RATING REPORT

Deokjae Connecting Roads (Private) Limited

REPORT DATE:
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RATING ANALYSTS:
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RATING DETAILS	
Rating Category	**Initial Rating**
Entity	A+/A-1
Rating Date	*June'13, 2016*
Rating Outlook	Stable

COMPANY INFORMATION	
Incorporated on August 18th, 2009.	External auditors: Deloitte Yousuf Adil Chartered Accountants
Private Limited Company	Chief Executive Officer: Mr. Muhammad Intesar Uddin
Key Shareholders (with stake 5% or more):	
Deokjae Construction Company (Pvt.) Limited – 69.7%	

APPLICABLE METHODOLOGY(IES)
JCR-VIS Entity Rating Criteria: Industrial Corporates (October 2003)

Deokjae Connecting Roads (Private) Limited

PROFILE

DCCPL, the parent entity, was incorporated on March 13th, 2009 as a private limited company through the technical collaboration between a private entrepreneur Mr. Jaffar Ali Naqvi and Deokjae Construction Company (Pvt.) Limited, Korea. The company was initially established to bid for the HMDC project.

The shareholding of DCCPL is split between two groups with Mr. Naqvi and his wife holding 50% of the company with remaining shareholding being held by Mr. Niaz Muhammad Khan and his family. DCCPL has a technical affiliation with Deokjae Korea and Sambo Engineering Company Ltd for expertise in construction, designing and engineering.

RATING RATIONALE

Deokjae Connecting Roads (Private) Limited (DCRPL) is a Special Project Company and is a subsidiary of Deokjae Construction Company Private Limited (DCCPL). The company has entered into a concession agreement for a period of 32 years with the Government of Sindh (GoS) for the construction, management and maintenance of the Hyderabad, Mirpurkhas Dual Carriageway (HMDC) project; the first Public Private Partnership project by the GoS. DCCPL, the parent entity, has affiliation with Deokjae Korea and Sambo Engineering Company Ltd for expertise in designing and engineering. The project started commercial operation in 2012, hence eliminating the initial stage construction & implementation risk.

Rating Drivers

Sponsor Support

Ratings incorporate strong sponsor support of GoS and DCCPL as had already been envisioned at the time of project conception. Support is evident from the following:

- Given the long gestation period, a well-structured mechanism is in place in the form of Minimum Revenue Guarantee (MRG), to ensure timely debt servicing, which have been complied by both sponsors. For MRG, GoS has set aside a sum of Rs. 2.17b with a commercial bank in order to ensure timely release of MRG payments for debt servicing.
- The sponsors have injected Rs. 290.4m in revenue shortfall to support repayment to senior lenders.
- GoS has a 30.75% equity participation (in the form of advance against issue of shares) in DCRPL.
- GoS has also contributed Rs. 1.75b for construction of the project at discounted rates and on flexible terms (Markup rate at 4% till 2020 and markup will only be accrued till payment of senior lenders is completed).
- GoS has also set aside an amount of Rs. 494.7m under minimum subsidy grant (MSG) as per which the mark-up amount over 10% will be paid by the GoS. Moreover, an amount of Rs. 261.6m each has been provided by both sponsors in the form of sub-ordinated loan for funding of cost overruns.

Revenue Risk: Volume: Traffic profile features a mix of commuter, agri and business related travel and is expected to remain moderately resilient to changes in economic cycles. Time savings over the course of the entire journey is significant; time taken over the route is less than half through alternate routes. Moreover, no competitive roads can be made within a 10KM radius of the HMDC project during the period of concession.

Infrastructure projects generally have a long gestation period and show a gradual rise in traffic and revenues. This has been built in the financial model and addressed through the arrangements outlined above. Volume of traffic on the route has depicted significant growth in the on-going year and has exceeded projections.

Revenue Risk: Price: Besides volumetric growth in traffic, increase in toll rates has also contributed to higher revenues. Toll rates are revised upward every two years (previously three years) based on cumulative CPI growth over the period. Despite significant stake of GoS in the project, hindrance or political interference in increasing tolls is mitigated by contractual mechanism in place for increasing tolls. Apart from tolls, healthy growth in revenues from other sources (weighbridge and right of way income) has been noted; however, presently the proportion is small but is expected to grow in the future.

Debt Servicing Coverage: Liquidity profile of the company draws support from growing revenues and a structured mechanism in place, in the form of built-in and triggered MRGs, to facilitate timely debt servicing. Based on growth in revenues in the ongoing year and projected cash outlays, FFOs are expected to be positive in the ongoing year (FY16). With improvement in cash flows, MRG utilized has witnessed a decline. Going forward, projected revenues and MRG's are expected to remain comfortable to meet operating expenses and debt obligations of senior lenders. As per management subsequent to 2020, additional cash flows after meeting operating expenses will be split in between GoS and DCCPL in terms of contributions made by each party. There is no structured mechanism in place for repayment of debt given by GoS. As per projections, first accrued mark-up is being reduced and reduction in GoS debt commences from 2027. The Present value of future cash flows is sizeable.

Maintenance/Infrastructure Development: Regular maintenance of the road is outsourced to DCCPL while documented maintenance manual is in place. Major overhaul of the road is due in 2027 funds for the same will be set aside subsequent to repayment of loan from senior lenders. A number of infrastructure development programs have been undertaken and are ongoing.

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix I

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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 II
Name of Rated Entity	Deokjae Connecting Roads (Private) Limited
Sector	Toll Roads
Type of Relationship	Solicited
Purpose of Rating	Entity rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	JCR-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	JCR-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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
13/06/2016	A+	A-1	Stable	Initial