# RATING REPORT

## Shaheen Air International (SAI)

**REPORT DATE:**
September 26, 2016

**RATING ANALYSTS:**
Talha Iqbal
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**RATING DETAILS**

| | Initial Rating | |
|---|---|---|
| **Rating Category** | **Long-term** | **Short-term** |
| **Entity** | A- | A-2 |
| ***Rating Date*** | *Sep 23, '16* | |
| **Rating Outlook** | Stable | |
| ***Outlook Date*** | *Sep 23, '16* | |

**COMPANY INFORMATION**

| | |
|---|---|
| **Incorporated in 1991** | **External auditors:** KPMG Taseer Hadi& Co. |
| **Public Limited Company** | **Chairman of the Board:** Mr. Kashif Mahmud Sehbai |
| **Key Shareholders:**<br>- Mr. Ehsan Khalid Sehbai – 99% | **Chief Executive Officer:** Mr. Ehsan Khalid Sehbai |

**APPLICABLE METHODOLOGY(IES)**

**JCR-VIS Entity Rating Criteria** ***Industrial Corporates (October 2003)***
*http://www.jcrvis.com.pk/images/IndustrialCorp.pdf*

# Shaheen Air International (SAI)

## OVERVIEW OF THE INSTITUTION

Shaheen Air International (SAI) is a public limited company incorporated in March 1991 in Pakistan under the Companies Ordinance, 1984. The company provides air transport (both passenger and cargo) services as a scheduled airline. The financial statements for FY15 were audited by KPMG Taseer Hadi & Company.

The management team of the company is spearheaded by Mr. Ehsan Khalid Sehbai who became the CEO in 2013. Subsequently, there have been a number of changes in management personnel which has improved the profile of the senior management team. The operational infrastructure will be tested further as the company's expansion plans materialize.

## RATING RATIONALE

Overall passenger traffic in Pakistan has grown at a CAGR of 5.3% over the last five years with air travel reaching 15.1m during FY15. As per independent estimates, air traffic in Pakistan is projected to witness healthy growth which supports the prospects of growing revenues for airliners. The aviation sector is characterized by soft barriers to entry (availability of lease financing), vulnerability to economic downturns and high adjusted leverage & cost structure (fixed, variable and regulatory costs). Given these inherent characteristics, the airline industry is generally considered to pose high business risk. The recently introduced national aviation policy has introduced a number of financial and operational requirements (fleet age, flight punctuality & regularity) which may pose a challenge for existing operators.

The assigned ratings reflect SAI growing market share, improving financial risk profile and favorable growth prospects. Sustained improvement in competitive positioning vis-à-vis peers in local and international operations and consolidation in financial profile will be considered credit positive. SAI's marketing strategy as a budget airline and increasing point to point flights gives it wider access to customer base locally and internationally. This strategy would need to be monitored closely with the increasing regional competition in airline business, going forward.

SAI is the second largest domestic airline in the country having a market share of 27% (FY14: 24%) and 11.9% (FY14: 12.4%) in domestic and international passenger traffic, respectively. In terms of domestic passengers, market share has grown significantly over the last five years. Overall market share for FY15 increased to 15%. Moreover, 2016 will be the sixth consecutive year of hajj operations for SAI with the company receiving the 2nd highest quota after Pakistan International Airlines.

SAI had a fleet of 24 aircrafts as at end-July'16 (June'15: 18; June'14: 14). The fleet includes 9 B737-400s, 7 A330s and 8 A-320s. Most of the new additions in the fleet were in the latter half of 2016 and included A 330s and A-320s. SAI has consolidated its previous expansion in fleet and is on course for another expansion; 1,304 aircraft seats have been added in the last 6 months and 1,092 more seats will be added in the next year. Seven new A319s are planned to be inducted during FY17 and FY18 (5 in FY17 and 2 in FY18). A319s can travel longer distances due to higher fuel capacity and are also expected to support cargo revenues. Average fleet age of the company is on the higher side and compares less favorably with other major local industry players. With gradual phasing out of B737-400 from the fleet, as required by the aviation policy, fleet age is expected to reduce, going forward. The entire fleet is projected to comprise of Airbus aircrafts. Given the increase in fleet size, a number of new domestic and international routes are planned to be introduced.

Revenues of SAI depicted modest growth during FY15 and have declined in 9MFY16 vis-à-vis 9MFY15 on account of non-availability of aircrafts as they were undergoing C Checks and lower average yields. With increase in fleet size during latter half of FY16 and induction of new aircrafts during FY17, revenues are expected to showcase an uptick during FY17. In the backdrop of decline in fuel prices and induction of aircrafts with lower fleet age, fuel cost as a proportion of cost of sales has declined from 46% in FY14 to 27% in 9M16. However, impact on gross margins was limited on account of lower yields, investment in new routes and significant increase in maintenance and lease charges.

Liquidity profile of the company is considered adequate in view of healthy cash flows in relation to outstanding obligations, matching working capital cycle and liquid assets carried on the balance sheet. Trade debts (receivables) were lower in absolute terms and comprise dues from travel agents, with majority of the same secured against guarantees and post-dated cheques, etc. Given the improvement in cash flows and corresponding decline in debt levels, FFO to total debt has markedly increased. Debt servicing coverage has improved and is expected to stay strong.

Shareholder's equity increased to Rs. 3.8b (FY15: Rs. 2.7b; FY14: Rs. 1.7b) at end-9MFY16 on account of healthy internal capital generation. With growth in equity and repayment of debt, gearing and leverage indicators have witnessed a significant decline on a timeline basis. Debt carried on balance sheet is entirely short-term in nature and comprises running finance facilities. The management does not foresee the need to mobilize long-term financing for funding future growth as internal cash generation is expected to remain healthy.

## Shaheen Air International (SAI) — Appendix I

### FINANCIAL SUMMARY *(amounts in PKR millions)*

| BALANCE SHEET | March 31, 2016 | June 30, 2015 | June 30, 2014 |
|---|---|---|---|
| Fixed Assets | 1,318 | 1,336 | 1,401 |
| Investments | 641 | 20 | 20 |
| Trade Debts | 1,075 | 1,029 | 1,499 |
| Cash & Bank Balances | 1,191 | 1,915 | 1,434 |
| Total Assets | 10,472 | 10,073 | 10,895 |
| Trade and Other Payables | 4,316 | 4,792 | 4,709 |
| Long Term Debt | - | - | 127 |
| Short Term Debt | 500 | 832 | 1,566 |
| Total Equity | 3,785 | 2,740 | 1,716 |
| | | | |
| **INCOME STATEMENT** | **March 31, 2016** | **June 30, 2015** | **June 30, 2014** |
| Net Sales | 24,192 | 34,096 | 32,769 |
| Gross Profit | 2,984 | 3,190 | 3,852 |
| Operating Profit | 1,641 | 1,777 | 2,563 |
| Profit After Tax | 1,044 | 1,024 | 1,302 |
| | | | |
| **RATIO ANALYSIS*** | **March 31, 2016** | **June 30, 2015** | **June 30, 2014** |
| Gross Margin (%) | 12.3% | 9.4% | 11.5% |
| Net Working Capital | 1,662 | 1,157 | 427 |
| FFO to Total Debt (x) | 2.42x | 0.75x | 1.24x |
| FFO to Long Term Debt (x) | - | - | 16.5x |
| Debt Servicing Coverage Ratio (x) | 42.1x | 5.9x | 6.0x |
| ROAA (%) | 16.9% | 9.8% | 13.5% |
| ROAE (%) | 45.9% | 37.4% | 64.3% |

**Annualized figures have been used where applicable*

## ISSUE/ISSUER RATING SCALE & DEFINITIONS  Appendix II

**Medium to Long-Term**

**AAA**
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

**AA+, AA, AA-**
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

**A+, A, A-**
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

**BBB+, BBB, BBB-**
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

**BB+, BB, BB-**
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

**B+, B, B-**
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

**CCC**
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

**CC**
A high default risk

**C**
A very high default risk

**D**
Defaulted obligations

**Short-Term**

**A-1+**
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

**A-1**
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

**A-2**
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

**A-3**
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

**B**
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

**C**
Capacity for timely payment of obligations is doubtful.

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**Rating Watch:** JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

**Rating Outlooks:** The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

**(SO) Rating:** A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

**'p' Rating:** A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

**'SD' Rating:** An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

| REGULATORY DISCLOSURES | Appendix III |
|---|---|
| **Name of Rated Entity** | Shaheen Air International |
| **Sector** | Air Transport |
| **Type of Relationship** | Solicited |
| **Purpose of Rating** | Entity Rating |
| **Rating History** | <table><tr><th>Rating Date</th><th>Medium to Long Term</th><th>Short Term</th><th>Rating Outlook</th><th>Rating Action</th></tr><tr><td colspan="5">RATING TYPE: ENTITY</td></tr><tr><td>23/09/201</td><td>A-</td><td>A-2</td><td>Stable</td><td>Initial</td></tr></table> |
| **Instrument Structure** | N/A |
| **Statement by the Rating Team** | JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities. |
| **Probability of Default** | JCR-VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default. |
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