The Pakistan Credit Rating Agency Limited

Rating Report

Narowal Energy Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Jun-2019	AA-	A1+	Stable	Maintain	-
27-Dec-2018	AA-	A1+	Stable	Maintain	-
11-Jul-2018	AA-	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect strong business profile of Narowal Energy Limited emanating from the demand risk coverage under Power Purchase Agreement signed between CPPA-G and the Company. Meanwhile, the Implementation Agreement provides sovereign guarantee for cash flows, given adherence to agreed performance benchmarks (Availability: 88%, Efficiency: 45%). The Company continues to meet its performance benchmarks. Nevertheless, delayed payments from the power purchaser remained a challenge as the same poses pressure on Company's working capital requirements. The ratings incorporate low operational risk, a result of in-house O&M undertaken by Hub Power Services Limited (HPSL) – an associated company. The Company's generation witnessed a decrease during 2HFY19 on the back of lower power demand by CPPA-G. Narowal Energy has been repaying its debt repayments (Principal and Markup) on time without availing benefit of forbearance period, facet of strong financial profile and working capital management. Sound financial profile of Hubco; the holding company, provides comfort to the ratings.

Adherence to good financial discipline towards both financial and commercial obligations would remain important. Meanwhile, upholding strong operational performance in line with agreed performance levels remain important. Because of the mounting receivables and consequent funding thereof from banking lines, remaining cushion in the available working capital facilities is limited, warranting management's immediate attention. However, management is continuously working for the release of overdue amount which would result in sufficient availability of funds.

Disclosure	
Name of Rated Entity	Narowal Energy 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

Profile

Plant Narowal Energy Limited (Narowal Energy) is a 225MW (gross) combined cycle thermal power plant, comprising 11 generating engines from MAN Diesel and one steam turbine from Dresser Rand.

Tariff The company negotiated revision in generation tariff with National Electric Power Regulatory Authority (NEPRA) at the commercial operations date in June 2012. Generation levelized tariff for years 1-25 is US 18.6-cents/ KWh as approved by NEPRA. The tariff is adjusted every quarter to account for variability as per PPA.

Return On Project The dollar IRR of Narowal Energy Limited, as agreed with NEPRA, is 15%.

Ownership

Ownership Structure Narowal Energy Limited is a 100% owned subsidiary of The Hub Power Company Limited (HUBCO). Mega Conglomerate Private Limited (19.4%) is the single largest shareholder of HUBCO, followed by Allied Bank Ltd (9.7%), Fauji Foundation (8.5%) and NBP (5%). The remaining shareholding is held by various Financial Institutions, Joint Stock Companies and Individuals respectively.

Stability Stability in the IPPs is drawn from the agreements signed between the company and power purchaser. However, sponsors association with HUBCO, Mega Conglomerate, Allied Bank & Fauji Foundation will continue to provide comfort.

Business Acumen Sponsor groups have significant experience in energy, cement, dairy, real estate and finance sector.

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

Governance

Board Structure Narowal Energy’s Board of Directors comprises of four Directors, including the CEO. The members of the Board are representatives of HUBCO. Mr.Khalid Mansoor, CEO of the Company, is also the chairman of Narowal Energy.

Members’ Profile HUBCO's strong professional profile assists the management in terms of strategic guidance and implementation of strong control framework.

Board Effectiveness The experiences of board will help guiding the management in developing effective operational and financial policies. No Board Committee is formed by the Board.

Financial Transparency A.F.Ferguson & Co. is the external auditor of Narowal Energy and the auditor has given unqualified report on the financial statements for the year ending June 2018.

Management

Organizational Structure Narowal Energy has a lean organizational structure with an efficient management team. The management control of the Narowal Energy vests with Mr. Khalid Mansoor, the CEO.

Management Team Mr. Khalid Mansoor, the CEO carries with him over three decades of experience in Energy & Petrochemical sectors in leading roles for mega size projects development, execution, management and operations. He is supported by a team of experienced professionals having relevant skills and expertise in their respective fields.

Effectiveness Narowal Energy’s management effectiveness plays a significant role in empowering the organization through positive results, which has made decision making process systematic.

Control Environment Narowal Energy has in place an efficient MIS reporting system named as Avanceon for its operations. The system generates real-time plant production data, enabling efficient monitoring and timely decision making.

Operational Risk

Power Purchase Agreement Narowal Energy’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.

Operation And Maintenance O&M of Narowal Energy has been outsourced to Narowal Energy’s associate Hub Power Services Limited (Hub Power Service). Hub Power Service is 100% owned subsidiary of Hubco incorporated to manage the O&M of HUBCO’s power plants

Resource Risk Bakri Trading Company is the fuel supplier for Narowal Plant. The agreed credit period is 30 days, but owing to better supplier relationship the company can avail credit period of more than 30 days if required.

Insurance Cover Narowal Energy Limited has adequate insurance coverage for property damage and business interruption. The insured values for damages include a property damage cover (upto USD 302mln) & business interruption cover (up to PKR 67mln).

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 During 9MFY19, electricity generation decreased to 524GWh (9MFY18: 899GWh; FY18: 1200GWh FY17: 1,334GWh). Generation was lower because of low demanded load by CPPA-G on the back of improving energy mix of the country through inclusion of coal and renewable energy based power projects.

Performance Benchmark The required availability for Narowal Energy Ltd under the PPA is 88%. During 9MFY19, average plant availability has been maintained at 95%. During 9MFY19, revenue has decreased on account of lower generation. Moreover, decreased production cost coupled with increased other income augmented the bottom line (9MFY19: PKR 2,653mln; 9MFY18: PKR 1,998mln; FY18: PKR 2,857mln).

Financial Risk

Financing Structure Analysis Narowal plant’s capital structure comprises 30% equity and 70% debt. Narowal Energy has paid 35 installments of its project debt till April 2019. The project debt will be totally paid by 2020. The outstanding balance as of date stands at PKR 4,072mln. Company has also secured a long term finance facility of PKR 3,100mln to fund the cost overrun of Narowal Power plant. The loan is repayable in 16 installments, as of date the outstanding balance of the respective loan stands at PKR 1,801mln.

Liquidity Profile During 9MFY19, total receivables of the company stood at PKR 13,993mln (FY18: PKR 13,578mln). 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 have decreased to 313 days as at 9MFY19 (FY18: 255days) on account of increase in receivable days (9MFY19: 299days; FY18: 272days) a facet of delayed payments recovery from CPPA-G. To bridge the working capital requirements, the company has procured short term lines of PKR 8,550mln out of which ~85% were utilized as at end March-19.

Cash Flow Analysis Free cash flow of the Company increased on the back of improved profitability (9MFY19: PKR 4,613mln; 9MFY18: PKR 3,711mln; FY18: PKR5,141mln). Despite the increase in FCFO, interest coverage decreased on YoY basis (FCFO / Gross interest: 9MFY19: 3.8x; FY18: 3.9x) on account of higher interest expense and current maturity of Long term debt.

Capitalization Narowal Energy has a moderately leveraged capital structure (FY18: 50.3%; FY17: 55.2%). Leveraging in Company’s total capital structure as of end-March19 stood at 43%.

PKR mln

Narowal Energy Limited

BALANCE SHEET	31-Mar-19	31-Dec-18	30-Jun-18	30-Jun-17
	9M	6M	Annual	Annual*
Non-Current Assets	**15,579**	**15,806**	**16,292**	**17,237**
Current Assets	**17,633**	**17,681**	**16,437**	**12,696**
Inventory	2,467	1,640	1,784	1,802
Trade Receivables	13,993	15,027	13,578	9,950
Other Current Assets	1,133	990	875	554
Cash & Bank Balances	40	24	199	391
Total Assets	**33,212**	**33,487**	**32,729**	**29,934**
Debt	**13,475**	**14,930**	**15,522**	**15,847**
Short-term	7,148	7,858	7,029	4,756
Long-term (Inlc. Current Maturity of long-term debt)	6,327	7,072	8,493	11,091
Other Short term liabilities (inclusive of trade payables)	1,768	1,488	1,892	1,207
Other Long term Liabilities	-	-	-	-
Shareholder's Equity	**17,969**	**17,069**	**15,316**	**12,880**
Total Liabilities & Equity	**33,212**	**33,487**	**32,729**	**29,934**
INCOME STATEMENT				
Turnover	**12,624**	**9,375**	**18,220**	**4,735**
Gross Profit	3,942	2,568	4,330	1,260
Operating Expenses	(74)	(48)	(146)	(98)
Interest Expense/Income	(1,218)	(768)	(1,330)	(348)
Net Income	**2,653**	**1,754**	**2,857**	**814**
Cashflow Statement				
Free Cashflow from Operations (FCFO)	4,613	3,012	5,141	1,406
Net Cash changes in Working Capital	(1,594)	(1,876)	(3,220)	(1,096)
Net Cash from Operating Activities	1,955	451	654	(16)
Net Cash from Investing Activities	(40)	(15)	(55)	(68)
Net Cash from Financing Activities	(2,074)	(611)	(790)	4,033
Net Cash generated during the period	(159)	(175)	(191)	3,949
Ratio Analysis				
Performance				
Turnover Growth	-3.6%	-48.5%	284.8%	-16.5%
Gross Margin	31.2%	27.4%	23.8%	26.6%
Net Margin	21.0%	18.7%	15.7%	17.2%
ROE	14.8%	10.3%	18.6%	6.3%
Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD)	1.6	1.3	1.8	0.9
Interest Coverage (X) (FCFO/Gross Interest)	3.8	3.9	3.9	4.0
FCFO Pre-WC/Gross interest+CMLTD	1.8	1.2	2.1	0.7
FCFO POST-WC/Gross interest+CMLTD	0.7	0.3	0.5	0.1
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	313	136	255	763
Capital Structure				
Net Debt/Net Debt+Equity	42.9%	46.7%	50.3%	55.2%

* FY17 P/L numbers are after demerger (3 months figure)

Rating Scale

Credit Rating Scale & Definitions

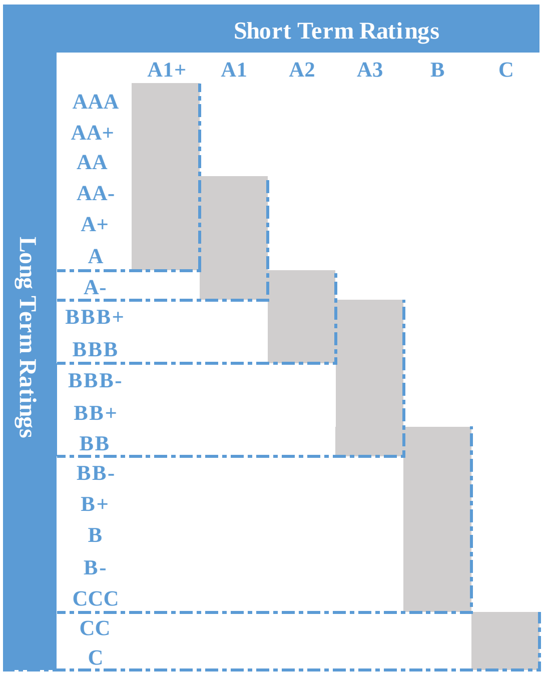
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

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 and in 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.** 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.

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.



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 surveill the opinion due to lack of requisite information.

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

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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)

Proprietary Information