RATING REPORT

Lahore Sialkot Motorway Infrastructure Management (Pvt.) Limited

REPORT DATE:
March 11, 2019

RATING ANALYSTS:
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RATING DETAILS

	Initial Rating	
Rating Category	**Long-term**	**Short-Term**
Entity	A-	A-2
Rating Date	*Mar 11' 2019*	
Rating Outlook	Stable	

COMPANY INFORMATION

Incorporated in 2016	**Chairman:** Maj Gen Inam Haider Malik
Private Limited Company	**Chief Executive Officer**: Brig (Retd.) Tahir Saddique Raja
Key Shareholders (with stake 5% or more):	**External Auditors:** Deloitte Yousuf Adil, Chartered Accountants
Frontier Works Organization	
National Highway Authority	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Industrial Corporates (May 2016)
https://www.vis.com.pk/kc-meth.aspx

VIS Rating Criteria: Toll Roads Rating (November 2018)
https://www.vis.com.pk/kc-meth.aspx

Lahore Sialkot Motorway Infrastructure Management (Pvt.) Limited

RATING RATIONALE

Incorporated in October 2016 as a private limited company, Lahore Sialkot Motorway Infrastructure Management (Pvt.) Limited (LSMIM) is a Special Project Company (SPC) with registered office based in Rawalpindi, Punjab. The company has entered into a concession agreement for a period of 25 years with National Highway Authority (NHA) for construction, management and maintenance of the Lahore Sialkot Motorway (LSM). The project will be established under the Public Private Partnership (PPP) regime on Build Operate & Transfer (BOT) basis, with Frontier Works Organization (FWO), shareholder of LSMIM, acting as Engineering, Procurement & Construction (EPC) Contractor and Operations & Maintenance (O&M) Contractor. The financial close of this project was achieved on Dec 29, 2017 and the construction is expected to be completed by beginning of August 2019. Further details about technical features of the road and key stakeholders in the project are presented in the tables below:

Figure 1: Technical features of the road

Length (km)	89.2 km
Number of lanes	4
Number of interchanges	7
Number of service areas	2

Figure 2: Key Stakeholders in the project

Stakeholder	Name
Independent Engineer	Osmani & Company (Private) Limited and Pavron Joint Venture
Independent Auditor	KPMG Taseer Hadi & Co. Chartered Accountants
Design	Directorate of Design and Consultancy (DD and C)
Engineering, Procurement & Construction (EPC) Contractor	Frontier Works Organization (FWO)
Operations & Maintenance (O&M) Contractor	Frontier Works Organization (FWO)
Traffic Study Conductor	Osmani & Company (Private) Limited

Rating Drivers

Sponsor Profile: The assigned ratings take into account sound profile of the two shareholders of LSMIM. Shareholding of LSMIM is vested with FWO (Class A shares) and NHA (Class B shares). Both shareholders of the company have considerable experience in infrastructure projects. During the last 5 years, NHA has completed 4 projects on PPP basis with a total size of USD 3.4 billion. Presently, more than 15 other PPP projects of NHA are either in implementation, development or preparation phase. Currently the volume of ongoing projects with FWO stands at over Rs. 1.2tr. However, the ratings are constrained by absence of sponsor support agreement between LSMIM and the sponsor (FWO) for any unexpected shortfalls.

Demand Risk (Volume): As per the concession agreement, the demand risk is parked entirely with LSMIM. Thus, any shortfall in the projected revenues on account of decrease in traffic volumes may have adverse impact SRL's debt repayment capacity. However, this risk is partly mitigated by conservative assumptions related to traffic volumes incorporated in the financial model. Projected traffic volumes are in line with the volumes indicated by the traffic survey study.

PROFILE

LSMIM was incorporated as a private limited company in 2016. The company is formed for the purpose of construction, collecting toll and operation and maintenance of Lahore Sialkot Motorway. Sponsors of the company include National Highway Authority (NHA) and Frontier Works Organization (FWO).

Traffic mix indicates that majority of the traffic on the proposed route is commuter related traffic. By using Lahore-Sialkot Motorway (LSM), the commuters will save approximately 1.25 hours in travel time and Rs. 400 in fuel costs in comparison to the travel via the alternate route (Grand Trunk (GT) Road). Higher time taken and fuel costs over the alternate route are a function of greater distance. Since time and cost savings are sizeable, traffic volumes are expected to be sustainable. Traffic survey study also indicates high willingness to pay toll by the consumers. Moreover, if NHA or any other public-sector entity decides to establish a competing route, then it will be ensured that the competing route shall be tolled at least equivalent to an amount 1.5 times higher than prevailing toll rates imposed at LSM. Otherwise, LSMIM is entitled to receive losses in toll revenues from NHA.

Demand Risk (Price): Toll revenues will also be a function of increase in toll rates as mandated in the concession agreement. Toll rates will be revised upwards by 8% every year. In case, the stipulated increase in toll rates is not implemented or any downward revision in toll rates, LSMIM is liable to receive compensation from NHA for the loss in revenues. Apart from tolls, growth in revenues from other sources (service area) is expected; however, their proportion is expected to remain small.

Construction Risk: As per the concession agreement, LSMIM is bound to achieve substantial completion of the motorway within 24 months of the financial close date. In case of a delay beyond 24 months due to non-performance by the LSMIM, the company is mandated to pay delay damages to the NHA. However, construction delay risk is partly mitigated due to sound track record of EPC contractor, FWO, which has ensured timely completion of several infrastructure projects. Moreover, FWO intends to complete the project in a time span of 22 months, whereas the stipulated time period for the same is 24 months in the concession agreement. Hence, some cushion for unanticipated delays exists. Furthermore, liquidated damages to be received from the EPC contractor, FWO, in case of a delay provide adequate coverage for compensation to be paid to the NHA.

Costs Overrun Risk: Changes in the prices of four major components including diesel, bitumen, steel and cement can have major impact on the overall costs of the toll road projects. In order to cover for such risk, management has already incorporated 2% contingency costs in the financial model. In case of any further increases in the prices of raw materials, the risk will be borne by Engineering, Procurement & Construction (EPC) Contractor, FWO.

Debt Servicing: Funding for project has been arranged from the sponsors and the financiers. The assigned ratings incorporate the presence of Debt Service Reserve Account (DSRA) with an amount equal to next debt repayment installment to be maintained at all times. This mechanism has been built as part of the overall project cost. NHA has injected its full equity and sub-ordinated loan amount in the project. Ratings also draw comfort from terms of the subordinated loan from NHA where repayment is to be made from the 11th year of the concession agreement.

Debt repayment capacity is contingent upon realization of project traffic volumes. As per the financial model, gross revenue is expected to increase on account of growth in traffic and escalation in toll rates on timeline basis. With higher profitability, FFO is expected to increase steadily over the years. Cushion in debt servicing is limited in the initial years but is projected to increase with growth in traffic and increase in toll rates. The company has the option of utilizing funding from DSRA in case of any shortfall in projected revenues.

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

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.

Rating Watch: 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.vis.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.vis.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 and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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.

REGULATORY DISCLOSURES	**Appendix II**
Name of Rated Entity	Lahore Sialkot Motorway Infrastructure Management (Pvt.) Limited
Sector	Toll Roads
Type of Relationship	Solicited
Purpose of Rating	Entity rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	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	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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
11/03/2019	A-	A-2	Stable	Initial