



The Pakistan Credit Rating Agency Limited

Rating Report

K-Electric Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
21-Jun-2023	AA	A1+	Stable	Maintain	Yes
29-Jun-2022	AA	A1+	Stable	Maintain	-
29-Jun-2021	AA	A1+	Stable	Maintain	-
29-Jun-2020	AA	A1+	Stable	Maintain	-
28-Dec-2019	AA	A1+	Stable	Maintain	Yes
28-Jun-2019	AA	A1+	Developing	Maintain	Yes
31-Dec-2018	AA	A1+	Developing	Maintain	Yes
14-Jun-2018	AA	A1+	Developing	Maintain	Yes
30-Dec-2017	AA	A1+	Developing	Maintain	Yes

Rating Rationale and Key Rating Drivers

The ratings incorporate the strategic importance of K-Electric Limited, (“the Company” or “KE”) being a vertically integrated power utility, responsible for the generation, transmission, and distribution of electricity in Karachi and adjoining areas of Sindh and Balochistan. During 9MFY23, KE reported a net loss of PKR 39.39bln (9MFY22: Profit of PKR 1.49bln). The loss is mainly attributable to macroeconomic factors including the reduction in sent-out units on the back of slow economy and increase in fuel prices. Furthermore, the consistent devaluation of Pak Rupee resulted in huge exchange loss combined with the increase in debt servicing cost because of the increase in policy rates. The Company operates under regulated tariff, and as per current MYT, no adjustment is provided in the tariff for changes in sent-out and policy rates. Working Capital also remains a challenge because the delayed payments from the government resulted in enhanced borrowings ultimately curtailing profitability. Consequently, finance cost coverage & debt coverage plummeted to 2.4x & 0.5x (FY22: 6.0x & 1.3x) respectively. Leveraging of the company also increased to 60% (FY22: 53%) and it is expected to increase further on account of the Board approved Investment Plan for the improvement of transmission and distribution segments. The comfort for the timely repayment of long-term borrowings is available as KE marks the funds in Master Collection Accounts (MCA) ensuring the viability to meet its obligations timely. Support has also been drawn from the sustained, rather improved performance metrics of the Company, owing to continuous improvement across various operational metrics including a reduction in T&D losses however, recovery ratio needs to improve going forward. KE has witnessed synchronization of 900MW RLNG-fired power project (BQPS-III). Both units of the BQPS III project have been successfully commissioned. In addition, the Company is actively pursuing to expedite the determination of pending quarterly tariff variation for cost which have been determined by authority. Going forward, as part of tariff renewal process, KE has filed separate tariffs for Generation, Transmission, Distribution and Supply businesses for better alignment with the regulatory framework and sector developments as well as to provide greater transparency for next control period from FY 24 to FY30. KE expects a sustainable cost-reflective tariff with a robust adjustments mechanism which will have a positive impact on its profitability going forward.

The Rating Watch status reflects the ongoing developments regarding the approval of tariffs by the National Electric Power Regulatory Authority (NEPRA), as requested by the Company for its Generation, Transmission, Distribution and Supply businesses. The outcome of the tariff determination exercise, as well as its impact on the Company, will be crucial factors in determining and maintaining the validity of the ratings. It is of utmost importance for the integrity of the ratings that this process reaches a timely resolution.

Disclosure

Name of Rated Entity	K-Electric Limited
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),Methodology Rating Modifiers(Jun-22)
Related Research	Sector Study Distribution Electricity(Feb-23)
Rating Analysts	Ahsan Zahid ahsan.zahid@pacra.com +92-42-35869504

Profile

Legal Structure K-Electric (KE), was incorporated in 1913 under the Companies Act, 2017 and its shares are quoted on the Pakistan Stock Exchange.

Background KE's current power generation capacity is 2,817MW. In addition to its own generation capacity, KE has power purchase agreements (PPA) with several IPPs & NTDC for 1650MW. KE's transmission network is interconnected with NTDC and comprises 220KV, 132KV, and 66KV transmission lines, 71 grid stations, and 180 power transformers.

Operations KE is principally engaged in the generation, transmission and distribution of electric energy under the Electricity Act, 1910 and the Regulation of Generation, Transmission and Distribution of Electric Power Act, 1997 (the NEPRA Act 1997) to its licensed areas.

Ownership

Ownership Structure The major portion of the company is owned by KES Power with controlling rights, Government of Pakistan owns ~24% and remaining ~10% is on free float. KES Power is owned by IGCF SPV 21 (53.8%), Al Jomiah (27.7%) and remaining (18.50%) is owned by National Industries Group (Denham Investments).

Stability The presence of Government of Pakistan among the owners of two different nations bode really well for stability of the company.

Business Acumen IGCF LP is a Cayman Island registered private investment fund with numerous institutional investors that is managed by the IGCF GP and holds multiple assets, including an indirect non-controlling shareholding in K-Electric. Further, Al-Jomaih Group, based in Saudi Arabia, is one of the recognized business conglomerates, with interests in the corporate and financial services sectors. National Industries Group (NIG), Kuwait is also one of the largest industrial companies in the Middle East.

Financial Strength Financial Strength of the stake holders emanate from their multiple successful ventures in automobile & oil marketing combine with the sovereign stake.

Governance

Board Structure The overall control of the company vests in thirteen-member board of directors (BoD) including the CEO. The board is majority controlled by KESP. Mr. Mark Gerard Skelton was appointed by the BOD as Chairman. Furthermore, Mr. Boudewijn Clemens Wentink, Ch. Khaqan Saadullah Khan and Ms. Sadia Khurram resigned from the position of Non-Executive Directors in October 2022 resulting in casual vacancies on the board. However, K-Electric cannot change its current Board composition till further orders from SECP in addition to the suit filed by Al Jomiah Power Limited & Denham Investments against IGCF SPV 21 restricting the company to make any change in composition of the board.

Members' Profile Mark Skelton is a Managing Director with Alvarez & Marsal's (A&M) Advisory practice in London. He brings more than 20 years of experience in corporate finance and advisory. His primary areas of concentration are cross border assignments crossing different legal jurisdictions and waterfall classes.

Board Effectiveness There are currently four committees at the board level, namely (i) Audit, (ii) Finance, (iii) Human Resource & Remuneration, and (iv) Board Strategy & Project to ensure the smooth flow of operations.

Financial Transparency AF Ferguson & Company, Chartered Accountants is the external auditor of the company. The auditors have given unqualified opinion and review report on the company's financial statements for the year ended June 30, 2022. At the same time, they have drawn attention to the matter that the markup/ financial charges on outstanding liabilities and receivables to and from govt controlled entities to be treated on net basis.

Management

Organizational Structure KE has a very organized Management Structure with defined hierarchy with three segments (Generation, Transmission & Distribution) guiding the way.

Management Team KE's management team comprises qualified and experienced professionals. 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 K-Electric Limited.

Effectiveness KE has constituted four strategic divisions – (i) Supply Chain, (ii) Corporate Strategy, (iii) Health Safety and Environment, and (iv) Special Projects – which aids in the execution of the company's overall strategy. Each division head reports directly to the CEO, with the exception of Internal Audit, who reports directly to the Audit Committee of the board.

MIS KE has implemented SAP's Industry Solution for Utilities/Customer Care System, along with SAP Customer Relationship Management and SAP Business Warehouse/ Business Intelligence Solution. These modules address the needs of a customer oriented utility company as well as managing day to day operations such as meter-to-cash cycle, customer level financial management, energy loss management, etc.

Control Environment The modules also support upcoming regulations like 'Time of Use' tariffs and potential deregulation of the power sector. Another key initiative is integration of the state-of-the-art Supervisory Control and Data Acquisition (SCADA) communication system at the nine newly constructed grids with the Load Dispatch Center.

Business Risk

Industry Dynamics Energy Sector is the backbone of an economy, while Power is one of the most significant segments of the Energy Sector. Among the three verticals of the Power Value Chain, i.e., Generation, Transmission and Distribution, Generation is the upstream sector which sets the direction of the country's power production and its fuel composition. Power generation in Pakistan stood at ~153,874GWh in FY22, up ~7% YoY. Generation capacity, on the other hand, stood at ~43,775MW up ~10% YoY.

Relative Position K-Electric Limited is the only vertically-integrated power utility of the country and has been in operations for over a century.

Revenues KE has a registered customer base of ~3.5 million at end-Mar23, of which 84% constitute residential consumers, 15% commercial, Industrial 0.7%, and the remaining 1% comprises of agricultural and public consumers. However, in terms of revenue, residential customers accounted for only 37% of tariff income for 9MFY23, while commercial, Industrial, Agricultural and public consumers accounted for 20%, 42% and 0.1% and 0.5%, respectively. This is due to the heavy consumptive requirements of industrial consumers. Given the developing stage of the economy, the demand for electricity is expected to increase going forward.

Margins During 9MFY23, challenging sociopolitical and macroeconomic factors have had a cascading impact on multiple sectors including the company. Impacted by these challenges, company has observed a reduction in units sent-out by 5.8% (9MFY23: 13,087 GWh, 9MFY22: 13,900 GWh) and the gross profitability of the company declined significantly by PKR 7.0bln (9MFY23: PKR 36,712mln, 9MFY22: PKR 43,694mln). Hence GP margin decline to 10% and NP Margin plummeted to -10%. The Company operates under regulated tariff, and as per current MYT, no adjustments is provided in the tariff for changes in sent-out and policy rates.

Sustainability KE is aggressively working on the expansion plans and have already filed for investment plan to NEPRA with the cost of PKR 484bln. Also, KE has been taking new initiatives to reduce the T&D losses which will ultimately complement the bottom line.

Financial Risk

Working Capital During 9MFY23, total receivables of the company are reported at PKR 97,502mln as compared to PKR 97,648mln in corresponding period (FY22: PKR 136,843mln) 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.

Coverages KE's coverages have exhibited a declining trend as reflected by the increasing cost of debt servicing and total debt and stressed FCFOs. FCFO (9MFY23: PKR 37bln; FY22: PKR 68bln; FY21: PKR 59.42bln). Interest coverage decreased to 2.4x in 9MFY23 from 6.0x during FY22. Similarly, debt service coverage plummeted to 0.5x during the period under review from 1.3x in Jun-22.

Capitalization Borrowings of the company has surged to PKR 317,202mln on back of capital expenditure on 900 MW RLNG project (BQPS-III) and because of enhanced short-term borrowings because of the continuous deterioration of working capital structure (PKR 115,417mln). Hence leveraging of the company increased to 60% by end Mar-23 (FY22: 53%, FY21: 45%).



K-Electric Limited Power	Mar-23 9M	Jun-22 12M	Jun-21 12M	Jun-20 12M
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A BALANCE SHEET

1 Non-Current Assets	512,432	489,791	424,484	361,321
2 Investments	23,987	19,249	2,987	3,048
3 Related Party Exposure	275	275	182	-
4 Current Assets	568,083	550,813	408,024	339,045
<i>a Inventories</i>	5,081	4,030	3,024	647
<i>b Trade Receivables</i>	97,502	136,843	104,714	99,832
5 Total Assets	1,104,776	1,060,128	835,677	703,414
6 Current Liabilities	520,090	476,818	382,145	295,378
<i>a Trade Payables</i>	414,806	379,069	297,613	217,625
7 Borrowings	317,202	283,088	184,300	155,574
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	56,702	50,050	45,281	41,795
10 Net Assets	210,782	250,172	223,952	210,667
11 Shareholders' Equity	210,782	250,172	223,952	210,658

B INCOME STATEMENT

1 Sales	368,141	518,777	325,049	288,807
<i>a Cost of Good Sold</i>	(331,429)	(446,362)	(265,854)	(244,914)
2 Gross Profit	36,712	72,416	59,195	43,893
<i>a Operating Expenses</i>	(47,465)	(27,598)	(25,225)	(21,523)
3 Operating Profit	(10,753)	44,817	33,970	22,370
<i>a Non Operating Income or (Expense)</i>	(3,798)	(24,049)	(7,511)	(5,275)
4 Profit or (Loss) before Interest and Tax	(14,550)	20,769	26,459	17,096
<i>a Total Finance Cost</i>	(21,457)	(15,120)	(11,113)	(16,737)
<i>b Taxation</i>	(3,383)	2,875	(3,348)	(3,318)
6 Net Income Or (Loss)	(39,390)	8,524	11,998	(2,959)

C CASH FLOW STATEMENT

<i>a Free Cash Flows from Operations (FCFO)</i>	37,431	68,380	59,424	48,785
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	1,391	48,261	44,556	27,160
<i>c Changes in Working Capital</i>	19,339	(75,117)	(2,296)	(4,512)
1 Net Cash provided by Operating Activities	20,729	(26,857)	42,259	22,648
2 Net Cash (Used in) or Available From Investing Activities	(21,159)	(63,843)	(74,465)	(49,411)
3 Net Cash (Used in) or Available From Financing Activities	736	84,804	22,061	26,415
4 Net Cash generated or (Used) during the period	307	(5,896)	(10,144)	(349)

D RATIO ANALYSIS

1 Performance				
<i>a Sales Growth (for the period)</i>	-5.4%	59.6%	12.5%	-0.1%
<i>b Gross Profit Margin</i>	10.0%	14.0%	18.2%	15.2%
<i>c Net Profit Margin</i>	-10.7%	1.6%	3.7%	-1.0%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	15.4%	-1.3%	17.6%	15.3%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh</i>	-22.8%	3.6%	5.5%	-1.4%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	91	87	117	134
<i>b Net Working Capital (Average Days)</i>	-205	-151	-172	-124
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	1.1	1.2	1.1	1.1
3 Coverages				
<i>a EBITDA / Finance Cost</i>	2.1	5.9	6.6	3.7
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	0.5	1.3	0.6	0.9
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	8.6	3.4	3.1	3.2
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	60.1%	53.1%	45.1%	42.5%
<i>b Interest or Markup Payable (Days)</i>	225.3	341.8	360.1	228.8
<i>c Entity Average Borrowing Rate</i>	7.4%	5.2%	5.3%	9.3%

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+	
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-	
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):
 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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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 | 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)

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)

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