The Pakistan Credit Rating Agency Limited

Rating Report

Habib Construction Services Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-Oct-2023	BBB+	A2	Stable	Maintain	-
12-Oct-2022	BBB+	A2	Stable	Upgrade	-
13-Oct-2021	BBB	A2	Stable	Maintain	-
16-Oct-2020	BBB	A2	Stable	Maintain	-
22-Oct-2019	BBB	A2	Stable	Maintain	-
22-Apr-2019	BBB	A2	Stable	Upgrade	-
18-Jan-2019	BBB	A3	Negative	Downgrade	Yes
30-Jun-2018	A-	A2	Stable	Maintain	-
29-Dec-2017	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Habib Construction Services Limited “the Company or HCS” has been in the construction industry for many decades. The Company established its footprint and developed a strong brand equity in the construction business over the years. Historically the Company has successfully delivered multiple public and government projects of which the completion spanned a number of years. HCS mostly undertake large infrastructure projects in collaboration with different JV partners including Chinese, Japanese and few local contractors. However, HCS is also focusing towards multi-lateral financed and multiple small projects. Recently HCS has awarded sizeable number of projects, which span a number of years, and are in the process - providing projected revenues in the coming years, few big projects are in pipeline as well. HCS’s sustained improvement in business performance with growth in revenue and operating margins. During FY23, topline witnessed growth of 5.6% and clocked at PKR 5.9bln (FY22: 5.56bln, FY21: 3.03bln), the same trend is expected to continue going forward. The pipeline is healthy; therein for the sake of sustainable long-term growth. As the entire income is tender-based, revenue depends on the Company’s ability to bid successfully. Therefore, the working capital requirement also depends on the project in execution; wherein performance guarantees are essential. The company’s leveraging indicators are adequate and has more reliance on non-funded banking lines as well as supplier credit to facilitate its business. Debt is procured for the project financing, with reliance only on short-term working capital excluding long term debt. Equity base of the Company is strong, especially when compared with the non-funded obligations assumed by the Company. The expansion in business is expected to reflect positively on the future risk profile of the Company. The Company is affably low leveraged and the performance of the company rests with projects in hand and timely completion. Realization of disputed claims regarding Orange line project, delivered by the Company, can improve its liquidity, and positive developments has been made in this regard. Stoppage of various projects, related to Bahria Town Islamabad for uncertain time period will remain critical to the ratings. Company’s exposure to cyclicality and political instability in construction sector leads to volatility in projects pipeline and revenue generation, thus resulting in high business risk.

The ratings are dependent on the timely completion of projects with sufficient cash inflows and maintaining a low leveraged capital structure. Simultaneously marinating a healthy project pipeline. Any prolonged downturn in subdued business volume can negatively affect the ratings. Good corporate governance practice is considered essential.

Disclosure

Name of Rated Entity	Habib Construction Services Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Construction(Mar-23)
Rating Analysts	Anam Waqas Ghayour | anam.waqas@pacra.com | +92-42-35869504

Profile

Legal Structure Habib Construction Services Limited (referred as ‘‘the Company’’ or ‘‘HCS"’) is a Public Limited Company (unquoted) incorporated in 2009.

Background Within a span of 13 years, HCS has completed many mega projects related to infrastructure. HCS has expertise in executing large & complex infrastructure and is driven to deliver projects ‘On-Time’. HCS holds a good position in the construction industry of Pakistan.

Operations HCS is registered with the Pakistan Engineering Council (PEC) and holds the C-A (no limit) license. HCS has completed projects like highways, airports, buildings, flyovers & bridges, etc. Significant projects to its credit are Lahore Ring Road, 2x2.5 MW hydel power project at Chashma, Bahria Grand hotel, Benazir Bhutto international airport civil works, Beijing underpass Lahore, Kalma Chowk underpass & overhead bridge, Metro Bus projects in Islamabad, Lahore & Multan.

Ownership

Ownership Structure HCS is owned by 31 shareholders. Two directors (Mr. Shahid Saleem & Mr. M. Shabbir) own ~52% of the shares while rest is held by personnel in management.

Stability HCS is majority owned by Mr. Shahid Saleem, holding ~42% shares. All executive directors, have extensive experience in relevant fields and power to direct relevant activities of the company. Ownership structure of HCS is seen as stable as no ownership changes are expected in near future.

Business Acumen All majority shareholders have strong knowledge and formal education in their respective fields of expertise. They posses extensive experience in the industry as well. Mr. Shabir has expertise in 'Quantity survey', whereas Mr. Mohsin is a member of ICAP. Mr. Mohsin has 30+ years of experience at different positions ranging from manager to Executive Director in different private sector construction companies.

Financial Strength The shareholders have high stakes in HCS, as most shareholders are not engaged in other businesses, and have always aspired to finance the company without relying heavily on funded facilities or long term debt. The company has 50% stake in an associated company 'Shajar roads Ltd' as well. The sponsors stand by to support as they have provided in the past in the form of personal guarantees.

Governance

Board Structure Overall control of the company now vests in a three-member BoD who have executive roles. Governance structure has room for improvement as currently, there is no independent director.

Members’ Profile All the board members are qualified individuals who carry extensive experience of the construction industry.

Board Effectiveness HCS has constituted two board committees (Audit Committee and Human Resource & Remuneration Committee) to ensure rigorous monitoring of management’s policies and entity’s operations. Attendance recorded during the board and its committees’ meetings was good and minutes have been properly documented.

Financial Transparency Malik Haroon Shahid Safder & Co. Chartered Accountants, the auditors of the Company have expressed an unqualified opinion on the financial statements for the year ended June 30, 2022.

Management

Organizational Structure A simplified organizational structure where operations are segregated into six departments, (i) Engineering Department, (ii) Information Technology Department, (iii) Contract Management Department, (iv) Surveyor Department, (v) Construction Managing Department, and (vi) Finance Department. Clear lines of responsibility are defined for each department.

Management Team The senior management consists of 3 project managers who report directly to the CEO, each with more than 25 years of experience in construction and 10 years with HCS, while the technical team mainly consists of planning engineers & site in-charge. Mr. Shahid Saleem, CEO, and one of the founding members of HCS, has over 31 years of experience in various appointments in renowned private sector construction companies. He is the person behind the success of the company leading with his visionary leadership.

Effectiveness No formal management committees are in place. However, meetings are conducted by the senior management on a need basis for discussion and decision making purposes. Moreover, the management reviews MIS based reports regularly, aiding in informed and timely decision making.

MIS HCS is currently using ERP software customized for the construction industry from BE-Tech. The software keeps track of receivables, payables, general ledger, accounts, etc.

Control Environment The Company has enough internal control systems and procedures in place to ensure the quality of goods produced on a continuing basis.

Business Risk

Industry Dynamics The construction sector contributed almost PKR~1,848bln to the GDP of Pakistan in FY22 (FY21: PKR~1,409bln), registering a growth of ~31.1% YoY basis (~3% on real basis). The Sector’s Contribution to GDP stands around 3% on average. Federal PSDP budget for FY22 was slashed to PKR~550bln from PKR~900bln originally budgeted, as Local and International Political and Economic Conditions worsened. In FY23 PKR~2,263bln was allocated for PSDP (PKR~800bln on Federal and PKR~1,463bln on Provincial Level). As of 8MFY23, ~50% of the federal allocated ~800bln got authorized/disbursed (8MFY22: ~43%). Industry margins are expected to shrink further, as End-Mar’23 prices of construction materials have jumped by ~38% YoY and labor wages have risen by ~19% YoY.

Relative Position Out of the 10,000+ firms registered with Pakistan Engineering Council as Constructors / Operators, only ~100 (1%), including HCS, hold the prestigious CA category (no limit) license which enables them to be on the pre-qualifying list of approved constructors. HCS holds a favorable position among its peers.

Revenues The major portion of entity’s current revenue mix comprises of construction contracts, mainly roads and buildings individually and topline is also supported by share from joint ventures. During FY23, the Company’s revenues growth of ~5.6%, clocked at PKR 5,868mln (FY22: PKR 5,557mln, FY21: PKR 3,033mln). The Company’s have nine projects with different joint ventures which amounts to PKR 31,544mln.

Margins During FY23, gross margins slightly increased and stood at 15.5% (FY22: 14.3%) irrespective of rising global prices of inputs such as steel, cement and crushing material as well as the PKR depreciation. As HCS holds a favorable position among its peers. Net profit margins represent minor decreased and stood at 3.9% compared with the corresponding period last year (FY22: 3.9%) due to higher tax paid in FY23 as compared to previous year.

Sustainability As at end June’23 HCSL have 30 projects in their pipeline out of which 9 completed 100%. In FY23, HCSL reported a revenue of PKR 5,868mln, improvement in revenue was primarily derived from a subset of their strong projects pipeline. Within this subset, 9 projects had already been successfully completed by the end of June’23, while the remaining 7 projects were in progress. This commendable financial performance was underscored by a profit of PKR 912mln.

Financial Risk

Working Capital For working capital needs, which is a function of inventory and receivables, HCS relies on both internal cash flows as well as short term borrowings (STB). During FY23, net working capital days decreased and stood at 153days (FY22: 178 days, FY21: 324 days). To fulfill the needs of working capital, the Company has availed short term funded credit facilities and nonfunded credit facilities.

Coverages During FY23, FCFOs stood at PKR 510mln (FY22: PKR 464mln, FY21: PKR 314mln). The coverage ratio [FCFO/Finance Cost] stood at 5.6x (FY22:4.6x). The debt amount is PKR 8mln in FY23 as compared to PKR 7mln in FY22. FCFO increased due to improvement in capital structure as short term borrwings decreased resulting decrease in finance cost.

Capitalization HCS has effectively managed its leveraged capital structure. Debt to Capital ratio stands at 4.4% at FY23 (FY22:6.2%) representing 96.7% of short-term borrowings. However, due to uncertainty of cash position due to its contracts’ nature, the Company has to rely heavily on bank guarantees. The leveraging of construction companies is usually minimal, since exposures are in the form of Letter of Guarantees – an Off Balance Sheet Exposure.

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Financial Summary
PKR mln

Habib Construction Services Limited	Jun-23	Jun-22	Jun-21	Jun-20
Infrastructure	12M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	3,163	3,336	2,524	2,630
2 Investments	750	607	358	146
3 Related Party Exposure	-	-	-	-
4 Current Assets	5,957	6,270	5,348	5,636
a Inventories	*433*	*389*	*211*	*113*
b Trade Receivables	*4,222*	*4,600*	*4,097*	*4,013*
5 Total Assets	9,869	10,212	8,231	8,411
6 Current Liabilities	4,086	4,554	3,884	3,978
a Trade Payables	*2,131*	*2,597*	*1,291*	*1,764*
7 Borrowings	246	340	263	376
8 Related Party Exposure	-	-	92	100
9 Non-Current Liabilities	180	180	29	29
10 Net Assets	5,357	5,138	3,962	3,929
11 Shareholders' Equity	5,357	5,139	3,962	3,929
B INCOME STATEMENT				
1 Sales	5,868	5,557	3,033	2,341
a Cost of Good Sold	*(4,955)*	*(4,762)*	*(2,423)*	*(2,504)*
2 Gross Profit	912	795	610	(163)
a Operating Expenses	(409)	(393)	(238)	(128)
3 Operating Profit	503	402	371	(292)
a Non Operating Income or (Expense)	*37*	*19*	*43*	*69*
4 Profit or (Loss) before Interest and Tax	540	422	414	(223)
a Total Finance Cost	*(90)*	*(101)*	*(86)*	*(131)*
b Taxation	*(233)*	*(105)*	*(173)*	*(164)*
6 Net Income Or (Loss)	217	216	155	(518)
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*510*	*464*	*314*	*(313)*
b Net Cash from Operating Activities before Working Capital Changes	*421*	*364*	*228*	*(443)*
c Changes in Working Capital	*(58)*	*(113)*	*278*	*611*
1 Net Cash provided by Operating Activities	363	250	506	168
2 Net Cash (Used in) or Available From Investing Activities	(221)	(321)	(214)	143
3 Net Cash (Used in) or Available From Financing Activities	(1)	(3)	(116)	-
4 Net Cash generated or (Used) during the period	141	(74)	175	311
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	5.6%	83.2%	29.6%	-32.8%
b Gross Profit Margin	15.5%	14.3%	20.1%	-7.0%
c Net Profit Margin	3.7%	3.9%	5.1%	-22.1%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	7.7%	6.3%	19.5%	12.8%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	4.1%	4.7%	3.9%	-12.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	300	305	508	569
b Net Working Capital (Average Days)	153	178	324	306
c Current Ratio (Current Assets / Current Liabilities)	1.5	1.4	1.4	1.4
3 Coverages				
a EBITDA / Finance Cost	9.9	8.1	13.9	-1.0
b FCFO / Finance Cost+CMLTB+Excess STB	5.6	4.2	5.7	-2.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.0	0.2	-0.1
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	4.4%	6.2%	6.2%	8.7%
b Interest or Markup Payable (Days)	34.5	23.9	50.1	16.7
c Entity Average Borrowing Rate	31.9%	31.5%	11.2%	30.1%

Credit Rating

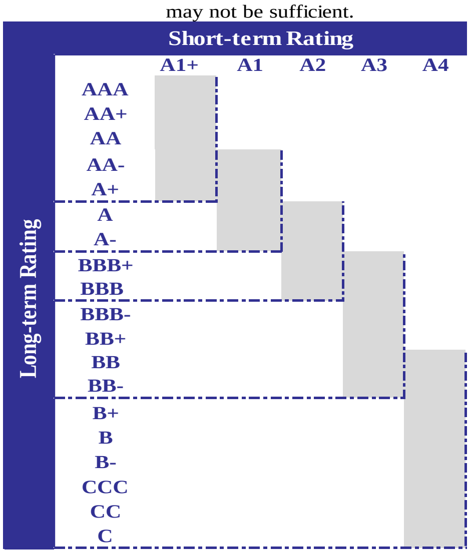
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information