



The Pakistan Credit Rating Agency Limited

## Rating Report

### Hub Power Company Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Jun-2019	AA+	A1+	Stable	Maintain	-
27-Dec-2018	AA+	A1+	Stable	Maintain	-
29-Jun-2018	AA+	A1+	Stable	Maintain	-
22-Dec-2017	AA+	A1+	Stable	Maintain	-
20-Apr-2017	AA+	A1+	Stable	Maintain	-

#### Rating Rationale and Key Rating Drivers

The Hub Power Company Limited (Hubco) is one of the largest power producers in the country. The rating reflects the holding company character of Hubco with an exclusive focus on the different dimension of the energy sector. In addition to the investment book, Hubco itself is a large RFO based power plant. Hubco aims to expand generation capacity to boost the country's power generation by utilizing Pakistan's indigenous natural resources. Hubco is setting up new coal power plants (i) China Power Hub Generation Company (CPHGC): 2x660MW coal fired power plant at Hub, (ii) Thar Energy Limited (TEL): 330MW mine-mouth coal fired power plant at Thar and (iii) Thalnova Power: 330MW mine-mouth coal fired power plant at Thar. CPHGC is being developed under a joint venture with China Power International Holdings Limited (CPIHL). Hubco also has investment in Sindh Engro Coal Mining Company (SECMC). These investments are being funded through a mix of short term and long term debt. The proportion of debt in the funding plan is predominant when compared to fresh equity. Fresh equity of PKR 7bln via right issue is just around the corner. Hubco has working capital related borrowing as well. The overall debt quantum in the wake of fresh investment is huge. The cash flows of the company can sustain the burden, which will be complemented by expected dividend inflows. The cash flows are taking positive benefit for the enhanced capacity payments, emanating from quarterly indexation. The management has forecasted sizable net cash position, reflecting dividend inflow from subsidiaries; materialization of same is crucial. Hubco pays dividend, which in an eventuality is an available resource, as evidenced by recent history. Hubco has used short term debt instruments and intends to raise borrowing through privately placed sukuk. These streams are already accounted for in the funding plan.

Cash flow streams of Hubco's plants are guaranteed by GoP under the Power Purchase Agreement (PPA), subject to adherence to the agreed upon performance benchmarks; this provides comfort to the ratings. Timely completion of new projects, settlement of receivable and payable and maintaining healthy debt service coverages are important.

#### Disclosure

<b>Name of Rated Entity</b>	Hub Power Company Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-18),Methodology   Criteria   Rating Modifier(Jun-18),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-18),Methodology   IPP (Jun-18)
<b>Related Research</b>	Sector Study   Power(Jan-19)
<b>Rating Analysts</b>	Faizan Arif   faizan.sufi@pacra.com   +92-42-35869504

## The Pakistan Credit Rating Agency Limited

### Profile

**Plant** The Hub Power Company Limited (Hub Power) consists of four generating units, each comprises of 323 MW gross outputs, with an oil-fired single re-heat boiler. Company has submitted a plan in May-19 to the government to convert furnace oil-fired plant into a coal-fired power plant prior to expiry of Power Purchase Agreement (PPA) in 2027.

**Tariff** The company negotiated revision in generation tariff with National Electric Power Regulatory Authority (NEPRA) in June 2012. Generation reference tariff (levelized tariff for years 1-25) is US 18.6-cents/ KWh as approved by NEPRA.

**Return On Project** The policy IRR of Hub Power, as agreed with NEPRA is 12%.

### Ownership

**Ownership Structure** Mega Conglomerate Private Limited (19%) is the single largest shareholder, followed by Allied Bank Limited (10%), Fauji Foundation (9%) and National Bank Pakistan (5%). 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 Mega Conglomerate and Fauji Foundation group will continue to provide comfort.

**Business Acumen** Mega Conglomerate having a diversified experience with presence in shipping, logistics, real state development, cement, energy and food sector.

**Financial Strength** Mega Conglomerate has a strong consolidated asset base of PKR 65bln supported by an equity base of PKR 15bln as at June'18. Consolidated revenue and profit stood at PKR115bln and PKR 1.1bln, respectively. Group's total revenue is PKR 116bln with net profit of PKR 14bln.

### Governance

**Board Structure** The Company's Board of Directors comprises of eleven Directors, The Board's efficacy is strengthened by the presence of an executive director, the CEO.

**Members' Profile** Directors having strong professional profile along with diversified experience assists the management in terms of strategic guidance and implementation of strong control framework.

**Board Effectiveness** For effective oversight of the matters the board has formed three board committees. (i) Board audit Committee (ii) Board Investment Committee and (iii) Board Compensation Committee. The company displays relevant information on website, stock exchange and financial reports in proper way.

**Financial Transparency** Ernst & Young Ford Rhodes Sidat Hyder is the external auditor of the company. The auditor has given unqualified opinion on company's financial statement as at 30th June 2018.

### Management

**Organizational Structure** Hub Power deploys a lean organizational structure. Six functions including Finance, Corporate services, Operations, and Audit report directly to CEO. The company's department – Manufacturing Excellence (MAX) – is responsible for improving the efficiency of the organization.

**Management Team** Mr. Khalid Mansoor is appointed as the CEO of the company, in May 2013 carrying 36 years of experience in Energy & Petrochemical Sectors. He is assisted by a team of experience professionals.

**Effectiveness** Hub Power management effectiveness plays a significant role in empowering the organization through positive results, which has made decision making process systematic.

**Control Environment** Hub Power has in place an efficient MIS reporting system for its operations. The system generates real-time plant production data, enabling efficient monitoring and timely decision making.

### Operational Risk

**Power Purchase Agreement** Hub Power'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** Hub Power has established a wholly owned subsidiary – Hub Power Services Limited (HPSL) – incorporated to manage the O&M in 2015.

**Resource Risk** Pakistan State Oil (PSO) is responsible for supplying RFO under the Fuel Supply Agreement (FSA) for 30 years. HUBCO is protected from fuel transportation issues as the company receives fuel directly from PSO.

**Insurance Cover** Hub Power has adequate insurance coverage for property damage and business interruption. The insured values for damages include a property damage cover (upto USD 1,733mln) & business interruption cover (up to USD 398mln).

### Performance Risk

**Industry Dynamics** Pakistan total power generation is increasing on the back of new power projects under CPEC. Going forward, cheap renewable electricity will be a challenge to viability of thermal power plants. During FY18, there has been a growth of ~30% in the actual power generation. Moreover, there has been an increase of ~18% in the installed capacity as at end-Jun18 to 32,613MW (FY17: 27,703MW).

**Generation** During 9MFY19, electricity generation decreased by 82% (9MFY19: 682GWH; 9MFY18: 4,150GWH; FY18: 5,201GWH, FY17: 6,793GWH) with average load factor of 9% (9MFY18: 52%). Generation was lower due to the facet of lower power demand on the back of improving energy mix. Hubco is receiving capacity payments despite having zero or minimal generation in the months of Jan, Feb and March 2019.

**Performance Benchmark** During 9MFY19, net profit has decreased owing to higher financing costs partly offset by depreciation of Rupee against USD (9MFY19: PKR 5,841mln; 9MFY18: PKR 6,129mln; FY18: PKR 8,565mln; FY17: PKR 8,256mln). Plant availability during 9MFY19 stood at 84% with load factor of 9% and thermal efficiency of 38.3%.

### Financial Risk

**Financing Structure Analysis** The Hub Power total project cost was \$1.5bln; with US \$175mln from international and local equity investors, US \$689mln from international banks, and the bulk of the rest coming via US \$589mln subordinated loan provided by the World Bank, JEXIM and ECAs. The project debt remained fully paid by the Company.

**Liquidity Profile** At 9MFY19, total receivables of the company stood at PKR 68,442mln (FY18: PKR 82,311mln; FY17: PKR 73,662mln). Reduction in receivables is due to recently issued sukuk by GoP for the power sector.

**Working Capital Financing** Receivable days have surged to 394 days in FY18 (FY17: 342 days) a facet of delayed payments recovery from CPPA-G. Receivables days as of 9MFY19 stood at 513days. Hubco has used short term debt instruments and intends to raise borrowing through a retail bond. Utilization of short term borrowings as of 9MFY19 stood at 93% (FY18: 73%). Short term debt instruments would act as bridging short-term facility to cover the timing difference between investments and cashflow from government. As of 9MFY19 company's long term equity investment stood at PKR 36bln (FY18: PKR 20bln), company through its wholly owned subsidiary Hub Holdings Limited has made an equity investment of PKR 22bln in China Power Hub Generation Company (CPHGC) and Thal Nova Power Ltd. During the period under review company holds 46% equity stake in CPHGC and 38.3% stake in Thal Nova.

**Cash Flow Analysis** During the review period, despite improvement in Free cash flows of the company, the debt coverage ratio has declined significantly (9MFY19: 0.6x; FY18: 2.1x; FY17: 1.5x) on account of increased interest expense. Free cash flows as of 9MFY19 stood at PKR 8,324mln (FY18: PKR 10,478mln; FY17: PKR 13,381mln).

**Capitalization** Hub Power leverage increased on the back recently issued commercial papers to finance equity investment in coal based power plants (Debt: equity; 9MFY19: 71%; FY18: 65%; FY17: 59%; FY16: 57%). Further drawdown from availed facility to invest equity in its subsidiary may cause leveraging to increase further.



The Hub Power Company Limited (Hubco)

PKRmln

BALANCE SHEET	31-Mar-19	30-Jun-18	30-Jun-17
	9M	Annual	Annual
<b>Non-Current Assets</b>	<b>14,172</b>	<b>15,477</b>	<b>17,440</b>
<b>Investments (Others)</b>	<b>36,215</b>	<b>20,679</b>	<b>11,174</b>
<b>Current Assets</b>	<b>82,022</b>	<b>100,462</b>	<b>86,369</b>
Inventory	3,493	7,643	4,746
Trade Receivables	68,442	82,684	73,662
Other Current Assets	9,785	9,708	6,737
Cash & Bank Balances	302	427	1,223
<b>Total Assets</b>	<b>132,409</b>	<b>136,617</b>	<b>114,983</b>
<b>Debt</b>	<b>54,947</b>	<b>36,424</b>	<b>27,867</b>
Short-term	32,578	21,776	20,091
Long-term (Incl. Current Maturity of long-term debt)	22,369	14,648	7,777
Other Short term liabilities (inclusive of trade payables)	55,040	80,367	67,630
Other Long term Liabilities	-	-	-
<b>Shareholder's Equity</b>	<b>22,423</b>	<b>19,827</b>	<b>19,486</b>
<b>Total Liabilities &amp; Equity</b>	<b>132,409</b>	<b>136,617</b>	<b>114,983</b>

INCOME STATEMENT	31-Mar-19	30-Jun-18	30-Jun-17
<b>Turnover</b>	<b>27,771</b>	<b>76,676</b>	<b>78,590</b>
Gross Profit	8,438	9,803	9,317
Other Operating Expense	(547)	(900)	(615)
Other Income	1,029	2,119	1,480
Financial Charges	(2,993)	(2,248)	(1,784)
Taxation	(86)	(209)	(142)
Profit from discontinued operations	-	-	1,344
<b>Net Income</b>	<b>5,841</b>	<b>8,565</b>	<b>9,600</b>

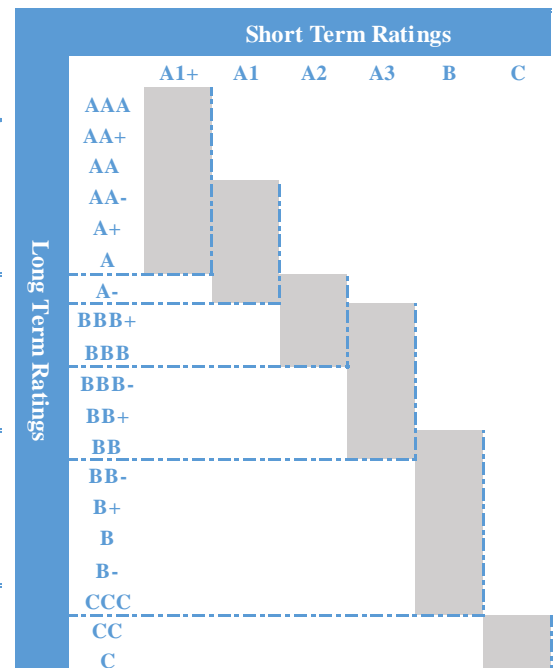
Cashflow Statement	31-Mar-19	30-Jun-18	30-Jun-17
Free Cashflow from Operations (FCFO)	8,324	10,478	13,381
Net Cash changes in Working Capital	(6,310)	(1,385)	(7,321)
Net Cash from Operating Activities	(647)	6,939	3,317
Net Cash from Investing Activities	(14,647)	(7,305)	(224)
Net Cash from Financing Activities	15,169	(430)	(8,709)
Cash transferred to NEL	-	-	3,558
Net Cash generated during the period	<b>(125)</b>	<b>(796)</b>	<b>(2,058)</b>

Ratio Analysis	31-Mar-19	30-Jun-18	30-Jun-17
<b>Performance</b>			
Turnover Growth	-51.5%	-2.4%	-9.1%
Gross Margin	30.4%	12.8%	11.9%
Net Margin	21.0%	11.2%	10.5%
ROE	111.4%	46.9%	39.1%
<b>Coverages</b>			
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD)	2.5	2.5	3.2
Interest Coverage (X) (FCFO/Gross Interest)	2.8	4.7	7.5
FCFO post WC / Gross Interest +CMLTD	0.6	2.1	1.5
<b>Liquidity</b>			
Short Term Borrowings Coverage	n.a.	0.4	0.6
Net Cash Cycle	-24.3	-11.0	22.3
<b>Capital Structure</b> (Total Debt**/Total Debt+Equity)	71.0%	64.8%	58.9%

## Credit Rating Scale & Definitions

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

Long Term Ratings		Short Term Ratings	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <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>A1</b>	A strong capacity for timely repayment.
<b>A+</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>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</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>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</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>B</b>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</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>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</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>D</b>	Obligations are currently in default.		



**Outlook (Stable, Positive, Negative, Developing)** Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

**Rating Watch** Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

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

**Disclaimer:** PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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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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(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.

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(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)

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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)

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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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