RATING REPORT

Lahore Sialkot Motorway Infrastructure Management (Private) Limited (LSMIM)

REPORT DATE:
October 07, 2021

RATING ANALYSTS:
Maham Qasim
maham.qasim@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*October 07, 2021*		*August 19, 2020*	

COMPANY INFORMATION

Incorporated in 2016	**Chief Executive Officer**: Brig. Badar Zaman
Private Limited Company	**Chairman:** Major General Kamal Azfar
Key Shareholders (with stake 5% or more):	**External Auditor:** Deloitte Yousuf Adil, Chartered Accountants
Frontier Works Organization - 21% (Class 'A' Shares)	
National Highway Authority - 79% (Class 'B' Shares)	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Corporates (August 2021)
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

VIS Rating Criteria: Toll Roads (August 2020)
https://docs.vis.com.pk/docs/TollRoads202008.pdf

Lahore Sialkot Motorway Infrastructure Management (Private) Limited (LSMIM)

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).

RATING RATIONALE

The ratings assigned to Lahore Sialkot Motorway Infrastructure Management (Private) Limited (LSMIM) take into account the sound financial profile of its two sponsors; the shareholding is vested with Frontier Works Organization (FWO) (Class A shares) and National Highway Authority (NHA) (Class B shares) with both having sizable experience in infrastructure projects. FWO has undertaken major projects under public private partnership (PPP) and Build-Operate-Transfer (BOT) mandates. The ratings derive strength from precise financial planning and execution resulting in avoidance of cost overruns. The assigned ratings take comfort from presence of Debt Service Reserve Account (DSRA) with an amount equal to next debt repayment installment to be maintained at all times after termination of grace period. Although, the account was not funded during the rating review period owing to one-year deferment allowed by the central bank, the risk of unavailability of adequate funds is mitigated as the responsibility of DSRA funding rests with the sponsor, FWO. In addition, implicit support from the sponsor was witnessed as the company procured subordinated loan from FWO during the outgoing year to meet liquidity constraints. As per agreement, any other shortfall in project financing going forward will also be provided by FWO in form of equity or subordinated loan.

Ratings incorporate the project's low leveraged financial plan, its completion status of 95% and it being operational since March 2020. However, shortfall in actual revenues from projected stemming from restricted travelling amid Covid and non-availability from NHA, the owner, of concession area, and consequential incomplete construction works at Sambrial Interchange continue to impact the ratings. Ratings take note of the increase in traffic volumes and revenue in the past year though behind targets. Further, in case of unprecedented scenarios involving downward revision of toll rates, the revenue risk is accounted for as LSMIM is guaranteed to receive compensation from NHA for the loss in revenues. The indigenous liquidity profile of the company remains weak in line with negative coverages; however, the same is mitigated at varying levels in line with support extended by sponsors. Going forward, ratings, besides the above commitments of FWO, also remain dependent on successful achievement of COD in stipulated time, with no further delays. Further, traffic volumes following COD and the maintenance of DSCR at certain level as specified in concession agreement, are imperative to the assigned ratings.

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 NHA for construction, management and maintenance of the Lahore Sialkot Motorway (LSM). The project is established under the Public Private Partnership (PPP) regime on BOT basis, with FWO. Under the agreement, LSMIM as concessionaire is responsible for construction as well as operations and maintenance. LSMIM has employed FWO as EPC Contractor and Operations and Maintenance (O&M) Contractor.

Rating Drivers

Capitalization and debt servicing: NHA has injected its equity amounting Rs. 18b and subordinated loan amounting Rs. 5b at the inception of the project; shares against equity were issued in subsequent periods. Ratings also draw comfort from terms of the subordinated loan from NHA having a grace period of ten years; the repayment is to be made from the 11th year of the concession agreement which is FY28. FWO has injected equity of Rs. 6.8b, out of which shares amounting to Rs. 2.1b were issued during the outgoing year. Initially it was planned that FWO will inject additional equity of Rs. 418.6m for the next EPC payment; however, now as the company will not be withdrawing any more of the

Syndicated Term Finance Facility (STFF) available, FWO will now be providing balance works for the unutilized loan facility and equity amount aggregating to Rs. 3.6b during the rating review period. LSMIM procured STFF of Rs. 8.8b against the total limit of Rs. 12b by end-FY20; the company applied for the extension of debt availability period *(availability period expired on March 31, 2020)*; however, the extension was not granted so the commercial borrowings will not exceed Rs. 8.8b. Further, as per agreement, any other shortfall in project financing will also be provided by FWO in the form of equity or subordinated loan. The company has also procured a temporary loan of Rs. 490.6m from FWO to meet funding requirements owing to slackened revenue generation due to pandemic crisis and unfinished construction. Total EPC payments to be made remained unchanged at Rs. 41.1b, against which Rs. 37.5b have been paid so far, while the remaining is now to be provided by FWO as non-cash balance works completion. The loan amount was pegged to be drawdown against EPC invoices due, which in turn were generated against actual milestones achieved, therefore, interruption in land acquisition by NHA resulted in delayed generation of invoices and thus leading to deferment in drawing loan facility.

The assigned ratings also incorporate the presence of Debt Service Reserve Account (DSRA) with an amount equal to next debt repayment installment to be maintained at all times after termination of grace period. This mechanism has been built as part of the overall project cost. Debt repayment capacity is contingent upon realization of project traffic volumes. Given relief package provided by GoP to counter economic compression owing to Covid'19, the management applied for rescheduling of first and second installments *(due on June 20, 2020 and December 20, 2020)* for one year; the approval for deferment of markup was granted for the first installment. The markup was delayed for one year till June'21 and staggered in eight equal semi-annual installments. Till date, three installments have been paid, first in June' 20 only entailing principal payment, second in Dec'20 including both principal and mark-up and the third in June'21 including principal, mark-up and first of eight installments of staggered markup. DSRA is not funded yet owing to loan installment deferment with the agent bank till June'21; moreover, the risk of repayment is mitigated from the company's side as the responsibility of funding the DSRA is vested with the sponsor, FWO. LSMIM has to maintain minimum Debt Service Coverage Ratio (DSCR) of 1.2x and target DSCR is 1.5x.

The mobilization advance reduced to Rs. 1.6b (FY20: Rs. 2.6b) during FY21; the same represents 30% advance extended to FWO under the Engineering, Procurement and Construction (EPC) for implementing the project. The advance was to be amortized within two years against interim payment certificates from FWO throughout the progress of the construction work; the same is expected to be fully amortized during the ongoing year. Moreover, trade and other payables decreased to Rs. 52.9m (FY20: Rs. 4.66.4m) during FY21 on account of Rs. 258.0m O&M payment made to FWO.

The gearing and leverage indicators have increased slightly to 0.68x (FY20: 0.64x) and 0.73x (FY20: 0.70x) by end-FY21 in line with increase in subordinated loans; the same is the function of temporary loan amounting to Rs. 418.6m obtained from FWO. As per the management, the commercial borrowings peaked to Rs. 8.8 at end-FY20 and that is the maximum number to be recorded on the company's booked as no incremental commercial funding can be obtained going forward. However, given another loan installment is due in Dec'21 with revenue generation not being at par with projections, management plans on procuring Rs. 500m from FWO in the form of subordinated loan during FY22. Therefore, the leverage indicators will slightly trend upwards while remaining within manageable limits during the review period.

No progress on construction made during FY21 with the project completion unchanged at 95%: The motorway is operational since March 18, 2020; however, the project has not yet achieved full completion as concession area is not available and some additional works are pending including construction of Sambrial Interchange. The projected timeline of completion of both projects was Oct'20; however, no advancement on the same was made during the outgoing year, the completion percentage still stands at 95% at end-FY21. For service area construction, extension of time (EOT) has been taken from NHA till Oct'21; however, the same is to be extended for another quarter so the completion is expended by end-Dec'21. Further for Sambrial Interchange, NHA has not been able to acquire the land so the completion is contingent upon exogenous factors. As per the management, once the acquisition is made the company would be able to construct the interchange within three months. Currently, LSMIM has substantial completion certificate as completion certificate can only be achieved once 100% construction is done.

Actual revenues were sizably lower than projected owing to limited travelling amid ongoing pandemic: The toll revenue was only around one-fourth of the projected on account of restricted travelling, periodic lockdowns and non-completion of construction works. Operational toll rates have been applied and an increase in toll collection has been noted since the motorway became fully operational; albeit, traffic volume data was significantly lower than the projected volumes due to the impact of pandemic. Toll collection amounted to Rs. 794.4m during FY21 as opposed to Rs. 137.7m in FY20 when the motorway was operational for three months. Highest toll collection was recorded from Kala Shah Kaku (39%) followed by Sambrial (19%) interchanges; as per the management the same trend is expected to continue going forward. The latest monthly toll collection and traffic volume figures are tabulated below:

Month	No. of Vehicles	Toll Revenue (Rs.)
July'20	490,961	52,986,690
Aug'20	556,297	56,022,930
Sep'20	574,654	60,558,650
Oct'20	627,736	65,557,290
Nov'20	697,731	69,450,610
Dec'20	604,383	58,642,080
Jan'21	630,151	63,119,410
Feb'21	561,618	61,406,530
Mar'21	749,367	86,628,680
Apr'21	583,905	72,462,790
May'21	607,958	72,410,400
Jun'21	599,378	75,175,250
July'21	653,559	81,037,190
Aug'21	627,079	78,374,290

Traffic mix indicates that majority of the volume on the proposed route is commuter related. By using LSM, the commuters will save approximately 1.25 hours in travel time and some saving in fuel cost 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. In addition, with the opening of Sialkot-Kharian Motorway (SKM)the management expects that the toll collection will increase by almost 60% as traffic will shift from GT Road to SKM to avoid congestion; the commuters in order to utilize both motorways will have to take two exits at Sambrial Interchange as no other mechanism for revenue sharing can be drafted. Currently, the incremental revenue from the opening of SKM is not inbuilt in the financial model. The management projects that the revenue will increase by around 12% during HYFY22 on account of 8% toll price increase coupled with 4% increase in traffic volume. Further, 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. In addition, in case of extraordinary circumstances, which are beyond reasonable control, the company is entitled to claim shortfall in revenue or complete loss of revenue under *Force Majeure* clause of concession agreement.

The project cost primarily includes O&M expense; an amount of Rs. 573.2m payable to O&M contractor, FWO, for FY21. The O&M expense is fixed and not pegged with traffic volumes although the same is applicable to 10% annual increase. As per the O&M agreement, 40% of the expense is to be paid on continuous yearly basis while the remaining 60% is payable after 8 years of project completion. The gross margins were recorded positive at 27.8% during FY21 as opposed to negative in the preceding year owing to the route being operational for the entire year. The administrative expenses increased slightly to Rs. 55.7m (FY20: Rs. 43.0m) during FY21 in line with inflationary pressure on employee related expenses and utilities. On the other hand, despite increase in average borrowings during the review period finance cost decreased to Rs. 705.5m (FY20: Rs. 804.5m) on account of sizable cut to policy rate by the central bank to counter the impact economic downturn amid ongoing pandemic. The slight improvement in the revenue collection did not reflect positively on the bottom line as traffic volumes remained stunted owing to pandemic crisis.

The liquidity profile of the company remained weak with negative Funds from Operations (FFO) reported; the same remains a function of profitability metrics. The management expects an increase in toll collection after overall relaxation in lockdowns, construction of service centers, provision of amenities, deployment of motorway police and increased awareness of commuters about the route. Liquidity profile draws support from projected growth in revenues.

Revenue risk related to toll rates remains largely addressed: 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, its proportion is expected to remain small.

Lahore Sialkot Motorway Infrastructure Management (Pvt.) Ltd. **Appendix I**

BALANCE SHEET *(in PKR millions)*	FY18	FY19	FY20	FY21
Fixed Assets	-	0.7	32,770.6	32,771.6
Concession Work in Progress	14,324.2	26,774.7	2,854.9	3,976.2
Mobilization Advance	11,061.5	8,242.1	2,614.2	1,555.3
Secured Advance	2,739.2	2,086.3	-	-
Cash and Bank Balances	1,967.0	45.6	180.8	24.3
Other Assets	182.8	214.6	262.6	283.0
Total Assets	30,274.7	37,363.3	38,683.1	38,610.4
Long Term Loan (including current maturity)	2,003.4	4,181.0	8,814.8	8,812.3
Subordinated loans	5,202.1	5,513.4	5,843.3	6,333.9
Tarde and Other Payables	337.6	4,901.7	621.3	44.4
Total/Tier-1 Equity	22,731.4	22,767.1	22,776.8	22,267.4
Paid-up Capital	21,643.3	22,765.8	22,765.8	22,765.8
INCOME STATEMENT	FY18	FY19	FY20	FY21
Net Sales	-	-	137.7	794.4
Gross Profit / (Loss)	-	-	(1,203.5)	221.0
Profit / (Loss) Before Tax	(46.1)	47.9	(2.045.3)	(527.6)
Profit After Tax	(42.0)	35.7	(2,051.9)	(527.6)
Funds from Operations (FFO)	-	-	(341.3)	(517.8)
RATIO ANALYSIS	FY18	FY19	FY20	FY21
Gross Margin (%)	-	-	-	27.8
Net Margin (%)	-	-	-	-
Current Ratio (x)	47.2	2.2	2.2	42.0
Net Working Capital	1,5603.3	5,681.3	1,655.2	1,818.3
FFO to Total Debt (x)	-	-	-	-
FFO to Long Term Debt	-	-	-	-
Debt Leverage (x)	0.33	0.64	0.70	0.73
Gearing (x)	0.32	0.43	0.64	0.68
DSCR (x)	-	-	-	-
ROAA (x)	-	0.1	-	-
ROAE (x)	-	0.2	-	-

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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 III
Name of Rated Entity	Lahore Sialkot Motorway Infrastructure Management (Private) Limited (LSMIM)
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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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
07/10/2021	A-	A-2	Stable	Reaffirmed
19/08/2020	A-	A-2	Stable	Reaffirmed
11/03/2019	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Imran Umer	Financial Controller	14th Sep, 2021