RATING REPORT

Swat Expressway Planning Construction and Operations (Private) Limited (SEPCO)

REPORT DATE:
July 12, 2021

RATING ANALYSTS:
Syed Fahim Haider Shah
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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		Stable	
Rating Date	*July 12, '21*		*June 30,'20*	

COMPANY INFORMATION	
Incorporated in 2016	**Chairman:** Maj Gen Kamal Azfar **CEO**: Brig Ahmed Shabbir Janjua
Private Limited Company	**External Auditor:** KPMG Taseer Hadi & Co. Chartered Accountants
Key Shareholders (with stake 5% or more): Frontier Works Organization – **42% (Class 'A' Shares)** Pakhtunkhwa Highways Authority – **58% (Class 'B' Shares)**	

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

Swat Expressway Planning Construction and Operations (Private) Limited (SEPCO)

PROFILE

Swat Expressway Planning Construction and Operations (Private) Limited (SEPCO) was incorporated as a private limited company in 2016. Key sponsors include Pakhtunkhwa Highways Authority (PKHA) and Frontier Works Organization (FWO). Registered office of the company is in Rawalpindi.

RATING RATIONALE

Swat Expressway Planning Construction and Operations (Private) Limited (SEPCO) is a Special Purpose Entity, principally formed for construction of Swat Expressway on Build-Operate-transfer (BOT) basis. The assigned ratings take into account strong sponsor profile, as shareholding of the company is held by Frontier Works Organization (FWO) (Class A shares) and Pakhtunkhwa Highways Authority (PKHA) (Class B shares), both having extensive experience in infrastructure development projects, including public-private partnership and BOT mandates. The ratings also factor in presence of a Concession Agreement for a period of 25 years with the PKHA for construction, management, & maintenance of the Swat Expressway and FWO being responsible for Engineering, Procurement, and Construction (EPC) and Operations & Maintenance (O&M). The ratings draw comfort from completion of the expressway within the projected cost estimate despite delays in availability of Concession Area and revision in original construction plan.

Rating Drivers

Complete motorway has been made operational while finishing of Service Area is underway and expected to be completed soon.

Swat Expressway project comprises 4-lane 80-km long Expressway, 3 twin tube tunnels, 26 bridges, and 7 interchanges, starting from Kernal Sher Khan (KSK) interchange up to Malik Ahmed Baba Allah Dhand Dheri (Chakdara) Interchange. The project was initially scheduled to be completed by May 31, 2019, however, due to non-availability of Concession Area and revision in original construction plan entailing additional structures, an independent engineer granted Extension of Time (EOT) up to September 30, 2020. While remaining within the budgeted project cost, complete road was made operational on September 30, 2020. Independent Engineer has issued a substantial completion certificate while finishing work on two Service Area on the sideways of the expressway is in progress and is expected to be completed soon.

Completion of project within the cost estimate and re-profiling of debt.

Total project cost is estimated at Rs. 37.6b, which has been funded through a mix of debt and equity. Sponsor equity comprised Rs. 9.2b contribution from FWO and Rs. 11.5b from PKHA. PKHA has also injected Rs. 5.5b in subordinated debt. Syndicated term finance facility (STFF) of Rs. 11.5b was availed from a consortium of banks led by the MCB Bank Limited. Total debt balance (inclusive of accrued markup on STFF) of the company stood at Rs. 16.1b at end-FY20, including STFF principal amount of Rs. 11.2b, accrued markup on STFF of Rs. 893m, and PKHA subordinated debt of Rs. 4.0b.

Upon the Board's decision to re-profile debt, the company has prepaid STFF along with all outstanding markup of MCB on February 4, 2021 amounting to Rs. 11.8b. The prepayment has been arranged through a mix of bridge finance facility of Rs. 5.0b from the National Bank of Pakistan (NBP) mobilized on February 4, 2021, at a markup rate of 6-month KIBOR plus 0.65% per annum, subordinated debt of Rs. 4.1b from FWO at a markup of 6-month KIBOR plus 0.65% per annum, and remaining Rs. 2.7 b was contributed by SEPCO from cash at bank balance. The company is currently in process of converting NBP bridge finance facility into STFF for a period of 10 years, including grace period of 2.5 years; the conversion is expected to be completed by end-July'2021. After re-profiling, total borrowings stood at Rs. 13.1b, resulting in gearing ratio of 0.70x.

Revenue shortfall led by travel restrictions and change in scope of project; improvement in traffic flow is expected, going forward.

While the Expressway is fully operational and toll is being collected on all interchanges, flow of traffic has been impacted by the enforcement of travel restrictions due to the outbreak of COVID-19. Revenue from toll collection has been recorded at Rs. 630m (FY20: Rs. 276m; FY19: Rs. 48m) during 11MFY21 with only 49 tolls booths out of 84 being currently functional. Going forward, remaining 35 are currently fully equipped and will be made functional based on expected increase in traffic flow due to ease in travel restrictions. Growth in projected revenues will also be a function of increase in toll rates, as specified in the Concession Agreement. Toll rates will be revised upwards every year at a rate of 8%. Moreover, completion of service area is also expected to contribute towards top-line of the company, however, its proportion is expected to remain low in overall revenue mix.

While repayment capacity of the company may be affected in case traffic volumes remain lower than projected in the near-to-medium-term due to COVID-19, the ratings draw comfort from re-profiling of debt and new terms of loan repayments having a grace period of 2.5 years.

Revenue risk related to toll rates remains largely addressed
Traffic profile depicts that majority travel will pertain to tourism and commuter related travel. Since time savings over the course of the entire journey on this route would be significant (~3-4 hours) vis-à-vis competing route, traffic volumes are expected to be sustainable. Higher time taken over the competing route is a function of greater distance and challenging terrain of the road. If PKHA or any other public-sector entity decides to establish a competing route, then it will be ensured that the competing route shall be tolled at least equivalent to an amount 1.5 times higher than prevailing toll rates imposed at Swat Expressway. Otherwise, SEPCO is entitled to receive losses in toll revenues from PKHA.

Swat Expressway Planning Construction and Operations (Pvt.) Ltd. Annexure I

BALANCE SHEET *(in PKR millions)*	FY18	FY19	FY20
Concession Assets	-	18,303.2	19,988.6
Concession Work in Progress	16,944.9	6,328.7	9,040.8
Long Term advance	9,917.6	7,921.6	2,412.5
Cash and Bank Balances	504.5	141.7	3,412.9
Other Assets	2.4	3.1	722.4
Total Assets	27,369.4	32,698.3	35,577.2
Long Term Loan (including current maturity)	8,071.0	11,559.2	16,092.0
Deferred Tax Liability	464.7	236.7	-
Retention Money Payable (including current maturity)	-	336.0	-
Tarde and Other Payables	48.9	195.4	573.4
Other Liabilities	220.9	284.6	179.1
Total/Tier-1 Equity	18,563.8	20,086.2	18,732.7
Paid-up Capital	16,695.6	19,170.3	19,815.3
INCOME STATEMENT	**FY18**	**FY19**	**FY20**
Net Sales	-	47.9	276.1
Gross Profit / (Loss)	-	(827.1)	(1,984.4)
Operating Profit	(28.4)	(862.0)	(2,021.1)
Profit / (Loss) Before Tax	48.2	(1,179.8)	(2,932.3)
Profit After Tax	199.0	(952.3)	(1,998.5)
Funds from Operations (FFO)	-	-	
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**
Gross Margin (%)	-	-	-
Net Margin (%)	-	-	-
Current Ratio (x)	4.2	0.16	1.70
Net Working Capital			-
FFO to Total Debt (x)	-	-	-
FFO to Long Term Debt	-	-	-
Debt Leverage (x)	0.47	0.63	0.90
Gearing (x)	0.43	0.58	0.86
DSCR (x)	-	-	-
ROAA (x)	-	-	-
ROAE (x)	-	-	-

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	Swat Expressway Planning Construction and Operations (Private) Limited (SEPCO)
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				
12/07/2021	A-	A-2	Stable	Reaffirmed
30/06/2020	A-	A-2	Stable	Reaffirmed
26/06/2019	A-	A-2	Stable	Reaffirmed
25/04/2018	A-	A-2	Stable	Initial

Instrument Structure	N/A
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.
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Due Diligence Meetings Conducted

Name	Designation	Date
Ms. Farzana Kausar	CFO	June 28, 2021