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
11-Oct-2024	BBB+	A2	Positive	Maintain	-
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

Rating Rationale and Key Rating Drivers

Habib Construction Services Limited “HCS or the Company” 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. The Company has a proven track record of successfully completing numerous public and government projects. HCS primarily focuses on large infrastructure projects, collaborating with various joint venture partners, including Chinese and Japanese firms, as well as local contractors. Recently, the Company has also shifted its focus toward multi-lateral financed and smaller-scale projects. As HCS operates on a tender-based income model, its revenue is closely tied to its ability to win bids. Consequently, working capital requirements fluctuate depending on ongoing projects, with performance guarantees being crucial. The financial health of the Company is dependent on project execution and timely completion. As per industry practice HCS relies significantly on non-funded banking lines and supplier credit for its operations, whereas the funded obligations remain minimal. The Company boasts a decent equity base, particularly in relation to its non-funded obligations. During FY24, the Company has secured a significant number of projects, few of them were completed and rest are underway, which will generate projected revenues over the coming years. The topline witnessed an extensive growth of ~220% and record a highest revenue since its inception which clocked at PKR 17.8bln (FY23: 5.56bln, FY22: 5.56bln). The positive outlook assigned for HCS reflects its enhanced financial and operational performance in FY24 and this upward trajectory is expected to persist, and translate the sustainable long-term growth, going forward. Regarding ongoing claims and disputes associated with the Lahore Orange Line Metro Train Project (Package-1), the Company is optimistic about the resolution of these claims, which could improve its liquidity.

The expansion of HCS's business is poised to enhance its future risk profile positively. However, HCS ratings remain vulnerable to the cyclical nature of the construction sector, particularly in light of political instability and a volatile economic environment. Timely project execution, along with the resolution of disputes related to the Orange Line Metro, will be crucial for improving the Company’s liquidity and ratings. Sustaining revenue growth while ensuring collection efficiency will also be essential for preserving its financial health. Additionally, any delays or stoppages in various projects related to Bahria Town could impact these ratings and remain a critical concern.

Disclosure

Name of Rated Entity	Habib Construction Services Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Rating Modifiers(Apr-24),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-24),Methodology | Corporate Rating(Jul-24)
Related Research	Sector Study | Construction(Apr-24)
Rating Analysts	Ali Arslan Malik | Ali.Arslan@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 approx. two decades, 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, Cavalry Ground underpass and 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 stake in an associated Company 'Malir Expressway Limited' and '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, 2023. Audit of FY24 currently is in process.

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 industry is grappling with several major challenges, including high import duties, rising taxes, and escalating prices for raw materials. Political and economic instability, coupled with tighter bank regulations and limited financial flexibility, has made it challenging for contractors to secure large bank guarantees, complicates the landscape further. A significant rise in interest rates, along with higher costs for oil, electricity, and coal, poses additional hurdles to the sector's growth. In 1HFY24, production figures for key materials showed modest gains, with cement at approximately -0.1%, glass plates and sheets at 3.5%, and steel products (both long and flat) at around 0.5% year-on-year. However, the construction sector itself experienced a decline of about 17.6% year-on-year during the same period.

Relative Position Out of the 10,000+ firms registered with Pakistan Engineering Council as Constructors / Operators, only ~156 (1.6%), including HCS, hold the prestigious CA category (no limit) license which enables them to be on the pre-qualifying list of approved constructors.

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 FY24, the Company experienced remarkable revenue growth of ~221%, reaching PKR 17,842mln, compared to PKR 5,562mln in FY23 and PKR 5,557mln in FY22. This growth is attributed to new projects awarded and executed during the period.

Margins The industry is highly fragmented, with numerous players competing for similar products and services. Given the challenging economic environment and highly competitive nature of the industry, the Company was able to improved gross margins at ~12% during FY24 (FY23: 7%, FY22: 14.3%) due to higher revenue contribution. PBIT margins also improved as compare to FY23 and stood at 9.2% from negative 1.4%. Additionally, net profit margins rose to 0.7%, a recovery from a negative 8.7% in the same period last year (FY22: 3.9%).

Sustainability As of the end of FY24, the Company managing 16 projects including two joint ventures. HCS is hopeful of recovery of claims & retention money, relating to projects approaching completion. New projects in pipeline stand to lift the topline as the Company eyes geographical diversity in its business stream.

Financial Risk

Working Capital For working capital needs, which depend on inventory and receivables, HCS utilizes both internal cash flows and short-term borrowings (STB). During FY24, the Company’s receivables rose slightly to PKR 1,875mln from PKR 1,716mln in FY23, while payables increased to PKR 2,269mln, compared to PKR 1,678mln in FY23. Despite these changes, net working capital days fell significantly, reflecting a substantial increase in revenue, now at just 6 days (FY23: 46 days, FY22: 130 days). STB reduced to PKR 133mln, down from PKR 224mln in FY23, due to improved cash flows.

Coverages During FY24, FCFOs stood at PKR 600mln (FY23: PKR (48)mln, FY22: PKR 464mln). Due to improved earnings and cashflows the coverages improved in current period. The coverage ratio [FCFO/Finance Cost] stood at 19.1x (FY23: (1.1)x). The Company recorded the positive growth in FCFOs backed by massive Profit before tax as well as decrease in short-term borrowings in the said period.

Capitalization The leveraging of the Company during FY24 stood at 4.7% (FY23: 11.9%, FY22: 15.5%). The leveraging of construction companies is usually minimal, since exposures are in the form of Letter of Guarantees – an Off Balance Sheet Exposure. Short term funding is an outcome of liquidity pressure but its quantum is insignificant against the equity base of PKR 5,777mln. The Company is mostly relying on short-term borrowings instead of long-term borrowings. During FY24, Short-term Borrowings/Total Borrowings stood at 96.4% (FY23: 97%).

The Pakistan Credit Rating Agency Limited

Financial Summary
PKR mln

Habib Construction Services Limited Infrastructure	Jun-24 12M	Jun-23 12M	Jun-22 12M	Jun-21 12M
A BALANCE SHEET				
1 Non-Current Assets	4,110	4,262	3,336	2,524
2 Investments	909	730	607	358
3 Related Party Exposure	192	133	117	-
4 Current Assets	6,113	5,501	6,154	5,348
a Inventories	*494*	*433*	*389*	*211*
b Trade Receivables	*1,683*	*1,716*	*2,297*	*4,097*
5 Total Assets	11,324	10,626	10,213	8,231
6 Current Liabilities	5,003	3,993	3,954	3,884
a Trade Payables	*2,269*	*1,678*	*1,746*	*1,291*
7 Borrowings	138	231	340	263
8 Related Party Exposure	145	529	600	92
9 Non-Current Liabilities	260	261	180	29
10 Net Assets	5,777	5,612	5,139	3,962
11 Shareholders' Equity	5,777	5,612	5,139	3,962
B INCOME STATEMENT				
1 Sales	17,842	5,562	5,557	3,033
a Cost of Good Sold	*(15,729)*	*(5,173)*	*(4,762)*	*(2,423)*
2 Gross Profit	2,113	390	795	610
a Operating Expenses	(490)	(492)	(393)	(238)
3 Operating Profit	1,623	(102)	402	371
a Non Operating Income or (Expense)	*23*	*24*	*19*	*43*
4 Profit or (Loss) before Interest and Tax	1,646	(78)	422	414
a Total Finance Cost	*(110)*	*(91)*	*(101)*	*(86)*
b Taxation	*(1,405)*	*(317)*	*(105)*	*(173)*
6 Net Income Or (Loss)	130	(486)	216	155
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*600*	*(48)*	*464*	*314*
b Net Cash from Operating Activities before Working Capital Changes	*490*	*(135)*	*364*	*228*
c Changes in Working Capital	*(179)*	*528*	*(113)*	*278*
1 Net Cash provided by Operating Activities	312	394	250	505
2 Net Cash (Used in) or Available From Investing Activities	(185)	(225)	(321)	(214)
3 Net Cash (Used in) or Available From Financing Activities	(3)	(4)	(3)	(116)
4 Net Cash generated or (Used) during the period	123	165	(74)	175
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	220.8%	0.1%	83.2%	29.6%
b Gross Profit Margin	11.8%	7.0%	14.3%	20.1%
c Net Profit Margin	0.7%	-8.7%	3.9%	5.1%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	2.4%	8.6%	6.3%	19.5%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	2.3%	-9.0%	4.7%	3.9%
2 Working Capital Management				
a Gross Working Capital (Average Days)	44	159	230	508
b Net Working Capital (Average Days)	4	46	130	324
c Current Ratio (Current Assets / Current Liabilities)	1.2	1.4	1.6	1.4
3 Coverages				
a EBITDA / Finance Cost	63.3	7.9	8.1	13.9
b FCFO / Finance Cost+CMLTB+Excess STB	18.0	-1.1	4.2	5.7
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.3	-6.0	1.7	0.2
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	4.7%	11.9%	15.5%	6.2%
b Interest or Markup Payable (Days)	83.9	73.4	23.9	50.1
c Entity Average Borrowing Rate	5.1%	6.5%	19.4%	11.2%

PACRA Entity Rating Scale

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.

Scale	Long-Term Rating
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.

Scale	Short-Term Rating
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.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.

Rating Modifiers | Rating Actions

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 surveil 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. Rating actions may include "maintain", "upgrade", or "downgrade".

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 Company

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 | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(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 | 17-(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 | 17-(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 | 14-3(f)(vii)
Proprietary Information
(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent