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WestConnex Finance Pty Ltd

25 October 2022

Sector: Infrastructure
Sub-sector: Toll Roads
Country: Australia
Ownership: Private

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Issuer Outline

WestConnex Finance Co Pty Ltd (WestConnex Finco) is the financing arm of WestConnex.

WestConnex (WCX) is a tolled Sydney metropolitan motorway comprising six roads, operated under three separate concessions that are physically joined. The six roads are: New M4, M5 East, M8, M5 South West, M4-M5 Link (scheduled to open in 2023), and Rozelle Interchange (to open in 2024). Once fully complete, the network will be 70km, providing efficient road transportation across Sydney.

WCX is fully owned by Sydney Transport Partners, a consortium including Transurban, AustralianSuper, Tawreed (part of the Abu Dhabi sovereign wealth fund) and Caisse de depot et placement du Quebec (a private Canadian investment manager). The NSW government previously owned 49% of WCX, but sold its stake to the consortium in September 2021 for AUD11.1bn. One road, M5 South West, is currently 100% owned by Transurban but will transfer to WestConnex once the current concession expires in December 2026.

Key Financials (AUDm)

LTM (30 Jun)	2022
Revenue	492
Underlying EBITDA	360
Net Interest Paid	(208)
Total Senior Debt	7,562

Source: FIIG Securities, Company

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call	Maturity Date
AU3CB0279057	AUD 650m	Senior Secured	3.15%	Semi-Annual	31 Dec 2030[1]	31 Mar 2031

[1] *Subject to redemption premium using a discount rate equal to the relevant swap rate+ 50bp.*

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Strengths

- Operational environment in Sydney: WCX is a tolled motorway linking Sydney's West and South-West with the Sydney CBD, Sydney Airport and Port Botany. It is a critical component of the NSW Government's long term, integrated transport and planning solution. Sydney roads have been congested for many years with this congestion exacerbated by steady population growth in Sydney over the past 20 years. While alternative free roads to the M4 and M5 corridors exist, they are not completely direct alternatives and are also highly congested, with travel times on these corridors often appreciably longer than on the M4 and M5 corridors. We further note that a number of other toll roads are operating in and around Sydney and there is strong acceptance of the 'user pay' model.
- Strategically integrated network asset: WCX operations benefit from being an integrated network, as it is tolled and operated as an integrated entity despite being financed as three separate concessions. The group of companies that manages the tolling and road operations (Transurban, Fulton Hogan Egis, and WCX) ensures that the road is run as one business, simplifying the administrative procedures.
- Long term asset certainty: WCX benefits from long concession agreements to 2060 with the NSW Government. The NSW toll road market is a mature one, has a supportive regulatory regime and a long history of private sector involvement.
- Minimal exposure to construction risk: The WCX project construction has been divided into four stages, with Stage 1 and Stage 2 (the widening and extension of the M4 and the M5 East and M8 tunnels) already complete. Stage 3A is the M4 and M5 Link mainline tunnels which are currently under construction and scheduled to complete in early-2023. As of 30 June 2022, the mechanical and electrical fitouts were more than 88% complete and all road surfaces had been laid. WCX has significant and demonstrated experience in delivering projects of this scale. The final stage, Stage 3B (Rozelle Interchange) is being delivered and fully funded by Transport for NSW.
- Certainty on toll price increases: WCX has certainty on toll price increases with annual escalation of the greater of CPI or 4% through to 2040, after which the escalation reverts to the greater of CPI and 0%. For M5 South West, tolls escalate at the greater of CPI or 0% a year. This toll escalation regime provides WCX a floor of 4% for the next 19 years, removing the downside risk of low inflation over this period. In addition, heavy commercial vehicles (HCVs) incur tolls at a rate of 3x light motor vehicles.
- Significant operating and traffic history: WCX benefits from 28 years of traffic history on the M4 and M5 West, and 19 years of traffic history on the M5 East. Toll road traffic in Sydney has historically been stable and reflected underlying GDP unless hampered by capacity constraints. Toll elasticity has been very low even as tolls have increased at 4% a year (i.e. greater than historic inflation) on a number of Sydney toll roads.
- Support from Transurban: Although investors in the WCX notes do not have direct recourse against the Transurban Group, we view TCL's credit profile as critical for WestConnex given its ownership (as part of a consortium), proven track record and success of operating toll roads in Australia, and implied support. On the WCX project, a master services agreement exists between the two groups, under which Transurban provides various services such as access to personnel to WCX. Transurban has also provided use of the GLIDe tolling system, which has been used on Transurban's other Australian toll roads for many years.

Risks

- Exposure to traffic volume risk: Lower future traffic levels or growth rates than expected or prolonged ramp-up on any of the WCX stages could weaken earnings and cash flow generation, especially during the debt amortisation period. While this exposure to uncertain tariff levels has been the reason for a number of failures of newly build toll roads in Australia over the last decade (Brisbane Airport Link, RiverCity tunnel, Cross City tunnel and Lane Cove tunnel), these assets did not have the benefit of existing traffic from assets that are already in operation (as is the case for WCX).
- Pandemic effects and changing working conditions: Since the pandemic, there has been a shift in the use of transport from public to private. Research undertaken by Transurban indicated 56% of individuals now prefer using private vehicles versus 27% for public, which has boosted TCL's earnings as a result of increased toll road usage. This has been further aided by

the reopening of travel and the associated demand, as airport-related corridors are often tolled. These trends are expected to normalise over time with public transport becoming more used. We also note that working conditions have shifted since the pandemic, with individuals expected to work 1.5 to 2.1 days from home a week and 70% have more flexibility around start and finishing times, meaning reduced car usage may act as a slight drag on earnings. This should be mitigated by the fact that the road networks in TCL's key markets are heavily congested which mean many users continue to see tolls as a non-discretionary expense.

- Structural subordination of WestConnex Finco notes: After the recent refinancing of M5 debt, WestConnex FinCo notes have security over:
    - All the assets and contracts in relation to WCX M4, including relevant project bank accounts;
    - All the assets and contracts in relation to WCX M5, including relevant project bank accounts;
    - Shares/units at WCX Holding Entities;
    - WCX Holding Entity equity interests in WCX M4, WCX M5 and WCX M4-M5 Link;
    - The cash proceeds of distributions paid to WCX Holding Entities from WCX M5 and WCX M4-M5.

  However, the WestConnex FinCo notes do not have security over the underlying assets, contracts, agreements, or accounts of WCX M4-M5 Link as these are pledged to the respective project financiers. WestConnex FinCo is exposed to delayed or reduced distributions from WCX M4-M5 Link as that would impact WestConnex FinCo's cash flow after debt service (CFADS). We note that these assets are reasonably geared, which provides comfort of a low likelihood that dividends could be retained at the underlying operating company level. We further note this structure is consistent with the debt structure for ASX-listed (and WCX's largest shareholder) Transurban. Finally, it is expected that the WCX M4-M5 Link project debt will be refinanced at the WestConnex FinCo level (as was the case for the M5 debt) once this project is completed, which will remove this structural subordination.

- Potential for additional indebtedness: Under the debt terms, the project is able to borrow additional debt in the ordinary course of business (including to fund distributions to equity), subject to the maintenance of a credit rating, or if no public rating is in place, a minimum DSCR test (backward and forward looking) of 1.8x for purposes other than distributions. We note that WCX's debt and financing strategy is heavily influenced by Transurban, who has demonstrated over the years a disciplined approach to its capital management strategy (including for its subsidiaries) with a strong desire of achieving rating stability for the benefit of debt investors.

- High leverage: WCX carries proportionally a very heavy debt load compared to its current earnings. This is primarily because a large part of this debt relates to projects that are yet to be completed (and therefore do not generate earnings). Based on FY22 results, WCX generated EBITDA of AUD360m compared to cash interest payment of AUD208m. While debt is expected to continue to increase as WCX's various projects reach completion, this will also drive additional earnings. In its analysis, S&P Global Ratings forecast that WCX's debt service cover ratio (i.e. a measure of debt serviceability) will reach a minimum of 1.88x in 2026 (and average 3.36x over the life of the WCX concession).

- Refinancing risk: WCX is currently financed through a number of short-term bullet maturities. Over the life of the notes, WCX will face refinancing and interest rate risk at multiple points.

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