

Technical Partner – IIRA, Bahrain | JV Partner – CRISL, Bangladesh

Karachi Electric Supply Company Limited

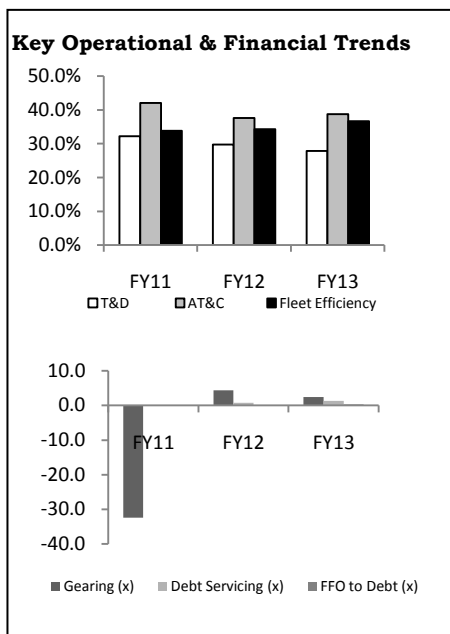
Chairman: Mr. Tabish Gauhar; Chief Executive Officer: Mr. Nayyer Hussain

January 2, 2014

Analysts: Talha Iqbal
 Mohammad Aarsal Ayub

Category	Latest	Previous
Entity	A+ / A-2 Jan 2, '14	A+ / A-2 Nov 25, '13
Sukuk-1 (Rs. 0.75b)	A+	A+*
Sukuk-2 (Rs. 3.75b)	A+	A+*
Sukuk-3 (Rs. 1.5b)	A+	A+*
	Jan 2, '14	Nov 25, '13
Outlook	Positive Jan 2, '14	Positive Nov 25, '13

*Preliminary



(All figures in PKR Billions)	FY11	FY12	FY13
Net Sales	130.7	162.8	189.0
Net Profit/(loss)	(9.4)	2.6	6.7
Gross Margin	0.2%	10.0%	15.3%
Net Margin	-7.2%	1.6%	3.6%
Tier-1 Equity	-2.4	15.4	28.9
Total Debt	62.4	66.9	69.4
Long Term Debt*	41.1	43.4	31.8
FFO	-3.6	5.3	21.1
FFO/Total Debt	-6%	7.9%	30.4%
ROAE	-	20.2%	30.4%
ROAA	-	1.0%	2.4%

*Including Current Maturity

Rating Rationale

The assigned ratings recognize the strategic importance of Karachi Electric Supply Company Limited (KESC), a vertically integrated utility company, having exclusive rights in its service area. KESC's strong business risk profile is supported by the enhanced efficiency of generation portfolio, reduction in Transmission & Distribution (T&D) Losses stable & professional management team and improving financial risk profile. Demonstrated financial support from the sponsor, Abraaj Capital, provides strength to the assessment of overall risk profile of the institution. Conversion of a portion of debt extended by International Finance Corporation (IFC) and Asian Development Bank (ADB) into equity also reflects confidence of stakeholders in KESC.

Over the last five years, generation capacity has been enhanced by over a 1,000MW's with over three fourths of the power added through more efficient combined cycle power plants (CCPP). This is evident in an increase in overall fleet efficiency of KESC's power plants from 30.7% to 37.8% over the last five years. Moreover, three existing open cycle plants are being converted into combined cycle which will result in further efficiency and capacity enhancements. Given the current supply shortage of gas, diversification of fuel mix is also being actively pursued. In this regard, conversion of two units of Bin Qasim Power Station-1 (BQPS-1) to coal is planned. The coal conversion project is being undertaken through the IPP structure by K-Energy (Pvt.) Limited; KESC will have a long term off-take agreement with the said entity. This is expected to result in reduction of consumer tariff besides bridging the demand supply gap, particularly in the backdrop of the scheduled expiry of 650 MW's Power Purchase Agreement with National Transmission & Despatch Company Limited (NTDC) in 2015. The coal conversion project will take at least two and a half years for completion, from the notification of tariff by National Electric & Power Regulatory Authority. Management believes that the tariff will be notified by year-end. Till such time that the coal project comes online, it may reasonably be expected that power from the national grid will continue to be made available, given the strategic importance of Karachi as the business hub of Pakistan.

Reorganization of the distribution department along with client segmentation in terms of losses has allowed the company to pursue a focused recovery drive, while also exempting a significant proportion of Karachi's population from load shedding. Despite significant improvements, T&D losses continue to be weaker than NEPRA's benchmark. Aggregate Technical & Commercial (AT&C) losses were higher in FY13 on account of decline in recoveries from certain public sector entities. A number of initiatives are on the anvil to address T&D losses in the high loss areas including implementation of Aerial Bundled Cabling, Smart Grids and Mobile Meter Reading solutions while active negotiation with all stakeholders is underway for improvement in recoveries from select public sector strategic consumers. Continued reduction in AT&C losses in line with projections is considered important.

KESC has an efficiency based tariff structure which allows the company to benefit from efficiency enhancements on the generation front while T&D losses also impact profitability. Net profits have depicted marked improvement since the commissioning of BQPS-2. Resultantly, cash flows and debt service coverage have also showcased improvement.

While gearing has declined on a timeline basis, the same continues to be on the higher side. Debt profile has witnessed a change in FY13 with an increase in the proportion of short term borrowings (54% at end-FY13 as compared to 35% at end FY12). Higher short-term borrowings were mobilized to meet enhanced working capital requirement to finance delays in receipt of tariff differential claim and trade receivables. Timely recovery of net tariff differential claims and dues from public sector entities is important from the perspective of cash flow management.

KESC plans to issue Sukuk of Rs. 6b in the on-going year to reduce reliance on short term bank credit. The Sukuk structure is based on Shirkat-ul-Milk. Sukuk is planned to be issued in three tenor buckets with maturities of 13 months, 3 years and 5 years, with bullet repayments. Given the anticipated increase in profits and resultantly FFO, projected debt service coverage in each of the next 5 years is over 1(x), both as per management's own projections and under realistic stress scenarios.

Overview of the Institution

KESC was incorporated on September 13, 1913. KESC was initially privatized in 2005 when Saudi Al-Jomaih Group of Companies and Kuwait's National Industries Group acquired major stake in the company. In 2008, Al-Jomaih approached Abraaj Capital and a deal to transfer management control was finalized between the two parties, which entailed investment of \$361m by Abraaj Capital over the subsequent few years. Abraaj Capital, through KES Power Limited, is now the major shareholder of KESC. Financial Statements for FY13 were

audited by M/s KPMG who have been re-appointed for FY14. JCR-VIS

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JCR-VIS Credit Rating Company Limited

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Rating Date	Medium to Long Term	Outlook	Short Term	Rating Action
<u>RATING TYPE: Entity</u>				
02-Jan-14	A+	Positive	A-2	Reaffirmed
25-Nov-13	A+	Positive	A-2	Initial
<u>RATING TYPE: Sukuk-1</u>				
02-Jan-14	A+	Positive		Final
25-Nov-13	A+	Positive		Preliminary
<u>RATING TYPE: Sukuk-2</u>				
02-Jan-14	A+	Positive		Final
25-Nov-13	A+	Positive		Preliminary
<u>RATING TYPE: Sukuk-3</u>				
02-Jan-14	A+	Positive		Final
25-Nov-13	A+	Positive		Preliminary