

## RATING REPORT

# Ghotki Kandhkot Road & Bridge Company (Pvt.) Limited (GKRBC)

### REPORT DATE:

November 29, 2021

### RATING ANALYST:

Asfia Aziz

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| Rating Category  | Latest Rating     |            | Previous Rating  |            |
|------------------|-------------------|------------|------------------|------------|
|                  | Long-term         | Short-term | Long-term        | Short-term |
| Entity           | A                 | A-2        | A                | A-2        |
| Rating Outlook   | Stable            |            | Stable           |            |
| Rating Date      | November 29, 2021 |            | October 23, 2020 |            |
| Bank Loan Rating | AA (blr)          |            | NA               |            |
| BLR Action       | Preliminary       |            | NA               |            |

### COMPANY INFORMATION

Incorporated in 2018

Chief Executive Officer: Mr. Abdul Karim Qureshi

Private Limited Company

Key Shareholders (with stake 5% or more):

Sachal Engineering Works (Pvt.) Limited – 53%

Government of Sindh – 47%

### APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporates (August 2021)

<https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf>

VIS Rating Criteria: Toll Roads Rating (August 2020)

<https://docs.vis.com.pk/docs/TollRoads202008.pdf>

**Ghotki Kandhkot Road & Bridge Company (Pvt.) Limited (GKRBC)**

**PROFILE**

**RATING RATIONALE**

*Ghotki Kandhkot Road & Bridge Company (GKRBC) was incorporated as a Private Limited Company in May 2018 to Design, Build, Finance, Operate, and Transfer (DFBOT) two sections of the road located at Ghotki Kandhkot site of Sindh province.*

| Salient Features of the Project |  |
|---------------------------------|--|
| Concession Agreement Date       | May 28, 2018   |
| Date of Commencement            | July 20, 2020  |
| Expected date of Completion     | July 19, 2023  |
| Time Lapsed                     | 12.5 months  |
| Construction period             | 3 years  |
| Concession period               | 25 years   |
| Design Consultants              | AA Associates (Pvt.) Ltd.  |
| Independent Engineer            | Consortium of Loya Associates & Techno-Consult International (Pvt.) Ltd. |
| Independent Auditor             | M/s Riaz Ahmed & Company   |
| EPC Contractor                  | M/s Sachal Engineering Works (Pvt.) Ltd.                                 |
| Transaction Advisors            | Ernst & Young (EY) – Financial Consultant                                |
|                                 | Loya Associates – Technical Consultant                                   |
|                                 | Haider Mota – Legal Consultant   |

Ghotki Kandhkot Road & Bridge Company (GKRBC) has been established to develop two sections of the road and bridge located at Ghotki Kandhkot site of the Sindh province. This Project will connect N-5 and N-55 between Ghotki on one side and Kandhkot on the other side of River Indus and end on existing by-pass of Indus Highway, N-55. At present, the distance between Kandhkot and Ghotki via Guddu Barrage, the alternate route, is approximately 151 km. Post construction of the project, the distance between the two cities will be reduced to 42 km, resulting in significant fuel cost and time savings. Commuter travel time would be reduced by approximately two hours. Moreover, the construction of the bridge is expected to promote industrial and commercial activity and create employment opportunities for the people in that locality.

The project will be established under the Public Private Partnership (PPP) regime on Design, Finance, Build, Operate & Transfer (DFBOT) basis, with one of the sponsors, Sachal Engineering Works (Pvt.) Limited (SEWPL), acting as the Engineering, Procurement & Construction (EPC) Contractor. GKRBC has entered into concession agreement with Government of Sindh (GoS) for a period of 28 years, out of which construction period is up to three-years and operations and maintenance period is up to twenty-five years. At the end of the concession period, the ownership of the project will be transferred to the GoS. The Concession Agreement was signed by & between Government of Sindh (GoS) through Secretary, Works & Services Department & GKRBC the Concessionaire dated 28th May 2018.

**Financing Arrangement**

Total project cost is estimated at Rs. 14.03b; financed through 70% debt and 30% equity. Construction of the project has commenced in July'2020 financed by the equity of the Concessionaire and GoS. Almost all of the equity has been utilized at end-July'2021. Construction of the project is expected to be completed by July 2023 as per agreed timelines. Financial close has not been achieved yet, and as per the Concessionaire agreement, inability to complete the financial close within 150 days of signing the agreement results in the onus of arrangement of debt funding on Government of Sindh. A revised term sheet has been signed and financial close is expected to be closed by 3QFY22. The Company is seeking the Syndicated Term Finance Facility (STFF) of Rs. 9.82b for a tenor of around 12 years (inclusive of 2 years grace period). As per the

indicative term sheet, security structure entails a Provincial Guarantee in favor of the financiers backed by an unconditional and irrevocable debit authority on the GoS Non-Food Account No. 1 maintained with SBP equivalent to the 50% of the facility amount. The debit authority shall continue at all times over the life of the STFF facility. Furthermore, a Bridge Financing Facility (BF) to the tune of Rs. 5b for a tenure of twelve months, is required immediately to continue construction works and avoid delay in COD. The security structure of the BF entails a Provincial Guarantee in favor of the financiers backed by an unconditional and irrevocable debit authority on the GoS Non-Food Account No. 1 maintained with SBP equivalent to the 111% of the facility amount. The debit authority shall continue at all times over the life of the BF. The Bridge Facility will be paid in full either from the proceeds of the STFF or from the Company's own sources. The mark-up rate on the Bridge facility is indicated at 3M KIBOR+115 bps per annum. Achievement of financial close as per projected timelines will be important for ratings going forward.

|                     | Amount (in PKR bn) |
|---------------------|--------------------|
| <b>GoS equity</b>   | 1.98               |
| <b>SEWPL equity</b> | 2.23               |
| <b>Total Equity</b> | 4.21               |
| <b>Debt (STFF)</b>  | 9.82               |
| <b>Total</b>        | 14.03              |

#### Key Rating Drivers:

**Sponsor Profile:** The assigned ratings take into account sound profile of the two shareholders of GKRBC. Shareholding of GKRBC is vested with Sachal Engineering Works (Pvt.) Limited (SEWPL) and Government of Sindh (GoS). SEWPL has 53% equity stake in the project and it holds ordinary Class A voting shares in the company along with the management control; the remaining shareholding (47%) is held by GoS, which has non-voting Class B shares. SEWPL has considerable experience and sound track record in executing infrastructure projects especially toll roads & bridges. The company has executed around Rs. 2.7tr worth infrastructure projects over the last three decades and is currently working on projects worth Rs. 50b. Financial profile of SEWPL is also sound.

| (Rs. in millions)           | FY17  | FY18  | FY19  | FY20  |
|-----------------------------|-------|-------|-------|-------|
| <b>Equity</b>               | 3,278 | 4,234 | 4,772 | 4,848 |
| <b>Liabilities</b>          | 2,310 | 1,680 | 2,030 | 2,279 |
| <b>Total Assets</b>         | 5,588 | 5,914 | 6,752 | 7,127 |
| <b>Revenue</b>              | 6,269 | 6,214 | 4,097 | 2,007 |
| <b>Operating Profit</b>     | 1,520 | 1,505 | 841   | 519   |
| <b>Net Profit</b>           | 955   | 956   | 488   | 127   |
| <b>Operating Margin (%)</b> | 24%   | 24%   | 21%   | 26%   |
| <b>Net Margin (%)</b>       | 15%   | 15%   | 12%   | 6%    |
| <b>Leverage</b>             | 0.70  | 0.40  | 0.42  | 0.47  |

**Demand Risk:** Demand risk, associated with uncertainty in future traffic volumes and toll rates, will not be borne by GKRBC as the company will receive fixed annuity payments from the GoS. GKRBC will receive quarterly annuity payments from the GoS. These annuity payments will cover the following components:

- Agreed operations and maintenance expense (including taxes) for that quarter
- Debt payment amount for that quarter (all rental/ interest payments);

- Agreed compensation for equity redemption for that quarter in a manner that 80% of Class A Shares will be redeemed in equal quarterly installments during the operations period (after debt redemption), whereas 20% will be redeemed at the end of Concession Period; and
- Return on equity, calculated in term of agreed Equity IRR of 17% for Sponsors.

**Risk of delay in annuity payments:** While fixed annuity payments mitigate demand risk for the company, the delay in payment of the same may pose operational challenges for the company as the annuity payments cover both O&M costs and debt payments. However, provisions in the annuity payment agreement ensure that delay risk is also minimal. Annuity payment agreement mandates that the GoS is required to deposit the funds equal to the annuity payment in the annuity payment account 105 days in advance. In case, GoS is unable to deposit the funds by the annuity payment due date, the same shall constitute a GoS event of default. In such a scenario, the GoS is liable to pay the outstanding principal financing provided by the financiers, interest/rental accrued on the debt, termination equity & termination dividend amount.

**Cost overrun risk:** Increase in the prices of escalable raw materials which include cement, bitumen, steel and POL for construction and machinery is an inherent risk in the project. Project costs already incorporate 10% increase in the costs of the escalable items (around Rs. 430m). Concession agreement stipulates that in case the cost of any escalable item exceeds by more than 10%, the GoS shall bear 50% of such escalation cost and the sponsor shall fund the remaining 50% escalation cost. In order to further mitigate cost overrun risk, management of GKRBC has set aside additional Rs. 100m for such contingencies in addition to 10% increase in prices already incorporated in project costs. While construction costs have escalated over the last year, management is confident that the built-in contingency is adequate to absorb the increase in costs. Moreover, saving on Interest During Construction (IDC) given no debt drawdown is expected to provide additional cushion against any cost overrun.

**Construction delay risk:** Both the GKRBC and the GoS have agreed on specific project construction milestones relating to the performance of Construction Works and other obligations to be performed by the Concessionaire until the Project Construction Completion Date. These milestones will have to be achieved as per specific dates mentioned in the construction program. In the event that the concessionaire fails to achieve any project construction milestone within a period of 30 days of the stipulated project milestone date, GKRBC will be liable to pay liquidated damages mandated in the concession agreement to the GoS. Moreover, if the project milestone is not achieved within 90 days of the Project Milestone Date, the same will constitute a concessionaire event of default and the government has the right to terminate the concession agreement. Similarly, GKRBC will also be liable to pay liquidated damages to GoS in case it fails to achieve Substantial Completion by the Scheduled Substantial Completion Date (36 months from Project commencement date). While financial close of the project has been delayed, the construction commenced as per plan in July'20 through upfront equity injection by the sponsors. Consequently, the timelines of the project are on track.

**Debt Servicing:** For the purpose of raising debt, GKRBC will be drawing a STFF to the tune of Rs. 9.82b. Following are some key features of the security:

- Pricing @ 3M KIBOR+1.3% based on robust security arrangement;
- Stretched tenor of the facility of 2+10 years;
- Security structure encompassing Provincial Guarantee in favor of the financiers backed by an unconditional and irrevocable debit authority on the GoS Non-Food Account No. 1 maintained with SBP equivalent for 50% of the facility amount.

The principal will be redeemed in 40 equal quarterly installments. Given that debt payments are covered under annuity payments, cushion in debt servicing is adequate. Moreover, till the attainment of the project finance facility, an interim bridge financing facility will be utilized to the tune of Rs. 5b in order to continue with works on the Project. Upon issuance of the project finance, bridge financing will be settled.

**Financial Analysis**

Quarterly annuity payments received from the GoS will be sole source of revenue for GKRBC. The annuity payments will include four major components as mentioned earlier. The two major maintenance overhaul expenses will be incurred in the 11th and 21st year of operations are not covered under the annuity payments to be received by GKRBC. GKRBC will acquire grants from the GoS in the 11th and 21st year to incur major maintenance expense. Given that debt payments are included in the annuity payments, DSCR of the company remains adequate throughout the life of the project.

## 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](http://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](http://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](http://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                  |   | Appendix III               |   |                       |                      |
|---|---|----------------------------|---|-----------------------|----------------------|
| <b>Name of Rated</b>                    | Ghotki Kandhkot Road & Bridge Company (Pvt.) Limited  |                            |   |                       |                      |
| <b>Sector</b>                           | Toll Roads  |                            |   |                       |                      |
| <b>Type of Relationship</b>             | Solicited   |                            |   |                       |                      |
| <b>Purpose of Rating</b>                | Entity & Debt Rating  |                            |   |                       |                      |
| <b>Rating History</b>                   | <b>Rating Date</b>  | <b>Medium to Long Term</b> | <b>Short Term</b>                             | <b>Rating Outlook</b> | <b>Rating Action</b> |
|   | <b>RATING TYPE: Entity</b>  |                            |   |                       |                      |
|   | 29/11/2021  | A                          | A-2   | Stable                | Reaffirmed           |
|   | 23/10/2020  | A                          | A-2   | Stable                | Initial              |
|   | <b>RATING TYPE: Bank Loan Rating</b>  |                            |   |                       |                      |
|   | 29/11/2021  | AA (blr)                   |   | Stable                | Preliminary          |
| <b>Bank Loan Structure</b>              | BLR is done for the STFF amounting Rs. 9.82b. The tenor of the facility is 12 years, including 2 years grace period. Applicable profit rate is 3-month KIBOR + 1.3%. The principal will be redeemed in 40 equal quarterly installments.   |                            |   |                       |                      |
| <b>Statement by the Rating Team</b>     | 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.  |                            |   |                       |                      |
| <b>Probability of Default</b>           | 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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| <b>Due Diligence Meetings Conducted</b> | <b>S.No</b>   | <b>Name</b>                | <b>Designation</b>                            | <b>Date</b>           |                      |
|   | 1   | Mr. Fuad Kehar             | Executive Director- Financial Unit            | August 23, 2021       |                      |
|   | 2   | Mr. Shafi Ullah Khan       | CEO   | August 23, 2021       |                      |
|   | 3   | Mr. Huzaifa Mazahir Ali    | Principal Strategy and Transactions E&Y       | August 23, 2021       |                      |
|   | 4   | Mr. Jawad                  | Senior Director Strategy and Transactions E&Y | August 23, 2021       |                      |