



The Pakistan Credit Rating Agency Limited

Rating Report

Sapphire Electric Company Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
20-Mar-2019	AA-	A1+	Stable	Maintain	-
06-Nov-2018	AA-	A1+	Stable	Maintain	-
29-Mar-2018	AA-	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect strong business profile of Sapphire Electric Company Limited (Sapphire Electric) emanating from the demand risk coverage under Power Purchase Agreement signed between CPPA-G (Central Power Purchasing Agency) and the company. Meanwhile, the Implementation Agreement provides sovereign guarantee for cashflows, given adherence to agreed performance benchmarks. Nevertheless, delayed payments from the power purchaser remained a challenge. The ratings incorporate low operational risk, a result of the performance of General Electric - the O&M operator. Primary fuel of the plant is Regasified Liquefied Natural Gas (RLNG) which is supplied by Sui Northern Gas Pipeline Limited (SNGPL). Thus fuel supply risk is considered adequate, pertaining to meaningful addition of RLNG in Pakistan's fuel mix. 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. As of Dec-18, short term lines utilization stood at 74%. Moreover, lately Sapphire Electric has been repaying its debt repayments (Principal and Markup) on time without availing benefit of forbearance period and committed to continue this practice till maturity. Sapphire Electric has total long term debt of PKR 3,679mln as at end-Dec-18 payable till September 2020. The company's association with Sapphire Group 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 sponsors' remains committed to sustain improvement in management of commercial obligations and timely debt repayments.

Disclosure

Name of Rated Entity	Sapphire Electric Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18),Methodology IPP (Jun-18)
Related Research	Sector Study Power(Jan-19)
Rating Analysts	Faizan Arif faizan.sufi@pacra.com +92-42-35869504

The Pakistan Credit Rating Agency Limited

Profile

Plant Sapphire Electric Company Limited (Sapphire Electric) is operating a Combined Cycle thermal power plant on a build-own-operate (BOO) basis, with gross capacity of 225 MW.

Tariff Sapphire Electric's key source of earnings is the generation tariff from the power purchaser, Central Power Purchasing Agency (CPPA-G). The reference generation tariff comprises a capacity charge component and an energy charge component. Levelized Tariff on Gas as per NEPRA determination is 5.32 Cents/KWH and on HSD fuel 18.51 Cents/KWH.

Return On Project The dollar IRR of Sapphire Electric, as agreed with NEPRA, is 15%.

Ownership

Ownership Structure Sapphire Electric's is majority owned by Sapphire Group with 70% holding, while Xenel Saudi Arabia (20%), Meezan Bank (5%), and high net worth individuals (5%) are other shareholders respectively.

Stability Stability in the IPPs is drawn from the agreements signed between the company and power purchaser. However, sponsors affiliation with Sapphire group will continue to provide comfort.

Business Acumen Sapphire Group is engaged in the business of manufacturing and selling of yarn & fabric and home textile products.

Financial Strength The financial strength of the sponsors is considered strong as the sponsors have well diversified profitable businesses.

Governance

Board Structure The seven-member Board of Directors (BoD) is majorly composed of representatives from Sapphire Group, including the CEO, while Xenel is represented by one member. Due to dominance of the Sapphire Group on the board, the board has limited diversification. All the board members are seasoned professionals having interests in various sectors of the industry.

Members' Profile Board members are qualified and have relevant experience in their portfolio reflecting strong management profile.

Board Effectiveness The experiences of board will help guiding the management in developing effective operational and financial policies. The board has formulated two committees, i) Audit, & ii) HR and Remuneration Committee, to ensure smooth and effective monitoring of operations. Participation of all board members during board meetings remained satisfactory.

Financial Transparency M/s A.F Ferguson is the external auditor of the company. They have expressed an unqualified opinion on the company's financial statements at end-Jun18.

Management

Organizational Structure Sapphire Electric's has a lean management structure. It has separate teams at head office and at plant site. The CEO is supported by a team of qualified and experienced professionals.

Management Team The management control of the company vests with Sapphire Fibres Limited being largest shareholder. Mr. Shahid Abdullah, the CEO, has been spearheading the company as he carries with him over three decades of experience in various fields of industry.

Effectiveness The management of Sapphire Electric is mostly engaged in the finance related activities. The operations and maintenance of the plant have been outsourced to GE by way of the O&M contract. In this regard, Company has built up a team of senior technicians at the plant site, whom are conducting bi-weekly and monthly meetings with GE personnel to further enhance and fortify their knowledge of operating the power plant.

Control Environment Sapphire Electric take advantage of advanced I.T. solutions deliver comparatively better on many fronts. Moreover, quality of the I.T. infrastructure and the breadth and depth of activities performed is remained well satisfactory.

Operational Risk

Power Purchase Agreement Sapphire Electric's key source of earnings is the revenue generated through sale of electricity to the power purchaser, CPPA-G. The Company will receive the capacity payments if it is at the benchmark availability and is ready to provide electricity, even if no purchase order is placed by Power Purchaser. Company has a power purchase agreement of 30 years with CPPA-G.

Operation And Maintenance Sapphire Electric has negotiated an O&M contract with GE for a period of 18 years, which commenced from the COD in October 2010.

Resource Risk Sapphire Electric's power plant is fueled by Pipeline Quality Gas supplied by Sui Northern Pipelines Limited (SNGPL). SECL has signed an interim agreement in 2018 with SNGPL for supplying RLNG due to acute shortages of gas in the country. In case of non-availability of RLNG, Company runs its plant on HSD.

Insurance Cover Sapphire Electric has significant insurance coverage for property damage and business interruption. The insured values for damages include a property damage cover (upto PKR 23.31bln) & business interruption cover (up to PKR 6.026bln). Local insurance is covered by Adamjee Insurance Co and foreign insurance is covered by Lockton (MENA) Limited.

Performance Risk

Industry Dynamics Pakistan total power generation is increasing on the back of new power projects under CPEC. Going forward, cheap renewable electricity will be a challenge to viability of thermal power plants. During FY18, there has been a growth of ~30% in the actual power generation. Moreover, there has been an increase of ~18% in the installed capacity as at end-Jun18 to 32,613MW (FY17: 27,703MW).

Generation Electricity produced during 1HFY19 is 425GWh (1HFY18: 171GWh; FY18: 815GWh) owing to the increase in power demanded by CPPA-G, on the back of improving energy mix of the country through inclusion of RLNG and coal based power projects. However, from Nov-Dec 18, Plant was not operational and no electricity was generated during the period on account of gas shortage. Plant is expected to remain close till March-19 until or unless demand rises from power purchaser.

Performance Benchmark The required availability for Sapphire Electric Company under the PPA is 88%. During 1HFY19, average plant availability has been maintained according to agreed parameters. Sapphire Electric's net income improved to PKR 1,473mln during 1HFY19 in comparison to same period last year (1HFY18: PKR 1,100mln) on account of increase in electricity dispatched during the respective period. Moreover, increase in other income to PKR 3.24mln (1HFY18: PKR 0.402mln) augmented the bottom line.

Financial Risk

Financial Structure Analysis Sapphire Electric's project capital structure comprises 25% equity (US\$ 61mln) and 75% debt (US\$ 183mln). The total outstanding balance of debt stood at PKR 3,679mln as at end Dec-18. The Company has repaid thirty three installments by end-Dec18, the debt servicing is mainly funded from capacity payments.

Liquidity Profile During 1HFY19, total receivables of the company stood at PKR 8,026mln (FY18: PKR 7,706mln, FY17: PKR 6,202mln), an increase of ~4%. As circular debt continues to be an issue for companies operating in power sector. Consequently, IPPs have to manage their liquidity requirements from short-term borrowings.

Working Capital Financing Cash cycle days stood at 187days for 1HFY18 (FY18: 175days, FY17: 116days). During 1HFY19, Sapphire Electric has available working capital lines of PKR 7,376mln (FY18: PKR 8,360mln) of which ~74% (FY18: 60%) has been utilized. Moreover, company is in negotiation with banks, to increase its working capital lines by PKR1.5bln.

Cash Flow Analysis Sapphire Electric coverages shown a stable trend in debt coverage ratio [FCFO pre WC / Gross Interest +CMLTD] to 1.5x during 1HFY19 (FY18:1.4x), mainly owing to the declining interest rates coupled with stable internal free cash flow generation.

Capitalization Sapphire Electric's leveraging for 1HFY19 remained moderate at ~42% (FY18: 46%, FY17: 47%). STD comprised 60% and LTD stood 40% of total debt financing.



Power

The Pakistan Credit Rating Agency Limited

Financials (Summary)

Sapphire Electric Company Limited

PKRmln

BALANCE SHEET	31-Dec-18	30-Jun-18	30-Jun-17	30-Jun-16
	6M	FY18	FY17	FY16
Non-Current Assets	12,882	13,173	13,783	14,357
Investments (Others)	87	65	-	-
Current Assets	9,767	8,649	7,090	5,004
Inventory	179	201	241	168
Trade Receivables	8,787	7,706	6,202	4,016
Other Current Assets	406	263	223	313
Cash & Bank Balances	395	478	424	507
Total Assets	22,736	21,887	20,873	19,362
Debt				
Short-term	5,440	4,990	2,910	1,015
Long-term (Incl. Current Maturity of long-term debt)	3,679	4,561	6,136	7,493
Other Short term liabilities (inclusive of trade payables)	1,116	1,308	1,771	1,908
Other Long term Liabilities	-	-	-	-
Shareholder's Equity	12,501	11,028	10,057	8,946
Total Liabilities & Equity	22,736	21,887	20,873	19,362

INCOME STATEMENT

Turnover	7,527	13,198	13,876	12,742
Gross Profit	1,966	3,170	3,255	3,294
Other Income	3	1	1	(7)
Financial Charges	(460)	(776)	(789)	(1,013)
Net Income	1,473	2,243	2,383	2,214

Cashflow Statement

Free Cashflow from Operations (FCFO)	2,219	3,606	3,746	3,808
Net Cash changes in Working Capital	(1,463)	(2,045)	(2,108)	1,819
Net Cash from Operating Activities	333	803	659	4,520
Net Cash from Investing Activities	(27)	(30)	(8)	(211)
Net Cash from Financing Activities	(432)	(763)	(733)	(4,313)
Net Cash generated during the period	(126)	57	(82)	(5)

Ratio Analysis

Performance				
Turnover Growth	65.3%	-4.9%	8.9%	6.2%
Gross Margin	26.1%	24.0%	23.5%	25.9%
Net Margin	19.6%	17.0%	17.2%	17.4%
ROE	23.6%	20.3%	23.7%	24.7%
Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD)	1.5	1.4	1.6	1.6
Interest Coverage (X) (FCFO/Gross Interest)	4.8	4.7	4.7	3.8
FCFO Pre-WC/Gross interest+CMLTD	1.5	1.4	1.6	1.6
Liquidity				
Short Term Borrowings Coverage (Adjusted Quick Assets/Shc)	1.6	1.6	2.2	4.1
Net Cash Cycle (Inventory Days + Receivable Days - Payable)	186.5	174.6	115.8	60.6
Capital Structure (Total Debt/Total Debt+Equity)	42.2%	46.4%	47.4%	48.7%

Sapphire Electric Company Limited

Mar-19

Credit Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; 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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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 and in economic conditions are more likely to impair this capacity.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
CCC CC C	Very high credit risk. Substantial 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.		



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/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'.

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. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

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, the 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, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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(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

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- (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.
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- (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)
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- (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)

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- (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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