RATING REPORT

Shajar Roads Limited

REPORT DATE:
November 24, 2020

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A	A-2	A	A-2
Rating Outlook	*Stable*		*Rating Watch-Developing*	
Rating Date	*November 24, '20*		*September 25, '19*	

COMPANY INFORMATION	
Incorporated in 2017	**External auditors:** EY Ford Rhodes, Chartered Accountants
Public Limited (Unlisted) Company	**Chairman & CEO:** Mr. Mohsin Hussnain
Key Shareholders (with stake 5% or more):	
Habib Construction Services – 51.0%	
Niaz Muhammad Khan & Brothers – 46%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Corporates (May 2019)
VIS Entity Rating Criteria: Toll Roads (August 2020)
https://www.vis.com.pk/kc-meth.aspx

Shajar Roads Limited

OVERVIEW OF THE INSTITUTION

Shajar Roads Limited (SRL) was incorporated as a public unlisted company in 2017. The shareholding of SRL is divided between three groups, namely Habib Construction Services (HCS) (51%), Niaz Muhammad Khan & Brothers (NKB) (46%) and Deokjae Construction Company Pakistan (DCCPL) (3%).

Profile of Chairman & CEO

Mr. Hussnain is a fellow Member of the Institute of Chartered Accountants of Pakistan and Fellow Member of Institute of Public Finance Accountants of Pakistan. He has over 17 years of professional experience in the financial sector.

RATING RATIONALE

Shajar Roads Limited (SRL) was established as a public limited (unlisted) company in order to undertake the dualization and oversee management and maintenance of the existing 43km Sheikhupura – Gujranwala Road under the Design, Build, Finance, Operate, and Transfer (DBFOT) arrangement for the duration of the concession period. The company has entered into a concession with Government of Punjab (GoPb) for a period of 25 years. The project is being established under the Public Private Partnership (PPP) regime, with one of the sponsors, HCS, acting as the Engineering, Procurement & Construction (EPC) Contractor of the company. The financial close was achieved on August 8, 2020 while construction work started on August 26, 2020. The company is targeting to start commercial operations from July 1, 2022.

Rating Drivers

Sponsor Profile

Ratings incorporate sound profile of the three sponsors of SRL. Shareholding of SRL is vested with Niaz Muhammad Khan & Brothers (NKB), Habib Construction Services (HCS), and Deokjae Construction Company Pakistan (DCCPL). Major stakeholders, HCS and NKB, have considerable experience in infrastructure projects. DCCPL has also been involved in construction and maintenance of Hyderabad-Mirpurkhas Dual Carriageway under BOT arrangement. HCS has delivered several large projects over the past couple of years, including Orange Line Metro Train (OLMT). HCS, however, faced challenges in OLMT project execution and revenue generation due to multiple reasons, and is currently pursuing court proceedings regarding de-notification of already approved rates on Non BOQ items and delays arising from the stay orders. As the OLMT project has attained commercial operations, performance guarantees have been released by the GoPb.

Delayed finalization of Project License Agreement

The road is being constructed under the BOT mode whereby SRL (concessionaire) is responsible for building the road, operating it for a period of 25 years and then transferring it to the GoPb. The responsibility of the construction of the road lies with HCS. NKB and DCCPL will be responsible for operation and toll collection. A tripartite agreement exist between the shareholders, which defines responsibilities of each shareholder as well as project milestones.

The financial close was initially planned for March 2018. However, due to repeated delays in the finalization and acquisition of Project Site License Agreement, the financial close was achieved on August 8, 2020. Moreover, the company is now targeting to achieve substantial completion with the stipulated time period of 21 months from the financial close date, as mentioned in the concession agreement. As per the new financing plan, sponsors will inject equity in 16 unequal monthly installments, from Oct'2020 to Jan'2022. Equity injection schedule is attached as Annexure III to the report.

Project Financing

Project cost outlay has remained largely unchanged at Rs. 5.78b despite considerable delay in land possession and financial close. According to the management, the cost stagnation was largely due to relatively weak demand of road construction materials and lower demand of related labor. Cost outlay is divided into three components namely a) EPC costs amounting to Rs. 5.35b, b) Non-EPC costs amounting to Rs. 265m and c) interest during construction amounting to Rs. 162m. As per the new term sheet, project financing mix been changed from 60% debt and 40% equity to 35% debt and 65% equity.

SRL has entered into agreement with Dubai Islamic Bank Pakistan Limited (DIBPL) for mobilization of Diminishing Musharaka Facility 1 (DM-1) and Diminishing Musharaka Facility 2 (DM-2), each amounting Rs. 1b. Tenor of both DMs is up to 7 years including grace period of 12-months or Commercial Operations Date (COD), whichever is earlier, commencing from the facility effective date. DM-2 will be availed first. The facility effective date for DM-2 is the date on which the conditions precedent to DM facility are satisfied and the facility become available for use. The principal condition of DM-2 facility is the establishment of TDR account with DIBPL by sponsors of SRL. The facility effective date for DM-1 is the date on which entire amount available under DM-2 is drawn and Auditor's certificate confirming the full amount of equity injected has been furnished. First drawdown of DM-2 is scheduled for March'2021 and will be completely utilized by December'2021. DM-1 will be drawdown in two installments – one in March'2022 and the other in June'2022.

Both DMs will be repaid in 24 quarterly principal payments such that 12.5% of the amount will be repaid annually in first four years whereas the remaining 50% will be repaid in the last two years. Profit rate on DM-1 facility is 3-motnh KIBOR plus a spread of 1.75% per annum and DM-2 is 3-month KIBOR plus a spread of 1.0% per annum. Debt drawdown and repayment schedule is also attached as Annexure III to the report.

As per the concession agreement, two major maintenance overhauls will be undertaken during the concession period. First major overhaul will be undertaken in the 10th year of operations, while the second major overhaul will be undertaken in the 20th year. The company has to maintain Major Maintenance Reserve Account (MMRA) at least six months prior to the first major maintenance commencement date.

Financial Analysis

The primary source of revenues will be the toll collected as per defined toll rates charged from different types of vehicles. Other sources of income include revenues charged from overweight vehicles and earnings from advertisements. Gross revenues in the base case scenario are expected to grow at a CAGR of 6.2% during the project life. Revenues are contingent upon the assumptions of normal passenger and commercial vehicle traffic and overweight vehicles traffic.

Assumption regarding the ADT volumes in the first year is in line with the current figure indicated by the survey conducted by Communications and Works Department, GoPb. Assumptions with regards to growth in ADT are considered to be on the conservative side as the projected growth in traffic volumes post-dualization of the road has not incorporated diversion of traffic from other routes. Rates charged from different vehicles are fixed as per concession agreement. In case, toll rates are revised downwards by the government, the government will compensate SRL for the losses incurred on account of decrease in toll revenues.

Cost base of the company comprises Operations & Maintenance cost. O&M is segregated into three components which include tolling expenses, maintenance cost and administrative expenses. Tolling expenses include salaries of staff deployed on tolls and expenses related to procurement of electronic toll and ticketing management system (ETTMS). Maintenance costs include maintenance costs related to different components such as maintenance of traffic signs, routine maintenance of highway, insurance costs and ETTMS costs. Administrative expenses constitute all the costs related to daily operations of SRL such as salaries & wages of employees, consultancy costs and costs related to CSR activities and rent and utilities.

With higher profitability, Funds from Operations (FFO) is projected to increase steadily over the years. Debt Service Coverage Ratio (DSCR) is projected to remain above 1.0x during the repayment period. Given the revised capital structure, leverage indicators are projected to remain low.

Demand Risk

As per the concession agreement, the demand risk is parked entirely with SRL and no minimum revenue guarantee has been provided by the GoPb. Thus, any shortfall in the projected revenues on account of decrease in projected volumetric traffic may have adverse impact SRL's debt repayment capacity. However, this risk is mitigated by factors such as conservative assumptions pertaining to traffic volumes incorporated in the financial model. Projected growth in volumes post dualization of the road has not been incorporated in the traffic volumes. Moreover, traffic volumes are in line with volumes specified in the traffic study conducted by the Communication and Works department of GoPb.

Traffic profile features a diverse mix of commuter, agri and business related travel and is expected to remain moderately resilient to changes in economic cycles. Moreover, no competing or alternative route exists within a radius of 10 km of the route, if any such route is constructed, GoPb will compensate SRL for any loss in revenues. Since time savings over the course of the entire journey on this route would be significant, traffic volumes are expected to be sustainable. Growth in projected revenues is also a function of increase toll rates. The toll rates have been specified in the concession agreement and the same take into account the projected inflation. SRL will be compensated by the government in case toll rates are revised downwards.

Construction Risk
In case of delay in construction of the project, SRL is liable to pay construction damages to the government for the first 90 days of the delay beyond the substantial completion date. In case road completion is delayed by more than 90 days, GoPb reserves the rights to terminate the contract. Construction risk is minimal considering sound track record of EPC contractor, which has completed several infrastructure projects in Punjab. In case of delay of more than 21 months, the liability to pay liquidated damages to the government will be borne by HCS.

Costs Overrun Risk
Risk associated with changes in prices of raw materials shall be borne by SRL. As per management, changes in the prices of four major components including diesel, bitumen, steel and cement can have major impact on the overall costs of the project. In order to cover for such risk, management has already incorporated 5% contingency costs in the financial model. As the construction activity is still trying to picking up the pace, changes in prices of raw materials are expected to have minimal impact on the overall costs.

Debt Servicing
Liquidity profile of the company draws support from growing projected revenues and a structured mechanism in place, in the form of an escrow account, to facilitate timely repayments. SRL will maintain a Financing Payment Account (FPA) through the retention of funds from collection account starting from the 13th month after disbursement, in a manner that an amount equivalent to the 1/3rd of the upcoming installment shall be deposited in the FPA every month till it equals the amount of upcoming installment. SRL will also maintain a Financing Service Reserve Account (FSRA) equivalent to one peak quarterly installment of principal and profit (required FSRA balance). In case of shortfall in the FPA, necessary funds from the FSRA will flow in to cover that shortfall in the FPA. Projected revenues to remain sufficient to meet operating expenses and debt obligations. Leverage indicators are projected to improve gradually on the back of debt repayment and profit retention. Cushion in debt servicing is expected to remain at adequate levels even after sensitizing for lower revenues and higher costs.

Shajar Roads Limited **Annexure I**

Financial Statement (*Amount in Million)*

BALANCE SHEET	FY18	FY19	FY20
Total Assets	55.3	54.7	58.6
Total Liabilities	15.7	19.3	26.4
Total Equity	39.6	35.4	32.3
Paid-Up Capital	59.0	59.0	59.0
INCOME STATEMENT	FY18	FY19	FY20
Net Sales	-	-	-
Gross Profit	-	-	-
Profit/(Loss) Before Tax	(14.7)	(4.2)	(3.1)
Profit/(Loss) After Tax	(14.7)	(4.2)	(3.1)
FFO	(14.6)	(3.9)	(2.9)
RATIO ANALYSIS	FY18	FY19	FY20
Gearing (x)	-	-	-
Debt Leverage (x)	0.40	0.54	0.82
Current Ratio	0.09	0.009	0.003

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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 DISCLOSURES — Annexure III

Name of Rated Entity	Shajar Roads Limited
Sector	Toll Roads
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
24/11/2020	A	A-2	Stable	Maintained
25/09/2019	A	A-2	Rating Watch-Developing	Maintained
4/1/2018	A	A-2	Stable	Initial

Statement by the Rating Team	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	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, 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. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Asif Haider Mirza	Advisor	October 16, 2020
Mr. Arsalan Yasin	Manager Business Development	October 16, 2020