The Pakistan Credit Rating Agency Limited

Rating Report

Motorway Operations and Rehabilitation Engineering (Private) Limited(MORE)

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Dec-2018	AA-	A1	Stable	Maintain	-
01-Jun-2018	AA-	A1	Stable	Maintain	-
29-Mar-2017	AA-	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

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 Apr-14). The construction phase comprised initial two years encompassing overlay and major rehabilitation work which was completed ahead of projected timeline in Aug-16. The business profile of the company is expected to remain strong due to 1) strong revenues emanating from robust traffic volume, 2) toll revenues subject to annual rate increase guaranteed by NHA, 3) income from ancillary services. The financial risk profile is expected to be managed with net cumulative cashflows providing good service coverages. The repayment of debt is comfortably being financed through cashflows emanating from business. The ratings recognize and incorporates strong financial muscle of sponsor.

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

Disclosure

Name of Rated Entity	Motorway Operations and Rehabilitation Engineering (Private) Limited(MORE)
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-18),Methodology | Criteria | Rating Modifier(Jun-18),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study | Road Infrastructure | Tolling(Jun-18)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Legal Structure Motorway Operations and Rehabilitation Engineering (Private) Limited (MORE) was incorporated on April 11, 2014 as a Special Purpose Vehicle (SPV).

Background The company has been established with the sole purpose of overlay and modernization of the Lahore-Islamabad Motorway (M-2).

Operations MORE signed a Concession Agreement on April 23, 2014 with National Highway Authority, an autonomous body under Ministry of Communication in Government of Pakistan, under a Build-Operate-Transfer (BOT) arrangement for a period of 20 years.

Ownership

Ownership Structure MORE is a wholly owned subsidiary of Frontier Works Organization (FWO). FWO – the parent organization – is the administrative (non-combatant) branch of Pakistan Army that comprises both military and civil personnel.

Stability The company's ownership structure – being wholly owned subsidiary of FWO – is not expected to change in future.

Business Acumen The business acumen of parent company is considered strong as it has successful track record of several projects which range from construction and development of railway lines and airfields to dams, bridges and highways, residential and industrial infrastructure.

Financial Strength The financial muscle of the parent company is very strong.

Governance

Board Structure MORE's Board of Directors consists of six FWO nominated members; four serving and one retired Army officer and one civilian – an engineer.

Members' Profile All board members are senior executives of FWO. The Commander FWO – Lieutenant General Muhammad Afzal (Hilal-I-Imtiaz, Military) – also designated as Chairman MORE, supervises all FWO projects. The CEO, Maj General Saeed Akhtar, reports to the Chairman MORE, Commander FWO.

Board Effectiveness Army officers are from engineering corp. of Pakistan Army having extensive technical expertise, which bodes well for the overall governance framework.

Financial Transparency M/s. EY Ford Rhodes, Chartered Accountants are appointed as the external auditor of the company. The auditors have expressed unqualified opinion on MORE's financial statements for the year ended June 30, 2018.

Management

Organizational Structure MORE has a lean organizational structure. Overall operations have been divided into three main departments, a) Finance, b) Legal, and c) Business Development. The head of each department reports to the COO.

Management Team The CEO of MORE, Major General Saeed Akhtar has extensive experience in construction projects. He is supported by a team of qualified individuals. Brig. Shamim Akram (Retd.) is the key person involved in the management and operational aspects of the project. Mr. Shaikh M. Khurshid Alam has been appointed as Chief Financial Officer in Jan-17.

Effectiveness The management is equipped with strong technical skills and majority has been associated since the inception of the company.

MIS The project primarily envisages Rehabilitation and Modernization of the Lahore-Islamabad Motorway (M-2), having a total length of 357 kilometers. The starting point of the project is M-2 Thokar Niaz Baig Interchange, and the end point is junction of M-1 & M-2 link road and National Highway (N-5). The concession area (357km) encompasses start and end points of the project including Motorway Service Areas. The concessionaire (MORE) has established toll plazas at the entry/exit points of M-1 and M-3 (constructed and operational). The construction of ancillary facilities under the project which includes building of restaurants/resorts, fuel stations, warehouses, and other commercial facilities are majorly completed.

Control Environment The Project, covered by 'concession agreement' signed between MORE and NHA, encompasses three distinct periods; i) Initial phase – till financial close, ii) Construction phase – till completion of planned construction work, and iii) Operation phase – commencing from the COD (post construction) till end of concession period, i.e., transfer to NHA. Operation phase also includes two distinct overlays of M-2 in the years 2025-26 and 2033-34.

Business Risk

Industry Dynamics Lately established tolling industry has been witnessing significant development as the construction on several projects throughout the country is underway at a faster pace. Going forward, traffic volume is expected to rise with the materialization of CPEC projects and Gwadar port.

Relative Position Out of the present and future network of motorways, expressways and highways, M-2 is one vital road as it connects two major cities of the country. Furthermore, materialisation of CPEC projects has further added to its importance as it connects Punjab province with KPK through the capital city.

Revenues The project's revenue stream is based on i) toll collection, and ii) Service Area revenues (MSA). During FY18, the revenue mix remained tilted towards toll collection 90% (FY17: toll: 91~% and MSA ~9). Since the inception, topline has been following growth trajectory. During FY18, revenue surged to PKR 8.9bln (FY17: PKR 7.7bln) - on account of both escalated toll rates and traffic volume. Service area revenues also continued to rise to PKR 933mln (FY17: PKR 736mln) driven by full occupancy of service areas and rise in rental rates. The company's gross profit witnessed significant increase to PKR 3bln (FY17: PKR 2.1bln), up 43% YoY. Finance costs of PKR 2.6bln (FY17: PKR 2.3bln) increased on account of principal repayments. Hence, the company posted profit after tax of PKR 216mln (FY17: loss of 201mln).

Margins Gross and operating margin increased to ~34% and ~33% (FY17: 27% and 26%) primarily driven by the escalation in toll rates.

Sustainability Going forward, the management is eyeing to strengthen the revenue streams by providing more amenities in service areas.

Financial Risk

Working Capital During FY18, the company's cash cycle increased to 49days (FY17: -24days) primarily due to surge in payables with one-off payment.

Coverages As at end-Jun18, Interest coverage remained at 1.9x (end-June17: 1.9x) as finance costs surged in line with increased operational cashflows.

Capitalization As the project has inherent debt: equity ratio of 70:30, the company's debt to debt plus equity ratio stands at 74% at end-Jun18 (end-Jun17: 76%) – marginally declined due to scheduled debt repayments. Going forward, the debt repayments are expected as per schedule and leveraging is not expected to rise.

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Financials (Summary)

PKR mln

MORE

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16
	Annual	*Annual*	*Annual*
Non-Current Assets	**37,367**	**41,155**	**43,290**
Investments (Incl. associates)	**2,076**	**3,273**	**1,053**
Equity	-	-	-
Debt	2,076	3,273	1,053
Investment property	-	-	-
Current Assets	**2,722**	**522**	**358**
Inventory	-	-	-
Trade Receivables	2,493	321	190
Others	229	201	168
Cash & Bank	0	0	0
Total Assets	**42,164**	**44,950**	**44,701**
Debt	**30,071**	**32,932**	**31,175**
Short-term	-	-	-
Long-term (Inlc. Current Maturity of long-term debt)	30,071	32,932	31,175
Other short term liabilities	586	775	2,866
Other Long term Liabilities	517	467	134
Shareholder's Equity	**10,991**	**10,775**	**10,525**
Total Liabilities & Equity	**42,164**	**44,950**	**44,701**
INCOME STATEMENT			
Turnover	**8,924**	**7,771**	**4,350**
Gross Profit	3,000	2,104	1,626
Net Other Income	81	58	73
Profit Before Tax	404	(253)	198
Net Income	**216**	**(201)**	**135**
CASHFLOW STATEMENT			
Free Cashflow from Operations (FCFO)	4,978	4,551	3,239
Net Cash changes in Working Capital	(2,420)	(1,016)	340
Net Cash from Operating Activities	865	2,352	2,071
Net Cash from InvestingActivities	(323)	(991)	(18,979)
Net Cash from Financing Activities	(1,739)	859	17,642
RATIO ANALYSIS			
Performance			
Gross Margin	33.6%	27.1%	37.4%
Net Margin	2.4%	-2.6%	3.1%
ROE	1.9%	-1.9%	1.6%
Coverages			
Interest Coverage (FCFO/Gross Interest)	1.9	1.9	2.2
Core: (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	0.9	1.0	0.9
Total: (TCF) / (Gross Interest+CMLTD+Uncovered Total STB)	0.9	1.0	0.9
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	12.9	15.4	18.4
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	48.9	-24.0	-71.3
Capital Structure (Total Debt/Total Debt+Equity)	73.6%	75.6%	74.8%

Rating Scale

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.

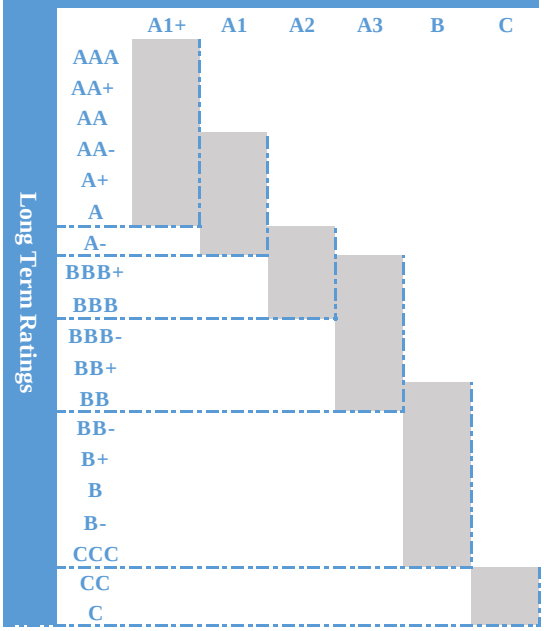
Long Term Ratings

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.

Short Term Ratings



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.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

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.
(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 | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(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 | 18-(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 | 18-(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-(f-VII)
Proprietary Information