



Moody's Investors Service

Global Credit Research
Credit Opinion
 21 NOV 2006

Credit Opinion: Road King Infrastructure Limited

Road King Infrastructure Limited

Bermuda

Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating	Ba1
Road King Infrastructure Finance (2004) Ltd	
Outlook	Stable
Bkd Senior Unsecured -Dom Curr	Ba1

Contacts

Analyst	Phone
Elizabeth Allen/Hong Kong	852.2916.1153
Kaven Tsang/Hong Kong	852.2916.1104
Brian Cahill/Sydney	612.9270.8105

Key Indicators

Road King Infrastructure Limited

FYE December 31	2005	2004	2003	2002	2001	5 yr. Average
Adj FFO/Interest Coverage [1]	7.2x	7.1x	10.3x	6.3x	4.1x	7.0x
Adj RCF/Capex+ Investments(net of disposals) [2]	29.2%	155.1%	43.4%	406.6%	[3]NA	158.6%
Adj Debt/Adj FFO [4]	2.9x	3.2x	1.6x	3.8x	5.3x	3.4x
Adj Leverage [5]	27.6%	28.3%	16.8%	28.4%	32.2%	26.7%

[1] (Funds From Operation post Working Capital+Interest Expense)/Interest Expense [2] (Retained Cash Flow post Working Capital)/(Capex-Sale of Tangible Fixed Assets+Acquisitions-Divestments) [3] In FY 2001, Road King recorded net positive cash inflow for Capex+Investments(net of disposals) [4] (Total Debt+Off Balance Sheet Debt+Convertible Preferred Stock)/Funds From Operation post Working Capital [5] (Total Debt+Off Balance Sheet Debt+Convertible Preferred Stock)/(Total Capital+Off Balance Sheet Debt+Convertible Preferred Stock)

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Company Profile

Road King Infrastructure Ltd (Road King) is a Hong Kong-listed company with primary investments in toll roads in China. It was established in 1994 and is one of the largest Hong Kong-listed toll road owners/operators in the country.

As of June 2006, Road King has investments of over HK\$6 billion and mileage of more than 1,000 kilometers. Its roads are spread throughout eight provinces in China: Guangdong, Anhui, Guangxi, Hebei, Henan, Hunan, Jiangsu and Shanxi. The company has also invested in a property development business in various cities in China, including Guangzhou and Changzhou.

Recent Developments

Moody's has downgraded Road King's rating to Ba1 from Baa3, reflecting Moody's expectation of greater business risk and cash flow volatility for Road King, in view of its ongoing investments in its property development business in China. Property business will generate around 50% of the company's cash flow within the next 2-3 years.

Rating Rationale

Road King has a diversified portfolio of toll road projects across China, which has shown a good track record for steady cash flow contributions. Its financial profile indicates investment grade ratings characteristics and compares very well against rated investment grade toll roads in Australia, for instance. The latter are typically monopoly assets operating in a transparent and stable regulated environment. Such strong operating profiles mitigate their high financial leverage.

On the other hand, Road King has a weaker operating profile. As such, its rating is constrained by (1) its exposure to China's developing operating and regulatory environment; (2) some of its toll roads are not trunk routes and are highly likely to face pressure from competing assets; and (3) its increasing investment in property development in China. These ongoing investments in its property business will introduce greater business risk and cash flow volatility for Road King.

Road King's 2006 year-end financial profile will still likely position it close to a borderline investment grade company. However, Moody's believes this is unlikely to remain the case over the coming years. The company has clearly decided to focus on property development which will inevitably increase its business risk, but without a sufficient reduction in financial leverage to justify a continuing investment grade rating.

When compared with the other Ba-rated property developers in China, Road King has a shorter track record in managing a sizable property portfolio. Furthermore, its land bank is less diversified relative to other Chinese property peers such as Greentown (rated Ba2). The overall property portfolio is more consistent with a low-Ba rating profile.

Mitigating such risk is the very stable recurring cash flow generated from Road King's diversified portfolio of 20 toll road projects across China. The company has a long operating track record in managing toll projects, and this business will continue to contribute half of projected cash flow over the next few years, providing strong support to Road King's Ba1 rating.

Overall, Moody's believes the Ba1 rating better reflects the company's increasing business risk, whilst also reflecting the ongoing strong recurring cash flow generated from its diversified portfolio of toll road projects.

Drivers of Rating Change

1) Stable recurring cash flow contributions from toll road investments - Road King has a diversified portfolio of 20 toll road projects, spanning 1,100 kilometers across eight mainland provinces. Most have operating histories of over four years and different joint venture (JV) maturities (between 2014 and 2033), and thus contribute strong and stable cash flow.

Although the top three projects account for almost 50% of its toll road-related cash flow, the portfolio's geographical diversification mitigates to a degree its exposure to regulatory, policy and competition risks. With toll roads spread across regions of varying wealth, Road King is also less susceptible to economic changes in any one area.

On the other hand, only five of these toll roads are expressways. The others are class 1 or 2 highways, which are smaller roads, and more prone to competition from alternate routes as China's highway network develops.

Road King has over ten years of experience in managing toll road investments. However, business risk could rise moderately as it makes new investments, such as Hefei-Yeji Expressway which is a greenfield project and involves some construction risk.

2) Service area and traffic profile - Road King's toll roads continue to benefit from economic growth, urbanisation and increased vehicle ownership. Chinese GDP has grown at an average 12% over the last ten years and vehicle ownership has increased at around 20% CAGR. While each road exhibits different operational and financial performances, the portfolio in aggregate has a good and steady record of growth. In FY2005, its existing roads (excluding any acquisitions and disposals that year) reported 4% growth in total traffic volume and 4% growth in its share of toll revenue. This situation translates into 19% growth for cash distributions to the company.

3) Regulatory uncertainties exist and patterns are difficult to predict - Protection for operators in China is less clear and generally low by global standards. Approvals for rises in toll rates rest primarily with the relevant provincial governments and price bureaus, which generally consider factors such as the rates of comparable highways in the same region and user affordability.

Between 1996 and 2003, Road King managed to obtain toll rises for many of its investments. Despite this success, China's regulatory regime and toll-approval mechanism lack transparency and their evolution is hard to predict. Therefore, uncertainties exist as to the probability of future rises in toll rates.

Typically, pre-agreed restrictions on building competing roads are also absent. Compensation or remedial

measures have to be negotiated on a case-by-case basis.

Similarly, China's regulatory regime for the property market lacks transparency and is hard to predict. Since 2005, the government has implemented several measures to cool the market. Any further measures may significantly affect the cash flow volatility and profitability of Road King's property development business.

4) Increased risk from property development business - Road King's diversification into the property development business increases its financial and business risks. The company has had relatively little experience in property development, and cash flow from this business is lumpier and less predictable than that from its toll roads. Partly mitigating this concern, housing demand in China remains strong and Road King has achieved solid pre-sales over the past year.

Road King has recently acquired 49% interests in Sunco A and 100% of Suzhou Sunco for RMB815 million. These investments have further increased the company's exposure to the property sector and hence the associated financial and market risks. Execution risk has also been raised, as the company does not have any track record in managing a property portfolio of the current scale.

Given Sunco A is an associated level project, whose financials are not reflected on Road King's balance sheet. Moody's has therefore incorporated Road King's share of Sunco A's debt in its adjusted debt calculation to reflect the underlying risk.

5) Financial policy - Road King's investments in new toll roads so far have been gradual with one new investment every one or two years or so. Management is cautious about not over-paying, and only selects roads in locations with which it is familiar and which show growth potential.

Road King has minority stakes in some of its investments and all of them are jointly-controlled entities. Although it does not have full control over these investments, it still has good management representation at project level, such that it participates actively in day-to-day operations and financial management.

Given the relatively slow progress in new road investments, management started investing in property developments from 2004.

Overall, the company's financial policy has been prudent with gearing (defined as total debt/equity) not more than 40% and EBITDA interest coverage over 4x, including cash-on-hand of at least HKD400 million. It typically maintains a dividend payout ratio of 50-60%.

6) Financial metrics - Road King's financial metrics are comparatively strong compared to rated investment grade toll roads in Australia. The latter are typically monopoly assets operating in a transparent and stable regulated environment, and such strong operating profiles mitigate their high financial leverage. Road King's leverage, gross cash flow interest coverage, and adjusted debt/GCF were at around 25-30%, around 7x, and around 3x respectively in 2005.

Given the increase in investment in property development, property business will generate around 50% of the company's cash flow in the next 2-3 years. While such cash flow is large in amount, it is lumpy and is dependent on the ability of Road King to achieve the sales plan, which introduces higher volatility to the company's earning profile and cash flow. Moody's expects GCF interest coverage to stay at around 5-6x and adjusted debt/GCF around 3-4x over the next 2 years.

Road King's liquidity is supported by its stable operating cash from its toll road business which is sufficient to cover short-term debt maturities and ongoing maintenance capex. Given an increased exposure to property sector, Road King may need to rely on external financing to fund ongoing land payments and construction expenses in the future. Moody's note that the company's recent announcement of HK\$850 million share placement will partially alleviate its external funding requirements.

7) Structural subordination

Currently, Road King does not have any debts from its operating subsidiary or JVs. However, going forward it may consider raising debt at the project holding company level. Also, its property subsidiary and JVs could require construction financing. Nonetheless, the total amount is expected to represent under 15% of total assets, such that Moody's is likely to consider structural subordination as immaterial.

If the company incurs further project-level debt to fund other new road acquisitions or its property development projects, the issue of subordination could have greater prominence. Notching of the rating could in turn become applicable.

Rating Outlook

The stable rating outlook reflects Moody's expectations that Road King will maintain a balanced mix of cash flow

contributions from its toll road and property development businesses in the near to medium term. Furthermore, Moody's expects that the company will pursue further expansion in the property development business in a prudent and gradual manner without materially leveraging up its balance sheet. Deviation from this expectation will pressure the rating.

What Could Change the Rating - Up

Upgrade of the rating is unlikely in the next 12-18 months in view of the core execution risks associated with the integration of its new acquisitions and the challenges involved with managing a much larger property development portfolio. Before considering an upgrade Moody's would like to see (1) a stabilization of the company's property strategy which at present appears opportunistic; and (2) a longer track record of successfully managing a larger property portfolio. Road King's strategy to maintain a stable cash flow from its diversified toll road projects is also an important factor in considering an upgrade.

What Could Change the Rating - Down

Further downgrade pressure would emerge if (1) Road King aggressively expands its property exposure, leading to an increase of property contribution to over 60-70% of total cash flow and over 50% of total assets; or (2) the company funds such property expansion predominantly with debt, combined with a material downturn in China's property market resulting in significant slowdown in property sales, such that adjusted debt/gross cash flow (GCF) consistently exceeds 5.5-6x and GCF interest coverage falls below 3.0-3.5x. A deterioration in the performance and hence cash flow generation capacity of its toll road business would also be negative for the rating.

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