



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
23-Jun-2021	AA-	A1+	Stable	Maintain	-
25-Jun-2020	AA-	A1+	Stable	Maintain	-
27-Dec-2019	AA-	A1+	Stable	Maintain	-
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 (PPA) signed between CPPA-G and the Company. Meanwhile, the Implementation Agreement provides sovereign guarantee for cash flows, given adherence to agreed performance benchmarks (Availability: 96%, 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. Because of the mounting receivables and consequent funding thereof from banking lines, company has arranged amicable working capital lines to cover its working capital requirement out of which 79% had been utilized as at Mar-21. Furthermore, Company has also secured a long-term finance facility of PKR 25mln under the salary refinancing scheme by SBP. The loan is repayable in eight equal quarterly installments and the repayments have already started from Jan 2021, providing the much needed comfort. 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 an increase during the 9MFY21 on account of better off-take from RFO based IPPs due to decline in FO prices. Narowal Energy has repaid all of its project debt obligations without availing any benefit of forbearance period indicating 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.

Disclosure

Name of Rated Entity	Narowal Energy Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology IPP(Jun-20),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria Rating Modifier(Jun-20)
Related Research	Sector Study Power(Jan-21)
Rating Analysts	Anam Waqas Ghayour anam.waqas@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 tariff has been finalized with National Electric Power Regulatory Authority (NEPRA) at the time of Commercial Operations Date in June 2012. The current applicable tariff is US 10.77cents/ KWh. The tariff is adjusted as per PPA.

Return On Project The ROE is 15% based on NEPRA's approved equity and indexed on quarterly basis as per PPA.

Ownership

Ownership Structure Narowal Energy Limited is a 100% owned subsidiary of The Hub Power Company Limited (HUBCO). Mega Conglomerate Private Limited (17.3%) is the single largest shareholder, followed by Allied Bank Limited (7.00%), Fauji Foundation (8.5%), Jubilee Life Insurance (4.74%) and National Bank Pakistan (3.6%). The remaining shareholding is held by various Financial Institutions, Joint Stock Companies and general public.

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 also Board members 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 2020.

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. No board committee is formed as the company/board's size is small.

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 (HPSL). Hub Power Service is 100% owned subsidiary of Hubco incorporated to manage the O&M of HUBCO's group 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 60 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 303mln) & business interruption cover (up to PKR 66mln).

Performance Risk

Industry Dynamics Owing to newly installed plants, Pakistan's energy mix is shifting towards Solar/Gas/and coal from Furnace Oil and other expensive sources. As on June-20, installed capacity of electricity reached 38,719 MW, which was 38,995 MW at end June-19, decline of 0.7%. (276MW)in FY20, due to the expunge of 784MW of GTPS-Kotri (144MW) and TPS Guddu (640MW). There was an increase of 508MW new power projects including CPEC from coal and renewable sources and this will increase further in coming years. Although electricity generation varies due to availability of inputs and other constraints, generation decreased from 136,532 GWh to 134,745 GWh, posting a decline of 1.3% in FY20 as compared to FY19.

Generation Company has dispatched 349GWh of electricity as compared with 298GWh during the corresponding nine months of the previous financial year (FY20: 338GWh ; FY19: 636GWh). Resultantly, the load factor remained at 25% as against 21%.

Performance Benchmark The plant's availability (9MFY21: 96%; 9MFY20: 96%) remained well above the required level (95% as per PPA). Company's profitability uptick following the increase in generation (9MFY21: PKR 4,429mln, 9MFY20: PKR 3,340mln; FY20: PKR 4,780mln, FY19: PKR 3,649mln).

Financial Risk

Financing Structure Analysis Narowal plant's capital structure comprises 30% equity and 70% debt. Narowal Energy has fully paid its project debt in July 20 without any delay in scheduled repayments. Company has also secured a long term finance facility of PKR 2.5mln under the salary refinancing scheme by SBP. The loan is repayable in eight equal quarterly installments starting from Jan 2021.

Liquidity Profile Receivable days surged further upwards (9MFY21: 503days; 9MFY20: 435, FY20: 461, FY19: 349days). 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 Continued lag of payments by CPPA-G has led Narowal Energy's receivables to reach at PKR 21,352mln as at end-March21 (Jun20: PKR 19,459mln, Jun19: PKR 15,479mln) out of which ~80% are overdue by more than 90 days. Moreover, payables to fuel supplier are also delayed to manage working capital needs. The overdue amount to fuel supplier stands at PKR 1,362mln at end-March21. Further, company has arranged working capital lines of PKR 8,130mln at end-March21 to meet its working capital requirements and to ensure smooth operations. These lines are utilized up to 91%.

Cash Flow Analysis The availability of cash flows to repay the debt depends on timely conversion of receivables due from CPPA-G. The coverages of the company witnessed deterioration (Pre-Working Capital FCFO/Interest + Current Maturity: 9MFY21: 4.9x 9MFY20: 1.8x; FY20: 2.3x FY19: 1.5x.) due to higher short term borrowings procured to meet increasing working capital needs – a facet of increase in overdue receivables.

Capitalization Narowal plant's capital structure comprises 30% equity and 70% debt. For financing the debt portion, a senior facility (PKR denominated senior syndicated term finance facility) has been arranged through conventional bank financing for this purpose. The size of the facility was PKR 14,733mln. This facility carries an interest rate of KIBOR plus 3.47% per annum. The repayment of debt portion of Narowal project is built in its tariff. Narowal is able to manage its cash flows and has made 39 installments of its project debt till April 2020. The outstanding balance as of date stands at PKR 1,902mln. Narowal Energy has a moderately leveraged capital structure (9MFY21: 27%, 9MFY20: 38.1%, FY20:36%, FY19: 46.1%). Leveraging in Company's total capital structure as of end-March19 stood at 38.1%.



STATEMENT OF FINANCIAL POSITION		Mar-21	Jun-20	Jun-19	Jun-18
		9M	12M	12M	12M
		Audited	Audited	Audited	Audited
A NON-CURRENT ASSETS					
1	Operating Fixed Assets - Owned and Leasehold	13,652	14,359	15,346	16,284
2	Intangible Assets	1	2	5	9
3	Other Non-Current Assets	1	1	0	0
4	Deferred Taxation	-	-	-	-
	<i>Non-Current Assets</i>	13,653	14,361	15,352	16,292
B INVESTMENTS					
1	Equity Instruments	-	-	-	-
2	Debt Instruments	-	-	-	-
3	Investment Property	-	-	-	-
	<i>Investments</i>	-	-	-	-
C RELATED PARTY EXPOSURE					
1	Equity Instruments	-	-	-	-
2	Debt Instruments (Including Lending)	-	-	-	-
3	Due from Related Parties	-	-	-	0
	<i>Related Party Exposure</i>	-	-	-	0
D CURRENT ASSETS					
1	Stores and Spares	1,048	1,098	1,197	1,125
2	Inventories				
	a. Raw Material	1,028	380	1,269	659
	b. Work in Process	-	-	-	-
	c. Finished Goods	-	-	-	-
		1,028	380	1,269	659
3	Trade Receivables	21,354	19,459	15,479	13,578
4	Advances to Suppliers	18	20	-	-
5	Taxes	-	-	-	555
6	Taxes Refundable	532	473	-	29
7	Other Current Assets	1,106	876	1,240	291
8	Cash and Bank Balances	144	106	1,008	199
	<i>Current Assets</i>	25,231	22,412	20,193	16,437
E TOTAL ASSETS		38,884	36,773	35,545	32,729
F CURRENT LIABILITIES					
1	Trade Payables	1,363	775	1,385	1,297
2	Advances from Customers	-	-	-	-
3	Taxes	-	-	-	-
4	Interest or Markup Payable	158	336	-	-
5	Workers' Funds	-	-	-	-
6	Accrued Liabilities	-	-	405	165
7	Other Current Liabilities	0	-	-	430
8	Dividend Payable	-	-	-	-
	<i>Current Liabilities</i>	1,521	1,110	1,790	1,892
G BORROWINGS					
1	Current Maturity of Long-Term Borrowings	660	1,459	2,558	2,935
2	Short-Term Borrowings	7,412	8,717	9,066	7,029
3	Long-Term Borrowings				
	a. Local	1,902	2,526	3,951	5,559
	b. Foreign	-	-	-	-
	<i>Long-Term Borrowings</i>	1,902	2,526	3,951	5,559
4	Debt Instruments	-	-	-	-
5	Preference Share Capital	-	-	-	-
	<i>Borrowings</i>	9,974	12,703	15,574	15,522
H RELATED PARTY EXPOSURE					
1	Borrowings	-	-	-	-
2	Subordinate Borrowings	-	-	-	-
3	Due to Related Parties	-	-	-	-
	<i>Related Party Exposure</i>	-	-	-	-
I NON-CURRENT LIABILITIES					
1	Deferred Taxation	-	-	-	-
2	Other Non-Current Liabilities	-	-	-	-
	<i>Non-Current Liabilities</i>	-	-	-	-
J NET ASSETS (E-F-G-H-I)		27,389	22,960	18,180	15,316
K SHAREHOLDERS' EQUITY					
1	Ordinary Share Capital	3,922	3,922	3,922	3,922
2	Capital Reserves	-	-	-	-
3	Revaluation Reserve				
	a. Fixed Assets	-	-	-	-
	b. Investments	-	-	-	-
		-	-	-	-
4	Revenue Reserves				
	a. General Reserves	-	-	-	-
	b. Unappropriated Profit	23,467	19,038	14,258	11,394
	<i>Shareholders' Equity</i>	23,467	19,038	14,258	11,394
		27,389	22,960	18,180	15,316
L MEMORANDUM ITEM/S					
1	Short Term Borrowing Limits	0	0	0	0
2	Commitments and Contingencies	0	0	0	0
	<i>Check</i>	-	-	-	0.00

Credit Rating

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
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.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

<p>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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- 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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Conduct of Business

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- (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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- (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)
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- (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)
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- (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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