The Pakistan Credit Rating Agency Limited

Rating Report

Habib Construction Services Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Jun-2018	A-	A2	Stable	Maintain	-
29-Dec-2017	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Habib Construction Services has delivered a number of infrastructure projects in the last couple of years and has built its repute as a "Fast Track" execution company. Lately the company has been engaged in one of the country's largest public sector transportation project - approaching completion. Over the years, Habib Construction Services has earned sizeable profits – contributing to its equity size. The majority shareholder is Mr. Shahid Saleem, while other executives and management members have remaining stake – furnishing fuel to the company’s growth. Construction business is dependent on award of public works (Federal & Provincial PSDP + CPEC). Habib Construction Services has a number of banking lines, predominantly non-funded, required for its construction business. With sustained cash flows, the financial risk profile is expected to remain adequate.

The ratings are dependent on sustaining a steady revenue stream and financial risk profile. 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 Methodology(Jul-17)
Related Research	Sector Study | Construction(Apr-18)
Rating Analysts	Muhammad Obaid | muhammad.obaid@pacra.com | +92-42-35869504 Jhangeer Hanif | jhangeer@pacra.com | +92-42-35869504

Habib Construction Services Limited (HCS) Profile	
Incorporated	2009
Major Business	Construction
Legal Status	Un-Listed
Head Office	Lahore

Ownership — Good

- HCS is registered as a public limited company with 29 shareholders. Five shareholders own 74.4% of the shares while the rest are held by the management team.
- Mr Shahid Saleem, CEO, with 51% ownership and one of the founding members of HCS, has over 30 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.

Governance — Adequate

- The overall control of the company vests in the seven-member board of directors. Five are executive directors, while one is an independent director and the other is a member of the sponsoring family.
- Although the presence of an independent director is important to ensure effective, transparent and independent oversight, the company would do better if it had its own internal audit function.
- The auditors of the company M/S Tariq Abdul Ghani Maqbool & Co. Chartered Accountants issued an unqualified audit opinion pertaining to annual financial statements for FY17.

Management

- HCS has a lean organizational structure with an experienced management team; a balanced mix of professionals from the construction industry.
- Mr. Shahid Saleem is the CEO and is assisted by a team of experienced professionals.
- Mr M. Azam Bhatti, Chairman of the Board, is a professional engineer and has 41 years of experience both in the Army as well as in the private sector. Mr Muhammad Shabir is a graduate in Quantity Surveying from UK and has worked in Quantity Surveying Consultancy in UK and upon returning to Pakistan has worked with NLC and NHA in various capacities. Mr Mohsin Hussnain is a fellow member of ICAP and IFPA. He has over 15 years of experience while serving in senior positions in renowned private sector companies. Ms Afia Suhail, holds a BSc in Civil Engineering and Masters in Environmental Design and has worked in senior positions in well-known consultancy's in Pakistan and abroad. General (retired) Ziauddin, independent director, is BSc Engineer from Military College of Engineering and has vast experience of large civil engineering projects. Ms Kainat Shahid, CEO's daughter, has a BSc Economics from LUMS and a Masters in Finance from University of Warwick.

Systems & Controls — Good

- HCS is currently using an ERP software customized for the construction industry from E-Tech.
- The software keeps track of receivables, payables, general ledger, accounts, etc. The payables module further bifurcates into GL based payables and un-invoiced payables, as unique to construction industry, materials are continuously arriving at project sites and at times even before a formal invoice is received by the company. To keep track of this movement in payables, this customization has been done so that management is always cognizant of its liabilities.
- The company's MIS generates quarterly reports for the Board. Whereas the project management module is used on a daily basis which keeps track of all the elements related to specific projects.

Performance — Good

- During 9MFY18, the top-line stood at PKR 9.7bln in comparison to prior years' revenues of PKR 17.9bln.
- During 9MFY18, though topline has declined a little, cost of sales has remained stagnant resulting in similar gross margins (9MFY18: 16.7%, FY17: 16.6%)
- With a static gross margin, but a considerably lower finance cost (9MFY18: 46mln, FY17: 91mln), however, resulted in growth of net profit margin for the period (9MFY18: 8.4%, FY17: 7.8%).
- HCS has some major projects in the pipeline starting in a few months' time. The entity is looking at contracts in excess of PKR 60 billion from infrastructure related construction projects in the next two years.

Financial Risk — Good

- Although net working capital days have increased a little, (9MFY18: 47 days, FY17: 31 days), they are still considerably good compared to the industry. Working capital requirements of the company increased primarily due to increase in trade payables.
- During 9MFY18, HCS STBs were reduced by PKR 8mln resulting in short-term total leverage of the company (room to borrow) increasing to 57% (FY17: 41%).
- During 9MFY18 HCS's operating cashflows (FCFO) stood at PKR 1.14bln (FY17: 1.70bln) due to lesser revenue so far, compared from last year.
- Due to a decrease in short term borrowing and lower borrowing expense, interest coverage ratio improved has improved (9MFY18: 24.7x, FY17: 18.7x). The company has not procured long term debt so far and has been funding the business through its equity, so going forward, if circumstances demand HCS has enough room to procure debt to further fuel its already robust growth.

Construction

The Pakistan Credit Rating Agency Limited

Financials (Summary)

PKR mln

Habib Construction Services Limited

BALANCE SHEET	31-Mar-18	30-Sep-17	30-Jun-17	30-Jun-16	30-Jun-15
	9MFY18	3MFY18	Annual	Annual	Annual
Non-Current Assets	**3,222**	**3,322**	**3,345**	**2,358**	**1,236**
Investments (Incl. Associates)	**175**	**7**	**7**	**-**	**24**
Equity	175	7	7	-	24
Debt Securities	-	-	-	-	-
Current Assets	**7,149**	**7,352**	**8,121**	**12,357**	**3,809**
Inventory	325	390	411	726	102
Trade Receivables	1,926	2,557	2,579	2,385	1,445
Others	4,898	4,405	5,131	9,246	2,262
Total Assets	**10,547**	**10,681**	**11,472**	**14,715**	**5,068**
Debt	**145**	**145**	**153**	**3,379**	**-**
Short-Term	145	145	153	3,379	-
Long-term (Incl. Current Maturity of Long-Term Debt)	-	-	-	-	-
Other Short-Term Liabilities	2,935	3,601	4,667	6,882	2,337
Other Long-Term Liabilities	16	16	16	12	9
Shareholder's Equity	**7,450**	**6,918**	**6,636**	**4,442**	**2,722**
Total Liabilities & Equity	**10,547**	**10,681**	**11,472**	**14,715**	**5,068**
INCOME STATEMENT					
Turnover	**9,692**	**3,288**	**17,935**	**19,729**	**10,102**
Gross Profit	1,616	552	2,976	3,386	1,550
Other Income	0	0	50	(11)	6
Financial Charges	(46)	(11)	(91)	(171)	(22)
Net Income	**814**	**282**	**1,391**	**1,507**	**728**
Cashflow Statement					
EBITDA	1,700	577	2,992	3,404	1,575
Free Cashflow from Operations (FCFO)	1,140	383	1,704	1,971	903
Net Cash changes in Working Capital	(602)	(208)	1,499	(4,842)	(750)
Net Cash from Operating Activities	492	164	3,112	(3,042)	132
Net Cash from InvestingActivities	(207)	(30)	(361)	(1,017)	(310)
Net Cash from Financing Activities	(7)	(7)	(3,379)	3,379	(200)
Net Cash Generated during the period	277	127	(627)	(680)	(378)
Ratio Analysis					
Performance					
Gross Margin	16.7%	16.8%	16.6%	17.2%	15.3%
Net Margin	8.4%	8.6%	7.8%	7.6%	7.2%
ROE	10.5%	3.9%	25.1%	42.1%	29.6%
Coverages					
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered S'	24.7	35.5	18.7	11.5	22.3
Interest Coverage (x) (FCFO/Gross Interest)	24.7	35.5	18.7	11.5	22.3
Debt Payback (Years) (Total Lt.Debt (excluding Covered Short Term Borrowings) / FCFO)	0.0	0.0	0.0	0.0	0.0
Liquidity					
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	47	83	31	21	27
Capital Structure (Total Debt/Total Debt+Equity)	2%	2%	2%	43%	0%

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**
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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

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(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
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(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.
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(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)
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(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)
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Rating Scale

Credit Rating Scale & Definitions

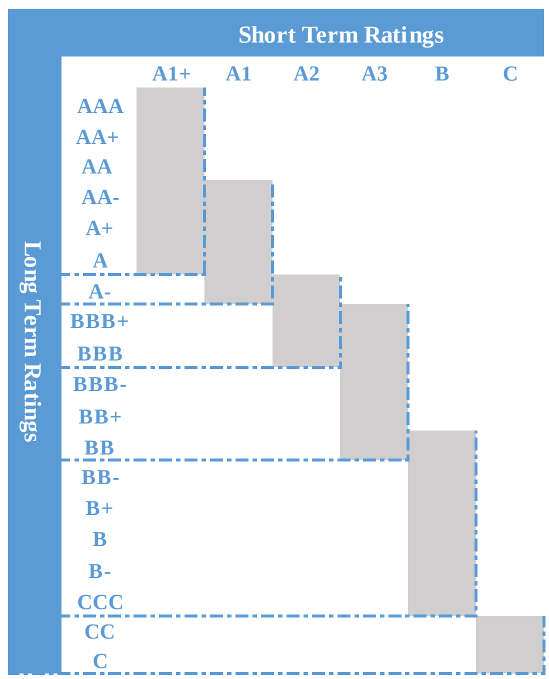
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

Rating	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 Ratings

Rating	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 conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) 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.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.