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SUKUK RATING REPORT

K-ELECTRIC LIMITED

February 2021

الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency
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K-ELECTRIC LIMITED

Report Date:

February 17, 2021

	Latest National Scale Rating (February 17, 2021)	Previous National Scale Rating (January 31, 2019)
PKR 22bn Sukuk	AA+ (pk) (Double A Plus)	AA+ (pk) (Double A Plus)
Outlook	Stable	Rating Watch

Company Information

- Established: 1913
- Vertically integrated power utility Company
- Sole electricity distributor for Karachi (and adjoining areas)
- Key Shareholders (> 5% stake at FY2020[1]):
  - KES Power Limited: 66.4%
  - Government of Pakistan, represented by the President of Pakistan: 24.4%
- **External Auditors**: Messrs A.F. Ferguson & Co. Chartered Accountants
- **Chief Executive Officer**: Syed Moonis Abdullah Alvi
- **Chairman**: Mr. Shan A. Ashary

[1] Ending June 30

CORPORATE PROFILE

K-Electric Limited ("KEL" or "the Company") is a vertically integrated power utility company engaged in generation, transmission and distribution of energy to over 2.9 million industrial and residential consumers combined in Karachi and adjoining areas of Sindh and Balochistan, in Islamic Republic of Pakistan ("Pakistan" or "the Country"). Besides being the only electricity provider in Karachi, KEL reserves exclusive rights of power distribution in the service area until July 2023. There have been no material changes in the Company's ownership since our last review. KEL majority shareholding is held by KES Power Limited ("KES"). In 2016, KES Power has entered into a share purchase agreement with Shanghai Electric Power Company Limited ("SEPL") for sale of up to 66.4% shares of KEL. The transaction will finalize once closing conditions and requisite regulatory and government approvals are obtained.

Gross annual production of KEL in FY2020 was 10,358 GWhs, down 3.6% vis-à-vis prior year due to suppressed demand during COVID-19, albeit until Q3'FY2020, YTD[2]growth in units sent-out was posted at 2.3%. Later with economic activity revival post COVID-19 lockdown, units sent-out in Q1'FY2021 increased by 7.3% vis-à-vis corresponding prior year quarter. At FY2020, the Company's own fleet of 5 power plants featured an average gross dependable capacity ("GDC")[3] of 1,963 MW[4]. Since 2009, the Company has added 1,057 MW of highly efficient generation plants. Further, the Company's transmission system includes 70 grid stations and 167 power transformers with capacity of over 6,350 MVA and supplemented by a transmission lines network spanning about 1,318 km.

KEL posted operational efficiencies including transmission and distribution ("T&D") capacity enhancement until FY2019; albeit due to COVID-19 T&D losses increased during FY2020. Due to the pandemic, the Company recognized net loss in FY2020; however, some improvement was noted with KEL having reported net profit in Q1'FY2021. Furthermore, the Company's planned capex over the next 3 years is US$1.5bn, which will be invested across the power value chain, with about PKR 139bn planned for FY2021.

Table 1: Ownership Structure as of end-June 2020

Shareholding Structure	%
KES Power Limited	66.4
Government of Pakistan	24.36
Local General Public	5.03
Local Financial Institutions	2.33
Mutual Funds	1.52
Foreign Shareholders	0.16
Public Sector Entities	0.2
Others	0.09

(Source: KEL Annual Report 2020)

Notable leadership changes are witnessed with the recent changes on the Board of directors. In April 2020, Mr. Riyadh S. A. A. Edrees was appointed as the Chairman in replacement of Mr. Ikram ul-Majeed Sehgal who resigned from the Board in November 2019. Later on September 7, 2020, the Company appointed Mr. Shan A. Ashary as the new Chairman of the Board. The incumbent Chairman is the longest serving[5] Board member at KEL, having represented KES.

The ratings assigned on the PKR22bn Sukuk have been removed from 'Rating Watch' and placed on 'Stable' outlook. Being a listed entity, IIRA is cognizant of the improvement in the Company's financial

[2] Year-to-date
[3] Represents the amount of electricity that can be reliably produced by a plant
[4] Megawatts
[5] Since 2005 (Source: KEL news)

filings frequency during 2020, wherein both past annual and quarterly financial reports have been issued retrospectively, and periodic accounts are expected to be published on a regular basis.

Tariff Regime

- Being a regulated power company, KEL is subject to NEPRA's Multi Year Tariff ("MYT") setting regime. While the tariff rates determined by NEPRA may be different for distribution companies, the government ensures applicability of uniform consumer-end tariff across the Country in accordance with uniform tariff policy of the Government of Pakistan ("GoP").
- With the expiry of the 7-year period of the previous MYT in June 2016, NEPRA issued a revised MYT for KEL in March 2017 for the next 7-year period (July 1, 2016 – June 30, 2023). Following review motion filed by KEL and subsequent reconsideration request by the GoP, base tariff was finalized at Rs. 12.82/kWh[6] in July 2018 and notified in May 2019. Within KEL's MYT, NEPRA has allowed KEL to claim actual write-offs, subject to criteria stipulated in the MYT reconsideration decision dated July 2018, which also includes verification by auditors.
- Nonetheless, KEL has been contesting the determined MYT tariff and has filed an appeal with the Appellate Tribunal, which is not yet functional.
- Further, within KEL's MYT, NEPRA has included a monthly and quarterly tariff variation mechanism involving variations in fuel cost (KEL and power purchases) allowed on monthly basis, whereas other indexations are allowed on quarterly basis in accordance with the prescribed adjustment.

Credit Risk - Moderate

- Credit risk in the power sector in Pakistan remains noteworthy due to the circular debt situation exacerbated by tariff differential claims ("TDC") delays on part of the GoP coupled with the non-payment of electricity bills by public sector companies ("PSC"). The delay in settlement of GoP receivables is an industry-wide issue also experienced by KEL. Despite these challenges, KEL has ensured timely payments of all current bills to its independent power producers ("IPPs") and fuel suppliers.

Table 2: Government and GRE related party transactions

Figures in PKR'bn	FY2018	FY2019	FY2020	Q1'FY2021
Receivables from GREs	**104**	**190**	**254**	**263**
TDC	51	128	202	207
KW&SB[7]	31	31	28	30
Govt. of Sindh	16	18	9	11
Other Federal & Provincial Entities	6	13	15	15
Payables to GREs:	**63**	**104**	**166**	**182**
NTDC / CPPA – G[8]	46	84	144	159
SSGC[9]	14	14	14	14
Other Federal & Provincial Entities	4	6	8	9
Net Receivable	**41**	**86**	**88**	**81 (P)**

(Source: KEL; (P): principal)

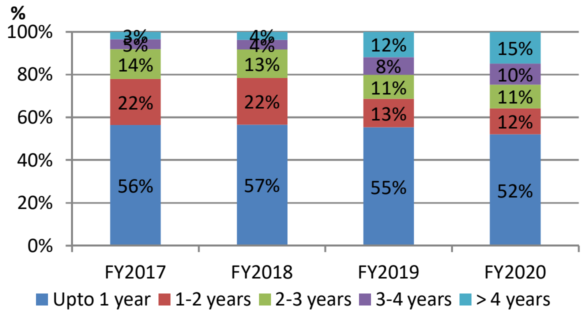
- At KEL, volume of receivables from various government- related entities ("GREs") including tariff differential subsidy claims from Government of Pakistan has remained significant. It may be notable that the Company expects settlement of these outstanding balances on net basis against its

[6]Kilowatt hour
[7]Karachi Water & Sewerage Board
[8] National Transmission and Dispatch Company / Central Power Purchasing Agency (Guarantee) Limited
[9] Sui Southern Gas Company Limited

payables to GREs, which partly mitigates the risk. Net receivables against GREs, on principal basis, stood at over PKR80.8bn at end-Q1'FY2021 (Table 2). While in relation to total assets, such net receivables have depicted a decline from FY2019 (13.0%) to Q1'FY2021 (11.0%); however, from a credit risk perspective, this may still be viewed as fairly large exposure.

- With respect to TDC receivable from GoP, KEL's outstanding receivables at FY2020 remained elevated at PKR201.9bn (FY2019: PKR127.5bn), whereas Company's payables stood at PKR 166bn (FY2019: PKR 104bn). It may be also noteworthy that the payable for power purchased through National Grid is set-off against KEL's TDC receivable from the GoP, in accordance with the Power Purchase Agreement ("PPA"). Up until FY2020, GoP had released the Company's TDC of about PKR393mn directly to NTDC. Additionally, the Company also directly paid PKR43.5bn up to FY2020 to NTDC / CPPA on account of its outstanding dues.
- Since January 2016, KEL has been receiving monthly payments against KW&SB related dues in line with Government of Sindh's ("GoS") commitment and court orders. Further, the Company has also been adjusting these dues with electricity duty payable by KEL to the GoS.
- As of end of FY2020, share of KEL's trade debts in total assets stood at 14.2% (FY2019: 16.7%), albeit having marginally edged up to 14.5% at Q1'FY2021. Pursuant to the adoption of IFRS 9, the Company recognized PKR25.7bn adjustment in FY2019 while also undertaking additional impairment provisions of PKR18.3bn (FY2018: PKR16.3bn). Provisioning charge during FY2020 was reduced to PKR 14.0bn. An aging analysis of trade exposure is presented in Figure 1.

Figure 1: Aging of Credit Exposure

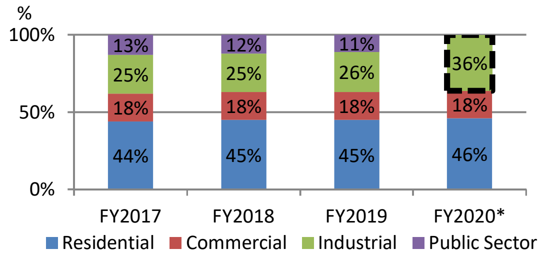


(Source: KEL Annual Report 2019)

Recovery and Liquidity Risk - Low

- KEL has a customer base of over 2.9mn as of June 2020, representing about 82% residential consumers' contribution of almost 50% of total revenue, whereas industrial consumers, which account for 1% of the total consumer base having around 30% share in revenue.

Figure 2: Revenues Generated as per Consumer Segments



*(Source: KEL July 2020 Sukuk Prospectus; FY2020 Annual Report; * Due to lack of further breakdown, the public sector and industrial consumer segments in FY2020 are shown as clubbed)*

Supply Side Risk– Moderate

- ***Power from National Grid***: While KEL is vertically integrated, the Company also purchases power from various IPPs and has arrangements for 800 MW supply from the National Grid. Out of this 800 MW, PPA on 650 MW from NTDC expired in January 2015. However, until date the supply of electricity of 650 MW continues in line with the High Court of Sindh's order. IIRA considers the probability of complete discontinuation or any reduction of power from the National Grid as remote given the strategic importance of Karachi.

- Due to delay in required approvals and considering surplus power in the National Grid, instead of the planned 700 MW Coal Project, KEL is now pursuing off-take of additional power from National Grid. In this regard, KEL is in discussions with relevant stakeholders to increase the total supply from the National Grid to 1,350 MW by summer 2022, and later to 2,050 MW by summer 2023, taking the total additional supply from National Grid to 1,400 MW. In addition, to bridge the demand supply gap, the Cabinet Committee on Energy ("CCoE") has given approval for off-take of additional power taking the total to 1,100 MW through existing interconnections, as an interim arrangement from April 2021.
- ***Own generation & transmission***: On self-generation, KEL is pursuing 900 MW RLNG-based combined power plant project (BQPS-III). Given the criticality of this project in terms of managing the demand-supply gap, KEL is pursuing this project on fast track basis and it is expected that the first unit of 900 MW RLNG plant will come online by summer of 2021 and project completion targeted for end of 2021. Further, the over US$450mn transmission project TP-1000 is progressing well to meet the growing load demand of the city with 94% completion as of FY2020.
- ***Fuel Supply:*** The Company's supply-side risk also stems from the possibility of discontinuation of fuel i.e. gas and furnace oil. KEL's existing supplier of gas for its generation plants is Sui Southern Gas Company Limited ("SSGC"), with which negotiations are underway to finalize a formal signed Gas Supply Agreement ("GSA"). However, gas supply to KEL has continued in line with specific orders of the Court. Further, over the coming months a separate agreement with Pakistan LNG Limited ("PLL") will be executed for supply of 150 MMCFD[10] RLNG through a dedicated pipeline to KEL's Bin Qasim Power Complex.
- With regards to supply of furnace oil, agreements with Pakistan State Oil Company Limited ("PSO") and BYCO are valid until June 2022 and October 2021, respectively. Further, KEL is making timely payment of current bills to its fuel suppliers including PSO and SSGC to ensure continuous fuel supply.
- ***Solar:*** In Q2'FY2021, the Company has incorporated KE Venture Company Private Limited ("KEVCL") that would be solely engaged in exploring investments in renewable energy. Within KEVCL, another wholly owned subsidiary K-Solar has also been incorporated to provide customers with opportunities to diversify their energy sources through high quality and affordable solutions. Given that this is in nascent stage, long-term benefits may be derived from the new revenue streams that will be created through this Company.

[10] Million cubic feet per day

Rate Risk - Moderate

- KEL's obligations predominantly represent floating rate debt, which are benchmarked to either Kibor[11] or Libor[12]. Recent benchmark rate cuts in 2020 are deemed favorable for the Company. In FY2020, a 1% shift in Kibor / Libor would have impacted the Company's net profits by about PKR1.6bn (FY2019: PKR1.3bn).

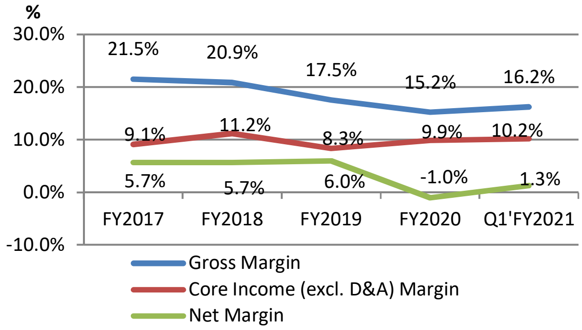
Other Risks - Moderate

- The Company may face sizable payouts in case of any adverse court decisions, currently disclosed in contingencies and commitments. However, management based on legal advice is confident of favorable decisions in these cases and also maintains necessary provisions in the Financial Statements.

[11] Karachi Interbank Offer Rate
[12] London Interbank Offer Rate

Financial performance:

Figure 3: Profitability Trend



(Source: IIRA adjusted KEL accounts; D&A: depreciation & amortization)

- During FY2019, the Company reported revenues higher by almost one-third vis-à-vis prior year benefiting from higher units billed that increased to 14,318 GWh[13] in FY2019 from 13,860 GWh a year ago. During FY2020, KEL posted marginal 0.1% decline in revenues due to weaker Q4 performance on account of COVID-19 pandemic. This along with lower commercial and industrial consumption, and increased power supply to high loss areas due to load-shed exemption translated into unfavorable sales mix leading to increase in T&D losses by around 0.6 percentage points to 19.7% in FY2020 vis-à-vis previous year. After having generated positive net earnings since FY2012, the Company posted net loss in FY2020 due to higher interest rate and adverse operational indicators owing to COVID-19 lock down. However, profitability for FY2021 is expected to recuperate driven by economic activity revival post COVID-19 lockdown and lower finance cost on the back of decrease in interest rates, as also evidenced in Q1 of the ongoing financial period.

- Mainly due to relatively higher oil prices, the Company's fuel consumption cost rose by 67.8% YoY[14] in FY2019, albeit having declined by about 3.7% in FY2020. Resultantly, overall cost of sales registered growth, outpacing sales increase, thereby contracting the gross margin.

- After having increased about 23% in FY2019, operating overheads marked decrease of about 12.6% YoY in FY2020, thereby translating into improved EBITDA in FY2020.

- As borrowing requirements surged, KEL's overall debt levels increased since FY2018, with greater concentration on short-term loans (Table 3). KEL has recently issued Sukuk to reduce reliance on short-term debt. Consequently with rising finance cost, KEL's EBIT coverage of interest has been on a downward trend.

- At FY2020, the DSCR ratio was 0.9x, which is lower than the required benchmark of 1.15x. This fall in DSCR did

Table 3: Capital Structure - Indicators

Figures in PKR'mn unless otherwise stated	FY2017	FY2018	FY2019	FY2020	Q1' FY2021
Assets	395,943	473,698	598,865	703,414	727,367
Liabilities	211,627	266,405	384,375	492,756	515,598
Adj. Total Debt	74,320	104,511	170,349	200,302	206,014
- Long Term Debt incl. Sukuk & Lease liabilities	28,747	34,621	60,723	83,213	82,493
- Current Maturity	8,834	6,585	7,675	11,544	13,268
- Short term Borrowing & Short term deposit	26,048	52,494	89,329	91,969	96,997
- Accrued Mark-up	5,809	6,370	7,528	8,314	8,191
- Unfunded employee benefit obligations	4,882	4,441	5,095	5,262	5,065
Equity	184,316	207,293	214,489	210,658	211,769
EBITDA / Debt	22.5%	23.3%	14.1%	14.3%	16.9%
Debt Service Coverage ("DSCR"; x)*	1.4x	2.6x	1.4x	0.9x	2.1x

*(Source: IIRA adjusted KEL accounts; *equals EBITDA/(Cash finance cost + current portion of long term debt))*

13 Gigawatt hour
14 Year-over-year, excluding impairment loss against trade debt

not have any adverse impact on the Company's ability to discharge its obligations towards Sukuk Holders, as all payments to Sukuk Holders were made on time through Master Collection Account ("MCA"), which remains insulated to such operational variances. Further, it is also important to note that along with the revival of economic activity in the Country post COVID-19 lockdown, KEL is now back to profitable operations having recorded profit in Q1'FY2021. Moreover, based on the financial projections, DCSR ratio is expected to remain compliant for the future periods.

- Due to significantly higher interest and tax paid during FY2020, KEL recorded consecutively lower funds from operations ("FFO"). Further, due to persisting issue of industry-wide circular debt, the Company's working capital is constrained, albeit notable improvement was noted in FY2020. In FY2019, KEL's cash flow from operations was stressed due to high and constantly growing receivables, particularly from government related enterprises. During FY2020, the government released PKR25bn in lieu of the pending TDC receivables, following which in Q1'FY2021 PKR6bn was released in relation to Prime Minister's relief package extended to SMEs[15] during COVID-19. The cash inflow was partly offset by stocking of strategic fuel reserves to benefit from lower oil price environment.
- Routine maintenance capex requirements of KEL have been moderate, albeit having increased to PKR49.9bn in FY2020 from PKR35.6bn in the previous year. For FY2021, the Company has budgeted about PKR139bn capex focusing on improving network safety and reliability along with capacity enhancement. The Company is pursuing few debt-funded brown field projects that may further keep the leverage elevated over the next two years. The Company has also resorted to bridge financing prior to the finalization of financial closure of some infrastructure projects.
- Net shortfall in cash was fulfilled by incremental loans and borrowings to the tune of PKR25.5bn in FY2020 (FY2019: PKR55.3bn), which increased overall debt levels by 17.6% YoY to PKR200.3bn (FY2019: PKR170.3bn).
- With higher indebtedness, KEL's EBITDA/debt ratio[16] weakened to 14.3% at FY2020, while also having remained under 30% since FY2017. This indicator bears significant importance in terms of the minimum covenant threshold of 30% that triggers accelerated repayments on the Diminishing Musharaka Sukuk. However, the Company received a waiver from the Sukuk investors for the covenant breach.
- At FY2020 KEL's adjusted debt/equity stood at 95.1% higher than 70% threshold under the debt covenants.
- During August 2020, the Company successfully issued a secured, rated and listed Sukuk of PKR25bn. The Sukuk has a tenor of 7 years, including 2 years grace period. Pre-IPO subscription amounting to PKR23.7bn was successfully closed through private placement in January 2020, whereas the remaining balance was subscribed through public offering.

[15] Small and Medium-sized Enterprises
[16] As per IIRA's calculations

Table 4: –KEL Financial Snapshot with IIRA Adjustments

PKR'mn unless otherwise stated	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	Q1'FY2021
Income Statement:							
Total Revenue	190,359	188,607	183,855	217,127	289,119	288,807	85,550
Total Cost of Revenue	147,095	131,452	144,334	171,829	238,413	244,914	71,682
Gross Profit (unadjusted for D&A)	43,264	57,155	39,521	45,297	50,706	43,893	13,868
Operating Expenses incl. impairment provisions & D&A	24,760	33,764	36,317	36,463	42,698	34,862	10,192*
EBITDA or Core Income (excl. D&A)	28,226^	36,602^	16,701	24,301	24,077	28,619	8,701
Other Income	6,111	6,433	9,399	8,470	7,564	8,510	1,490
Operating Profit or EBIT	24,836	30,051	12,603	17,304	15,573	17,541	5,166
Finance Cost	9,760	5,100	3,891	3,585	6,690	17,182	3,021*
Net Profit Before Tax	15,076	24,951	8,712	13,719	8,883	359	2,146
Taxation (benefit)	-13,248	-6,856	-1,708	1,407	-8,391	3,318	1,035
Net Profit	28,325	31,807	10,419	12,312	17,274	-2,959	1,111
Balance Sheet:							
Assets	352,914	377,798	395,943	473,698	598,865	703,414	727,367
Liabilities	224,698	206,510	211,627	266,405	384,375	492,756	515,598
- Adjusted Total Debt	93,044	81,056	74,320	104,511	170,349	200,302	206,014
Long Term Debt including Sukuk	37,785	36,745	28,747	34,621	60,723	83,116	82,398
Current Portion of LT Debt and leases	3,028	2,927	8,834	6,585	7,675	11,544	13,268
Short term Borrowings & deposits	43,842	30,796	26,048	52,494	89,329	91,969	96,997
Mark-up accrued	5,867	5,470	5,809	6,370	7,528	8,314	8,191
Lease liabilities	-	-	-	-	-	97	94
Unfunded employee benefit obligations	5,522	5,119	4,882	4,441	5,095	5,262	5,065
Long-term debt as per Company's calculations	28,073	29,116	20,147	24,903	49,914	71,397	70,492
Total debt as per Company's calculations	67,844	55,394	49,404	72,805	129,511	155,462	160,470
Equity	128,215	171,288	184,316	207,293	214,489	210,658	211,769
Cash Flow Statement:							
FFO	35,906	52,644	39,000	44,045	42,190	27,165	10,666
CFO	18,585	41,097	27,836	19,335	-16,884	22,648	1,564
Capital expenditure incurred ("Capex")	15,093	22,840	23,767	44,614	35,574	49,919	7,973
FOCF	3,492	18,257	4,069	-25,279	-52,458	-27,271	-6,409
Key Ratios:							
Growth in sales (%)		-0.9%	-2.5%	18.1%	33.2%	-0.1%	-4.9%
Growth in cost of sales incl. D&A (%)		-10.6%	9.8%	19.1%	38.8%	2.7%	-7.0%
Gross Margin	22.7%	30.3%	21.5%	20.9%	17.5%	15.2%	16.2%
EBITDA or Core Income (excl. D&A) Margin	14.8%	19.4%	9.1%	11.2%	8.3%	9.9%	10.2%
EBIT Margin	13.0%	15.9%	6.9%	8.0%	5.4%	6.1%	6.0%
Net Margin	14.9%	16.9%	5.7%	5.7%	6.0%	-1.0%	1.3%
EBIT Interest Coverage (x)	2.5	5.9	3.2	4.8	2.3	1.0	1.7
EBITDA Debt Service Coverage (x)	2.2	4.4	1.4	2.6	1.4	0.9	2.1
FFO / Debt (%)	38.6%	65.0%	52.5%	42.1%	24.8%	13.6%	20.7%
CFO / Debt (%)	20.0%	50.7%	37.5%	18.5%	-9.9%	11.3%	3.0%
FOCF / Debt (%)	3.8%	22.5%	5.5%	-24.2%	-31.0%	-13.6%	-12.4%
Cash conversion cycle (days; receivables less payables)	-103.9	-107.1	-80.1	-89.6	-117.7	-215.4	-202.9
Current Ratio (x)	0.9	1.1	1.0	1.0	0.9	0.9	0.9
Trade debts / Total assets (%)	26.4%	26.7%	26.1%	24.4%	16.7%	14.2%	14.5%
Adj. EBITDA / Debt (%)	30.3%	45.2%	22.5%	23.3%	14.1%	14.3%	16.9%
Adj. Debt / EBITDA (x)	3.3	2.2	4.5	4.3	7.1	7.0	5.9
Adj. Debt / Equity (x)	72.6%	47.3%	40.3%	50.4%	79.4%	95.1%	97.3%
Adj. Long-term debt/(LT debt + equity) as per Company's calculations (x)	0.18	0.15	0.10	0.11	0.19	0.25	0.25
Operating Statistics:							
Units Generated (GWhs) (Net)	8,614	9,563	9,374	9,557	9,928	9,629	3,278
Units Purchased (GWhs)	7,497	6,981	7,206	7,862	7,769	8,158	2,452
T&D Losses (%)	23.7%	22.2%	21.7%	20.4%	19.1%	19.7%	20.9%
Units Billed(GWhs)	12,294	12,865	12,981	13,860	14,318	14,277	4,531
Recovery Ratio (%)	90.4%	87.6%	90.1%	91.0%	92.6%	92.1%	87.8%
Generation fleet efficiency (%)	37.0%	37.4%	36.7%	37.4%	37.1%	38.0%	36.8%

*(Source: IIRA adjusted KEL accounts; KEL Information; * unadjusted for interest on consumer deposits as information is not available; ^ including rental on meter rent in FY2015-FY2016; Interim ratios annualized where necessary)*

KEL Sukuk-ul-Shirkah (KEL Sukuk)

KEL's Sukuk certificates issued in FY2015 having face value of PKR22bn has initial grace period, which elapsed with the principle repayment having commenced in September 2017. As of end-December 2020, the outstanding principal amount of the Sukuk stood at PKR6.6bn, with equivalent remaining balance due to be repaid in quarterly amortizations until June 2022. In August 2020, the Company sucessfully issued another Sukuk of PKR25bn under Diminishing Mursharakah structure.

The PKR22bn Sukuk features built-in investor protection mechanism in the form of covenants and securitization arrangements in place. The Diminishing Musharaka structure of the instrument is fully asset-backed by KEL's generating fixed assets. In addition, the underlying securitization arrangement has earmarked recievables from 495 identified industrial consumers; historical recovery ratio from these consumers has been recorded high at around 95%[17]. It may also be noted that receivables from the specific consumers are also earmarked against servicing another debt arrangements.

Table 5: Actual Collection & Retention

Figures in PKR'bn	Collection	Retention	Payment	Excess Release	Surplus
FY2019	24.6	13.7	11.4	2.3	10.9
FY2020	24.1	18.1	15.1	3.0	6.0
Q1'FY2021	7.4	3.7	3.0	0.6	3.8

(Source: KEL)

As per the agreement between the trustee and KEL's banker, the payments from these earmarked consumers are routed through an escrow account, whereby the trustee marks a lien on an amount equivalent to one-third of the next installment, while the remaining amount is released to KEL. In accordance with the Sukuk agreement between KEL and the trustee, the bills are routed to the designated escrow account on a monthly basis. IIRA has received the confirmation of compliance with the terms set out in the trust deed from the trustee. Table 5 represents stable actual collections and declining surplus due to higher retention during FY2019 and FY2020, albeit quarterly collection and surplus in Q1'2021 is noted to have been relatively higher vis-à-vis Q1'FY2020.

The Trust Deed also entails few financial covenants, the breach of which may accelerate recovery. These include additional financial indebtedness, the threshold of Company's EBITDA to total debt falling below 30%, maintenance of debt-to equity ratio under 70:30 and a minimum debt service coverage of 1.2x. During FY2019, the Company was in breach of EBITDA-to-total debt ratio, for which necessary waiver was obtained from the Sukuk investors.

The structure of PKR22bn Sukuk was reviewed by a panel of 4 eminent Shari'a scholars in Pakistan at the time of issuance. The panel through its Fatwa had affirmed the transaction structure's compliance with Shari'a guidelines as issued by regulatory authorities in its entirety, and stated that the relevant documents do not contain any element, which may be non-compliant with Shari'a.

[17] As per management representation

APPENDIX:

A) Key financial indicators and ratios

Definitions and adjustments for the purpose of this report
Gross Profit = (Revenue - Cost of sales)
EBITDA or Core Income (excl. D&A) = (Gross profit - Consumers services and administrative expenses - Impairment loss against trade debts - Other operating expenses + Interest on consumer deposits + Depreciation and amortization). Also includes 'Rental of meters and equipments' in FY2015 and FY2016 that was classified under 'Other income'
Operating Profit or EBIT = (EBITDA + Other income comprising 'income from financial and non-financial assets' - Depreciation and amortization). Excluding any double count of 'rental of meters and equipments' in FY2015 and FY2016 already forming part of EBITDA above
Finance cost = (Reported finance cost + Interest on consumer deposits classified under 'Other operating expenses')
Adjusted Total Debt = (Long-term Diminishing Musharaka + Long-term financing + Long-term deposits + Lease liabilities + Current maturity of long-term Diminishing Musharaka + Current maturity of long-term financing + Current maturity of lease liabilities + Short-term borrowings + Short-term deposits + Accrued mark-up + Unfunded Employee retirement benefits)
Long-term debt as per KEL = (Long-term Diminishing Musharaka + Long-term financing)
Total Debt as per KEL = (Long-term Diminishing Musharaka + Current maturity of long-term Diminishing Musharaka + Long-term financing + Current maturity of long-term financing + Short-term borrowings)
CFO i.e. Cash flow from operations = Net cash generated from / (used in) operating activities
FFO i.e. Funds from operations = (CFO +/- Increase / decrease in current assets and current liabilities)
FOCF i.e. Free operating cash flow = (CFO – Capital expenditure incurred)
Gross Margin = (Gross profit % of Revenue)
EBITDA Margin or Core Income (excl. D&A) Margin = (EBITDA as % of Revenue)
EBIT Margin = (EBIT as % of Revenue)
Net Margin = (Net profit as % of Revenue)
EBIT Interest Coverage (x) = (EBIT / Finance cost as calculated above)
EBITDA Debt Service Coverage (x) = (EBITDA / (Current portion of long-term Diminishing Musharaka, Financings and Lease liabilities + 'Finance cost paid' as stated in the Cash flow statement)
Current Ratio (x) = (Current assets / Current liabilities)
Receivable days = (Average Trade debt * 365 / Revenue)
Payable days outstanding = (Average Trade and other payables * 365 / Cost of sales)

IIRA Rating Scales & Definitions

Ratings on International Scale

Foreign Currency Ratings

The foreign currency ratings by IIRA measure the ability of the rated entities to service their foreign currency obligations. These ratings incorporate all the sovereign risks of a country, including the risk of converting local currency to foreign currency.

Local Currency Ratings

The local currency ratings by IIRA measure the ability of the rated entities to service their local currency obligations. These ratings incorporate all the sovereign risks of a country, except the risk of converting local currency to foreign currency.

Ratings on National Scale

The national scale local currency ratings assigned by IIRA are tiered against an assumed local government rating of 'AAA' and, therefore, do not incorporate all the sovereign risks of a country.

Issue/Issuer Rating Scale & Definitions

Medium to Long Term

IIRA uses a scale of AAA to D to rate credit worthiness of the issuer and long term issues, with AAA being the highest possible rating and D being the lowest possible rating.

AAA: Highest credit quality. Represent the least credit risk.

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

A : Good credit quality. Protection factors are adequate. Risk factors may vary with possible changes in the economy.

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

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 : Obligations deemed 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

Note: IIRA appends modifiers + or - to each generic rating classification from AA through B. The modifier + indicates that the obligation ranks in the higher end of its generic rating category; no modifier indicates a mid-range ranking; and the modifier - indicates a ranking in the lower end of that generic rating category.

Rating Outlook : The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of rating change.

Rating Watch-list : IIRA places entities and issues on 'Watch-list' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). A 'Watch-list' announcement means that the status of the assigned rating(s) is uncertain and an event or deviation from an expected trend has occurred or is expected and additional information is necessary to take a rating action.

Short Term

IIRA uses a scale of A1+ to C to rate credit worthiness of the issuer and its short term obligations, with A1+ being the highest possible rating and C being the lowest possible rating.

A1+ : Highest certainty of timely payment. Short-term liquidity, including internal operating factors and / or access to alternative source of funds, is outstanding and safety is just below risk free short-term obligations.

A1 : High certainty of timely payment. Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A2 : Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A3 : 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.

Fiduciary Rating Score

(91-100) – Very Strong Fiduciary Standards
(91-93), (94-97), (98-100)*
Rights of various stakeholders are well protected and the overall governance framework is strong.

(76-90) – Strong Fiduciary Standards
(76-80), (81-85), (86-90)*
Rights of various stakeholders are protected. Minor weaknesses have been identified in the overall governance framework.

(61-75) – Adequate Fiduciary Standards
(61-65), (66-70), (71-75)*
Rights of various stakeholders are adequately protected. Certain weaknesses have been identified in a few governance related areas.

(40-60) – Basic Fiduciary Standards
(40-46), (47-53), (54-60)*
Rights of various stakeholders are relatively vulnerable. Significant weaknesses have been identified in the overall governance framework.

(Less than 40) – Low Fiduciary standards
Rights of various stakeholders are at high risk and the overall governance framework is weak.

**Apart from the lowest score range, all score ranges have been split into three sub-divisions for further clarity*

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Islamic International Rating Agency