(*) Year-end has been changed by the company from Dec to June therefore these numbers show half year performance

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-IV

Name of Rated Entity	Zhenfa Pakistan New Energy Company Limited
Sector	Power
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see below
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	see below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
03-12-2021	A-	A-2	Stable	Initial

Due Diligence Meetings

	Name	Designation	Date
1	Mr. Khaled Mahmood	CFO	16th Nov 2022
2	Mr. Farrukh Munir	Manager Finance	16th Nov 2022