

**HUB POWER COMPANY LIMITED (HUBCO)****RATINGS (MAY 2011)**

	NEW	PREVIOUS
ENTITY		
Long Term	AA+	AA+
Short Term	A1+	A1+

FINANCIAL DATA

PKR (mln)

	Mar-11	Jun-10	Jun-09
Total Assets	160,311	122,696	90,185
Equity	28,380	29,881	29,532
Net Turnover	80,329	99,694	82,783
Net Income	4,285	5,556	3,780
EBITDA	7,316	8,859	7,482
Net Debt /FCFO(x)	3.4	3.5	1.9
EBITDA Net Interest	3.9	4.9	3.6
Cover (x)			
Net Debt/Net Debt+Equity	54	51	33
(%)			

* Based on unaudited accounts for nine months ended Mar 31, 2011.

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POWER PROJECTS:

a) Narowal, a 225 MW combined cycle thermal Power Project, has been financed in the ratio of 70:30, whereby 70% has been raised as project debt, while the rest has been invested by HUBCO. The total cost of the project is PKR 25,178mln (Estimated at financial close: PKR 22,500mln). The project achieved its Commercial Operation Date (COD) in April 2011 as against Required COD of Mar10. HUBCO has paid US\$1.125mln on account of LoS guarantee to PPIB. However, the liquidity damages are yet to be paid. Meanwhile, the company is in the process of recovering related costs and damages from EPC contractor – MAN diesel.

b) LARAIB, 75% owned by HUBCO, is a 84MW hydropower project with an IRR of 17%. It is the first private sector hydel power project in Pakistan. The project cost is ~ PKR 20,060mln or US\$ 236mln (Estimated at financial close: US\$ 233mln). The project financing comprises 75% debt and 25% equity. For its equity contribution, HUBCO is mostly relying on borrowings. The COD is expected in Jul-13. The EPC contractor is Sambu Construction Company, a Korean entity.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect the company's consistent performance track record, reflected in high availability and adequate efficiency. The ratings also recognize successful completion of company's Narowal power project, though delayed from its required operations date. Meanwhile, stable cashflows stream as guaranteed by GoP under the Power Purchase Agreement (PPA), subject to adherence to agreed upon performance benchmarks provides comfort to the ratings. However, weak financial discipline of the sole customer, Water and Power Development Authority (WAPDA) remains a key consideration. HUBCO's association with a major international private power producer (IPP) - International Power Plc – as a key shareholder and O&M operator is also an important rating factor.
- The ratings are dependent on the company's ability to manage HUBCO's operating risks, especially those emanating from the Operations & Maintenance (O&M) contractor's performance while prudently managing its cashflows to repay its debt obligations. Meanwhile, successful execution of Laraib project without any material delay would remain important. Though the company has partially settled its overdues from WAPDA lately, timely resolution of circular debt will be critical to avoid stress on cash flows.

ASSESSMENT

- HUBCO has an established operating track record of 14 years. International Power Plc (IPPLC)¹, the O&M Operator, has extensive global power sector experience. The operator has maintained good performance. Strong systems and controls are in place to monitor agreed performance benchmarks.
- HUBCO's fuel supplier is Pakistan State Oil (PSO), the leading local oil marketing company. The Fuel Supply Agreement (FSA) is backed by a government guarantee. Furthermore, HUBCO has an advantage over most other IPPs as RFO is pumped from the Pipri terminal to the plant through a dedicated underground pipeline ensuring relatively smooth supply. HUBCO has exclusive right to use this pipeline for transmission of RFO to its plant.
- HUBCO's key source of earnings is the generation tariff, comprising a capacity and an energy charge component². During 1HFY11 and FY10, the plant operated (load factor during 1HFY10: 71%; FY10: 79.3%) at relatively high load factor while meeting its other performance standards (1HFY11: 86.5%; FY10: 85.3%; Required under PPA: 78%).
- The quality of the company's balance sheet continues to face pressure due to inter-corporate debt in the country's power sector. As at end-Mar11, HUBCO's accumulated receivables (mainly, overdues from the power purchaser) increased to PKR 99,407mln. Concurrently, payables to fuel supplier increased to PKR 88,241mln in the same period, hence, deteriorating the working capital situation. Lately, the company received an amount of PKR 60,000mln from WAPDA which has subsequently been used to reduce the payable to PSO by the same amount. HUBCO has arranged short term lines of PKR 9,300mln (utilized: PKR 8,087 mln at end Mar-11) to provide it with sufficient cushion to meet working capital requirements.
- The stability and adequacy of HUBCO's cash flows is ensured through the minimum guaranteed capacity payments. However, the company's expansion (Narowal and LARAIB) has exposed it mainly to two types of risks i.e. cashflow and interest rate risks as the company has financed its equity portion in these projects through debt, besides agreed loan financing as per PPA. Therefore, timely and judicious matching of cashflows to repay the obligations would remain crucial. Meanwhile, in Narowal project, the debt financed equity is priced against guaranteed capped return originating the interest rate risk. However, HUBCO retains strong capacity to manage these risks from its existing cashflows. Also, once the 30% equity portion of Narowal project is paid off, cash flow stream originating from Narowal's operations is expected to further strengthen this capacity.
- HUBCO has a moderately leveraged capital structure (Net Debt to Net Debt and Equity : 53% at end Mar-11). The debt-to-equity ratio has risen, mainly to support expansion, which is expected to slightly increase initially for further investment in subsidiary. With the debt repayment of HUBCO and Narowal projects, the capital structure would ease out, going forward.

PROFILE

- Hub Power Company Limited (HUBCO), one of the largest and the first thermal IPP (based on RFO), with an installed capacity of 1292 MW, commenced commercial operations in Mar97 under Power Policy 1984-85 for electricity generation. The company is listed on all three stock exchanges and its Global Depository Receipts are listed on Luxembourg Stock Exchange. The remaining contractual life of the project is 16 years.
- The shareholding structure of HUBCO is diverse. The key shareholders include International Power Plc (17%), followed by Xenel Industries Limited (12%), and Fauji Foundation (9%). The company's diverse ownership structure has implications for sponsor support at the time of need. The board of directors (BoD) comprises fifteen-members including the Chief Executive Officer (CEO) of HUBCO.
- Mr. Vince Harris, a chartered engineer, with over four decades of experience mainly in power sector is the CEO of HUBCO. Lately, the board has appointed Mr. Zafar Iqbal Sobani as the CEO of the company with effect from July 01, 2011. Mr. Sobani. Chartered accountant by profession, holds over 30 years of diversified experience.

¹ IPPLC entered into a merger transaction with GDF Suez - a French multinational energy company - in February 2011 wherein GDF acquired 70% equity in IPPLC, making combined entity's installed capacity to more than 107,000MW.

² The former is based on dependable capacity and constitutes a minimum tariff guaranteed to the company which covers the fixed O&M costs, insurance charges, debt servicing and return on equity. The latter is a function of actual electricity dispatched, variable O&M, and fuel charges. These charges, with the exception of agreed return to project shareholders with adjustment for performance achievements, are pass-through having no bearing on the IPP's core profitability.