RATING REPORT

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

REPORT DATE:
November 14, 2022

RATING ANALYSTS:
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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	*November 11, 2022*		*October 07, 2021*	
Rating Action	*Reaffirmed*		*Reaffirmed*	

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:** 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

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. During the outgoing year, Operations and Maintenance (O&M) responisibility has been transferred from FWO to LSMIM since September 25, 2021.

Key Rating Drivers

Sound financial profile and implicit support of the sponsors

- 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 with cost of the project stable at Rs. 41.1b.
- The assigned ratings take comfort from presence of Finance Payment Account (FPA) with an amount equal to next debt repayment installment replenished two days before due date of repayment. With losses being incurred on LSMIM books, the responsibility of FPA funding rests with the sponsor, FWO as per the Letter of Comfort provided to the financiers. Letter of comfort clearly provides an irrevocable and unconditional guarantee to the financiers for meeting shortfall of the debt principal and markup payments till whichever of the following occurs earlier:
    - the date on which the aggregate funds standing to the credit of the Financing Service Reserve Amount are equal to the highest Required Financing Service Reserve Amount relating to any Repayment/Payment Date or,
    - the Financing Termination Date.
- Implicit support of the sponsor was evident from procurement of subordinated loan from FWO in FY21 and FY22 to make debt repayments and 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.

Completion rate of the project at 97% with hindrances caused by non-acquision of land at Sambiral-Interchange from NHA

- 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 and 2 service areas across the motorway.
- The motorway is operational by renting the disputed land area. The rent expenses are reimbursed by NHA.
- During FY22, around 50-60% of the work on service areas was completed. Remaining is dependent on achievement of certain area of disputed land acquisition from NHA.
- Overall project completion stands at 97% (FY21: 95%) at end-FY22. For service area construction, extension of time (EOT) has been taken from NHA till June'23. 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 subdued traffic volumes

LSMIM-Toll Revenue Detail- FY 2021-22					
Month	No. of Veh	Toll Revenue (Rs)	Daily Toll Avg	Toll Avg as per FM	%age achievement
Jul-21	653,559	81,037,190	2.61	8.47	30.86%
Aug-21	627,079	78,374,290	2.53	8.47	29.85%
Sep-21	647,183	80,740,850	2.69	8.47	31.77%
Oct-21	826,145	107,859,090	3.48	8.47	41.07%
Nov-21	608,397	97,047,180	3.24	8.47	38.19%
Dec-21	409,736	80,595,070	2.60	8.47	30.70%
Jan-22	395,331	70,796,580	2.28	9.35	24.43%
Feb-22	453,098	78,683,430	2.91	9.35	31.17%
Mar-22	616,308	107,749,130	3.48	9.35	37.18%
Apr-22	437,774	79,231,730	2.64	9.35	28.25%
May-22	519,153	87,462,600	2.82	9.35	30.17%
Jun-22	432,533	79,372,940	2.65	9.35	28.30%
TOTAL		1,028,950,080			

- Toll collection was reported higher amounting Rs. 1b during (FY21: 794.4m) FY22 being significantly lower than projected levels as per financial model. The subdued motor traffic on account of LSM being an alternate route along with elevated fuel costs restricting consumer traffic.
- Highest toll collection was recorded from Kala Shah Kaku (34%) followed by Sambrial (17%) interchanges; as per the management the same trend is expected to continue going forward.
- 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. Management expects commencement of this motorway by FY25.

- 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.

Revenue risk related to toll rates remains largely addressed; however escalation rate is far lower than inflation levels in the country

- 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.

Low leveraged capital structure, however equity erosion since the past two years due to losses has resorted the company to avail financial support from the sponsors for debt repayment

- Debt composition at end-FY22 comprised Rs. 8.1b (FY21: Rs. 8.8b) of long-term loan from Syndicated Term Finance Facility (STFF) and subordinated loans amounting Rs. 7.5b (FY21: Rs. 6.7b).
- As the company will not be withdrawing any more of the Syndicated Term Finance Facility (STFF) available (Rs. 12b), FWO will now be providing balance works for the unutilized loan facility and equity amount aggregating to Rs. 3.7b. 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.
- Ratings also draw comfort from terms of the subordinated loan from NHA (Rs. 5b initially and Rs. 6.5b at end-FY22 adding interest payments) having a grace period of ten years; the repayment is to be made from the 11th year of the concession agreement which is FY28.
- During the outgoing year, FWO granted subordinated loan to the tune of Rs. 550m totaling its dues to Rs. 1.04b (FY21: Rs. 490.6m) at end-Jun'22. The same was provided to make outstanding debt repayments.
- Till date, five installments have been paid, first in June' 20 only entailing principal payment, second in Dec'20 including both principal and mark-up, third in June'21 including principal, mark-up and first of eight installments of staggered markup, fourth in Dec'21 and fifth in June'22.
- LSMIM is unable to maintain minimum Debt Service Coverage Ratio (DSCR) of 1.2x as per concession agreement due to consistent losses.

- Trade and other payables increased to Rs. 385m (FY21: Rs. 132.2m) during FY21 on account of payables related to O&M and M-Tag recharge amount payable to FWO.
- The gearing and leverage indicators have increased slightly to 1.0x (FY21: 0.8x, FY20: 0.64x) and 1.1x (FY21: 0.9x, FY20: 0.70x) at end-FY22 due to increase in subordinated loans and erosion in equity base due to losses over the past two years.
- With revenue generation being below par against projections yielding losses, subordinated loan from FWO will continue till LSMIM achieves profitability. Therefore, the leverage indicators will slightly trend upwards while remaining within manageable limits over the rating horizon.

Weak profitability and liquidity profile

- With low traffic volumes, high costs to operate and maintain the motorway, and elevated finance charges the company reported losses to the tune of Rs. 3b (FY21: Rs. 3.3b) in FY22.
- Management envisages improvement in gross margins of the company given complete control of O&M costs and not incurring annual charges to FWO.
- To maintain quality control, the motorway is supervised regularly by NHA and NHM police.
- 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.
- The management expects an increase in toll collection after construction of service centers, provision of amenities, deployment of motorway police, commencement of SKM and increased awareness of commuters about the route.

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.

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

BALANCE SHEET *(in PKR millions)*	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**
Fixed Assets		0.7	32,770.6	30,364.2	27,956.7
Concession Work in Progress	14,324.2	26,774.7	2,854.9	3,978.7	4,314.0
Mobilization Advance	11,061.5	8,242.1	2,614.2	1,555.3	1,244.1
Secured Advance	2,739.2	2,086.3	-	-	-
Cash and Bank Balances	1,967.0	45.6	180.8	26.1	44.6
Other Assets	182.8	214.6	262.6	276.1	280.5
Total Assets	30,274.7	37,363.3	38,683.1	36,200.3	33,839.9
Long Term Loan (including current maturity)	2,003.4	4,181.0	8,814.8	8,813.3	8,127.7
Subordinated loans	5,202.1	5,513.4	5,843.3	6,694.8	7,527.1
Tarde and Other Payables	337.6	4,901.7	621.3	1,227.1	385.0
Total/Tier-1 Equity	22,731.4	22,767.1	22,776.8	19,465.1	16,448.2
Paid-up Capital	21,643.3	22,765.8	24,827.4	24,827.4	24,827.4
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**
Net Sales	-	-	137.7	794.4	1,031.2
Gross Profit / (Loss)	-	-	(1,203.5)	(2,170.8)	(1,756.6)
Profit / (Loss) Before Tax	(46.1)	47.9	(2,045.3)	(3,301.8)	(3,004.1)
Profit After Tax	(42.0)	35.7	(2,051.9)	(3,311.7)	(3,017.0)
Funds from Operations (FFO)	-	-	(341.3)	(620.9)	(347.7)
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**
Gross Margin (%)	NA	NA	NA	NA	NA
Net Margin (%)	NA	NA	NA	NA	NA
Current Ratio (x)	47.2	2.2	2.2	0.97	1.3
Net Working Capital	15,603.3	5,681.3	1,655.2	(55.3)	322.2
FFO to Total Debt (x)	NA	NA	NA	NA	NA
FFO to Long Term Debt	NA	NA	NA	NA	NA
Debt Leverage (x)	0.3	0.6	0.7	0.9	1.1
Gearing (x)	0.3	0.4	0.6	0.8	1.0
DSCR (x)	NA	NA	NA	NA	NA
ROAA (x)	NA	10%	NA	NA	NA
ROAE (x)	NA	20%	NA	NA	NA

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

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
14/11/2022	A-	A-2	Stable	Reaffirmed
07/10/2021	A-	A-2	Stable	Reaffirmed
19/08/2020	A-	A-2	Stable	Reaffirmed
11/03/2019	A-	A-2	Stable	Initial

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

	Name	Designation	Date
1	Mr. Imran Umer	Financial Controller	November 08, 2022