The Pakistan Credit Rating Agency Limited

Rating Report

Foundation Power Company Daharki Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2018	AA-	A1+	Stable	Maintain	-
16-Oct-2017	AA-	A1+	Stable	Upgrade	-
24-Mar-2017	A+	A1	Positive	Maintain	-
24-Mar-2016	A+	A1	Stable	Maintain	-
08-Apr-2015	A+	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect strong business profile of FPCDL emanating from the demand risk coverage under Power Purchase Agreement signed between NTDC (through Central Power Purchasing Agency) and the company. Meanwhile, the Implementation Agreement provides sovereign guarantee for cashflows, given adherence to agreed performance benchmarks. The ratings incorporate low operational risk, a result of the performance of KEPCO - the O&M operator. Fuel of the plant is 'low BTU' gas, which is supplied by an associate - Mari Petroleum Company Limited (40% owned by Fauji Foundation). Thus fuel supply risk is considered low. Although there are delays in payments from power purchaser, the company manages the impact by aligning the payments to fuel supplier with its receipts. This keeps working capital needs under check. Short-term borrowing lines are available and mainly used to fund any short-fall in working capital requirements. FPCDL has total long term debt of PKR 5,666mln as at end-Dec17 payable till June 2020. Moreover, FPCDL has been repaying its debt repayments (Principal and Markup) on time without availing benefit of forbearance period. The company's association with Fauji Foundation (FF) provides comfort to the ratings.

Sustained good financial discipline and upholding strong operational performance in line with agreed performance levels remain important. Accumulation of circular debt would pose threat to the company’s ability to continue with this practice. However, the management ably supported by sponosrs remains committed to sustain improvement in management of commercial obligations and timely debt repayments. Material cushion in un-utilized lines provide comfort.

Disclosure	
Name of Rated Entity	Foundation Power Company Daharki Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17),Methodology | Independent Power Producers (IPP)(May-17)
Related Research	Sector Study | Power DISCOs(Jun-17)
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FOUNDATION POWER COMPANY DAHARKI LIMITED PROFILE	
Incorporated	2005
Major business lines	Independent Power Producer
Legal status	Public Limited
COD	2011
Plant Specifications	Combined Cycle
Capacity	180 MW
Primary Fuel	Natural Gas
Plant Location	Daharki, Sindh
Head Office	Rawalpindi

INDUSTRY SNAPSHOT

- Pakistan total power generation is increasing on the back of new power projects under CPEC
- Pakistan's energy mix is shifting towards Gas/RLNG and coal from Furnace Oil and other expensive sources
- Gas fired power plants have lowest per unit cost among all fossil fuel power plants.
- Going forward, cheap renewable electricity will be a challenge to viability of Gas based power plants.

OWNERSHIP

- Foundation Power Company Daharki Limited (Foundation Power Company) is majority owned by Daharki Power Holdings Limited (DPHL), which, in turn is owned by Fauji Foundation (FF) (81%) and Asian Development Bank (ADB) (19%).
- The actual cost of the project claimed by Foundation Power Company was USD 272mln. However, NEPRA determined the project cost at USD 212mln in its tariff adjustments after the Commercial Operation Date (COD). As per the Project Fund Agreement, rise in project cost would be funded by the lenders and sponsors in the same debt: equity ratio (75:25) as that of the project. However, negative cost overruns were to be financed by Fauji Foundation (FF).
- Fauji Foundation (also known as Fauji Group), is amongst the largest business conglomerate in Pakistan over more than seven decades. The Group gradually diversified in various industries with operations across fertilizer, cement, gas, food & allied and energy.

GOVERNANCE

- Foundation Power Company has a six member Board, comprising five representatives from FF (including the MD), and one from ADB. FF's strong professional profile assists the management in terms of strategic guidance and implementation of strong control framework.
- All the board members are seasoned professionals having interests in various sectors of the industry.
- Lt. Gen. Syed Tariq Nadeem Gilani (Retd.) – Managing Director of FF – is the Chairman of the Board and currently chairing the Board with his visionary leadership and vast experience.
- The board has three committees in place – (i) Audit and Finance Committee, (ii) Technical Committee, and (iii) Human Resource Committee.

MANAGEMENT

- The management control of the company vests with Daharki Power Holdings Limited (DPHL), which, in turn is owned by Fauji Foundation (FF), being largest shareholder.
- Lt. Gen. Jamil Haider (Retd) is the Managing Director of Foundation Power Company. He had a distinguished career in the Pakistan Army spanning over 40 years.
- The management team is experienced and is ably handling the affairs of the company.

BUSINESS AND OPERATIONAL RISK

- Foundation Power Company has negotiated an O&M contract with KEPCO for a period of 18 years, signed in 2008.
- Foundation Power Company has negotiated the GSA with Mari Petroleum, for supply of 65mmcfd of Low BTU Gas to the plant. The contract is for a period of 25 years. The construction and commissioning of the gas pipeline was completed in February 2009.

PERFORMANCE

- During 9MFY18, the plant's availability was 96% against requirement of 88%, operating well above the required benchmark. The plant generated a total of 1,052,723 MWh of electricity during 9MFY18 (9MFY17: 922,673 MWh), depicting high demand form the power purchaser.
- Meanwhile, the efficiency of the plant was 48.8% during 9MFY18 (9MFY17: 48.8%); at par with the required benchmark of 48.8%.
- Moreover, turnover stood at PKR 4,715mln at 1HFY18 (1HFY17: 5,186mln, FY17: 10,259mln, FY16: PKR 11,235mln) with improved gross margin at 1HFY18: 27.9% (1HFY17: 22.9%; FY17: 25.5%; FY16: 27.8%).

FINANCIAL RISK

- FPCDL's improved profits have resulted from high demand of low cost electricity and in turn have also resulted in improved free cashflows from operations (FCFO) at 1HFY18: 1,607mln (1HFY17: 1,469mln; FY17: PKR 3,206mln; FY16: PKR 3,695 mln).
- Increased trade payable days at 1HFY18:249 days (end-FY17:189 days; end-FY16:152 days), leading to a negative cash cycle (1HY18: -19 days; FY17: -14 days; FY16: -17 days).
- Constantly having negative cash cycle depicts the Co's strategy to align its receivable days with payable days and leaving the large portion of available working capital lines un-utilized i.e. ~32% utilization of working capital lines (available line: PKR 476mln) at end-1HFY18 (end-1HFY17: ~84%; FY17: ~11%; FY16: ~96%).
- During the period, owing to increased working capital requirement, the company's coverages reflects slight decline in (FCFO post WC / Gross Interest + CMLTD + Uncovered STB: 1HFY18: 1.0x; 1HFY17: 1.2x; FY17: 1.3x; FY16: 1.1x).
- The project cost (75%) was financed through a syndicated term finance loan. The loan size, PKR 11,565mln, is priced at 6-month KIBOR + 2.93% p.a., out of which PKR 5,678mln is outstanding as on 31-Dec-17. It is to be repaid in 20 unequal semi-annual installments. Fifteen installments have been made to date.
- Foundation Power has moderately leveraged capital structure at 1HFY18: 43% (FY17: 47%; FY16: 55%; FY15: 63%).

Foundation Power Company Daharki Limited *PKR in mln*

BALANCE SHEET	31-Dec-17	30-Jun-17	30-Jun-16	30-Jun-15
	6M	Annual	Annual	Annual
Non-Current Assets	**13,286**	**13,669**	**14,178**	**14,843**
Current Assets	**6,368**	**5,594**	**5,379**	**7,137**
Inventory	34	34	37	41
Trade Receivables	5,957	4,925	4,169	5,799
Other Current Assets	277	375	585	278
Cash & Bank Balances	100	261	588	1,019
Total Assets	**19,654**	**19,263**	**19,557**	**21,980**
Debt	**5,816**	**6,506**	**8,223**	**9,263**
Short-term	150	50	457	463
Long-term (Inlc. Current Maturity of long-term debt)	5,666	6,456	7,766	8,800
Other Short term liabilities (inclusive of trade payables)	6,061	5,375	4,664	7,143
Other Long term Liabilities	56	63	43	38
Shareholder's Equity	**7,721**	**7,320**	**6,627**	**5,535**
Total Liabilities & Equity	**19,654**	**19,263**	**19,557**	**21,980**
INCOME STATEMENT				
Turnover	**4,715**	**10,259**	**11,235**	**11,866**
Gross Profit	1,317	2,612	3,118	2,981
Other Income	18	53	63	70
Financial Charges	(356)	(818)	(1,019)	(1,939)
Net Income	**900**	**1,689**	**1,990**	**942**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	1,607	3,206	3,695	3,558
Net Cash changes in Working Capital	(296)	49	(1,227)	19
Net Cash from Operating Activities	1,010	2,555	1,544	1,822
Net Cash from InvestingActivities	19	(157)	(24)	147
Net Cash from Financing Activities	(1,189)	(2,726)	(1,951)	(1,741)
Net Cash generated during the period	(160)	(328)	(431)	229
Ratio Analysis				
Performance				
Turnover Growth	-9.1%	-8.7%	-5.3%	14.9%
Gross Margin	27.9%	25.5%	27.8%	25.1%
Net Margin	19.1%	16.5%	17.7%	7.9%
ROE	23.3%	23.1%	30.0%	17.0%
Coverages				
FCFO Pre-WC/Gross interest+CMLTD	1.2	1.3	1.6	1.0
FCFO Post-WC/Gross interest+CMLTD	1.0	1.3	1.1	1.0
Liquidity				
Net Cash Cycle	-18.5	-14.0	-16.8	-58.4
Capital Structure				
Net Debt/Net Debt+Equity	43.0%	47.1%	55.4%	62.6%

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ **AA** **AA-**	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ **A** **A-**	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ **BBB** **BBB-**	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances or economic conditions are more likely to impair this capacity.
BB+ **BB** **BB-**	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business, and economic environment.
CCC **CC** **C**	**Very high credit risk.** "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business or financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, a suspended rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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