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Road King Infrastructure Ltd.

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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 June 30, 2005)
Within 1 year: HK$211 mil.
Between 1 and 2 years: HK$4 mil.
Between 2 and 5 years: HK$4 mil.
After 5 years: HK$1,559 mil.

Bank lines/Liquid assets:
The company had committed bank facilities amounting to US$120 mil. as at June 30, 2005.

Recovery prospects:
Uncertain

Corporate credit rating history:

Feb. 7, 2002	BBB-
June 20, 2000	BB+

Major Rating Factors

Strengths

- Strong economic growth in China
- Preferential profit distribution

- Good operating track record
- A diverse portfolio of projects

Weaknesses

- Increased operating risk
- Good diversity
- Regulatory risks for transport projects in China
- Foreign exchange risk

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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 (2004) Ltd. reflects the following strengths:

- RKI benefits from China's economic development, which has seen strong growth in road usage and vehicle ownership. In fiscal 2004 (ended Dec. 31, 2004), RKI's annual average daily traffic volume and annual toll revenue increased 11.9% and 30.9%, respectively. There was also strong growth in the first half of 2005, with daily traffic figures up 10.3% over the corresponding period in 2004.
- RKI has strong joint-venture agreements. It has significant operational control for projects, and mitigates competitive threats through preferential profit distributions that result in an accelerated payback period.
- The company has a good operating track record and financial profile, with overall low levels of debt and good liquidity. As additional debt is expected from its property development projects in China, the company's ratio of net debt to total capital is estimated to increase to no more than 30% over the next two years.
- RKI has a diverse portfolio of projects, with 21 roads in eight provinces. The portfolio is broken down along geographic and market lines, and this helps to protect RKI against falling demand as a result of a specific macroeconomic event. RKI's current concentration on expressways is expected to strengthen its competitive position and stabilize toll revenue. In general, expressways are subject to less duplication than smaller, less expensive roads.

RKI's strengths are offset by the following risks.

- RKI is in an investment phase, which is aimed at sustaining and growing cash flow generation. The company has several toll road projects under consideration. One of the new projects involves some construction risk.
- The company has also ventured into mainland China's residential real estate market, but on a limited scale. The planned investments will increase RKI's debt, free cash flow volatility, and execution risks over the short to medium term.
- Transport projects in mainland China face regulatory and operating risks, and uncertainty over tariff increases. Any changes in the government's toll road policies could lead to changes in RKI's credit profile.
- RKI is exposed to foreign exchange risk as a result of the significant currency mismatch between its revenue and debt. RKI's revenue is primarily

denominated in Chinese renminbi, while most of its long-term debt is denominated in US dollars.

Liquidity

RKI maintains a strong liquidity position, with cash and short-term deposits totaling Hong Kong dollars (HK$) 323 million as at June 30, 2005 compared with short-term debt of HK$211 million. The company also has US$120 million in available committed credit facilities, of which US$10 million was drawn as at June 30, 2005.

Recovery

RKI's recovery prospects are uncertain, reflecting the relatively illiquid nature of its saleable assets and the difficulty in enforcing creditors' rights under China's legal system. While the timing and extent of any recovery will be influenced by market conditions at the time of default, 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 expectations that the company's financial performance will remain stable over the next few years. Standard & Poor's, however, believes that RKI's investments in new toll road projects and China's residential real estate market will increase its overall debt levels in the next year and its free cash flow volatility in the medium term. RKI's overall business strategy also seems increasingly aggressive because of its foray into China's property development business. Nevertheless, Standard & Poor's expects management to proceed with the company's planned real estate projects prudently, and to continue to focus on the toll road business as its core business segment. RKI's property development strategy in China is to develop the large projects in phases, and this should give the company the flexibility to react to market conditions. An unexpected shift toward more aggressive debt-financed investments in property development in mainland China could put pressure on the ratings.

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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 (47%), a Hong Kong-listed investment holding company with civil engineering and quarry 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 two directors on RKI's board of 10, 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 leads the company to be 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 June 30, 2005, RKI had a portfolio of 21 toll road and bridge projects across eight provinces in mainland China, covering about 1,080 kilometers. The company also has a 78% interest in Canada-listed Chai-Na-Ta

Corp., one of the world's largest suppliers of North American ginseng. In 2004, the company also began a real estate business in China that will focus on investments in the residential market.

Table 1 Table 1 Road King Infrastructure Ltd. Toll Road Portfolio by Province			
	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	317	2
Hebei	282.2	2,237	4
Henan	80	205	1
Hunan	75.6	618	1
Jiangsu	52.8	194	1
Shanxi	113.1	541	4
Total	1,081.80	6,349	21

Regulation, joint venture structure, and legal issues
China's toll road sector is fragmented, and regulated at both the national and provincial level. RKI follows the direction of the provincial governments by entering into joint-venture agreements to operate its road projects directly with local partners. Under the joint-venture agreement, RKI typically co-manages the project with the local partners 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 a municipal or provincial government that has knowledge of local conditions and the relevant technical expertise.

Most of its cooperative joint ventures provide a rapid payback period for RKI through the receipt of preferential profit distribution arrangements. These preferential profit sharing arrangements allow RKI to receive up to 100% of cash distributions from a 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.

While the company has a track record of securing toll rate increases, further increases in toll rates are not expected given the Chinese government's recent policy of toll rate unification. This new policy was expected to be adopted by all provinces on Jan. 1, 2005. Of the eight provinces that RKI has invested in, six have already implemented the unification policy, which brings a small net toll rate increase of about 2% to the company. When the remaining two provinces have adopted the policy, the overall net impact on RKI's toll road portfolio is not expected to be significant.

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. RKI's dependence on MIUs is minimal, constituting about 0.4% of fiscal 2004 revenue, compared with 1.6% in 2003. MIUs are expected to be entirely phased out over the next year, with the Chinese government stating that such minimum return guarantee arrangements will not be extended to future projects.

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 five large expressway projects, including the Guangsan and Jihe expressways in Guangdong, the Baoding-Tianjin and Tangshan-Tianjin expressways in Hebei, and the Changsha-Yiyang Expressway in Hunan.

China's economic growth rate and its entry to the World Trade Organization (WTO) have fueled growth in vehicle registrations and traffic volumes over the past few years. This trend is expected to continue despite the government's intention to control the economic growth rate. Future traffic volume growth is supported by strong but slower growth in GDP, increased affordability of vehicle ownership, increased road demand (as a result of the country's WTO status) and a government that is focused on the construction of a national transportation network, as stated in the 10th five-year plan.

Table 2 Mainland China Economic/Financial Indicators

(% change)	2006f	2005f	2004	2003	2002	2001
Real GDP	8.5	9.3	9.4	9.3	8.9	7.4
Real fixed investment	14.7	14.7	20.2	21.7	12.9	11.9
Real exports	17.9	21.7	33	35.2	21.9	10.5
CPI inflation	1.4	3.4	2.4	1.2	(0.8)	0.7

f—Forecast.

RKI's road portfolio continued to perform well in fiscal 2004 with average daily traffic volume up 11.9% and yearly toll revenue up 30.9%. Results for the first half of 2005 are also positive, with daily traffic up 10.3% compared with the corresponding period in 2004.

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 China ('000)	Passenger vehicles registered in China ('000)
2004	993	349,000	N.A.	N.A.
2003	815	312,000	8,535	14,788
2002	748	288,000	8,122	12,024
2001	733	289,000	7,652	9,940
2000	725	272,000	7,163	8,537

N.A.—Not available. Source: Road King Infrastructure Ltd.

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, 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 its exposure to construction risk and reduces the time before traffic growth is achieved. RKI typically seeks about a 50% interest in its joint-venture projects.

RKI is currently pursuing new project investments in mainland China. It solely focuses on expressways. In general, the business risk associated with expressways is limited because they are subject to less duplication than smaller, less expensive roads. In January 2005, the company acquired a 45% equity interest in the Tangshan-Tianjin Expressway in Hebei province. This project began to contribute to the company's profits and cash flow in February 2005.

In May 2004, the company entered into a conditional agreement to invest approximately RMB1.1 billion in the Hefei-Yeji Expressway in Anhui. This project, which will require some debt financing, is still awaiting approval from related Chinese authorities. The Hefei-Yeji Expressway differs from RKI's standard investments in that it exposes the company to construction and execution risks associated with greenfield site development. While RKI has a qualified engineering team and years of experience in operating roads in mainland China, its track record in managing the construction of road projects is limited. 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, has been awarded to independent contractors to work on different sections on a competitive bid basis. RKI expects to work with the contractors and manage the project.

In January 2005, the company disposed of its entire interest in the Changzhou-Caoqiao Highway project in Jiangsu province to a third party in China for a consideration of HK$106million.

In 2004, the company entered the property development business in China on a limited scale. Currently, the company has projects in Guangzhou, Guangdong province and Changzhou, Jiangsu province. The total budgeted investment in property development, including land and construction costs, amounts to about HK$3.5 billion, which will be spent over the next five years. These projects are expected to contribute to the company's profit from 2006 and to net cash flow from 2007. Although RKI's exposure to property development is still considered limited at this stage, the opportunities available in the Chinese property market may persuade the company to invest more aggressively, and this could increase the company's overall risk profile.

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 partially mitigate this risk. RKI's expansion of its toll road portfolio, with emphasis on expressways, also helps reduce this risk.

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Financial Profile

Financial Policy: Moderate

RKI has a moderate financial policy. The company's debt level increased substantially in 2004, and is likely to continue to increase in the short term as it expands into the property development business. RKI also maintains a currency mismatch, with toll revenue received in renminbi and debt denominated in Hong Kong dollars and US dollars. RKI's dividend payout ratio was about 50% in fiscal 2004, and is expected to remain at about 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 2004 all of RKI's projects follow the equity method of accounting, even where RKI's ownership is more than 50%. 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, and this 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 (FFO).

Profitability and cash flow protection

Growth in toll revenue resulted in good profitability and cash flow for RKI in the year ended Dec. 31, 2004. The company's EBIT interest coverage declined to 4.9x in fiscal 2004 from 6.6x in fiscal 2003, owing to a rise in interest expenses as a result of the increase in the company's debt level. For similar reasons, the company's ratio of FFO to total debt decreased to 34.3% in 2004 from 54.8% in 2003. Profitability is expected to continue to increase over the next several years because of the growth of the toll road business and profit contributions from the company's real estate projects. While RKI's operating cash flows will remain stable, its free cash flows are expected to be volatile in the medium term, given the cash outlays required for new toll road investments and the property development business.

RKI plans to invest in new expressway projects in mainland China over the next few years. New investment is required to stabilize and maintain the growth of cash flows as preferential profit distributions shift in favor of joint-venture partners or as individual joint-venture projects conclude. The company's operating cash flows will not be sufficient to cover these new investments. While planned investments are intended to sustain or increase cash flows, it is recognized that RKI's financial flexibility and liquidity will be constrained over the next few years.

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

	Year ended Dec. 31					
(HK$ mil.)	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**
Cash distribution from joint ventures	622	509	527	496	479	459
Minimum income undertakings from joint-venture partners	65	106	63	45	88	124
Project cash flow to Road King Infrastructure Ltd.	687	614	590	541	567	583

Capital structure

During 2004, RKI's capital structure became more aggressive, with the ratio of debt to capitalization increasing to 27.6% in fiscal year 2004 from 17.6% in fiscal year 2003. The ratio of net debt to capitalization improved to 7.2% as at Dec. 31, 2004 from 9.9% as at Dec. 31, 2003 though. As at June 30. 2005, the company maintained its moderate debt to capital ratio of 25.7% and net debt to capitalization of 22.1%. Absolute debt levels are expected to increase over the next year and start to fall in the following years. RKI is expected to incur additional debt next year to fund the initial capital outlays for its real estate projects. Management expects the company's property development business to become self-financing beyond that point, given the sales and presales proceeds from the projects. Debt to capitalization is expected to peak at a low 30% in the short term, with a net debt to capital ratio of no more than 30%. Including the project level debt, which the company is expected to incur from its new toll road investments, the adjusted debt to capitalization ratio should peak around 35%.

Year due	Amount (HK$ mil.)	Total debt (%)
Within 1 year	210.793	11.86
After 1 year but within 2 years	4.264	0.24
After 2 years but within 5 years	3.892	0.22
After 5 years	1,558.76	87.68

Liquidity and liability management

RKI has a strong liquidity position, with cash and short-term deposits of HK$323 million as at June 30, 2005, compared with HK$211 million in debt falling due. The company also maintains committed loan facilities totaling US$120 million, of which US$10 million was drawn as at June 30, 2005. The company's liquidity position will be constrained in the medium term, however, by the capital outlays required for new investments. Cash levels dropped from HK$1.5 billion as at fiscal year-end 2004 (Dec. 31) to HK$323 million as at June 30, 2005.

RKI is exposed to exchange rate risk because of the currency mismatch between its debt and revenue. As at Dec. 31, 2005, RKI's debt was principally denominated in either US 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. The renminbi revaluation in July 2005 is expected to have a positive impact on the company, given that most of the company's debt is denominated in US dollars. The company's cash balance is invested predominantly in US dollars and Hong Kong dollars to create a hedge against foreign exchange risk. To help mitigate this risk, RKI coverts Chinese renminbi to Hong Kong dollars or US dollars each month.

Financial flexibility

RKI has adequate financial flexibility as a result of its strong project cash flows, which easily cover operating costs and interest payments. As indicated, however, new investment in expressways and more aggressive property development or other business expansion could lower the company's overall financial flexibility.

Table 6 Road King Infrastructure Ltd. Financial Highlights	
	Year ended Dec. 31

(HK$ mil.)	2004	2003	2002	2001	2000
Income statement					
Gross revenue	48.3	119.3	163.7	245.6	275.8
Operating expenses*	124.7	145.8	155.9	173.6	128.6
Depreciation and amortization	2.3	3.8	7.1	7.1	7.3
EBITDA¶	(76.4)	(26.4)	7.8	72.0	147.2
Interest incurred	103.7	65.9	80.6	111.3	130.7
Net interest incurred	91.0	56.8	62.8	96.5	106.6
Net income	368.8	318.3	312.8	240.8	428.1
Earnings protection					
Operating income/sales (%)	(158.2)	(22.1)	4.8	29.3	53.4
Adjusted operating income/sales (%)	(158.2)	(22.1)	4.8	29.3	53.4
EBIT interest coverage (x)	4.9	6.6	5.3	3.4	4.5
Adjusted EBIT interest coverage (x)	4.9	6.6	5.3	3.4	4.5
Net EBIT interest coverage (x)	5.5	7.5	6.5	3.7	5.4
Adjusted net EBIT interest coverage (x)	5.5	7.5	6.5	3.7	5.4
EBITDA interest coverage (x)	(0.8)	(0.4)	0.1	0.7	1.2
Adjusted EBITDA interest coverage (x)	(0.8)	(0.4)	0.1	0.7	1.2
Adjusted total debt/EBITDA (x)	(25.0)	(38.4)	145.6	16.7	9.4
Adjusted net debt/EBITDA (x)	(5.1)	(19.7)	(4.7)	3.2	6.4
Adjusted return on average permanent capital (%)	8.0	7.6	7.6	6.7	10.2
Balance sheet					
Cash and equivalents	1,524.9	495.4	1,177.4	968.5	390.5
Net plant	64.7	45.9	117.1	127.8	144.4
Total assets	7,004.2	5,827.6	5,725.7	5,625.7	5,728.4
Short-term debt	132.7	54.6	195.6	99.6	149.1
Long-term debt	1,779.2	960.8	945.2	1,099.6	1,239.6
Preferred stock	-	-	-	-	0.1
Common equity	5,013.9	4,756.4	4,521.9	4,368.3	4,252.9
Total capitalization	6,925.8	5,771.7	5,662.7	5,567.5	5,641.6
Total off-balance-sheet obligations	-	-	116.8	150.5	155.0
Balance-sheet-ratios					
Short-term debt/total capital (%)	1.9	0.9	3.5	1.8	2.6
Long-term debt/capital (%)	25.7	16.6	16.7	19.8	22.0
Common equity/total capital (%)	72.4	82.4	79.9	78.5	75.4
Total debt/total capitalization (%)	27.6	17.6	20.2	21.5	24.6
Adjusted total debt/total capital (%)	27.6	17.6	20.2	21.5	24.6

Net debt/net total capital (%)	7.2	9.9	(0.8)	5.0	18.1
Adjusted net debt/net total capital (%)	7.2	9.9	(0.8)	5.0	18.1
Cash flow					
Net income	368.8	318.3	312.8	240.8	428.1
Depreciation	2.3	3.8	7.1	7.1	7.3
Funds from operations (FFO)	655.7	556.8	384.0	303.4	466.4
Preferred dividends	-	-	31.4	38.9	38.9
Common dividends	152.3	141.7	129.0	70.9	209.3
Net cash flow	503.4	415.1	223.6	193.6	218.2
Net capital expenditure (capex)	27.0	12.7	5.4	4.1	7.0
Discretionary cash flow	477.2	469.5	294.1	277.9	(7.3)
Cash flow adequacy					
Capex/average total capital (%)	0.4	0.2	0.1	0.1	0.1
Net cash flow/capex (%)	1,861.8	3,261.8	4,151.8	4,721.5	3,110.4
Net cash flow/capex and net acquisitions (%)	219.9	37.1	994.9	(44.4)	83.3
FFO/total debt (%)	34.3	54.8	33.7	25.3	33.6
Adjusted funds from operations/total debt (%)	34.3	54.8	33.7	25.3	33.6
FFO/net debt (%)	169.0	120.0	(1,049.1)	131.5	49.8
Adjusted FFO/net debt (%)	169.0	120.0	(1,049.1)	131.5	49.8
FFO interest coverage (x)	7.2	10.3	5.7	3.7	4.8
Adjusted FFO interest coverage (x)	7.2	10.3	5.7	3.7	4.8
FFO net interest coverage (x)	8.1	11.9	7.0	4.1	5.6
Adjusted funds from operations net interest coverage (x)	8.1	11.9	7.0	4.1	5.6
*Excludes depreciation, depletion, and amortization. EBITDA—Revenue minus cost of goods sold minus SG&A.					

Peer group analysis

Table 7 Road King Infrastructure Ltd. Peer Comparison

	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, 94% of French roads	Roads in city of Melbourne	Roads, about 52% of national road system	Gas distribution
Network (km)	1,080	2,941	22	3,408	N.A.

Toll mechanism	Requires approval	Escalated at minimum guaranteed levels	Automatic	Five-year adjustment mechanism	N.A.
Business arrangement	Long-term joint ventures	Concession with 27 years remaining	Concession with 29 years remaining	Concession with 33 years remaining	Long-term joint ventures
Country	China	France	Australia	Italy	China
Government ownership	No	51%	No	No	No
Year of data	2004	2004	2004	2003	2004
Rating	BBB-/Stable	A+/Watch Neg.	BBB+/Stable	A/Stable	BB+/Negative
Total assets (HK$ mil.)	7,004	119,894	26,183	145,849	3,939
Total dsebt (HK$ mil.)	1,912	78,782	13,273	100,556	1,950
Funds from operations (FFO)/net interest (x)	8.1	3	1.9	3.1	22.9
FFO/net debt (%)	169	11.2	7.2	10	(177.8)
Net debt/capital (%)	7.2	70	52.3	83.7	(13.0)
Net cash flow/capital expenditure (%)	1,861.75	115	425.6	56.3	83.2
N.A.—Not applicable.					

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