

RATING (JUNE 2010)

CITY SCHOOLS (PRIVATE) LIMITED (CSPL)

PRELIMINARY

TFCs

Secured, privately placed

PKR A+
1,600mln

FINANCIAL DATA

(IPPs - COMBINED)

PKR (mln)

	FY09	FY08
Total Assets	33,184	34,800
Revenue	41,233	45,602
Net Income	4,462	3,477
EBITDA	7,524	6,063
Dividend Payout	1,416	6,218

ANALYSTS

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RATING RATIONALE AND KEY DRIVERS

- The rating primarily draws its strength from the security structure of the instrument. This includes, inter alia, first exclusive charge over dividend receivables from two operational IPPs (~700MW) and assignment of the same in favor of the Agent Bank, and first equitable mortgage over land and building of City Schools with 20% margin. Although the instrument remains exposed to timing mismatch, it would be cushioned through, among other things, considerable dividend retention after debt repayment. Nevertheless, the rating incorporates challenges ensuing from upcoming change in ownership of IPPs and continuing tough socio-economic environment beset particularly with circular debt.
- The rating is dependent on the continued compliance with the predefined security structure of the instrument. Moreover, any significant deterioration in the performance of the IPPs, impacting the projected dividend stream, would have negative implications for the rating.

INSTRUMENT STRUCTURE

- Established in 1978 in Karachi, City Schools is among the leading academic chains in the country. It is owned by Dr. Farzana Firoz, the Chairperson and a highly acclaimed educationalist, and her two sons. The sponsors of City Schools, Abu Dhabi Investment Company and Nishat Group – the Consortium, have entered into agreement to acquire 90% and 100% stake in AES Pak Gen (Pvt.) Limited and AES Lal Pir (Pvt.) Limited (the IPPs), respectively for a consideration of USD 115mln (~PKR 10bln). City Schools sponsors will be acquiring 20% stake in the IPPs for a consideration of PKR 2,000mln.
- The sponsoring family, to finance this acquisition, is issuing secured Privately Placed, Rated, Term Finance Certificates (TFCs) of PKR 1,600mln through City Schools. The TFC proceeds will be lent with the same terms and conditions onwards to Engen Private Limited, a Special Purpose Vehicle fully owned by the sponsors of City Schools and created for this purpose. The remaining amount, PKR 400mln, will be financed through equity, which will be injected directly by the sponsors into Engen. The proceeds of TFCs would be received in multiple installments by CSPL (first disbursement made in May 2010 – PKR 1,100mln).
- The instrument is for a tenor of five years including grace period of six months (on principal only) and carries profit at the rate of 6 month KIBOR plus 225bps payable semi-annually. The principal would be repaid in 9 un-equal, consecutive semi-annual installments, beginning May 2011. The instrument has a call option after 12 months of the Facility Effective Date (28th May 2010), by providing 60 days notice period to investors.
- The underlying source of repayments of the TFCs will be dividends from the IPPs. As per the shareholders agreement, the IPPs will maintain 90% payout throughout the tenor of the instrument. TFC holders would have first exclusive charge over dividend receivables from the IPPs. The dividends would be assigned in favour of the Agent Bank (Faysal Bank Limited) to fund Debt Payment Account (DPA) through issue of irrevocable and unconditional standing instructions by City Schools and Engen. Dividend from Engen would not be paid unless two upcoming installments are covered including one for DPA. If, for any period, DPA is not sufficiently funded due to timing mismatch between dividends and installment, City Schools will be obligated for replenishing the shortfall from its own sources. At least fifteen days prior to the installment date, the balance in DPA should be sufficient to meet the upcoming installment amount (principal plus interest). In case of divestment of Engen's stake in IPPs through Initial Public Offering (IPO), all proceeds including share premium will be utilized for prepayment of the TFCs.
- In addition, TFC holders will have exclusive first equitable mortgage on the land and related buildings of commercial, owned, and unencumbered properties of City Schools with 20% margin on the principal amount for the entire tenor of the instrument. These properties are situated in Lahore and Rawalpindi and have been valued by a PBA approved valuator upto ~PKR 2bln. Meanwhile, the instrument is backed by a personal guarantee of CSPL's Chairperson.
- During the tenor of the instrument, the debt equity ratio of CSPL is not allowed to exceed 70:30 and the school is restricted on paying cash dividend incase coverage is not met. Meanwhile, maximum gearing ratio of Engen would be 80:20.

ASSESSMENT

- The business model of all IPPs is structured in a way that these are protected from many risks simultaneously emanating from force majeure, fuel supply, interest rate movement and currency devaluation since costs incurred are pass-through costs. Moreover, the demand related risks of IPPs are mitigated through the Implementation Agreement, and GoP guarantee thereof through off-take commitments. This ensures stability in revenue stream through capacity payments, even if an IPP produces no electricity (in case of no demand from the power purchaser). Meanwhile, the operating risks emanating from Operations & Maintenance (O&M) are not covered by either agreed mechanism or government guarantee.
- Both IPPs, with combined capacity of approximately 700MW, have been operative for about 13 years now. Their historical profitability is robust, with the same pattern expected to continue in the medium-term. Moreover, IPPs' capacity to manage ongoing circular debt issue is stronger given their almost deleveraged capital structure.