



Moody's Investors Service

Global Credit Research
 Credit Opinion
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Credit Opinion: Road King Infrastructure Limited

Road King Infrastructure Limited

Bermuda

Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Issuer Rating	Baa3
Road King Infrastructure Finance (2004) Ltd	
Outlook	Rating(s) Under Review
Bkd Senior Unsecured -Dom Curr	Baa3

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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 Limited (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. It had investments of over HKD6 billion and mileage of more than 1,000 kilometres as of June 2006. Its roads are spread through 8 provinces: Guangdong, Anhui, Guangxi, Hebei, Henan, Hunan, Jiangsu and Shanxi.

Recent Developments

Road King's Baa3 rating has been put on review for possible downgrade following the company's announcement of its potential acquisition of property interests from Sunco China Holdings Ltd, a PRC-based developer with 42

projects in 16 mainland cities.

According to its arrangements with the Sunco Group - including the provision of an upfront cash advance and security deposits of approx RMB550m - Road King is entitled to have options to acquire interests in up to 8 million square meters of gross floor area of land bank for a consideration of up to RMB1.2bn. However, the company's decision to exercise the options depends, among other things, upon the due diligence that it is going to conduct.

In Moody's view, this potential transaction points to the ongoing shift in Road King's strategy towards investments in property development projects in China, a process that will raise its overall business risk profile and cash flow volatility.

Rating Rationale

The Baa3 rating reflects Road King's diversified portfolio of 20 toll road projects across China, and which has shown a good track record for steady cash flow contributions. Its financial profile shows the characteristics of A/Baa ratings, and compares very well against the rated investment grade toll roads in Australia. The latter are typically monopoly assets operating in a transparent and stable regulated environment, and such strong A-type operating profiles mitigate their high financial leverage.

On the other hand, Road King has a weaker operating profile, such that 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 involvement in property development in China. Its investments in property partly offset the stability of cash flow generated from its toll roads.

Furthermore, Road King's business risks could also increase as new investments in toll roads continue. These potential projects, likely to be larger than its existing roads and maybe greenfield projects which involve some degree of construction risk and uncertainty in their operating profiles. All these factors combined are consistent with a Baa3 rating.

Drivers of Rating Change

1) Stable recurring cash flow contribution from toll road investments - Road King has a diversified portfolio of 21 toll road projects, spanning 1,100 kilometres across 8 provinces. Most have operating histories of over 4 years and different JV maturities (between 2014 and 2033), and thus contribute strong and stable cash flow. Although the top 3 account for almost 50% of its toll road-related cash flow, the portfolio's geographical diversification mitigates to a certain extent 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 5 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 10 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 which involves 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 an average 12% in the last 10 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 in 2005) reported 4% growth in total traffic volume and 4% growth in its share of toll revenue. This situation in turn translates into 19% growth for cash distributions to the company.

3) Regulatory uncertainties exist and patterns 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, but 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 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 had no prior experience in property development and cash flow from this business is lumpier and less predictable than that from its toll roads. In addition, investments in property development have weakened its near-term credit metrics.

Prior to the recent announcement, Moody's expects Road King's property exposure, at its peak, to measure 30-35% of group assets. And by 2008-2009, as the larger projects are completed, there is a likelihood that cash flow from property will account for about 50% of the company's cash inflow.

5) Financial policy - Road King's investments in new toll roads so far have been gradual with about one new investment every one or two years. Management is cautious about not over-paying and selects roads in locations with which it is familiar and 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 the 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 deployed resources to property development from 2004.

Overall, the company's financial policy is prudent with gearing (defined as total debt/equity) below 50% and EBITDA interest coverage over 4x, including cash-on-hand of at least HKD400m. It typically maintains a dividend payout ratio of 50-60%. It has a USD120m committed syndicated loan with a Material Adverse Change Clause, and of which USD80m was undrawn as at 30 June 2006.

It also has a small uncommitted revolving loan of HKD100m. It exhibits a healthy debt maturity profile and liquidity position. Short-term debt of HKD362m - as of 31 December 2005 - is covered by cash-on-hand of HKD421m.

6) Financial metrics - Road King's Baa3 rating is well positioned on a financial metrics basis (before incorporating the impact from the latest announcement). Leverage and gross cash flow (GCF) interest coverage are expected to remain slightly above 25% and 5x respectively. RCF/Capex fell from above 1x to below 0.2x in 2005 due to acquisitions of land for development. Moody's expects these ratios to improve slightly in the next few years as the property businesses begin to generate net cash inflows. Total debt/GCF was 3.1x as of December 2005 and the ratio is expected to stay in the range of 3-4x in the next 1-2 years. Road King also has a strong liquidity position. It has strong and stable operating cash, which can sufficiently cover short-term debt maturities and capex for maintenance.

However, Moody's expects Road King's financial profile and liquidity profile will potentially weaken if the proposed property investment goes ahead.

7) Structural subordination

Currently, Road King does not hold any debt at its operating subsidiary or joint venture levels. Hence, structural subordination is absent. However, going forward it may consider raising debt at the project holding company level. The amount is expected to represent under 15% of total debt and 10% of total assets such that Moody's is likely to consider structural subordination as immaterial.

Nonetheless, 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 rating is on review for possible downgrade.

What Could Change the Rating - Up

Upside potential is limited given the rating is currently on review for possible downgrade.

What Could Change the Rating - Down

The current rating review will evaluate the company's plan for property investments (including ongoing capital expenditure), and whether any factors will mitigate its appetite for higher business risk.

In particular, Moody's will focus on whether Road King's exposure to property is likely to continue rising and whether it will become materially enough to significantly change its risk profile. Moody's will consider whether this

transaction will lead to property and property-related investments accounting for over 35% of total assets now, or in the next 1-2 years.

In addition, the review will focus on how the investment will be funded and the consequent impact on leverage and liquidity. To the extent Road King's adjusted debt/gross cash flow exceeds 4x or a material deterioration occurs in its liquidity profile, then the rating could be downgraded to non-investment grade.

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