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Road King Infrastructure Ltd.

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Major Rating Factors

Rationale

Outlook

Business Profile

Financial Profile

ISSUER CREDIT RATING

Road King Infrastructure Ltd.

Corporate Credit Rating

BBB-/Stable/--

AFFIRMED RATING

Road King Infrastructure Ltd.

Sr unsecd debt

Foreign currency

BBB-

Business profile:

Average

Financial policy:

Moderate

Debt maturities:

(As at April 30, 2004)

2004 HK\$591 mil.

2005 HK\$87.5 mil.

2006 HK\$87.5 mil.

2007 HK\$131.3 mil.

Bank lines/Liquid assets:

The company had a committed undrawn bank term loan facility amounting to US\$120 million as at April 30, 2004.

Recovery prospects:

Uncertain.

Corporate credit rating history:

Feb. 7, 2002

BBB-

June 20, 2000

BB+

Major Rating Factors

Strengths.

- Strong economic growth in mainland China is creating a positive trend for traffic growth and affordability over the short to medium term;
- Preferential profit distribution secured on most projects;

- Good operating track record and good financial performance; and
- A diverse portfolio of projects with a new emphasis on expressway projects.

Weaknesses.

- Increased operating risk as Road King Infrastructure Ltd. (RKI) enters new investment cycles, including construction risk on one potential new investment;
- Potential for increased diversification and operating risk as RKI begins to invest in mainland China's residential real estate developments at the holding company level;
- Regulatory and operating risks for transport projects in mainland China; and
- Foreign exchange risk, with most of the company's revenue denominated in Chinese renminbi and most of its debt denominated in foreign currency.

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Rationale

Road King Infrastructure Ltd. (RKI) is a Hong Kong-listed company that primarily invests in toll road projects in mainland China. The rating on RKI and its wholly owned subsidiary, Road King Infrastructure Finance (1997) Ltd. reflects the following strengths:

- RKI benefits from mainland China's developing economy with strong growth in road usage and vehicle ownership. In fiscal 2003 (ended Dec. 31, 2003), RKI's annual average daily traffic volume and annual toll revenue increased 8.3% and 13.1% respectively. Figures for the first half of 2004 also show strong growth with first quarter average daily traffic figures up 14.5%.
- Strong joint venture agreements whereby RKI assumes operational control for the project and mitigates competitive threats with preferential profit distributions resulting in an accelerated payback period. The company also enjoys a strong track record of securing toll rate increases.
- Good operating track record and good financial profile with overall low levels of debt and good liquidity. Including the US\$200 million debt issuance in the second half of 2004 the company's ratio of net debt to total capital is estimated to peak at about 20% in 2006, with funds from operations to net debt at about 60% and funds from operations interest coverage at more than 6x.
- A diverse portfolio of projects, with 21 roads in eight provinces. The portfolio is broken down along geographic and market lines and helps protect RKI against drops in demand that result from particular macro economic events. RKI's current concentration on expressways is expected to further strengthen the company's competitive position and stabilize toll revenue.

RKI's strengths are offset by the following risks.

- RKI is currently entering an investment phase aimed at sustaining and growing cash flow generation. The company currently has several toll road projects under consideration. On one of the new projects, RKI expects to undertake construction risk. The company is also considering limited investment in mainland China's residential real estate market. The planned investments will increase RKI's debt and execution risks over the short term.
- Transport projects in mainland China face regulatory and operating risks, including unclear franchise structures and uncertainty over tariff increases. Any changes in the government's toll road policies could ultimately lead to changes

in RKI's credit profile.

- RKI is exposed to foreign exchange risk as a result of the company's significant currency mismatch between revenue and debt. RKI's revenue is primarily denominated in Chinese renminbi (RMB), while most of its long-term debt is denominated in U.S. dollars.

Liquidity.

RKI maintains a strong liquidity position, with cash and short-term deposits totaling Hong Kong dollar (HK\$) 488 million as at Dec. 31, 2003 compared with short-term debt of HK\$54.6 million. As at April 30, 2004, the company had HK\$591 million in debt due by the end of September with HK\$585 million in cash on hand and US\$120 million in available committed credit facilities.

Recovery.

RKI's recovery prospects are uncertain reflecting the relatively illiquid nature of its saleable assets and the difficulty in enforcing creditors rights under mainland China's legal system. While the timing and amounts of any ultimate recovery will be influenced by market conditions at the time of default, mainland China's legal and regulatory system remains characterized by a general lack of transparency and inconsistent enforcement.

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Outlook

The outlook reflects the expectation that the company's financial performance will remain stable over the next few years as a result of a moderate use of external debt and a conservative strategy of diversification.

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Business Profile

Background.

RKI was founded by Wai Kee Holdings Ltd. (Wai Kee) in 1993 and listed on the Hong Kong stock exchange in 1996. The company's major shareholders include Wai Kee (45%), a Hong Kong-listed civil engineering company with operations in Hong Kong and mainland China, Shenzhen Investment Co. (25%) an investment arm of the Shenzhen municipal government, and Value Partners 11%, an Asian investment fund. Despite majority ownership, Wai Kee's influence over RKI is limited. Wai Kee has only three directors on RKI's board of 10 directors and therefore does not exercise overall control. Furthermore, the company maintains an independent audit committee. Financially, Wai Kee is not as strong as RKI. RKI's credit profile could be negatively affected if a change in ownership resulted in the company being controlled by the weaker parent.

RKI's core business activity is the development and operation of toll highways, bridges, and expressways in mainland China. As at Dec. 31, 2003, RKI had a portfolio of 21 toll road and bridge projects across eight provinces in mainland China, covering about 1,050 kilometers. The company also has a 78% interest in Canadian listed Chai-Na-Ta Corp. the world's largest supplier of North American ginseng. The company is also in the process of establishing a Chinese real estate division focused on investments in the residential market.

	Distance (Km)	Road King's share of investment (RMB mil.)	Number of projects
Anhui	301.8	1,157	5
Guangdong	110.3	1,080	3
Guangxi	66.0	317	2
Hebei	224.0	1,438	3
Henan	80.0	205	1
Hunan	75.6	618	1
Jiangsu	78.9	344	2
Shanxi	113.1	541	4
Total	1,049.7	5,700	21

Regulation, joint venture structure, and legal issues.

Mainland China's toll road sector is fragmented, and is regulated at both the national and provincial level. RKI is subject mainly to provincial regulation as the company typically enters into joint-venture agreements to operate its road projects directly with local partners. Under the joint-venture agreement, RKI typically manages the project and retains operational control for 20–25 years. The local partner is often a provincial governmental body, which is supervised by local highway bureaus, or municipal or provincial governments that have knowledge of local conditions and the relevant technical expertise.

RKI has never been denied a toll rate increase. Approval for toll rate increases rests primarily with the relevant provincial government and provincial price bureaus. These organizations generally take into account the toll rate of comparable toll highways in the same region, affordability to users, the prevailing rate of inflation, and the return for investors. In 2003, a 35% toll rate increase for the Xunan Highway was awarded.

Most of RKI's cooperative joint ventures allow the company a rapid payback period through the receipt of preferential profit distribution arrangements. These preferential profit sharing arrangements allow RKI to receive up to 100% of cash distributions from the road for the first few years of the joint-venture period until the company's initial investment is recouped. Profit distribution then shifts in favor of the Chinese party or local joint-venture partner, until it too has recouped its investment. Once both joint-venture partners have recouped their initial investments, profits are distributed along ownership lines.

For a few projects, mainland China partners have also provided minimum income undertakings (MIUs) to cover any deficiencies arising if operating profits fail to fully cover RKI's entitled distributions. MIUs are expected to decline in importance over the next few years. While the legality and enforceability of guaranteed returns in the form of MIUs are questionable under current regulations, the relatively small amounts remaining to be collected and the short amount of time remaining on the distribution period mitigate concerns.

Markets.

RKI benefits from an extremely diverse project portfolio in a rapidly growing economy. RKI's 21 road projects are located in the eight provinces of Hebei, Anhui, Guangdong,

Hunan, Shanxi, Jiangsu, Henan, and the Guangxi Zhuang Autonomous Region. The company's projects include various bridges and highways and four large expressway projects including the Guangsan and Jihe Expressways in Guangdong, the Baoding-Tianjing Expressway in Hebei, and the Changsha-Yiyang Expressway in Hunan. Investment in expressways accounted for 29% of cash distributions in fiscal 2003.

Mainland China's economic growth rate and its entry to the World Trade Organization have fueled growth in vehicle registrations and traffic volumes over the past few years. This trend is expected to continue despite the fact that the government intends to control the rate of growth in the economy. Future traffic volume growth is supported by a strong but slower growth in GDP, increased affordability of vehicle ownership, increased road demand—as a result of the country's World Trade Organization status—and a government that is focused on the construction of a national transportation network as stated in the Tenth Five Year plan.

Table 2 Mainland China Economic/Financial Indicators

(% change)	2006F	2005F	2004F	2003	2002	2001
Real GDP	7.9	7.5	8.9	10.8	8.9	7.4
Real fixed investment	10.8	9.6	11.4	21.7	12.9	11.9
Real exports	16.7	17.1	18.5	35.2	21.9	10.5
CPI inflation	1.1	1.7	4.4	3.2	(0.8)	0.7

*NFPE—Non-financial public enterprises. F—Forecast.

RKI's road portfolio continued to perform well in fiscal 2003 with average daily traffic volume up 8.3% and yearly toll revenue up 13.1%. Traffic volume and toll revenue grew despite an outbreak of Severe Acute Respiratory Syndrome in mainland China during the first half of 2003 demonstrating the positive portfolio effect the roads enjoy as a result of good geographic diversification and varied market positioning. Results for the first quarter of 2004 are also positive with daily traffic up 14.5% compared with the corresponding period in 2003.

Table 3 Road King Infrastructure Ltd. Toll Roads Operating Statistics

	RKI's share of annual toll revenue (HK\$ mil.)	RKI's average daily traffic volume	Freight vehicles registered in mainland China ('000)	Passenger vehicles registered in mainland China ('000)
2003	815	312,000	N.A.	N.A.
2002	748	288,000	8,122	12,024
2001	733	289,000	7,652	9,940
2000	725	272,000	7,163	8,537
1999	659	260,000	6,769	7,402

N.A.—Not available. Source: Road King Infrastructure Ltd. and China Statistical Yearbook, 2003.

Operations.

RKI enjoys a long track record of favorable operations in mainland China and is one of

the few foreign investors with a portfolio of toll roads in the country. RKI has made a commitment to invest in expressways in mainland China, particularly those located in Hebei and serving Beijing, and Tianjin. RKI typically invests in roads that are already operational and have proven traffic volumes and toll revenue collections. This policy minimizes the company's exposure to construction risk and reduces the time before traffic growth is achieved. RKI typically seeks a 50% or 60% interest in its joint-venture projects.

RKI is currently pursuing new project investments in mainland China. It's priority focuses on expressways. In general, the business risk associated with expressways is limited because they are subject to less duplication compared with smaller, less expensive roads. In March and May 2004, the company entered into two conditional agreements to invest RMB760 million-RMB810 million in the Tangshan-Tianjin Expressway (Hebei section) and RMB0.97 billion-to RMB1.3 billion on the Hefei-Yeji Expressway in Anhui. These investments follow a HK\$960 million investment in the Baojin Expressway project in Hebei province in September 2003.

The Hefei-Yeji Expressway differs from RKI's standard investments in that it exposes the company to construction and execution risks associated with green field site development. While RKI has a qualified engineering team and years of experience in operating roads in mainland China, it does not have a track record for managing the construction of road projects. The Hefei-Yeji project involves the construction of a new expressway and the upgrade of portions of the existing Heye Highway to connect with the new expressway. The project, which was designed by the Provincial Design Institute, will be awarded to an independent contractor on a competitive bid basis. RKI expects to work with the contractor and manage the project.

Competition.

Given the fragmented nature of regulation and the speed at which infrastructure development occurs within mainland China, RKI is exposed to the risk that competing roads will be developed. Preferential profit sharing agreements and strong relationships with Chinese partners can only partially mitigate this risk.

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Financial Profile

Financial Policy: Moderate

RKI has a moderate financial policy, despite the low level of debt reflected in its financial accounts at the end of 2003. A moderate classification indicates that the company's level of debt is likely to increase in 2004 as the company develops several new toll road projects. The company also maintains a currency mismatch, with toll revenue received in Chinese renminbi and debt denominated in Hong Kong dollars and U.S. dollars. RKI's dividend payout ratio was fairly low at about 45% in fiscal 2003 and is expected to remain below 50% of profit over the next few years.

Accounting policy.

RKI's accounts are prepared in accordance with Hong Kong's generally accepted accounting practices. As of fiscal 2003 all of RKI's projects follow the equity method of accounting, even where RKI's ownership is more than 50%. The only project consolidated into RKI's financial accounts in previous years—the Zhongshan Qijiang project—was sold in fiscal 2003. Under equity accounting, toll income net of joint-venture operating expenses and depreciation of the highway operation rights using

RKI's depreciation policy is recorded as profit from joint ventures, which goes directly to RKI's bottom line.

In line with equity accounting, cash flow from the Chinese joint ventures is not classified as cash flow from operating activities, but as cash from investing activities in the form of dividends received from, and repayment of, loans from infrastructure joint ventures. The loans to infrastructure joint ventures are unsecured, interest free, and have no fixed repayment terms. Standard & Poor's treats all dividends and loan repayments from infrastructure joint ventures as part of funds from operations.

Profitability and Cash flow protection.

Growth in toll revenue coupled with an increase in project cash flows (including MIUs), and a low level of corporate debt resulted in good profitability and cash flow results for RKI for the year ended Dec. 31, 2003. The company's EBIT interest coverage increased to 6.6x in fiscal 2003 from 5.3x in fiscal 2002. The company's funds from operations net interest coverage increased to 10.3x in 2003 from 5.6x in 2002, with its ratio of funds from operations to total debt at 61.5% compared with 33.7% over the same period. Profitability and cash flows are expected to increase as the company invests in new projects with a proven operating history. Operating coverage ratios and funds from operations to debt are expected to decline, however, reflecting an increase in the amount of debt borrowed at the holding company level.

The company plans to invest millions in new expressway projects in mainland China over the next few years. New investment is required to stabilize cash flows as preferential profit distributions shift in favor of joint venture partners or as individual project joint ventures conclude. As a result of this new investment, operating cash flows will not be sufficient to cover the acquisition costs of new projects. Debt at RKI is expected to increase substantially over the next few years, albeit from a very low level. While it is appreciated that the planned investments are required to sustain or grow cash flows; it is also recognized that RKI's financial flexibility and liquidity will be constrained over the investment period.

Table 4 Road King Infrastructure Ltd. Historical MIUs and Cash Distribution

(HK\$ mil.)	—Year ended Dec. 31—					
	2003	2002	2001	2000	1999	1998
Cash distribution from joint ventures	509	527	496	479	459	428
MIU from joint-venture partners	106	63	45	88	124	151
Project cash flow to Road King Infrastructure Ltd.	614	590	541	567	583	579
MIU—Minimum income undertakings.						

Capital structure.

RKI's current capital structure is conservative with a ratio of debt to capitalization of 17.6% and a ratio of net debt to capitalization of 9.9% as at Dec. 31, 2003. Absolute debt levels are expected to nearly triple over the next few years with the level of debt to capitalization becoming more moderate. Debt to capitalization is expected to peak at 33% over the next three to five years with net debt to capital at 20%. All of RKI's debt is at the corporate level. None of RKI's road projects carry project level debt.

Table 5 Road King Infrastructure Ltd. Debt Maturity Profile as at April 30, 2004

Year due	Amount (HK\$ mil.)	Total debt (%)
2004	591.0	67.1
2005	87.5	9.4
2006	87.5	9.4
2007	131.3	14.1

Amounts due in 2004 reflect projected prepayment of the secured notes due in 2007.

Liquidity and liability management.

RKI maintains a strong liquidity position, with cash and short-term deposits of HK\$585 million as at April 30, 2003 compared with HK\$591 million in debt falling due. The company also maintains committed loan facilities totaling US\$120 million.

RKI is exposed to exchange rate risk because of currency mismatch between its debt and revenue. As at Dec. 31, 2003 RKI had about 100% of its debt denominated in either U.S. dollars or Hong Kong dollars, while almost all of its toll revenue is denominated in Chinese renminbi. The only exception is the company's Jihe Expressway, which has partial Hong Kong dollar-denominated toll revenue. About 70% of the company's cash balance is invested in U.S. dollars and Hong Kong dollars to create a hedge against foreign exchange risk. To help mitigate this risk RKI converts Chinese renminbi to Hong Kong dollars or U.S. dollars each month.

Financial flexibility.

RKI has adequate financial flexibility as a result of its strong project cash flows that easily cover operating costs and interest payments. However, as indicated by the rating on the company, its flexibility remains vulnerable to a decline in decreases in traffic volumes or changes in toll rate policies in mainland China. Aggressive new investment in expressway's or other businesses could also decrease the company's overall financial flexibility.

Table 6 Road King Infrastructure Ltd. Financial Highlights

(HK\$ mil.)	—Year ended Dec. 31—				
	2003	2002	2001	2000	1999
Income statement					
Gross revenue	119.3	163.7	245.6	275.8	243.2
Operating expenses*	145.8	155.9	173.6	128.6	75.6
Depreciation and amortization	3.8	7.1	7.1	7.3	6.3
EBITDA†	(26.4)	7.8	72.0	147.2	167.6

Interest incurred	65.9	80.6	111.3	130.7	133.4
Net interest incurred	56.8	62.8	96.5	106.6	98.9
Net income	318.3	312.8	240.8	428.1	610.3
Earnings protection					
Operating income/sales (%)	(22.1)	4.8	29.3	53.4	68.9
Adjusted operating income/sales (%)	(22.1)	4.8	29.3	53.4	68.9
EBIT interest coverage (x)	6.6	5.3	3.4	4.5	4.2
Adjusted EBIT interest coverage (x)	6.6	5.3	3.4	4.5	4.2
Net EBIT interest coverage (x)	7.5	6.5	3.7	5.4	5.3
Adjusted net EBIT interest coverage (x)	7.5	6.5	3.7	5.4	5.3
EBITDA interest coverage (x)	(0.4)	0.1	0.7	1.2	1.3
Adjusted EBITDA interest coverage (x)	(0.4)	0.1	0.7	1.2	1.3
Adjusted total debt/EBITDA (x)	(38.4)	145.6	16.7	9.4	9.2
Adjusted net debt/EBITDA (x)	(19.7)	(4.7)	3.2	6.4	3.5
Adjusted return on average permanent capital (%)	7.6	7.6	6.7	10.2	9.7
Balance sheet					
Cash and equivalents	495.4	1,177.4	968.5	390.5	900.3
Net plant	45.9	117.1	127.8	144.4	100.8
Total assets	5,827.6	5,725.7	5,625.7	5,728.4	5,698.3
Short-term debt	54.6	195.6	99.6	149.1	154.2
Long-term debt	960.8	945.2	1,099.6	1,239.6	1,378.7
Preferred stock	-	-	-	0.1	0.1
Common equity	4,756.4	4,521.9	4,368.3	4,252.9	4,086.9
Total capitalization	5,771.7	5,662.7	5,567.5	5,641.6	5,619.8
Total off-balance-sheet obligations	-	116.8	150.5	155.0	-
Balance-sheet-ratios					
Short-term debt/total capital (%)	0.9	3.5	1.8	2.6	2.7
Long-term debt/capital (%)	16.6	16.7	19.8	22.0	24.5
Common equity/total capital (%)	82.4	79.9	78.5	75.4	72.7
Total debt/total capitalization (%)	17.6	20.2	21.5	24.6	27.3
Adjusted total debt/total capital (%)	17.6	20.2	21.5	24.6	27.3
Net debt/net total capital (%)	9.9	(0.8)	5.0	18.1	12.7
Adjusted net debt/net total capital (%)	9.9	(0.8)	5.0	18.1	12.7
Cash flow					
Net income	318.3	312.8	240.8	428.1	610.3
Depreciation	3.8	7.1	7.1	7.3	6.3
Funds from operations	556.8	384.0	303.4	466.4	508.1

Preferred dividends	-	31.4	38.9	38.9	38.9
Common dividends	141.7	129.0	70.9	209.3	213.6
Net cash flow	415.1	223.6	193.6	218.2	255.6
Net capital expenditure	12.7	5.4	4.1	7.0	3.7
Discretionary cash flow	469.5	294.1	277.9	(7.3)	294.1
Cash flow adequacy					
Capital expenditure/average total capital (%)	0.2	0.1	0.1	0.1	0.1
Net cash flow/capital expenditure (%)	3,261.8	4,151.8	4,721.5	3,110.4	6,855.2
Net cash flow/capital expenditure and net acquisitions (%)	37.1	994.9	(44.4)	83.3	(51.1)
Funds from operations/total debt (%)	61.5	33.7	25.3	33.6	33.1
Adjusted funds from operations/total debt (%)	61.5	33.7	25.3	33.6	33.1
Funds from operations/net debt (%)	120.0	(1,049.1)	131.5	49.8	85.7
Adjusted funds from operations/net debt (%)	120.0	(1,049.1)	131.5	49.8	85.7
Funds from operations interest coverage (x)	10.3	5.7	3.7	4.8	4.9
Adjusted funds from operations interest coverage (x)	10.3	5.7	3.7	4.8	4.9
Funds from operations net interest coverage (x)	11.9	7.0	4.1	5.6	6.4
Adjusted funds from operations net interest coverage (x)	11.9	7.0	4.1	5.6	6.4
*Excludes depreciation, depletion, and amortization. EBITDA—Defined as revenue minus cost of goods sold minus SG&A.					

Peer group analysis.

Table 7 Road King Infrastructure Ltd. Peer Comparison Table

	Road King Infrastructure Ltd.	Autoroutes du Sud de la France S.A.	Transurban Finance Co. Pty Ltd.	Autostrade SpA	Panva Gas Holdings Ltd.
Business segment	Roads, less than 1% of national road system	Roads, 92% of French roads	Roads in city of Melbourne	Roads, about 52% of national road system	Gas distribution
Kilometer (km) network	1,000	2,870	22	3,408	N.A.
Toll mechanism	Require approval	Escalated at minimum guaranteed levels	Automatic	Five year adjustment mechanism	N.A.
Business arrangement	Long-term joint ventures	Concession—28 years remaining	Concession—30 years remaining	Concession—34 years remaining	Long-term joint ventures

Country	China	France	Australia	Italy	Mainland China
Government ownership (%)	No	51	No	No	No
Year of data	2003	2003	2003	2002	2003
Rating	BBB-/Stable	A+/Stable	BBB+/Negative	A/Negative	BB+/Negative
Total assets (HK\$ mil.)	5,828	121,368	23,906	74,353	1,436
Total debt (HK\$ mil.)	1,015	81,457	11,747	21,724	415
Funds from operations/net interest (x)	11.9	2.6	1.9	14.4	33.9
Funds from operations/net debt (%)	120.0	10.0	5.6	74.6	377.7
Net debt/capital (%)	9.9	71.0	50.2	31.5	8.6
Net cash flow/capital expenditure (%)	37.1	96.0	337.2	125.6	141.1
N.A.—Not applicable.					

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