The Pakistan Credit Rating Agency Limited

MOTORWAY OPERATIONS & REHABILITATION ENGINEERING (PVT.) LIMITED (MORE)

RATING REPORT

	INITIAL [MAR-17]
Long Term	AA-
Short Term	A1
Outlook	Stable
Action	Initial

MARCH 2017

Profile & Ownership

- MORE – a wholly owned subsidiary of FWO – was incorporated on April 11, 2014 as a Special Purpose Vehicle for overlay and modernization of Lahore-Islamabad Motorway (M2)-357kms.
- Signed a 20 year 'Concession Agreement' with NHA on Build-Operate-Transfer (BOT) arrangement.

Governance & Management

- Experienced six members BoD mainly comprising serving Army Officers, and is headed by Lieutenant General Muhammad Afzal (Hilal-I-Imtiaz, Military) - CEO of MORE and DG FWO.
- COO is the key person involved in management and operational aspects of project, and is supported by experienced and able management team.

The Project

- The project has entered Operation Phase (comprising ~18 years); construction has been completed ahead of planned time on August 26, 2016.
- Modernization aspect of the project includes landscaping, tree plantation, improvement of toll collection system and emergency call system.
- Two major overlays during operation phase (Year 2025-26 & Year 2033-34).

Project Risk

- EPC contractor - FWO - carries extensive relevant experience along with modern construction equipment and machinery. Hence, construction phase was completed ahead of planned time.
- Experienced Quality Assurance Inspector was hired to monitor the works and adherence to International Roughness Index (IRI) Parameters. On construction completion date, IRI of all sample patches met the required level
- FWO is responsible for O&M, having sound relevant experience

Business Risk

- Revenue stream comprises i) toll, ii) service area revenues, and iii) other revenue
- Revenues are sensitive to traffic volume and toll rates. MORE carries only traffic volume risk as NHA will provide subsidy in case of non-escalation (10% annual for major tenure of concession period) of toll rates.
- M-2 operations transferred to MORE books in Dec-14.
- During FY16, company reported revenue of PKR 4bln, wherein traffic volume increased by ~17% YoY, however tolling rates remained same.
- Gross margins improved to 48% (2HFY15: 45%), on account of lower costs incurred
- In 1QFY17, performance improved significantly due to twofold effects; continued traffic growth (25%) and revision up of tolling rates (14%) upon CoD in line with agreed terms; operating margins jumped to 70%

Financial Risk

- Overall estimated cost of project is PKR 36.8bln – including upfront payment of PKR 9.5bln to NHA; 70% financed through debt
- Moreover, MORE shall be paying remaining cost of PKLR 9.5bln in five equal installments starting from year 2018
- Security structure is superior due to arrangement of three special purpose accounts, i) Collection Account, ii) Financing Payment Account, and iii) Financing Service Reserve Account; ensuring timely accumulation of cash flows to service debt; in case of shortfall FWO may make payments
- NHA will receive payments during currency of agreement – staggered (PKR 9,500mln – Years 2018-22), and revenue share (42% - Years 2025-34).
- With increase in company's profitability, debt service coverage strengthened (1QFY17: 1.4x, FY16: 0.7x).
- As the project is mainly debt driven, debt-to-equity ratio was 72% at end-Sep16. However, profit retention has augmented the equity base, which is a positive sign. Going forward, the debt levels are not expected to rise.

RATING RATIONALE

MORE - a wholly owned subsidiary of Frontier Works Organization (FWO) - is specifically established for overlay and modernization of Lahore-Islamabad Motorway (M-2). The project is assigned by National Highway Authority on a Build-Operate-Transfer (BOT) basis for 20 years (beginning Apr14). The construction phase comprised initial two years encompassing overlay and major rehabilitation work. Benefitting from the technical expertise of FWO, the company has successfully achieved construction completion in Aug-16, ahead of projected timeline. O&M contract is also outsourced to FWO, having successful track record. This along with independent quality control mechanism vetted by Joint Auditor and Quality Assurance Inspector are positives. The ratings recognize i) strong revenues, since CoD, mainly emanating from robust traffic volume ii) toll revenues subject to annual rate increase guaranteed by NHA, and, iii) good build-up of revenues from ancillary services. Financial risk is expected to be adequately managed with net cumulative cashflows providing good debt service coverage. Although there is no explicit commitment; FWO having strong financial muscle, is likely to provide support in case need arises. Additionally, debt repayments are ensured through gradual buildup of reserves.

KEY RATING DRIVER

The ratings are dependent on the realization of projected cash flows. Meanwhile, any material reduction in traffic volumes thereby impacting overall revenues, and related cashflows will have negative rating implication.

INDUSTRY

Pakistan, strategically located in the region, is equipped with a road network of 263,356km – majorly Punjab (41%). Tolling collection is a significant revenue generating avenue, through 39 National Highways, Motorways, expressways and strategic Roads, covering 12,131km. Taking note of rising transportation needs amidst CPEC related requirements, GoP have been working on an influx of 61 new projects of tolling roads rehabilitation and modernization costing PKR 11.6trillion. A sophisticated mechanism of Public Private Partnership (PPP) or BOT is used, whereby an SPV takes care of each projects.

PKR mln

MORE

BALANCE SHEET	30-Jun-16 Annual	30-Jun-15 Annual
Non-Current Assets	**43,150**	**24,342**
Investments (Incl. associates)	**1,053**	**319**
Equity	-	-
Debt	1,053	319
Investment property	-	-
Current Assets	**358**	**348**
Inventory	-	-
Trade Receivables	190	168
Others	168	180
Total Assets	**44,560**	**25,009**
Debt	**30,682**	**18,230**
Short-term	-	-
Long-term (Inlc. Current Maturity of long-term debt)	30,682	18,230
Other short term liabilities	2,919	1,300
Other Long term Liabilities	134	96
Shareholder's Equity	**10,826**	**5,383**
Total Liabilities & Equity	**44,560**	**25,009**
INCOME STATEMENT		
Turnover	**4,350**	**2,158**
Gross Profit	2,087	964
Net Other Income	73	55
Financial Charges	(1,411)	(873)
Net Income	**167**	**69**
Cashflow Statement		
Free Cashflow from Operations (FCFO)	2,290	1,242
Net Cash changes in Working Capital	1,288	1,259
Net Cash from Operating Activities	783	688
Net Cash from InvestingActivities	(18,979)	(19,348)
Net Cash from Financing Activities	17,642	17,719
Ratio Analysis		
Performance		
Gross Margin	48.0%	44.7%
Net Margin	3.8%	3.2%
ROE	2.0%	0.9%
Coverages		
Interest Coverage (FCFO/Gross Interest)	1.8	1.9
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	0.7	1.3
FCFO Dividend adjusted/Gross Interest+CMLTD+Uncovered Short Term Borrowings	0.7	1.4
Compliance with Debt Covenants	1.0	1.0
Liquidity		
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	-72.7	-61.1
Capital Structure (Total Debt/Total Debt+Equity)	74.0%	77.3%

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

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

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

Rated Entity

Name of Rated Entity Motorway Operations & Rehabilitation Engineering (Pvt.) Limited
Sector Road Infrastructure
Type of Relationship Solicited

Purpose of the Rating: Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook
29-Mar-17	AA-	A1	Stable

Related Criteria and Research

Methodology: Corporate Rating Methodology

Rating Analysts

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Rating Team Statement

Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

Disclaimer

PACRA maintains principle of integrity in seeking rating business.
PACRA has used due care in preparation of this document. Our information has been obtained directly from the underlying entity and public sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information.

Conflict of Interest

PACRA, 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 done by them.
The analysts involved in the rating process do not have any interest in a credit rating or any of its family members has any such interest.
The analysts and members of the rating committees including the external member members have disclosed all the conflict of interest, including those of their family members, if any, to the Compliance Office PACRA.
The analysts or any of its family members do not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This is, however, not applicable on investment in securities through collective investment schemes. PACRA has established appropriate policies governing investments and trading in securities by its employees
PACRA may provide consultancy/advisory services or other services to any of its clients or to any of its clients' associated companies and associated undertakings that is being rated or has been rated by it. In such cases, PACRA has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities.
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 ii) fee mandate - signed with the payer, which can be different from the entity.
PACRA ensures that the credit rating assigned to an entity or instrument should 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

Surveillance

PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer.
PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so.
PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating.

Reporting of Misconduct

PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality

PACRA has framed a confidentiality policy to prevent; abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties
Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter;

Prohibition

Probability of Default (PD)

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.