RATING REPORT

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

REPORT DATE:
October 06, 2023

RATING ANALYSTS:

Hannan Athar
hannan.athar@vis.com.pk

Tayyaba Ijaz, CFA
tayyaba.ijaz@vis.com.pk

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 Action	*Reaffirmed*		*Reaffirmed*	
Rating Date	*October 06, '23*		*August 04, '22*	

COMPANY INFORMATION	
Incorporated in 2016	**Chairman:** Mr. Abdul Sami **CEO**: Mr. Farooq Ahmed Joiya
Private Limited Company	**External Auditor:** M/s BDO Ebrahim & 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, 2023) ***https://docs.vis.com.pk/docs/CorporateMethodology.pdf***
VIS Rating Scale ***https://docs.vis.com.pk/docs/VISRatingScales.pdf***

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. The Company is a subsidiary of Frontier Works Organisation (FWO). Registered office of the company is in Rawalpindi.

RATING RATIONALE

Swat Expressway Planning Construction and Operations (Private) Limited ('SEPCO' or 'the Company') is a Special Purpose Company (SPC), jointly owned entity of Frontier Works Organization (FWO) and Pakhtunkhwa Highways Authority (PKHA). SEPCO was formed for construction of Swat Expressway (SER) on Build-Operate-Transfer (BOT) basis. The Company entered into a 25-year concession agreement with the PKHA for construction, management, maintenance & operations of the SER on 17th October, 2016. FWO is responsible for Engineering, Procurement, and Construction (EPC) and Operations & Maintenance (O&M) of SER.

SER project comprises 4-lane 81-km long motorway, 3 twin tube tunnels, 26 bridges, and 7 interchanges, starting from Kernal Sher Khan (KSK) interchange up to 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). SER's construction was concluded on March 31' 2022, which is the date when the Company received the completion certificate from Independent Engineer Associated Consultancy Center (IE). SER offers various savings to commuters including lower vehicle operating cost, lesser time and distance, which are its competitive advantage vis-à-vis alternative route. Toll collection from the road commenced in January, 2019.

Key Rating Drivers

Assigned rating incorporates strong sponsor profile

The 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 (PPP) and Build Operate Transfer (BOT) mandates.

Revenues & Profitability:
Traffic profile depicts that majority travel pertains to tourism and commuter related travel. Revenue is entirely derived from toll and service area charges. As a result of devastating floods and high inflation amidst economic slowdown, overall vehicle turnover was reported lower. Resultantly, net revenues decreased to Rs. 961.2m (FY22: Rs. 1.01b), which included toll collection amounting to Rs. 894.97m (FY22: Rs. 961.1m) and service area charges of Rs. 66.2m (FY22: Rs. 45.5m). Some impact from decline in number of vehicles was offset by 8% annual increase in toll tax, which is implemented on 1st October of every calendar year as per concession agreement.

Month	Toll	M-Tag	Total
Jul'22	78,795,350	11,818,840	90,614,190
Aug'22	62,715,380	10,236,010	72,951,390
Sep'22	58,750,540	8,863,750	67,614,290
Oct'22	67,282,670	10,089,200	77,371,870
Nov'22	64,024,800	9,508,510	73,533,310
Dec'22	61,983,780	9,829,320	71,813,100
Jan'23	59,569,560	10,147,230	69,716,790
Feb'23	58,154,910	9,578,990	67,733,900
Mar'23	60,891,930	9,954,570	70,846,500
Apr'23	55,246,260	8,629,680	63,875,940
May'23	73,009,690	8,724,920	81,734,610
Jun'23	76,790,780	10,377,000	87,167,780
Total	**777,215,650**	**117,758,020**	**894,973,670**

	FY20	% of total FY20	FY21	% of total FY21	FY22	% of total FY22	FY23	% of total FY23
Car	2,717,500	81.4%	3,731,516	76.0%	3,922,038	73.1%	3,105,406	70.5%
Wagon	214,614	6.4%	322,667	6.6%	343,526	6.4%	299,996	6.8%
Coaster/ Mini Buses	222,660	6.7%	588,333	12.0%	733,151	13.7%	704,778	16.0%
Buses	10,744	0.3%	35,933	0.7%	53,737	1.0%	44,305	1.0%
2&3 Axle Truck	165,885	5.0%	209,940	4.3%	272,534	5.1%	210,092	4.8%
Articulated Truck	7,723	0.2%	24,419	0.5%	40,909	0.8%	40,175	0.9%
	3,339,126		**4,912,808**		**5,365,895**		**4,404,752**	

As a result of subdued traffic volumes and higher depreciation charge on road infrastructure, overall profitability profile has remained stressed. Previously, FWO was the O&M contractor for SEPCO and the company had to make fixed payments on monthly basis. However, during a Board of Directors meeting on 25th February 2022, the company decided to manage its own O&M, thereon to effectively manage costs. Hence, now the company incurs O&M costs on an actual basis rather than making fixed payments which has led to significant reduction in cost. Administrative expenses amounted to Rs. 36.5m (FY22: Rs. 40.9m) in FY23. Finance cost incurred was recorded higher at Rs. 1.68b (FY22: Rs. 1.44b) mainly due to higher mark-up rates. The company posted higher net losses amounting to Rs. 4.1b (FY22: Rs. 2.78b) mainly owing to no adjustment of deferred tax assets in FY23, as compared to the same amounting Rs. 1.2b in the preceding year.

According to management, given monthly inflation rate hovering at ~30% and massive hike in fuel prices, traffic volumes are expected to remain low in the ongoing year. In addition, inflated mark-up rates would continue to strain bottomline of the company. The management expects to incur a net loss of more than Rs. 4b in the ongoing year. Albeit, the financial risk profile has been deteriorating, the project is passing through a phase where its cash flow are falling behind its annual revenue build up which is normal in long gestation infrastructure projects. This is expected to be normalized in the next few years as envisaged in planning.

Liquidity Profile: Liquidity profile has remained under pressure on account of net losses. Resultantly, funds from operations (FFO), were recorded negative during the review period leading to negative cash flow coverages. Interest payments on bank loan have been made on timely basis until now. However, as per the management, the company has requested the bank to defer instalments for mark-up payments falling on Oct'23 and Mar'24 in case there is shortfall in required cash flows. Meanwhile, the deferred payment of the difference will be clubbed with the last two instalments. Similarly, debt service coverage ratio (DSCR) has also remained inadequate. SEPCO has paid first three mark-up payments on NBP loan, falling due on April 18th and Oct 18th, 2022 and April 18th, 2023 from own cash flows. Nonetheless, comfort is driven by the fact that FWO has provided a sponsor support agreement to cover debt repayment shortfall to the company. Given the arrangement by FWO, the strength of the sponsors and the importance of the road to KPK forms the basis of the proposed rating.

Due to limited cash flow generation, the company was unable to make O&M payments to FWO. Therefore, out of the total amount of Rs. 1.4b due to FWO, Rs. 750.0m have been frozen and recorded as 'due to related parties' under trade and other payables in FY22, whereas, the remaining have been converted to subordinated debt from FWO. Prepayment, receivables and advances were recorded at Rs. 118.2m (FY22: Rs. 61.3b) at end-FY23. Cash and bank balances were recorded lower at Rs. 37.3m (FY22: Rs. 173.5m).

Capitalization Profile: Equity base of the company has eroded (FY23:Rs. 8.17b; FY22: Rs. 12.3b; FY21: Rs. 15.0b) on a timeline basis on account of sizable losses incurred since commencement of operations. Subsequent to the debt re-profiling, 66.62% of the debt mix comprised sponsor debt as of Jun 30, 2023. The remaining is syndicate term financing facility (STFF) from national Bank of Pakistan (NBP). The sponsor loans are subordinated to the loan from NBP. Long term loan (inc. current maturity) was recorded higher at Rs. 13.97b (FY22: Rs. 13.06b). These include unsecured loan from PKHA and FWO, while a secured long term loan has been mobilized from NBP.

Long-Term Loan from PKHA: This represents subordinate loan granted by PKHA under the subordinate loan agreement between PKHA and the Company. The loan is repayable in 15 fixed annual instalments after a grace period of 11 years from the date of concession agreement. As presented in the table below, first repayment of PKHA loan amounting Rs. 1.0m, will be made after four years on Oct 7, 2027. SEPCO has to repay Rs. 2.0m in each of the next 9 yearly instalments. Meanwhile, last 5 instalments will entail fixed payment to the tune of Rs. 2.87b each year.

Table 1: Subordinated Debt –PKHA Schedule

Subordinated Debt - PKHA Schedule	
Due Date	**Principal + Interest (in Rs. mil)**
7-Oct-27	1
7-Oct-28	2
7-Oct-29	2
7-Oct-30	2
7-Oct-31	2
7-Oct-32	2
7-Oct-33	2
7-Oct-34	2
7-Oct-35	2
7-Oct-36	2
7-Oct-37	2,873.35
7-Oct-38	2,873.35
7-Oct-39	2,873.35
7-Oct-40	2,873.35
7-Oct-41	2,873.35
Total	**14,385.75**

Long-Term Loan from FWO: This represents amount payable to FWO against subordinated loan obtained to partly prepay the MCB STFF facility of Rs. 11.5b. The loan was obtained on February 4, 2021 for a tenure of 11 years. Interest payments are charged at 6-M KIBOR plus 0.65% spread. Total outstanding value of this loan stood at Rs. 6.1b (FY22: 5.3b), where the increase is due to conversion of a payable to FWO in lieu of O&M payments, into long term loan, as discussed above in the report. The company has paid first two mark-up payments on this loan on due date in 2021. As per initial terms, repayment of FWO loan (principal + mark-up due) was to be commenced in 2022 (falling on May 31st and Nov 30th of each year). However, SEPCO was not able to repay any further, owing to cash flow constraints. As per management, with recovery in macroeconomic indicators and improvement in SEPCO's cash flow position, the company will start repaying FWO loan.

Long-Term Loan from NBP: This represents conversion of bridge financing facility from National Bank of Pakistan (NBP) amounting Rs. 5.0b for the purpose of financing the prepayment of the outstanding principal amount of the STFF obtained from MCB. During FY22, bridge finance facility was converted into long term STFF (Rs. 3.1b into conventional facility and Rs. 1.9b into Musharaka Facility). Syndicate comprises of NBP, Faysal Bank, Askari Bank and Bank of Punjab while NBP is the lead arranger. This STFF facility is priced at 6-M KIBOR plus 0.65% margin.

Table 2: Loan Schedule (NBP)

STFF Loan Schedule (NBP)			
Due Date	**Principal (P) (in Rs. mi)**	**Markup (I) (in Rs. mi)**	**Total Installment (P+I) (in Rs. mi)**
18-Apr-22	-	223.6	223.6
19-Oct-22	-	346.4	346.4
18-Apr-23	-	409.4	409.4
18-Oct-23	-	570.3	570.3

18-Apr-24	-	570.3	570.3
19-Oct-24	75	317.1	392.1
18-Apr-25	75	310.7	385.7
18-Oct-25	125	307.6	432.6
18-Apr-26	125	298.0	423.0
19-Oct-26	175	291.7	466.7
18-Apr-27	175	279.1	454.1
18-Oct-27	250	269.5	519.5
18-Apr-28	250	253.7	503.7
19-Oct-28	350	237.8	587.8
18-Apr-29	350	214.5	564.5
18-Oct-29	450	193.4	643.4
18-Apr-30	475	164.0	639.0
19-Oct-30	625	134.8	759.8
18-Apr-31	650	94.6	744.6
18-Oct-31	850	53.9	903.9
Total	**5,000.0**	**5,540.5**	**10,540.5**

Outstanding value of STFF stood at Rs. 3.29b (FY22: Rs. 3.22b). Long-term musharaka facility amounted to Rs. 2.06b (FY22: Rs. 1.98b) at end-FY23. These loan amounts are inclusive of current maturity and accrued mark-up. The musharaka agreement has been secured under a consortium of lenders NBP, BOP and Faysal bank, with NBP as the lead arranger. Gearing and debt leverage have trended upward due to declining equity base. However, after adjusting for sponsors' debt, gearing stood at 0.40x (FY22: 0.22x).

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

FINANCIAL SUMMARY	(amounts in PKR millions)			
BALANCE SHEET	**FY20**	**FY21**	**FY22**	**FY23**
Property, Plant & Equipment	29,029.5	29,793.3	27,050.5	24,011.6
Long term advance	3,064.0	206.4	0.0	0.0
Deferred Tax Asset	701.3	765.1	2,000.1	2,000.1
Cash and Bank Balances	3,412.9	343.5	173.5	34.1
Other Assets	21.1	29.6	63.5	137.7
Total Assets	**36,228.7**	**31,137.9**	**29,287.6**	**26,183.5**
Long-Term loan *(Inc. current maturity)*	11,829.4	8,527.9	13,063.8	13,965.1
Long-Term musharka *(Inc. current maturity)*	4,262.7	0.0	1,974.3	2,059.9
Retention money payable (Inc. current maturity)	651.5	981.4	1,016.1	1,016.1
Deferred Liabilities (Provision for handback)	170.5	182.3	194.8	194.8
Bridge finance	0.0	5,165.3	0.0	0.0
Trade and other payables	573.4	1,228.7	768.0	780.3
Other Liabilties	8.6	3.3	2.5	4.5
Total Liabilities	**17,496.0**	**16,088.9**	**17,019.5**	**18,020.7**
Paid-Up Capital	19,815.3	19,815.3	19,815.3	19,815.3
Tier-1 Equity/ Total Equity	18,732.7	15,049.0	12,268.1	8,162.8
INCOME STATEMENT	**FY20**	**FY21**	**FY22**	**FY23**
Net Sales	276.1	722.7	1,006.5	961.2
Gross Profit	-1,984.4	-2,781.7	-2,551.3	-2,403.2
Finance Cost	1,128.6	1,048.4	1,436.2	1,684.7
Other Income	217.4	128.8	25.1	16.5
Profit Before Tax	-2,932.3	-3,736.7	-4,003.3	-4,105.4
Profit After Tax	-1,998.5	-3,683.7	-2,780.9	-4,105.4
FFO	-	34.3	-	-
RATIO ANALYSIS	**FY20**	**FY21**	**FY22**	**FY23**
Gross Margin (%)	-	-	-	-
Net Margin (%)	-	-	-	-
Current Ratio (x)	1.58	0.05	0.06	0.06
Net Working Capital	1,259.4	-6,569.5	-3,422.1	-2,765.1
FFO to Long-Term Debt	0.02	0.05	0.03	0.04
FFO to Total Debt	0.02	0.03	0.03	0.04
Adjusted FFO to Total Debt*	-	0.01	-	-
Adjusted FFO to Long-term Debt*	-	-	-	-
Debt Servicing Coverage Ratio (x)	0.61	1.08	0.70	0.87
ROAA (%)	-	-	-	-
ROAE (%)	-	-	-	-
Gearing (x)	0.86	0.91	1.23	1.96
Adjusted Gearing (x)*	-	0.34	0.22	0.40
Debt Leverage (x)	0.93	1.07	1.39	2.21

*Adjusted for sponsors debt from FWO & PKHA

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		
06/10/2023	A-	A-2	Stable	Reaffirmed
04/08/2022	A-	A-2	Stable	Reaffirmed
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.
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. Copyright 2023 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Due Diligence Meetings Conducted	Name	Designation	Date
	Ms. Farzana Kausar	CFO	30th August 2023