CCXAP assigns long-term credit rating of BBB$_g$- to Shandong Commercial Group Co. Ltd., with stable outlook.

Hong Kong, 31 August 2022 – China Chengxin (Asia Pacific) Credit Ratings Company Limited ("CCXAP") has assigned a long-term credit rating of BBB$_g$- to Shandong Commercial Group Co. Ltd. ("Lushang" or the "Company"), with stable outlook.

The BBB$_g$- long-term credit rating of Lushang Group is underpinned by the Company's (1) strong regional competitiveness in the retail sector; (2) reasonable product mix in pharmaceutical business, with extensive sales network; and (3) good access to both equity and debt capital markets. The rating also reflects that moderate support is available from the Shandong Provincial Government when necessary, which is based on the Company's (1) strategic importance to shareholders; and (2) good track record of receiving ongoing support.

However, the rating is also constrained by the Company's (1) weakened retail performance due to the COVID-19 outbreak, economic downturns and intensified competitions; (2) heightened downward pressure on property sales along with slow destocking; and (3) high debt leverage and modest liquidity position.

Corporate Profile

Founded in 1992, Lushang Group is a state-owned capital investment platform in Shandong Province. The Company mainly engages in retail, health and wellness properties, and pharmaceutical businesses. The Company has three publicly listed subsidiaries, Inzone Group Co., Ltd. (Stock Code: 600858.SH), Lushang Health Industry Development Co., Ltd. (Stock Code: 600223.SH), and Lushang Life Services Co., Ltd. (Stock Code: 2376.HK).

As of 30 April 2022, the Shandong Province State-owned Assets Supervision and Administration Commission ("Shandong SASAC") directly held 70% of the Company's shares and was its ultimate controller, while Shandong Guohui Investment Co., Ltd and Shandong Caixin Asset Operation Co., Ltd held 20% and 10%, respectively.

Rating Rationale

Credit Strengths

Strong regional competitiveness in retail sector. With 30 years of operating track record, Lushang Group has become a leading retail business operator in Shandong Province. According to data from China Chain Store & Franchise Association, in 2021, it ranked second among chain store operators in Shandong Province in terms of sales volume. As of 31 March 2022, the Company owned 444 retail shops, with a total area of 5.2 million square meters ("sqm").

Reasonable product mix in pharmaceutical business, with extensive sales network. Lushang Group's pharmaceutical and healthcare products are sold across China and its skin care ingredients are exported to over 80 countries in North America, the European Union, Japan, and South Korea. We believe that a reasonable product mix and a worldwide distribution network can help the Company reduce concentration risk in a single product and a single market, which are credit positive.

Good access to both equity and debt capital markets. Lushang Group has maintained good relationships with financial institutions, and was granted total credit facilities of RMB45.8 billion with an undrawn amount of RMB19.5 billion as of 31 March 2022. Through holding three listed subsidiaries, the Company also has direct access to equity financing channels. Moreover, the Company has good access to both onshore and offshore capital markets.

Good track record of receiving ongoing support. We assessed the Lushang Group's status, ownership, and control by the Shandong Government as moderate due to its economic and strategic importance to Shandong Province. The local government has provided ongoing support to the Company through subsidies and assets injections.

Credit Challenges

Weakened retail performance due to the COVID-19 outbreak, economic downturns and intensified competitions. Lushang Group's retail business is largely subject to economic conditions and external shocks, especially sales of high-end products. In addition, the growth of online shopping has also put pressure on the traditional retail business, affecting the profitability of the Company. In 2021, 14 of the 46 department stores and supermarket complexes that opened in the early stage have accumulated losses of about RMB179 million.

Heightened downward pressure on property sales along with slow destocking. Lushang Group's property development is highly concentrated in Shandong Province, which is subject to changes in local regulatory policies and economic conditions. Due to the decelerated property market in China, the Company's contracted sales fell from RMB17.6 billion in 2020 to RMB14.6 billion in 2021; while the revenue from the health and wellness properties business fell from RMB12.1 billion to RMB10.0 billion for the same period.

High debt leverage and modest liquidity position. With debt-funded capital expenditure incurred from the expansion of retail and health and wellness properties business, Lushang Group's debt leverage has remained at a high level in recent years. As of 31 March 2022, its adjusted total debt (including perpetual debts) amounted to RMB54.4 billion, with a total capitalization ratio of 73.1%. The Company also has a modest liquidity position. It reported cash reserves of RMB13.4 billion were insufficient to cover its short-term debt of RMB31.6 billion.

Rating Outlook

The stable outlook on Lushang Group's rating reflects our expectation that the Company will maintain strong competitiveness in the retail sector in Shandong Province. We also expect that, as a state-owned enterprise, it will receive ongoing support from its shareholders.

What could upgrade the rating?

The rating could be upgraded if (1) the Company's business strength and asset quality improves; and (2) the Company's stand-alone credit profile improves significantly, such as improvement in debt structure and leverage.

What could downgrade the rating?

The rating could be downgraded if (1) the likelihood of government support for the Company decreases; or (2) the Company's stand-alone credit profile weakens significantly, such as deterioration in debt leverage or liquidity.

Rating Methodology

The methodology used in this rating is the [Rating Methodology for General Corporate (April 2019)].

Regulatory Disclosures

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