RATING REPORT

K-Electric Limited

REPORT DATE:
January 6, 2015

RATING ANALYSTS:
Talha Iqbal
talha.iqbal@jcrvis.com.pk

Narendar Shankar Lal
narendar.shankar@jcrvis.com.pk

RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	AA	A-1	AA	A-1
Sukuk – 2 (Rs. 3.75b)	AA	-	AA	-
Sukuk – 3 (Rs. 1.5b)	AA	-	AA	-
Sukuk – 4 (Rs. 22b)	AA+	-	AA+	-
Rating Outlook	Stable		Stable	
Outlook Date	*December 30, 2015*		*December 1, 2014*	

COMPANY INFORMATION

Incorporated in 1913	**External auditors:** KPMG Taseer Hadi & Company, Chartered Accountants
Public Limited Company	**Chairman of the Board:** Mr. Waqar Hassan Siddique
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Tayyab Tareen
KES Power Limited – 66.40%	
Government of Pakistan – 24.36%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria : *Industrial Corporates (October 2003)*
http://www.jcrvis.com.pk/images/IndustrialCorp.pdf

Rating The Issue (September 2014)
http://jcrvis.com.pk/Images/criteria_instrument.pdf

K-Electric Limited

OVERVIEW OF THE INSTITUTION

K-Electric Limited (KE) was incorporated as a limited liability company in 1913. It is a vertically integrated utility responsible for generation, transmission and distribution of electricity in Karachi. Abraaj Capital, through KES Power, is the major shareholder of the company.

RATING RATIONALE

The assigned ratings predicate the strategic importance of K-Electric Limited (KE) as a vertically integrated utility having exclusive rights to distribute electricity in the largest metropolitan city of Pakistan. Ratings also incorporate enhanced financial risk profile of the company as evident from improving profitability and cash flows in relation to outstanding obligations while business risk profile draws support from continuous improvement across various operational metrics.

Fleet efficiency of the generation portfolio for FY15 stood at 37% (FY14: 37%); the same has improved from 30.4% to 37% from FY09 to FY15. Further improvement in fleet efficiency is expected in the ongoing year with the completion of Korangi Combined Cycle Power Plant (KCCPP) in May'2015 and conversion of two additional open cycle power plants to combined cycle power plants in the ongoing year. KE is in the process of negotiating a long-term gas supply arrangement with Sui Southern Gas Company (SSGC) which is considered essential to ensure continuity of gas supply and is important for maintaining/enhancing efficiency of generation portfolio. However, KE has extended gas supply arrangement with SSGC for one year through which SSGC is incentivized to ensure a committed gas supply against payment of arrears. As per management, the arrangement is effectively catering to the gas supply needs of the company. Management has taken a number of initiatives in order to bridge demand supply gap and cater to increasing electricity demand of the city through up-gradation of existing power plants, establishment of new power plants and agreements for purchase of power from IPPs. Transmission infrastructure is also being upgraded through an extensive TP-1000 project which will increase transmission capacity by 33%.

Overall declining trend in T&D losses has continued with the same being lower at 23.7% (FY14: 25.3%) in FY15; T&D losses continue to be higher than NEPRA benchmark. Further decline in T&D losses (Over 6% in the next 5 years) is projected on the back of a number of initiatives taken by the management including technical loss reduction project, aerial bundling cabling, introduction of smart meters and mobile meter reading solutions. While recovery ratio has shown a sizeable jump due to netting of receivables from public sector entities against electricity duty payable to Government of Sindh, overall exposure to credit risk remains high with around 50% of trade receivables being overdue for more than a year. Given that receivables from public sector entities are higher than electricity duty for a particular year, receivables for KE would continue to pile up unless permanent resolution of the same is achieved.

Profit before tax increased by 57.5% during FY15. Going forward, profitability of the company is expected to continue to grow on the back of reduction in T&D losses and enhanced efficiency of the generation portfolio vis-à-vis NEPRA benchmarks and lower finance cost. Given the improved profitability and higher recovery ratio, cash flow from operations has remained healthy. Leverage indicators have trended downwards on account of increase in equity due to retained profits. Sizeable capex is planned to be incurred over the next 3 years (FY16-FY18); most significant portion of the capex pertains to funding the TP-1000 project. Major portion of the funding will be raised through debt. In this regard, KE is in the process of signing $250m financing agreement with OPIC and has already signed Export Credit Agency (ECA) backed financing facilities supported by German (ECA) Euler Hermes for Euro 46.5m and Chinese ECA Sinosure for $91.5m. This is the first Sinosure guaranteed financing for private sector entity in Pakistan without sovereign guarantee. However, leverage indicators are expected to remain within manageable levels.

Provision of 650 MWs from National Transmission & Dispatch Company has continued even after the expiry of the agreement in January'2015. As per management, discussion with GoP on various issues, including renewal of 650MW agreement with NTDC, are expected to be finalized soon.

The assigned ratings to Sukuk issued by KE incorporate adequate debt servicing capacity and structure of the Sukuk. The entire Sukuk issue has repayment linked to specific receivables from 495 identified industrial customers, which have an extended history of timely payments with the Company and have priority of electricity supply over other consumers. Other structural features of the Sukuk include retention of amount equivalent to one-third of the quarterly installment by the collection agent from the revenues of these 495 customers to meet the upcoming installment while excess proceeds after meeting the retention requirement is being released to KE each month. The ratings are supported by additional cushion whereby a cash collection mechanism will be triggered if overall entity level debt service coverage falls below a pre-defined threshold.

K-Electric Limited — Appendix I

FINANCIAL SUMMARY *(amounts in PKR billions)*

BALANCE SHEET	FY15	FY14	FY13
Fixed Assets	214.0	170.7	165.2
Investments	-	-	-
Stock-in-Trade	6.8	6.0	4.6
Trade Debts	83.3	75.7	62.8
Cash & Bank Balances	1.3	0.7	0.8
Total Assets	367.6	306.3	278.9
Trade and Other Payables	103.4	106.5	94.7
Long Term Debt *(*incl. current maturity)*	37.5	33.2	33.8
Short Term Debt	32.4	39.6	37.2
Total Equity *(*excluding surplus)*	74.1	43.5	28.5
Total Equity *(*including surplus)*	128.2	71.0	53.7
INCOME STATEMENT	**FY15**	**FY14**	**FY13**
Net Sales	190.4	194.5	189.0
Gross Profit	43.3	32.4	28.8
Operating Profit	24.8	20.9	18.0
Profit After Tax	28.3	12.9	6.8
RATIO ANALYSIS	**FY15**	**FY14**	**FY13**
Gross Margin (%)	22.7	16.6	15.2
Net Working Capital	(19.6)	(41.8)	(47.1)
FFO to Total Debt (x)	51.4	35.8	29.8
FFO to Long Term Debt (x)	95.9	78.6	62.5
Debt Servicing Coverage Ratio (x)	2.3	1.7	1.3
ROAA (%)	8.8	4.4	2.5
ROAE (%)	31.8	21.5	14.1

KEY OPERATIONAL METRICS

	FY15	FY14	FY13
Transmission & Distribution Losses (%)	23.7	25.3	27.8
Fleet Efficiency (%)	37.0	37.0	36.6
Aggregate Technical and Commercial Loss (%)	31.0	35.0	38.7
Recovery Ratio (%)	90.4	87.1	84.9

ISSUE/ISSUER RATING SCALE & DEFINITIONS — Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURE — Appendix III

Name of Rated Entity	K-Electric Limited
Sector	Power
Type of Relationship	Solicited
Purpose of Rating	Entity and TFC Ratings

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
30-Dec-15	AA	A-1	Stable	Reaffirmed
1-Dec-14	AA	A-1	Stable	Upgrade
2-Jan-14	A+	A-2	Positive	Reaffirmed
25-Nov-13	A+	A-2	Positive	Initial

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
	RATING TYPE: SUKUK-2		
30-Dec-15	AA	Stable	Reaffirmed
1-Dec-14	AA	Stable	Upgrade
2-Jan-14	A+	Positive	Final
25-Nov-13	A+	Positive	Preliminary

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
	RATING TYPE: SUKUK-3		
30-Dec-15	AA	Stable	Reaffirmed
1-Dec-14	AA	Stable	Upgrade
2-Jan-14	A+	Positive	Final
25-Nov-13	A+	Positive	Preliminary

Rating Date	Medium to Long Term	Rating Outlook	Rating Action
	RATING TYPE: SUKUK-4		
30-Dec-15	AA+	Stable	Reaffirmed
26-Mar-15	AA+	Stable	Final
29-Jan-15	AA+	Stable	Preliminary

Instrument Structure

Sukuk 2&3: Both Sukuk were issued in FY14 and are based on Shirkat-ul-Milk structure. Funds raised from Sukuk 2 amounted to Rs. 3.75b, while amount raised from Sukuk 3 was equivalent to Rs. 1.5b. Tenors of Sukuk-2 and Sukuk-3 were 3 and 5 years respectively.

Sukuk 4: Sukuk 4 was issued by KE in FY15 and funds raised from this Sukuk amounted to Rs. 22b. It possesses a tenor of 7 years, with a grace period of 2 years. It is structured as a diminishing musharaka arrangement and carries an interest rate of 3 month KIBOR plus 1%.

Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, JCR-VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. JCR-VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2015 JCR-VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to JCR-VIS.