The Pakistan Credit Rating Agency Limited

Rating Report

Foundation Power Company Daharki Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
02-Oct-2019	AA-	A1+	Stable	Maintain	-
30-Apr-2019	AA-	A1+	Stable	Maintain	-
22-Nov-2018	AA-	A1+	Stable	Maintain	-
30-Apr-2018	AA-	A1+	Stable	Maintain	-
16-Oct-2017	AA-	A1+	Stable	Upgrade	-
24-Mar-2017	A+	A1	Positive	Maintain	-
24-Mar-2016	A+	A1	Stable	Maintain	-
08-Apr-2015	A+	A1	Stable	Maintain	-
14-Apr-2014	A+	A1	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect strong business profile of Foundation Power Company Daharki Limited (Foundation Power) emanating from the demand risk coverage under Power Purchase Agreement signed between NTDC (through Central Power Purchasing Agency) and the company. Meanwhile, the Implementation Agreement provides sovereign guarantee for cashflows, given adherence to agreed performance benchmarks. The ratings incorporate low operational risk, a result of the performance of KEPCO - the O&M operator. Fuel of the plant is 'low BTU' gas, which is supplied by an associate - Mari Petroleum Company Limited (40% owned by Fauji Foundation). Thus, fuel supply risk is considered low. Although there are delays in payments from power purchaser, the company manages the impact by aligning the payments to fuel supplier with its receipts. This keeps working capital needs under check. Short-term borrowing lines are available and available cushion therein is significant at end-June19, which provides comfort. Foundation Power has total long-term debt of PKR 2,930mln as at end-June19 payable till June 2020. Moreover, Foundation Power has been repaying its debt repayments (Principal and Markup) on time without availing benefit of forbearance period. The company's association with Fauji Foundation (FF) provides comfort to the ratings.

Sustained good financial discipline and upholding strong operational performance in line with agreed performance levels remain important. Accumulation of circular debt would pose threat to the company's ability to continue with this practice. However, the management ably supported by sponsors remains committed to sustain improvement in management of commercial obligations and timely debt repayments.

Disclosure

Name of Rated Entity	Foundation Power Company Daharki Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_IPP_FY19(Jun-19),PACRA_Crtieria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study | Power(Jan-19)
Rating Analysts	Mubasher Bhatti | mubasher.bhatti@pacra.com | +92-42-35869504

Profile

Plant Foundation Power Company Daharki Limited (Foundation Power), a public limited company, is operating a combined cycle power plant on a build-own-operate (BOO) basis with a net initial capacity of 180MW (7.8MW auxiliary consumption).

Tariff Foundation Power key source of earnings is the generation tariff from the power purchaser, NTDC. The reference generation tariff comprises a capacity charge component and an energy charge component. Foundation Power's levelized tariff is US¢ 6.55/kWh.

Return On Project The dollar IRR of Foundation Power, as agreed with NEPRA is 15%.

Ownership

Ownership Structure Foundation power is majority owned by Daharki Power Holdings Limited (DPHL), which, in turn is owned by Fauji Foundation (FF) (81%) and Asian Development Bank (ADB) (19%).

Stability Stability in the IPPs is drawn from the agreements signed between the company and power purchaser. However, Company's association with Fauji Foundation group and Asian Development Bank will continue to provide comfort.

Business Acumen Sponsor groups have significant experience in the manufacturing and selling of energy, fertilizer, cement and chemicals.

Financial Strength Fauji Foundation (also known as Fauji Group), is amongst the largest business conglomerate in Pakistan. The financial strength of the sponsors is considered strong as the sponsors have well diversified profitable businesses.

Governance

Board Structure The six-member Board, comprising five representatives from Fauji Foundation and one from Asian Development Bank (presently awaiting nomination for designate as a replacement to previous nominee director) provides adequate guidance to the company. Appointed in 2018, Lt. Gen. Syed Tariq Nadeem Gilani (Retd.) – Managing Director of Fauji Foundation – is the Chairman of the Board.

Members' Profile Fauji Foundation's strong professional profile assists the management in terms of strategic guidance and implementation of strong control framework.

Board Effectiveness The experiences of board will help guiding the management in developing effective operational and financial policies. The board has formulated three committees, i) Audit and Finance Committee, ii), Technical Committee and (iii) Human Resource Committee to ensure smooth and effective monitoring of operations. Participation of all board members during board meetings remained satisfactory.

Financial Transparency A.F. Ferguson & Co. has been engaged as Foundation Power's external auditors. The auditors expressed an unqualified opinion on the audited financial statements of the company for the year ended June 30, 2019.

Management

Organizational Structure Foundation Power has a lean management structure, mainly comprises finance, internal audit and technical staff. The management control of the company vests with Daharki Power Holdings Limited (DPHL), which, in turn is owned by Fauji Foundation (FF), being largest shareholder.

Management Team Maj Gen Asghar Nawaz, HI(M) (Retd) is the Managing Director of Foundation Power Company. He had a distinguished career in the Pakistan Army. The management team is experienced and is ably handling the affairs of the company.

Effectiveness The management of Foundation Power is mostly engaged in the finance related activities. The operations and maintenance of the plant have been outsourced to KEPCO Plant Service & Engineering Company Limited (KEPCO). The management has engaged three site engineers, with the title of managers, who maintain daily correspondence with the O&M team to ensure oversight and liaison with the head office.

Control Environment The company maintains an adequate MIS which helps management to keep track of all operations and liaison with O&M operator.

Operational Risk

Power Purchase Agreement Foundation Power's key source of earnings is the revenue generated through sale of electricity to the power purchaser, NTDC. 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. The term of the agreement is 25 years.

Operation And Maintenance Foundation Power Company has negotiated an O&M contract with KEPCO for a period of 18 years, signed in 2008. KEPCO, the O&M operator, ensures adherence of the plant to meet minimum performance benchmarks (Availability: Actual: 98.6%; Benchmark: 88%, Efficiency: Actual: 48.8%; Benchmark: 48.8%) during FY19.

Resource Risk Foundation Power Company has negotiated the GSA with Mari Petroleum, for supply of 65mmcfd of Low BTU Gas to the plant. The contract is for a period of 25 years. The construction and commissioning of the gas pipeline was completed in February 2009.

Insurance Cover Foundation Power has adequate insurance coverage for property damage and business interruption.

Performance Risk

Industry Dynamics Pakistan total power generation is increasing on the back of new power projects under CPEC. Owing to newly installed plants, Pakistan's energy mix is shifting towards Solar/Gas/RLNG and coal from Furnace Oil and other expensive sources. Pakistan total power generation is increasing on the back of new power projects under CPEC. During July - March FY2019, installed capacity of electricity reached 34,282 MW, which was 33,433 MW in corresponding period last year, thus, posting a growth of 2.5 percent. Although electricity generation varies due to availability of inputs and other constraints, the generation increased from 82,011 GWh to 84,680 GWh, posting a growth of 3.3 percent during the period under discussion.

Generation Electricity generation stood at 1,329GWh, reduced by 4.5% during FY19 as compare to FY18 (FY18: 1,392GWh; FY17: 1,265GWh); a facet of lower electricity demand from the power purchaser.

Performance Benchmark The required availability for Foundation Power under the PPA is 88%. During FY18, Foundation Power Daharki's efficiency and availability has been maintained according to agreed parameters. Meanwhile, the efficiency of the plant was 48.8% during FY19 (FY18: 48.8%); at par with the required benchmark of 48.8%, thus it made an operating profit of PKR 3,323mln during FY19 (FY18: PKR 2,738mln, FY17: PKR 2,445mln).

Financial Risk

Financing Structure Analysis Foundation Power's project cost (75%) was financed through a syndicated term finance loan. The loan size, PKR 11,565mln, is priced at 6-month KIBOR + 2.93% p.a., out of which PKR 2,930mln is outstanding as at 30 June 2019. It is to be repaid in 20 unequal semi-annual installments. Eighteen installments have been made to date.

Liquidity Profile At 30 June 2019, trade receivables of the company stood at PKR 10,270mln (FY18: PKR 6,785mln; FY17: PKR 4,925mln). As circular debt continues to be an issue for companies operating in power sector. Consequently, IPPs have to manage their liquidity requirements from internal cash generation and short-term borrowings.

Working Capital Financing A better working capital management is reflected from Foundation Power's financial statements. Increased trade payable days at FY19: 336 days (FY18: 277 days; FY17: 189 days), leading to a negative cash cycle (FY19: -44 days; FY18: -31 days; FY17: -14 days). Constantly having negative cash cycle depicts the Co's strategy to align its receivable days with payable days while leaving available working capital lines un-utilized.

Cash Flow Analysis Despite reduced interest cost and increased cashflows, the company's coverages reflects slight decline in (FCFO post WC / Gross Interest + CMLTD: FY19: 0.8x; FY18: 1.0x; FY17: 1.3x).

Capitalization Foundation Power has a moderately leveraged capital structure (Total Debt/Total Debt+Equity) as at 30 June 2019 stood at 22.6% (FY18: 37.4%; FY17: 47.1%).

Foundation Power Company Daharki Limited *PKR in mln*

BALANCE SHEET	30-Jun-19	30-Jun-18	30-Jun-17
	Annual	Annual	Annual
Non-Current Assets	**12,140**	**12,901**	**13,669**
Current Assets	**11,218**	**7,595**	**5,594**
Inventory	39	34	34
Trade Receivables	10,271	6,785	4,925
Other Current Assets	453	364	375
Cash & Bank Balances	455	412	261
Total Assets	**23,358**	**20,496**	**19,263**
Debt	**2,930**	**5,045**	**6,506**
Short-term	-	-	50
Long-term (Inlc. Current Maturity of long-term debt)	2,930	5,045	6,456
Other Short term liabilities (inclusive of trade payables)	10,322	6,948	5,375
Other Long term Liabilities	1,404	1,407	1,455
Shareholder's Equity	**8,701**	**7,097**	**5,928**
Total Liabilities & Equity	**23,358**	**20,497**	**19,263**

INCOME STATEMENT			
Turnover	**12,870**	**10,060**	**10,259**
Gross Profit	3,639	2,929	2,612
Other Income	47	31	53
Financial Charges	(608)	(672)	(818)
Net Income	**2,735**	**2,088**	**1,689**

Cashflow Statement			
Free Cashflow from Operations (FCFO)	4,212	3,495	3,206
Net Cash changes in Working Capital	(441)	(380)	49
Net Cash from Operating Activities	3,315	2,817	2,555
Net Cash from InvestingActivities	(16)	27	(157)
Net Cash from Financing Activities	(3,255)	(2,693)	(2,733)
Net Cash generated during the period	43	151	(335)

Ratio Analysis			
Performance			
Turnover Growth	27.9%	-1.9%	-8.7%
Gross Margin	28.3%	29.1%	25.5%
Net Margin	21.3%	20.8%	16.5%
ROE	27.2%	24.7%	23.1%
Coverages			
FCFO Pre-WC/Gross interest+CMLTD	0.8	1.1	1.3
FCFO Post-WC/Gross interest+CMLTD	0.8	1.0	1.3
Liquidity			
Net Cash Cycle	-44.3	-30.6	-14.0
Capital Structure			
Net Debt/Net Debt+Equity	22.6%	37.4%	47.1%

Rating Scale | Corporate

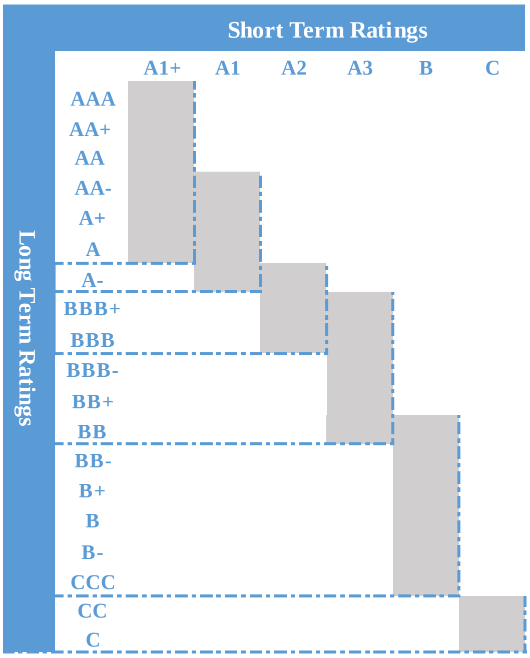
2019

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	
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 Ratings	
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.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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 surveill the opinion due to lack of requisite information.

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

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**
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.
(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)
Proprietary Information