

## RATING (AUGUST 2011)

### STRUCTURED TFCs BY CITY SCHOOLS (PRIVATE) LIMITED (CSPL)

PRELIMINARY RATINGS	NEW	PREVIOUS
TFCs		
PKR 1,150mln	A+	A+
<i>Secured, privately placed</i>		

## FINANCIAL DATA

### (PAKGEN POWER LIMITED AND LALPIR POWER LIMITED - COMBINED)

PKR (mln)

	Jun-11*	Dec-10
Total Assets	40,369	36,812
Revenue	28,173	38,474
Net Income	2,198	3,046
EBITDA	3,190	4,770
Dividend Payout	401	1,634

\* Based on unaudited accounts for the 6 months

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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 independent power producer - 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 continuing tough socio-economic environment beset particularly with circular debt in energy chain, adding uncertainty to timeliness of cashflows to IPPs.
- 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, through a Special Purpose Vehicle - Engen (Pvt.) Limited - fully owned by the sponsors of City Schools and created for this purpose, acquired 20% stake in Pakgen Power Limited (formerly AES Pak Gen (Pvt.) Company Limited) and Lalpir Power Limited (formerly AES Lal Pir (Pvt.) Limited) for a consideration of PKR 2,000mln.
- The sponsoring family, to finance this acquisition, has acquired a loan of PKR 1,150mln from Faysal Bank Limited at the rate of 6 month Kibor plus 225bps payable semi-annually. The loan was raised at the balance sheet of City Schools. The loan proceeds were lent with the same cost and repayment schedule onwards to Engen (Pvt.) Limited. The rest of the amount (PKR 850mln) was raised through the group's internal resources comprising short term loans from directors and City Schools and a long term loan from City Schools Employee Provident Fund Trust. The Director's loan is interest free while the latter bear competitive interest rates.
- The bank loan, disbursed in May 2010, is for a tenor of five years including grace period of 12 months (on principal only). The principal would be repaid in 9 un-equal, consecutive semi-annual installments, beginning May-11. The instrument has a call option after 12 months of the Facility Effective Date (28th May 2010). City Schools and Faysal Bank have agreed to convert the loan into an instrument (privately placed term finance certificates) with no change in the terms and conditions except for a slight downward revision (~15bps) in the spread. The process of issuance of TFCs is at an advanced stage, to be finalized shortly.
- The underlying source of repayments of the TFCs is 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 have been 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 Engen. Engen cannot distribute any surplus accruing to it 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. 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. 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 (current structure is 24:76 at end-Mar11) and the school is restricted on paying cash dividend in case coverage is not met. Meanwhile, maximum gearing ratio of Engen would be 80:20. Herein, the interest free loan from directors would be treated as quasi equity for calculating gearing.

## 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. Both IPPs, with combined capacity of approximately 700MW, have been operative for about 14 years now. Their profitability suffered during 2010 on account of floods in the country and has normalized during 1H2011. Moreover, IPPs' capacity to manage ongoing circular debt issue is stronger given their almost deleveraged capital structure.
- During 2010, Pakgen paid a dividend of PKR 1,375 approximately 90% of profits for the year. However, the dividend payout for Lalpir was 17%. Subsequently, both companies have paid dividend PKR 1/share during 1H2011. In cognizance of low dividend payout, the board is proposing a dividend of PKR 4/share for Pakgen and PKR 5/share for Lalpir, which would compensate for the low dividend payout to date.
- To date, Engen has paid two installment of interest (PKR 83mln and PKR 88mln) and one principal installment of PKR 36mln. The next repayment (principal - PKR 72mln + interest ~PKR 90mln) would fall in Nov-11, for which current dividend payout would more than suffice.
- Lately shareholders of Pakgen have offloaded 10% of their stake in Pakgen at a premium of PKR 9/share. Engen has utilized the ensuing proceeds in retiring its short term borrowings.