RATING REPORT

Deokjae Connecting Roads (Private) Limited

REPORT DATE:
March 12, 2020

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Latest Rating**	**Previous Rating**
Entity	A+/A-1	A+/A-1
Rating Date	*March 12, 2020*	*April 20, 2018*
Rating Outlook	Stable	Stable

COMPANY INFORMATION	
Incorporated on August 18, 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)
VIS Entity Rating Criteria: ***Industrial Corporates (May 2019)***
Toll Roads (November 2018)
http://www.vis.com.pk/kc-meth.aspx

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

Established as a Special Project Company (SPC), Deokjae Connecting Roads (Private) Limited (DCRPL) entered into a Concession Agreement with the Government of Sindh (GoS) for a period of 32 years on November 11, 2009. The company's primary responsibilities cover the construction, improvement, management, maintenance and operation of the Hyderabad-Mirpurkhas Dual Carriageway (HMDC). It is a subsidiary of Deokjae Construction Company (Private) Limited (DCCPL) with its registered office of the company in Karachi. DCCPL has technical affiliation with Deokjae Korea and Sambo Engineering Company Ltd for expertise in designing and engineering. The project started commercial operations in 2012 and received project completion certificate in 2015. Total cost of the project was approximately 6.0b, 70% was financed through debt and the remaining by equity.

Key Rating Drivers

Assigned ratings continue to draw strength from the sponsor support of both Government of Sindh (GoS) and Deokjae Construction Company Private Limited (DCCPL).
Both GoS and DCCPL have provided support to the company in the form of financial and technical assistance. While DCCPL holds interest of 69.25% in DCRPL, GoS, along with its 30.75% equity stake, had provided additional loan to the company. GoS assisted DCRPL with a loan amounting Rs. 1.75b 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). Furthermore, the arrangement also covers cost overruns through subordinated loans by both sponsors and standby interest rate subsidy by GoS beyond a 10% threshold level. GoS also provided support in the form of Minimum Revenue Guarantee (MRG) for which it has set aside funds on present value basis with a commercial bank for facilitating debt servicing ability of the company. GoS had created a MRG fund of Rs. 2.2b of which Rs 2.05b have been utilized.

Revenue of the company continues to grow at a steady pace.

Revenue base of the company is a function of both traffic flow and toll rates. Given the significant time savings incurred by commuters through this route and a diversified traffic mix, actual traffic volumes have been reported higher during the period under review; 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; if so, GoS guaranteed DCRPL for the loss in revenue. Given that toll rates are inflation indexed, prices of the same are also expected to increase which will support the top line. Going forward, revision in toll rates 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 profile of the company is considered manageable on account of financial support from sponsors.

Liquidity profile of the company is supported by higher revenue base and a structured mechanism in place, in the form of built-in and triggered MRGs, to facilitate timely debt servicing. FFO levels of the company remain positive and were reported at Rs. 211.7m (FY18: Rs. 141.4m) at end-June 2019. 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 likely to be withdrawn in the coming year, given the last debt repayment to senior lenders of Rs. 156m is due by June 2020. 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.

Deokjae Connecting Roads (Private) Limited Appendix I

FINANCIAL SUMMARY			(amounts in PKR millions)
BALANCE SHEET	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**
Fixed Assets *(Property, plant and equipment)*	5,395.3	5,142.8	4,893.7
Long Term Loans	420.3	385.0	410.0
Accrued Markup	33.7	50.0	68.6
Other Receivables	155.9	118.9	153.4
Cash & Bank Balances	250.9	176.1	196.9
Current Assets	449.3	392.9	440.8
Total Assets	6,264.9	5,923.2	5,746.2
Trade and Other Payables	157.0	155.6	172.9
Current Liabilities	570.9	468.1	581.2
Long Term Debt *(*incl. current maturity)*	1,000.8	615.1	385.7
Subordinated Long Term Loan	2,940.0	3,397.3	3,852.6
Deferred Grant from GoS	2,215.1	2,113.0	1,930.9
Paid Up Capital	1,233.1	1,233.1	1,233.1
Total Equity	(76.5)	(365.9)	(628.2)
INCOME STATEMENT	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**
Revenue	515.8	560.1	578.5
Gross Profit	38.3	15.1	40.5
Administrative Expenses	49.8	44.6	50.3
Finance Cost	436.4	461.5	495.8
Profit Before Tax	(332.1)	(286.0)	(257.2)
Profit After Tax	(9.8)	(289.4)	(267.8)
RATIO ANALYSIS	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**
Net Margin (%)	-2%	-52%	-46%
Net Working Capital	(121.6)	(75.2)	(140.4)
Current Ratio	0.8	0.8	0.8
FFO	171.8	141.4	211.7
FFO to Total Debt (x)	0.2	0.2	0.5
FFO to Long Term Debt (x)	0.2	0.2	0.5
Debt Servicing Coverage Ratio (x)		0.5	0.7
Gearing (x)	(13.1)	(1.7)	(0.6)
Debt Leverage (x)	(82.9)	(17.2)	(10.1)

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

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

'SD' Rating: An 'SD' rating is assigned when 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 III

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	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	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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.
Due Diligence Meetings Conducted	None

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
12/3/2020	A+	A-1	Stable	Reaffirmed
20/04/2018	A+	A-1	Stable	Reaffirmed
13/06/2016	A+	A-1	Stable	Initial