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
28-Jun-2019	AA-	A1	Positive	Maintain	-
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 continued to remain good due to 1) revenues emanating from good traffic volume, 2) toll revenues subject to annual rate increase guaranteed by NHA, 3) income from ancillary services. The growth in traffic volume was higher in initial years of operational phase. Establishment of separate toll plazas and major rehabilitation work has been completed. Payments to NHA, as per the agreement, are being done through cashflows emanating from business. The financial risk profile is expected to be managed with net cumulative cashflows providing adequate service coverage. Increasing interest rate environment and stepped up principal repayments in upcoming years are key factors that may impact financial risk profile. The ratings recognize and incorporates strong financial muscle of sponsor.

Positive outlook captures the sustained improvement in the liquidity of the company, continuity of the same will be considered positive. 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(Apr-19)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Road Infrastructure

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 MORE is an SPV established by FWO; its ownership structure will remain same over the remaining period of concession agreement.

Business Acumen The business acumen of sponsor is considered very strong given extensive past experience of construction of several projects of strategic importance.

Financial Strength The financial muscle of parent company is considered strong.

Governance

Board Structure MORE's Board of Directors consists of four FWO nominated members; one serving and two retired army officers (one engineer) and one civilian (finance professional).

Members' Profile All board members are senior executives of FWO. The Director General FWO – Major General Inam Haider – also designated as Chairman MORE, supervises all FWO projects. The CEO, Brig. Shamim Akhram (Retd.), reports to the Chairman MORE, Commander FWO.

Board Effectiveness Army officers are from engineering corp. of Pakistan Army having extensive technical expertise in field of engineering and construction. Governance framework considered adequate attributable to absence of independent member on board.

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 CEO.

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

Effectiveness 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).

MIS 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. However, establishment of more small-scale service areas is planned.

Control Environment Modernization aspect of the project encompasses activities like landscaping and tree plantation, modernization of toll collections system, installation of state-of-the-art emergency call system, and police fine collection system, centralized operation centre, and weigh-in-motion systems. Further, provision of rescue and recovery system, emergency medical response system, vehicle fitness checking system, and solar fog lighting system are also mandatory components of modernization.

Business Risk

Industry Dynamics Establishment and rehabilitation of national highways and motorways is underway since many years; low or higher pace. During last few years, the country's road infrastructure was given special emphasis in the wake of CPEC. Eastern and Central alignment are taken up to be completed in short and medium term respectively. After completion of whole network, traffic volume is likely to rise manifolds as time duration will shorten.

Relative Position M2 (Lahore - Islamabad motorway) connects two major cities of the country and has strategic importance as compare to other national highways and motorways. Currently, traffic volume includes both commercial and passenger vehicles. With the development of whole eastern and central alignment of motorways and highways in next few years, traffic volume will be impacted positively.

Revenues The project's revenue stream is based on i) toll collection, ii) M-2 Service Area revenues (MSA), and iii) Other sources (mainly from right of way). During FY18, the revenue mix remained tilted towards toll collection 89% (FY17: toll: 91% and MSA 9). The revenue analysis reveals that the toll collection comprises major portion of the revenue stream. Traffic volume have been witnessing an upward trend since completion of construction. During FY18, traffic volume witnessed sizable increase to stand at 37mln (FY17: ~28mln). During FY18, revenue recorded increase to clock-in at PKR 8.9bln (FY17: PKR 7.7bln) attributable to increase in both traffic volume and toll rates. The service area rentals increased to PKR 933mln (FY17: PKR 736mln) as service areas remained fully occupied and increase in rent.

Margins Operating expenses stood at PKR 5.9bln (FY17: PKR 5.6bln) – primarily operations, maintenance cost and depreciation charge. Hence, the Company posted gross profit of PKR 2.9bln (FY17: PKR 2.1bln), up 38% YoY. Administrative expenditure increased to PKR 71bln (FY17: PKR 38bln). Other income of PKR 81mln (FY17: PKR 58mln) supplemented the bottom-line. However, finance cost increased to PKR 2.6bln (FY17: PKR 2.3bln). Hence, the company posted net profit of PKR 215mln against net loss incurred by company in FY17 of PKR 200mln.

Sustainability MORE, being concessionaire, established for sole purpose of overlay and modernization of M2 will operate in same capacity for the remaining years of concession agreement.

Financial Risk

Working Capital During concession period, current ratio (current assets divided by current liabilities) of at least 1:1 must be maintained by MORE.

Coverages As at end-Jun18, Interest coverage stood at 1.9x (end-June17: 1.9x) attributable to scheduled repayments of long term loan being paid by the company. Going forward, increasing key policy rate will impact the financing cost; coverage is likely to remain range bound.

Capitalization As the project has debt: equity ratio of 70:30, the company's debt to debt plus equity ratio stands at 72% at end-Dec18 (end-Jun18: 73%). The equity base has increased to PKR 11.4bln as at end-Dec18 (end-Jun18: PKR 10.9bln). Going forward, the debt repayments are as per schedule and leveraging is not expected to rise.

Road Infrastructure
Financials (Summary) in PKR mln
The Pakistan Credit Rating Agency Limited

PKR mln

MORE

Private Limited

BALANCE SHEET	Dec'18	Jun'18	Jun'17	Jun'16
	6M	12M	12M	12M
a Non-Current Assets	**34,656**	**36,685**	**40,800**	**42,854**
b Investments (Incl. Associates)	**3,931**	**2,076**	**3,273**	**1,053**
Equity Instruments	-	-	-	-
Debt Instruments	3,931	2,076	3,273	1,053
c Related Party Exposure	2,535	881	544	568
d Current Assets	**1,841**	**2,523**	**333**	**225**
Inventory	-	-	-	-
Trade Receivables	1,726	2,493	321	190
Others	115	30	11	35
e Total Assets	**42,964**	**42,164**	**44,950**	**44,700**
f Debt/Borrowings	**29,444**	**30,071**	**32,932**	**31,175**
Related Party Exposure	6,550	6,212	7,359	6,590
Long-Term (Incl. Current Maturity of Long-Term Debt)	22,894	23,858	25,573	24,585
Other Short-Term Liabilities	1,507	586	775	2,866
Other Long-Term Liabilities	553	517	467	134
g Shareholder's Equity	**11,460**	**10,991**	**10,775**	**10,525**
h Total Liabilities & Equity	**42,964**	**42,164**	**44,950**	**44,701**
INCOME STATEMENT				
a Turnover	**4,865**	**8,924**	**7,771**	**4,350**
b Gross Profit	1,828	3,000	2,104	1,626
c Net Other Income	5	4	4	5
d Financial Charges	(1,341)	(2,605)	(2,377)	(1,979)
e Net Income	**470**	**216**	**(201)**	**(387)**
CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	2,651	4,978	4,551	3,239
b Total Cashflows (TCF)	2,651	5,031	4,614	3,298
RATIO ANALYSIS				
a Performance				
Turnover Growth	9.0%	14.8%	78.6%	101.6%
Gross Margin	37.6%	33.6%	27.1%	37.4%
Net Margin	9.7%	2.4%	-2.6%	-8.9%
ROE	8.4%	2.0%	-1.9%	-4.9%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.9	0.9	1.0	0.8
Interest Coverage (X) (FCFO/Gross Interest)	2.0	1.9	1.9	1.6
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	11.2	12.7	15.1	26.0
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	68	49	-24	-71
d Capital Structure (Total Debt/Total Debt+Equity)	72%	73%	75%	75%

MORE

May-19

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.

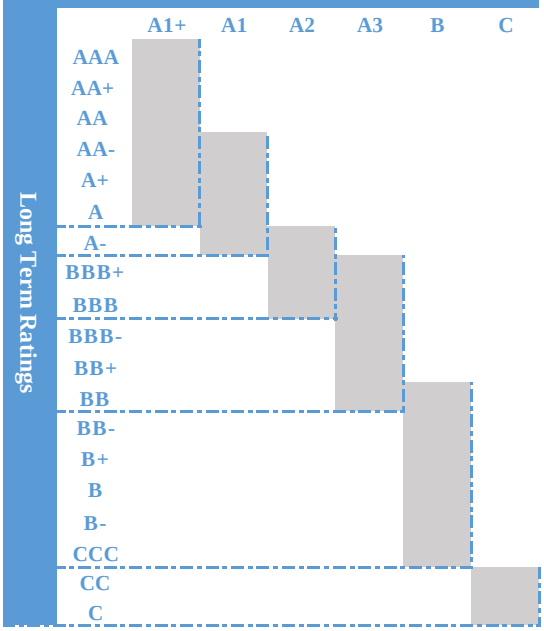
Long Term Ratings

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