The Pakistan Credit Rating Agency Limited

Rating Report

Sindh Engro Coal Mining Company

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
19-Jul-2022	AA	A1+	Stable	Maintain	-
19-Jul-2021	AA	A1+	Stable	Maintain	-
24-Jul-2020	AA	A1+	Stable	Maintain	-
25-Jul-2019	AA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Sindh Engro coal mining company's ownership structure-owned by the Government of Sindh and financially sound business groups of the country. The rating also incorporates the fact that indigenous coal is expected to play a dominant role in meeting the country's future energy requirement. SECMC has leased Block-II (out of 12 blocks) of Thar, for the period of thirty (30) years, which has a cumulative capacity of ~1.57bln tonnes of coal which could be used to produce 5,000 MW for fifty (50) years. The Policy for Coal Tariff Determination offers a guaranteed internal rate of return, cost indexation and pass-through tariff structure for SECMC. Comfort is drawn from China Machinery Engineering Corporation (CMEC) – the O&M operator – having significant experience of International EPC Projects in Power Plants. Business risk is considered low, exhibited by demand risk coverage as SECMC has signed a Coal Supply Agreement with its associated company, Engro Powergen Thar Limited (EPTL), incorporated to operate mine-mouth coal-fired Power Plant (2x330MW) for phase-I and with Thal Nova Power Thar (Private) Limited (TNPTL) and Thar Energy Limited (TEL) for annual supply of 1.9 million tonnes of coal to each for Phase II, having potential of soaring coal capacity to 7.6 TPA. The rating favorably factors in successful commissioning of 3.8mln TPA (Phase-I) mine on 10th July 2019, three months earlier than the Scheduled COD. The COD of Phase-II Expansion is expected to get completed by 1HFY2023, and expected to be aligned with the COD of TEL and TNPTL the coal purchaser from block II under Coal supply agreement. With the successful commissioning of Phase-I SECMC reported its topline to be PKR 39bln and is expected to upsurge further, when phase-II comes online. Consistent profitability and improved FCFOs support the timely repayment of phase-I project debt. While going forward, with the draw down for phase-II leveraging will increase. The Strong cash position and un-utilized short-term borrowing lines depicts healthy financial position of the company.

Adherence to good financial discipline towards both financial and commercial obligations is considered a strength. Meanwhile, upholding strong operational performance in line with agreed performance levels remain important. Effective management of the project, favorable regulatory regime, and consistency in related policies remain critical for the ratings. The ratings incorporate the prevailing challenges on account of circular debt crisis. Company's liquidity situation in terms of pending receivables seems stringent.

Disclosure

Name of Rated Entity	Sindh Engro Coal Mining Company
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Mehtodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Coal Mining and Trading(Jul-21)
Rating Analysts	Anam Waqas Ghayour | anam.waqas@pacra.com | +92-42-35869504

Coal Mining and Trading

Profile

Legal Structure Sindh Engro Coal Mining Company Limited is a public unlisted company, incorporated in Pakistan on October 15, 2009. The Company has its registered office at, The Harbor Front Building, Clifton, Karachi.

Background The Company had commenced an initial feasibility study of the project in November 2009 through a team of International Consultants and local experts to confirm the technical, environmental, social and economic viability of the Project. The study was carried out on an area of 79.6 sq. km allocated to the Company in Thar Coalfield which was approved by the Technical Committee of the Government of Sindh on August 31, 2010.

Operations The Company was formed under a Joint Venture Agreement, dated September 8, 2009, between the Government of Sindh (GoS), Engro Energy Limited (EEL) [formerly Engro Powergen Limited (EPL)] and Engro Corporation Limited for the development, construction and operations of an open-cast lignite mine in BlockII of Thar Coal Field, Sindh.

Ownership

Ownership Structure The company's ordinary shares, ~91.5% of the total equity, are owned by Government of Sindh (~54.70%), Engro Energy Limited (~11.90%), Thal Limited (~11.90%), Habib ank Limited (~9.50%), HUBCO (~8%), and CMEC Thar Mining Investments LTD (~4%). While preference shares, ~8.5% of the total equity, are owned by Huolinhe Open Pit Coal (HK) Investment Co. Ltd (100%).

Stability Majority shareholding owned by Government of Sindh provides support to stability of the company. Comfort is also drawn as the country's biggest conglomerate, Engro Corporation Limited (ECorp), has its stake in the company through its subsidiary company, Engro Energy Limited, and Mega Conglomerate Private Limited through its subsidiary company HUBCO.

Business Acumen Government of Sindh holds SECMC as its strategically vital asset, whereas more technical knowledge flows in from Engro, HUBCO & CMEC. The business acumen of sponsors of the company is considered strong.

Financial Strength Joint ownership from the Government of Sindh (GoS) and association of financially sound conglomerates provide absolute financial strength to the company. Given the strategic importance of SECMC to the GoS, in terms of its socio-economic policies and its quest of reducing the import bill, the probability of sovereign support, in case the company requires it, remains high.

Governance

Board Structure The board of SECMC, comprises of a total number of twelve directors (including the CEO), out of which five directors are nominated by the Government of Sindh and the remaining directors (including the CEO), are nominated by Engro and its affiliates. Currently, there are five nominees from the Government of Sindh, two nominees from Engro, two nominees from Thal Limited and one nominee each from Habib Bank Limited, HUBCO and Huolinhe Investment.

Members' Profile Imtiaz Ahmed Sheikh is the Chairman of the board. He is a seasoned Pakistani politician who is the current and Provincial Minister of Sindh for Energy, in office since 5 September 2018. He has been a member of the Provincial Assembly of Sindh since August 2018.

Board Effectiveness During CY20, the board held six meetings to address the strategic decisions of the company. There are five committees at the Board level, namely i) Audit Committee, ii) Risk Management committee, iii) Peoples Committee, iv) Procurement Committee, v) CSA Committee

Financial Transparency A.F.Ferguson & Co., a member firm of PWC, is the auditor of the company. They expressed an unqualified opinion on the company's financial statements at end Dec21. Though the company is non-listed, still financial statements have been being prepared in a timely fashion to maintain financial transparency intact.

Management

Organizational Structure Company's organization is structured around the effective functioning of seven major departments. Each department is headed by an experienced professional, reporting directly to the CEO. The departments comprise: a) Finance, b) HR & Admin, c) Site Operations, d) Mine Tech & Expansion, e) Water Resources, f) Commercial Operations, & g) Audit.

Management Team Mr. Amir Iqbal is the Chief Executive Officer of the company, a mechanical engineer by profession. He is associated with the group for ~21 years with overall ~22 years of experience in his portfolio. His expertise lies in project management, strategic management & execution of large, industrial complexes.

Effectiveness To oversee the management of the company, SECMC has constituted an internal management committee comprising of executives from SECMC and of all subsidiaries Engro Energy Limited. The purpose of the committee is to drive the strategic decision making for the company and formulates new strategies to deal with developments that the company encounters.

MIS SECMC uses SAP as its Enterprise Resources Planning (ERP) Software specifically the FICO (Finance Module) for maintaining its financial database. SAP FI is made up of submodules. The sub-modules that are often used to generate reports of accounts receivables, accounts payables, asset accounting, general ledger accounting, and bank accounting.

Control Environment SECMC maintains an effective control environment with defined policies and procedures. Company's internal audit function performs regular reviews on the financial, operational and compliance controls and reports directly to the audit committee for all critical issues.

Business Risk

Industry Dynamics Pakistan's total coal reserves stood at ~185,175mln tonnes and is ranked 7th amongst the lignite (coal) rich countries of the world. Of all the reserves ~99% of the reserves are present in Sindh province, while Punjab, and Baluchistan shares ~0.1% each to the total reserves. The country's largest coal reserves are located at Tharparkar District in the south-eastern province of Sindh, where about ~175,506mln Tonnes is identified, which is ~94% of the total reserves and ~95% of the reserves in Sindh Province.

Relative Position SECMC project is being developed in Block II which has five phases. Block II has the total reserves of ~1,584mln Tonnes which is ~1% of the total reserves in Thar region of Sindh. It is estimated that exploitable reserves of 1,584mln tons can be used to produce 5,000 MW for 50 years.

Revenues Company's revenue source is a component of i) Tariff that will be being charged to its customer, and ii) coal that will be supplied. Levelised tariff, for phase-I, that is determined at the time of financial close is $58.03 per tons. The true-up revenue is filed with NEPRA and notification of the same is awaited. Company has started operations in July-19 and at 3MCY21 company's revenue generation is reported at PKR 8,832mln (CY20: PKR 37,101mln).

Margins During 3MCY22, Company's gross margin has been reported at 53.1% in comparison to 44.9% during 3MCY21. Company has posted a net profit of PKR 3127mln during 3MCY22 (CY21: PKR 11,008mln, CY20: PKR 11,014mln) on account of trickledown effect of exchange currency loss and increased finance cost. Hence, company's net profit margin has improved to 32.3% (CY21: 28.1%).

Sustainability Coal is mostly imported in Pakistan to meet domestic demand and, although imported coal is a cheap source of fuel compared to imported oil. With the development of Pakistan's huge coal reserves at Thar, the country will be able to substitute its use of imported oil and, through the use of affordable and sustainable energy sources.

Financial Risk

Working Capital During 3MCY22 company's net working capital cycle stood at 296 days compared 270days in CY21. SECMC manages its working capital cycle through mix of internal cashflows and short term borrowings. During review, Company's reliance on short term borrowings stands nil.

Coverages As per 3MCY22, FCFO of the company, which is a function of profitability stood at PKR 6,612mln (CY21: PKR 21,525mln). Coverages were also impacted during 3MCY22 [Interest Coverage: 3MCY22: 5.4x CY21: ~5.4x).

Capitalization The total project cost of phase I was ~USD 626.8mln which is being financed with a debt to equity ratio of 75:25. Debt portion is a mix of local and foreign financing. The first principal payment for the same was due in June-20 and the respective obligation is timely fulfilled by the entity. Phase II has a total project cost of USD 216mln. The debt portion comprises of local financing of USD 149mln respectively.

PKR mln

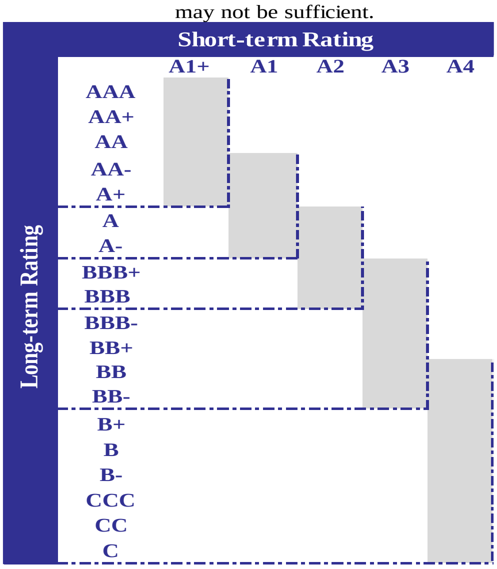
Sindh Engro Coal Mining Company Coal Mining	Mar-22 3M	Dec-21 12M	Dec-20 12M	Dec-19 12M
A BALANCE SHEET				
1 Non-Current Assets	91,431	87,033	77,630	72,597
2 Investments	-	-	-	-
3 Related Party Exposure	206	206	206	206
4 Current Assets	78,244	71,528	46,526	30,180
a Inventories	*1,103*	*683*	*667*	*585*
b Trade Receivables	*31,098*	*31,785*	*26,178*	*20,026*
5 Total Assets	169,881	158,767	124,362	102,983
6 Current Liabilities	42,297	37,551	20,754	12,443
a Trade Payables	-	-	-	-
7 Borrowings	73,267	70,027	67,402	65,349
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	-	-	-	-
10 Net Assets	54,316	51,190	36,205	25,191
11 Shareholders' Equity	54,316	51,190	36,205	25,191
B INCOME STATEMENT				
1 Sales	9,693	39,111	37,101	17,011
a Cost of Good Sold	*(4,542)*	*(21,336)*	*(19,470)*	*(8,098)*
2 Gross Profit	5,151	17,775	17,631	8,913
a Operating Expenses	465	(699)	(656)	(429)
3 Operating Profit	5,616	17,076	16,975	8,483
a Non Operating Income or (Expense)	*(1,097)*	*(1,486)*	*(299)*	*52*
4 Profit or (Loss) before Interest and Tax	4,518	15,590	16,676	8,536
a Total Finance Cost	*(1,198)*	*(4,177)*	*(5,675)*	*(2,844)*
b Taxation	*(193)*	*(405)*	*14*	*(11)*
6 Net Income Or (Loss)	3,127	11,008	11,014	5,681
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*6,612*	*21,525*	*20,561*	*10,323*
b Net Cash from Operating Activities before Working Capital Changes	*6,589*	*16,813*	*14,001*	*5,506*
c Changes in Working Capital	*3,251*	*9,549*	*1,727*	*(17,717)*
1 Net Cash provided by Operating Activities	9,840	26,363	15,728	(12,211)
2 Net Cash (Used in) or Available From Investing Activities	(4,975)	(12,333)	(8,641)	(7,003)
3 Net Cash (Used in) or Available From Financing Activities	2,000	3,491	838	25,395
4 Net Cash generated or (Used) during the period	6,865	17,521	7,926	6,182
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	-0.9%	5.4%	118.1%	--
b Gross Profit Margin	53.1%	45.4%	47.5%	52.4%
c Net Profit Margin	32.3%	28.1%	29.7%	33.4%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	101.8%	79.5%	60.1%	-43.5%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	23.7%	25.2%	35.9%	29.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	296	270	227	430
b Net Working Capital (Average Days)	296	270	227	430
c Current Ratio (Current Assets / Current Liabilities)	1.8	1.9	2.2	2.4
3 Coverages				
a EBITDA / Finance Cost	5.4	5.4	3.6	3.6
b FCFO / Finance Cost+CMLTB+Excess STB	2.8	2.5	2.1	1.6
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	3.3	3.8	4.4	8.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	57.4%	57.8%	65.1%	72.2%
b Interest or Markup Payable (Days)	168.8	45.7	24.5	230.4
c Entity Average Borrowing Rate	6.4%	5.7%	8.5%	5.2%

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.

Long-term Rating	
Scale	**Definition**
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 Rating	
Scale	**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
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 surveill 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):

Entities
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

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

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**
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(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 | Clause 11-(A)(p).
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(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)
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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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