RATING REPORT

Deokjae Connecting Roads (Private) Limited

REPORT DATE:
April 23, 2018

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	A+/A-1	A+/A-1
Rating Date	*April'20, 2018*	*June'13, 2016*
Rating Outlook	Stable	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 (May 2016) http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf

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 (SPC) and is a subsidiary of Deokjae Construction Company (Private) Limited (DCCPL). Registered office of the company is based in Karachi. The company has entered into a concession agreement for a period of 32 years ending 2042 with Government of Sindh (GoS) for the construction, management and maintenance Hyderabad-Mirpurkhas Dual Carriageway (HMDC). DCCPL, the parent entity, has technical affiliation with Deokjae Korea and Sambo Engineering Company Ltd for expertise in designing and engineering. The project started commercial operations in 2012, while the company received project completion certificate in 2015. Total cost of the project is approximately 6.0b, with 70:30 debt to equity ratio.

Rating Drivers

Sponsor Support: Ratings reflect strong sponsor support of both GoS and DCCPL as evident from the following factors:

- Presence of a timely debt repayment mechanism in the form of Minimum Revenue Guarantee (MRG) as a result of contribution from both sponsors. MRG is divided into two parts including built-in MRG and triggered MRG. GoS has set aside a sum of Rs. 2.2b with a commercial bank for timely release of built-in MRG payments for debt repayments, while triggered MRG will also come into play in case actual revenues fall short of projected revenues and quantum of same is fixed as per specific percentage of projected revenues. At end-Dec'17, approximately Rs. 600.5m of both built-in and triggered MRG remained unutilized.
- DCRPL has also injected Rs. 290.4m in revenue shortfall to support repayment to senior lenders.
- GoS has 30.75% equity stake (in the form of advance against issue of shares) in DCRPL.
- GoS has also provided Rs. 1.75b loan to DCRPL for construction of this 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. Subsequently markup will be charged at 8% till the end of concession period).
- GoS has kept aside an amount equal to Rs. 315.7m under Minimum Subsidy Grant (MSG). Mark-up amount over 10% will be paid through MSG.
- Both sponsors provided a sum of Rs. 261.6m in the form of sub-ordinated loan for funding cost overruns.

Revenue Risk (Volume): Actual traffic volumes during FY17 and HY18 have been reported higher than the projected volumes. Given the significant time savings incurred by commuters through this route and a diversified traffic mix, growth in traffic volumes is expected to sustain going forward. Additionally, no competing route is to be developed within a 10km radius of the HMDC project during the period of concession; otherwise, GoS will compensate DCRPL for the loss in revenue.

Revenue Risk (Price): Revenue of the company is also a function of toll rates. During FY17, Sindh High Court (SHC) had passed a judgment revising the toll rates downwards and subsequently the company had to comply with this order. Resultantly, revenues of the company were reported lower than projections for a brief period three month period until the toll were reinstated by a subsequent decision of Supreme Court of Pakistan (SCP). However, the company was covered under the concession agreement for such events and the management claimed the loss in toll revenues from the GoS for this period. Going forward, revision in toll rates based on cumulative CPI growth over the last two years and incorporating concessionary rates for local residents are expected to continue as planned. Weighbridge revenues have also trended upwards and are expected to grow further in future to support toll revenues.

Liquidity: Liquidity profile of the company is supported by presence growing revenues and a structured mechanism in place, in the form of built-in and triggered MRGs, to facilitate timely debt servicing. FFOs of the company have become positive and trended upwards in the period from FY16 to FY17. Given the sizeable quantum of MRG outstanding and projected revenue growth due to higher volumes it is expected that the company's ability to meet senior debt obligations remains manageable. However, ratings remain constrained due to reliance of company on MRG to meet senior debt obligations; this dependence is expected to decline in the coming years. Since the loan acquired from GoS is subordinated in nature and will be repaid post repayment of debt acquired from senior lenders, no structured mechanism exists for repayment of debt given by GoS. As per projections, first principal payment of GoS loan will be repaid in June 2029.

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	
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				
20/04/2018	A+	A-1	Stable	Reaffirmed
13/06/2016	A+	A-1	Stable	Initial