

RATING REPORT

Shaheen Air International (SAI)

REPORT DATE:

March 2, 2018

RATING ANALYSTS:

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| RATING DETAILS | | |
|-----------------|---------------|-------------------|
| Rating Category | Latest Rating | Previous Rating |
| Entity | A-/A-2 | A-/A-2 |
| Rating Date | March 1, 2018 | September 23, '16 |
| Rating Outlook | Negative | Stable |
| Outlook Date | March 1, 2018 | September 23, '16 |

COMPANY INFORMATION

| | |
|---|--|
| Incorporated in 1991 | External auditors: KPMG Taseer Hadi& Co. |
| Public Unlisted Company | Chairman of the Board: Mr. Kashif Mahmud Sehbai |
| Key Shareholders: - Mr. Ehsan Khalid Sehbai – 99.99% | Chief Executive Officer: Mr. Ehsan Khalid Sehbai |

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016)

<http://www.jcrvis.com.pk/kc-meth.aspx>

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 FY17 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.

His contribution to the company revolves around strategic fleet management through purchase of modernized aircrafts replacing outdated ones coupled with reinvigoration of SAI's technological infrastructure.

RATING RATIONALE

Aviation Sector

Global Airline Business Confidence Index (January'2018) reveal a positive outlook for air travel supported by healthy demand growth on both freight and passenger traffic. IATA forecasts global air passengers to register a 20-yr CAGR of 3.8% per annum, and intra Pakistan air traffic to grow at a CAGR of 9.9% over the next 20 years. Total passenger traffic (domestic and international) in Pakistan has grown at a CAGR of 7% over the past five years with number of passengers reported at 18m during FY17 (FY12: 12.6m). Growth in international passenger traffic with a CAGR of 9% over the last five years has outpaced domestic passenger traffic with a CAGR of 2%.

JCR-VIS's assessment of the aviation sector in Pakistan is characterized by low barriers to entry (lease financing), vulnerability to economic downturns, increasing regulatory requirements and high leverage and cost structure posing high business risk. In the backdrop of expected new entrants over the next 18 months and rising fuel prices, competitive pressures are expected to intensify going forward.

Market Position

SAI is the second largest domestic airline in Pakistan having a market share of 16% (FY16: 24%) and 11% (FY16: 9%) in domestic and international passenger traffic, respectively during FY17. While market share has witnessed recovery in FY17 in international passenger traffic, market share in domestic passenger traffic has witnessed a significant decline over the last two years. This is partly attributable to greater focus towards international routes where margins tend to be higher. The Government of Kingdom of Saudi Arabia (KSA) allocated a hajj quota of 179,210 pilgrims (2016: 143,368) to Pakistan during 2017 whereby SAI's share increased to 27% (2016: 23%) catering to 48,495 (2016: 32,981) passengers. Hajj sales contributed around one-tenth of the company's total revenue during FY17. The management plans to further increase their market share in hajj operations, going forward.

Fleet Composition and Operational Highlights

SAI had a fleet of 17 aircrafts at end June'2017 (June'2016: 18, June'2015:18) which includes 8 A320s, 4 A330s and 5 A319s. The company's fleet management strategy during FY17 primarily involved reduction in fleet age. 5 A319s with relatively lower fleet age were inducted in the fleet while Boeing aircrafts are planned to be scrapped and sold. Resultantly, average fleet age reduced from 17.75 years to 13.1 years. The entire fleet now comprises Airbus aircrafts which is forecasted to result in operational and maintenance cost efficiencies. However, despite improvement in fleet profile, the firm's operating performance did not show significant improvement on the back of the following factors:

- Lower occupancy leading to losses on the Islamabad to Manchester route launched by the company owing to significant price competition from PIA. Given the sizeable losses incurred on the route, the company has ceased to operate on the route.
- During the outgoing year, SAI lost significant passenger traffic due to imposition of additional fee of 2,000 SAR on Umrah pilgrims (who perform Umrah more than once in three years) by the Government of KSA. However, traffic has normalized on the route post revision in this policy (now additional fee is collected only from passengers who do Umrah twice in one Islamic year).
- With induction of new aircrafts, the company applied for permission to increase frequency on existing routes. Delay in permission from regulator led to a dip in utilization levels and surge in fixed costs (on-ground and lease charges). Permission for operating on new routes was received on 16th November'2017.

At end FY17, SAI operated to 20 destinations (FY16: 23) comprising 9 domestic and 11

international routes. Going forward, route selection strategy of the company entails diversification to new routes to reduce reliance on existing routes where there is sizeable concentration in revenues.

Sales and Profitability

Sales revenue of the company reported an increase of 5% during FY17 clocking at Rs. 33.5b (FY16: Rs. 32b). Share of passenger revenue from international operations increased to 90% (FY16: 87%) during FY17 which shall continue to remain a key focus area for the management. In terms of geographical break-up of revenues, over four-fifth of total revenues emanate from KSA and UAE. While revenues showcased an upward trend, gross profitability significantly declined owing to rising fuel prices, higher employee related cost and maintenance checks. In the backdrop of lower margins and operational issues mentioned above, the company reported loss after tax during FY17. Quantum of losses have reduced during the first half of FY18, and based on profitability trend over the last quarter management expects to post profits for full year FY18 due to projected increase in utilization levels post approval of regulator to increase frequency of flights on existing routes.

Liquidity and Capitalization

Liquidity indicators of the company have weakened in relation to outstanding obligations due to operating losses in FY17. Increase in trade and other payables due to Civil Aviation Authority and lessors and significant increase in short term borrowings have weakened SAI's current ratio to 0.84x (FY16: 1.25x) at end-FY17. Short-term borrowing utilization stood at Rs. 1.4b (FY16: Rs. 529m) at end-FY17. With improvement in cash flows, trade and other payables have witnessed significant decline at end-December'2017. Shareholder's equity declined to Rs. 2.2b at end FY17 owing to loss incurred. With decline in equity base and increase in debt levels, gearing and leverage indicators have trended upwards to 0.99x (FY16: 0.16x) and 4.74x (FY16: 1.83x), respectively at end-FY17. Strengthening of capitalization indicators to bring them in line with benchmarks for the assigned ratings is considered important.

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix I

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

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

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.

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.

JCR-VIS Credit Rating Company Limited

Technical Partner – IIRA, Bahrain | JV Partner – CRISL, Bangladesh

| REGULATORY DISCLOSURES | | Appendix II | | | |
|-------------------------------------|---|----------------------------|-------------------|-----------------------|----------------------|
| Name of Rated Entity | Shaheen Air International | | | | |
| Sector | Air Transport | | | | |
| Type of Relationship | Solicited | | | | |
| Purpose of Rating | Entity Rating | | | | |
| Rating History | Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
| | RATING TYPE: ENTITY | | | | |
| | 01/03/2018 | A- | A-2 | Negative | Maintain |
| | 23/09/2016 | A- | A-2 | Stable | Initial |
| 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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