



The Pakistan Credit Rating Agency Limited

## Rating Report

### K-Electric | PPSTS-6 | PKR 5bln | Apr-22

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
31-Aug-2022	AA	A1+	Stable	Initial	-
26-Apr-2022	AA	A1+	Stable	Preliminary	-

#### Rating Rationale and Key Rating Drivers

The ratings incorporate the strategic importance of K-Electric Limited, (“The Company” or “K-Electric”) being a vertically integrated power utility, responsible for the generation, transmission, and distribution of electricity in Karachi and adjoining areas of Sindh and Balochistan. Support has been drawn from the sustained rather improved performance metrics of the Company, owing to growing demand for electricity and continuous improvement across various operational metrics including reduction in T&D losses and better recovery ratio. The financial risk profile and profitability indicators showed improvement in FY21 (gross profit increased by 35% as compared to last year) driven by these operational improvements. However, in 3QFY22 a decline in net profit of the Company was observed on back of negative adjustment in Mid-term review by Nepra, severe devaluation of Pak Rupee, and increase in effective rate of borrowing. Working Capital also remains a challenge because of the delayed payments from the government resulted in enhanced borrowings ultimately curtailing the profitability because of increased finance cost. To steer from this turbulent situation the Company is in a continuous process to add to its asset base: expansion was noted in plants, distribution and transmission. The Company is pursuing its 900 MW RLNG project on fast-track basis, of which 1st unit of 450 MW has been installed and will be commissioned soon, the generation capacity of company will increase and being efficient plant electricity will be produced at lower rate having positive impact on working capital of the Company. And the management is confident to close the bottom line on the positive note. Further, the Company is also engaged with GoP for direct release of net TDS to ease working capital requirements considering recent increase in fuel prices, which the management is hopeful to receive.

The expected increase in consumer tariff, generation fleet efficiency and additional power purchase from GoP, are imperative for the ratings, going forward. At the same time, upholding business and financial metrics is of utmost importance.

#### Disclosure

<b>Name of Rated Entity</b>	K-Electric   PPSTS-6   PKR 5bln   Apr-22
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Debt Instrument Rating
<b>Applicable Criteria</b>	Methodology   Debt Instrument Rating(Jun-22),Methodology   Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology   Rating Modifiers(Jun-22),Methodology   Independent Power Producer Rating(Jun-22)
<b>Related Research</b>	Sector Study   Power(Jan-22)
<b>Rating Analysts</b>	Madiha Sohail   madiha.sohail@pacra.com   +92-42-35869504



## Issuer Profile

**Profile** K-Electric Limited, a vertically-integrated power utility, has been in operations for over a century. It is the only vertically-integrated power utility in Pakistan, which means the organisation manages all three key areas – Generation, Transmission and Distribution – of producing and delivering energy to consumers. Total installed capacity of K-Electric Limited power generation plants is 2,267MW1. K-Electric Limited has an arrangement with external power producers for ~1,400 MW including 1,100 MW from the National Grid.

**Ownership** The company is ~66% owned by KES Power Limited, while GoP holds ~24% stake. KES Power is the major shareholder of the Company. However, KES Power is a consortium of Al-Jomaih Group of KSA, NIG of Kuwait and IGCF, a private equity fund formerly managed by Abraaj comprised of several Middle East institutional investors. KES Power has entered into a Share Purchase Agreement with Shanghai Electric Power Company Limited (SEP) for sale of up to 66.4% shares of K-Electric Limited. The transaction will close once customary closing conditions and requisite regulatory approvals are obtained.

**Governance** The company's board of directors comprises of thirteen directors. Mr. Shan A. Ashary is the Chairman of the Board since 7 September 2020. All the board members are seasoned professionals having interests in various sectors of the industry. There are six committees at the board level, namely i) Audit, ii) Finance, ii) Human Resource & Remuneration iv) Strategy & Projects Committee and v) Risk Management & Safety, vi) Board Regulatory Affairs Committee This ensures effective oversight of the company's affairs and strengthening the board's governance role. GOP has notified on 22 May 2019, Multiyear Tariff (MYT) for K-Electric Limited for the period of seven (7) years applicable from 1 July 2016 to 30 June 2023.

**Management** The management control of the company vests with KES Power Limited, being the largest shareholder. Mr. Moonis Alvi has been spearheading the company since being the CEO in June 2018. He has also previously served as the Chief Financial Officer of KElectric Limited. The organizational structure of K-Electric Limited is divided into three main business areas, namely (i) Generation, (ii) Transmission, and (iii) Distribution. Meanwhile, support functions such as Treasury & Corporate Finance, Marketing, and HR, supply chain etc. are centralized at the company level and are headed by professionals having considerable experience in their respective fields.

**Business Risk** K-Electric Limited has a registered customer base of ~3.2mln at end-March22 (FY21: ~3.1mln), of which 73.4% constitute residential consumers, 13.4% commercial, Industrial 0.8%, and remaining comprises the agriculture sector and public consumers. During 9MFY22, with the drop in consumption by industrial and commercial consumer segments and decline in units sent-out, management was able to reduce the overall T&D losses by 1.5% to stand at 14.5% (9MFY21: 16%; FY 2020: 19.7%; FY 2019: 19.1%). Driven by these operational improvements, the Company's gross profit increased by 35% as compared to last year. Further, finance cost in FY21 was around 34% lower than that of the previous year. This was mainly on account of a reduction in KIBOR rates resulting in a decrease in average borrowing cost for the Company by approximately 5%, contributing over PKR 5 billion to the bottom line. The Company's gross profit in 6MFY22 witnessed an uptick (6MFY22: 33bln, 6MFY21: 29bln) on account of decrease in T&D losses and increase in unit distribution. Unfortunately, the same did not translate into net profitability mainly because of the Pak rupee devaluation. As a result, profitability deteriorated and resulted in a net profit of PKR 3.313bln (6MFY21: 6.87bln), which declined by 51%, compared to the corresponding period last year. Moreover, in 3QFY22 declining trend continues and the company reported a loss of PKR 1.82bln as compared to the profit of PKR 2.57bln in the corresponding quarter last year. Consequently, overall performance in 9MFY22 impacted and resulted in a net profit of PKR 1.49bln (9MFY21: 9.4bln), with decline of 84%, compared to the corresponding period last year. The reason for the decline in profit is mainly on account of negative adjustment in Mid- term review (MTR) decision (net decline in gross profit of PKR 2.4bln severe devaluation of Pak Rupee, and increase in effective rate of borrowing. The similar trend was observed in cash flow coverages of the Company. KE is setting up a 900 MW RLNG Project. Effective and timely execution of project is likely to further uplift company's profile in medium to long term.

**Financial Risk** Units billed during 9MFY22 have increased to 11,884GWh as compared to 11,352 in the corresponding period (FY21:13,522GWh; FY20:14,277GWh; FY19:14,318GWh). The total amount billed to customers for the review period is recorded at PKR 258,589mln (FY20: PKR 262,381mln; FY19: PKR 230,402mln). Recovery ratio has started to show improvement to 96% during 9MFY22 (FY20: 89%). Furthermore, the management is anticipating improvement in public sector recoveries on account of settlement of old recoveries from KWSB. During 9MFY22, total receivables of the company are reported at PKR 97,648 as compared to PKR 94,549mln in corresponding period (FY20: PKR 99,832mln) owing to delay in public sector recoveries and the prevailing circular debt crisis in the country. The company has strong cash generation ability. The outstanding receivable balances and tariff differential claims have placed constraints on cashflow streams, and for working capital requirement company is resorting to short term debt avenues. The leverage is in the comfortable range, particularly in the context of equity base. The equity base itself is strong

## Instrument Rating Considerations

**About The Instrument** K-Electric issued a privately placed, short term, unsecured Sukuk of PKR 5,000mln in April 2022, to finance the company's working capital requirements. The tenor of PPSTS-6 is up to 6 months and carries a profit rate of 6MK+70bps. Profit will be realized at the time of maturity.

**Relative Seniority/Subordination Of Instrument**

**Credit Enhancement** The instrument is unsecured.



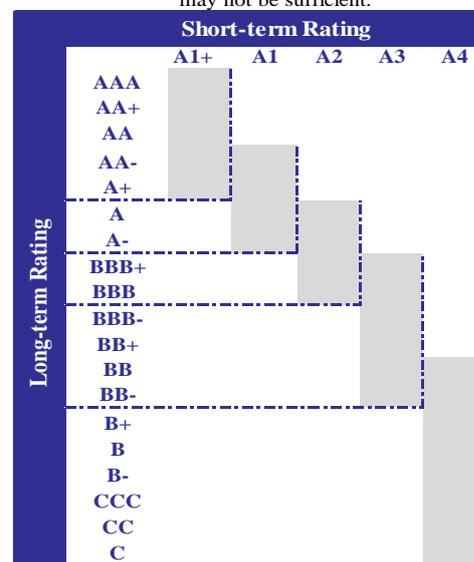
K Electric Limited Power	Mar-22 9M	Jun-21 12M	Jun-20 12M	Jun-19 12M
<b>A BALANCE SHEET</b>				
1 Non-Current Assets	452,770	424,484	361,321	326,857
2 Investments	2,941	2,987	3,048	-
3 Related Party Exposure	275	182	-	-
4 Current Assets	507,213	408,024	339,045	272,008
<i>a Inventories</i>	3,740	3,024	647	12,078
<i>b Trade Receivables</i>	97,648	104,714	99,832	99,928
5 Total Assets	963,198	835,677	703,414	598,865
6 Current Liabilities	459,736	382,145	295,378	215,752
<i>a Trade Payables</i>	366,077	297,613	217,625	190,795
7 Borrowings	218,827	184,300	155,574	129,511
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	47,039	45,281	41,795	39,113
10 Net Assets	237,597	223,952	210,667	214,489
11 Shareholders' Equity	225,442	223,952	210,658	214,489
<b>B INCOME STATEMENT</b>				
1 Sales	311,572	325,049	288,807	289,119
<i>a Cost of Good Sold</i>	(267,878)	(265,854)	(244,914)	(238,413)
2 Gross Profit	43,694	59,195	43,893	50,706
<i>a Operating Expenses</i>	(37,681)	(25,225)	(21,523)	(43,103)
3 Operating Profit	6,013	33,970	22,370	7,603
<i>a Non Operating Income or (Expense)</i>	7,941	(7,511)	(5,275)	7,564
4 Profit or (Loss) before Interest and Tax	13,954	26,459	17,096	15,167
<i>a Total Finance Cost</i>	(9,695)	(11,113)	(16,737)	(6,285)
<i>b Taxation</i>	(2,769)	(3,348)	(3,318)	8,391
6 Net Income Or (Loss)	1,490	11,998	(2,959)	17,274
<b>C CASH FLOW STATEMENT</b>				
<i>a Free Cash Flows from Operations (FCFO)</i>	35,122	59,424	48,785	51,725
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	17,037	44,556	27,160	42,190
<i>c Changes in Working Capital</i>	(19,093)	(2,296)	(4,512)	(59,074)
1 Net Cash provided by Operating Activities	(2,055)	42,259	22,648	(16,884)
2 Net Cash (Used in) or Available From Investing Activities	(34,210)	(74,465)	(49,411)	(33,842)
3 Net Cash (Used in) or Available From Financing Activities	39,699	22,061	26,415	52,012
4 Net Cash generated or (Used) during the period	3,433	(10,144)	(349)	1,285
<b>D RATIO ANALYSIS</b>				
<b>1 Performance</b>				
<i>a Sales Growth (for the period)</i>	27.8%	12.5%	-0.1%	30.6%
<i>b Gross Profit Margin</i>	14.0%	18.2%	15.2%	17.5%
<i>c Net Profit Margin</i>	0.5%	3.7%	-1.0%	6.0%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	5.1%	17.6%	15.3%	-2.5%
<i>e Return on Equity [ Net Profit Margin * Asset Turnover * (Total Assets/Shareholders' Equity)]</i>	0.9%	5.5%	-1.4%	8.2%
<b>2 Working Capital Management</b>				
<i>a Gross Working Capital (Average Days)</i>	92	117	134	143
<i>b Net Working Capital (Average Days)</i>	-200	-172	-124	-36
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	1.1	1.1	1.1	1.3
<b>3 Coverages</b>				
<i>a EBITDA / Finance Cost</i>	4.6	6.6	3.7	7.8
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	0.6	0.6	0.9	1.7
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	4.7	3.1	3.2	1.6
<b>4 Capital Structure</b>				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	49.3%	45.1%	42.5%	37.6%
<i>b Interest or Markup Payable (Days)</i>	278.9	360.1	228.8	437.2
<i>c Entity Average Borrowing Rate</i>	5.3%	5.3%	9.3%	6.2%

**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.

Scale	Long-term Rating Definition
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
<b>AA+</b>	
<b>AA</b>	<b>Very high credit quality.</b> 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.
<b>AA-</b>	
<b>A+</b>	
<b>A</b>	<b>High credit quality.</b> 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.
<b>A-</b>	
<b>BBB+</b>	
<b>BBB</b>	<b>Good credit quality.</b> 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.
<b>BBB-</b>	
<b>BB+</b>	<b>Moderate risk.</b> 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>BB</b>	
<b>BB-</b>	
<b>B+</b>	
<b>B</b>	<b>High credit risk.</b> 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>B-</b>	
<b>CCC</b>	<b>Very high credit risk.</b> 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.
<b>CC</b>	
<b>C</b>	
<b>D</b>	Obligations are currently in default.

Scale	Short-term Rating Definition
<b>A1+</b>	The highest capacity for timely repayment.
<b>A1</b>	A strong capacity for timely repayment.
<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
<b>A4</b>	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):

- a) Broker Entity Rating
- b) Corporate Rating
- c) Debt Instrument Rating
- d) Financial Institution Rating
- e) Holding Company Rating
- f) Independent Power Producer Rating
- g) Microfinance Institution Rating
- h) Non-Banking Finance Companies Rating

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

(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)

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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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Regulatory and Supplementary Disclosure

Nature of Instrument	Size of Issue (PKR)	Tenor	Security	Quantum of Security	Nature of Assets	Lead Advisor	Book Value of Assets (PKR mln)
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Rated, Privately Placed, Short Term Sukuk (PPSTS-6)	5,000mln	6 months	Unsecured	N/A	N/A	Faysal Bank Limited	N/A
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Name of Issuer	K- Electric Limited (K-Electric)						
Issue Date	Apr-22						
Maturity	Oct-22						
Option	N/A						

Due Date Principal*	Opening Principal	Principal Repayment*	Due Date Markup/ Profit*	Markup/Profit rate	6M Kibor Plus 70bps	Markup/Profit Payment	Installment Payable	Principal Outstanding
	PKR in mln							
Issuance								4,500
Apr-22	5,000			6M KIBOR + 0.7%	12.38%		-	4,500
Oct-22	5,000	5,000	Oct-22	6M KIBOR + 0.7%	12.38%	279	4,221	-
		5,000				279	4,221	