

## INDUSTRY OUTLOOK | China's Toll Road Industry

**Improved Position While Challenges Remain, Outlook Stable****Executive Summary**

*The 2015 outlook for China's toll road industry is moderately stable, which reflects our opinion that, in the light of the "One Belt, One Road" policy, moderate economic growth and increase in passenger vehicle ownership are supporting the industry. However, the fundamentals of toll road companies will remain challenging due to the decline in toll revenue growth and the increase in investment in 2015.*

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- Given the economic slowdown in China as well as slow traffic growth, we expect the growth of toll revenue to be moderate in 2015.
- Investment in fixed assets had a double-digit growth in the first half of 2014. However, we reckon the growth rate in 2015 will be lower than in 2014.
- We expect the debt levels of certain number of toll road companies will rise, especially for those companies heavily invested in the western region of China.
- Toll-rate adjustment is controlled by the government so that any policy change will have a significant impact on the profitability of toll road companies. No significant policy was implemented in the past six months. The effects of the implementation of the "Green Channel" toll-free policy and the "Holiday Toll-Free Scheme" are reflected in the financial results of the toll road companies.
- The credit quality of the large toll road companies will remain stable as they benefit from their state-owned status to raise fund in the capital markets.
- Growing in ownership of passenger vehicles will support the growth of toll revenue, but those toll road companies in the western region of China will face bigger challenges due to their heavy reliance on freight transport.

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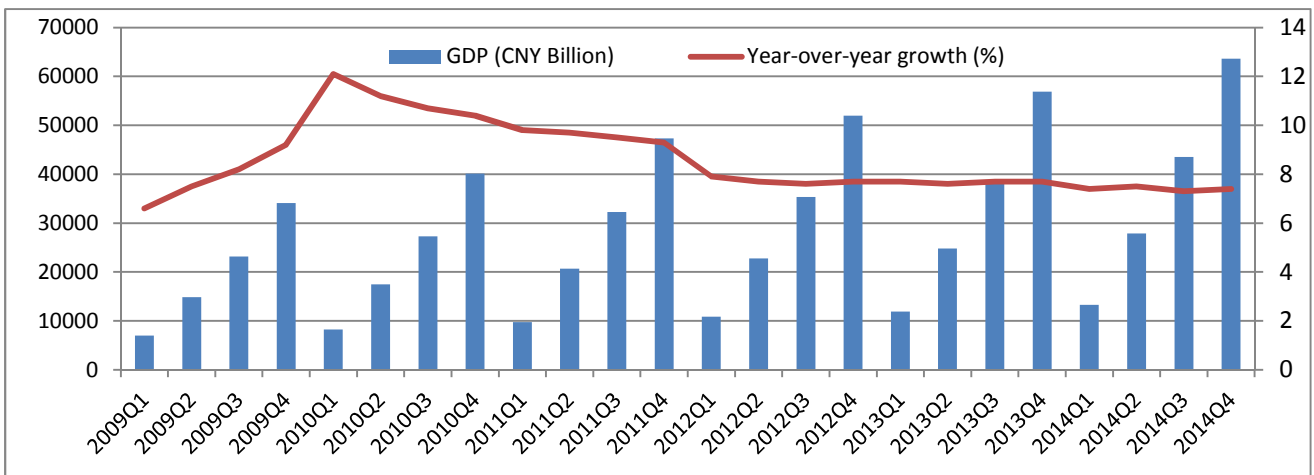
## 1. Industry Overview

- The 2014 GDP growth rate was 7.4% in 2014. The Chinese government forecasts the economy will further slowdown that the GDP growth rate of 2015 is set at about 7%. In our opinion, the GDP growth rate target will be reached or at most one or two percent lower.
- The 2014 transport of passengers and freight grew with rate of 2.2% for passengers and 9.2% for freight for the first three quarters, but the lowest since 2010. The slow growth may not reflect the actual situation as the methodology in calculating the number of passengers and traffic volume was revised. In our opinion, the slowdown in economy is the main cause of the decline in the transport growth rate.
- Amongst all vehicles, new passenger vehicles showed a considerable growth in sales whereas commercial vehicles continued dropping in sales. Since the transport of freight is the major contributor to toll revenue, the drop in commercial vehicle sales will hamper the industry.

### 1.1. Stabilized GDP Growth in 2015 hence moderate growth in traffic volume

Traffic volume of toll roads is highly correlated with the macro-economy. Roads are the backbone of China's transportation network. According to the National Bureau of Statistics of China, 87% of passengers and 76% of freight chose to travel by road transport.

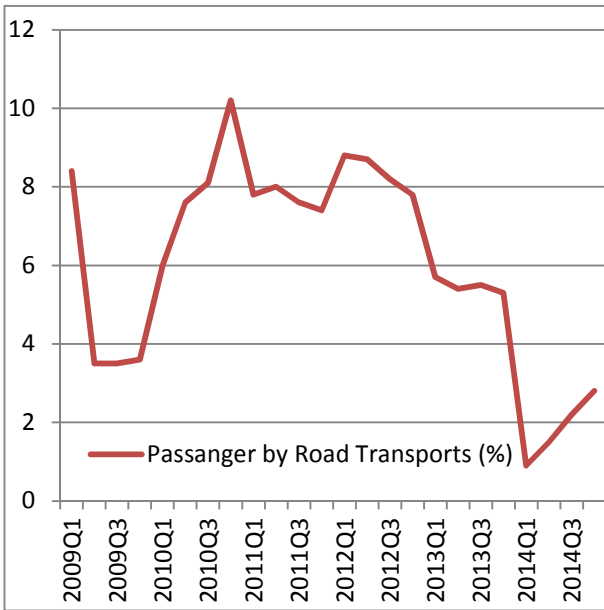
Exhibit 1: GDP of China



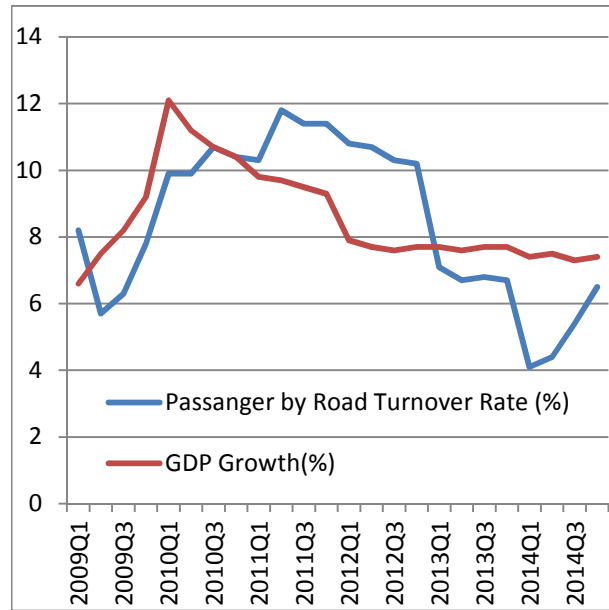
Source: National Bureau of Statistics of China, CCXAP Research

The year-on-year growth in passenger transport slipped from the peak at 10.2% in the fourth quarter of 2010 to 1.5% in the second quarter of 2014. Total road passengers on reached 19,053.49 million during 2014, an increase of 2.8% year-on-year.

**Exhibit 2: Year-over-year Growth in Passenger Transport**



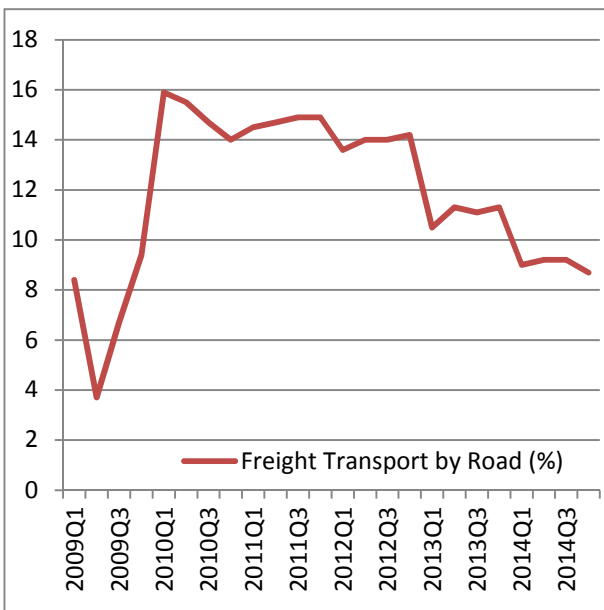
**Exhibit 3: Year-over-year Growth in Turnover Rate of Passenger Transport**



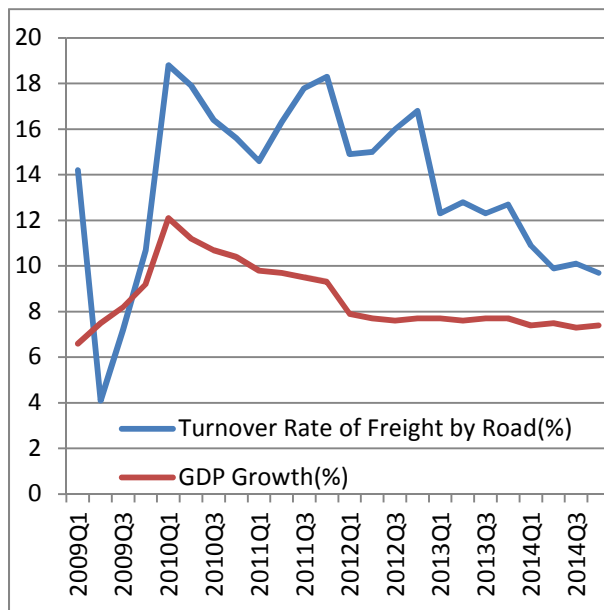
Source: National Bureau of Statistics of China, CCXAP Research

Total weights of goods transferred by road transport reached 33,434.82 million tons in 2014, a growth rate of 8.7% year-on-year which is higher than the GDP growth rate, but the gap between the two rates is getting narrower.

**Exhibit 4: Year-over-year Growth in Freight Transport**



**Exhibit 5: Year-over-year Growth in Turnover Rate of Freight Transport**



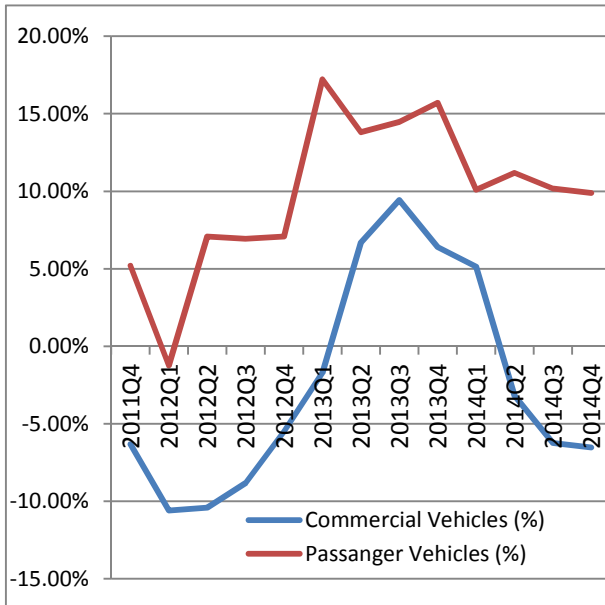
Source: National Bureau of Statistics of China, CCXAP Research

The main cause of the slowdown in growth of passenger transport and freight transport in 2014 was due to the slowdown in economy. In our opinion, improvement in the high-speed railway system and implementation of the toll-free policy adversely affect the toll road business. In the light of the “One Belt, One Road” policy, the traffic flow will be moderately improved in 2015.

## 1.2. New passenger vehicles support toll revenue growth

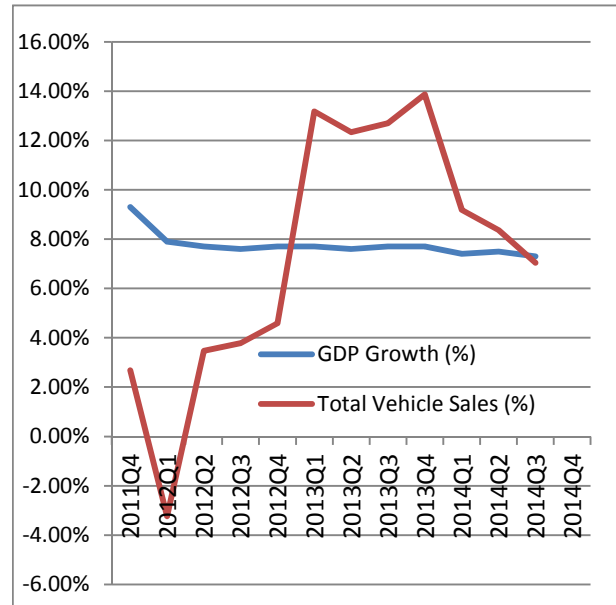
The new passenger vehicle<sup>1</sup> sales ended with a double digit growth in 2014. Freight transport is the major contributor of toll revenue. The new passenger vehicles sales reached 197.01 million, up 9.89% year-over-year that supports the growth of toll revenue. But, the sale of commercial vehicles<sup>2</sup> in 2014 was far from satisfaction; decreased by 6.53% year-by-year which will hampers the development of the industry.

Exhibit 6: New Vehicle Sales Year-over-Year Growth



Source: China Association of Automobile Manufacturers, CCXAP Research

Exhibit 7: Total Vehicles Sales and GDP Growth



Source: China Association of Automobile Manufacturers & National Bureau of Statistics of China, CCXAP Research

## 2. Policies

- No significant policy on road transport was implemented by the government in 2014.
- Chinese toll road companies have had to deal with the policy changes after the government responded to public complaints on high toll rates and removed irregularities since 2012. For example, the implementation of the “Green Channel” toll-free policy of waiving toll fees for fresh agricultural products carrier vehicles, and the toll-free policy for passenger vehicles during the four national holidays have adversely affected toll revenue.
- On 8 May 2013, the Ministry of Transport invited comments on toll road management regulations which intend to modify the toll collection period and provide compensation for the toll-free policy to toll road companies. This policy would offset some of the adverse effects of the implemented policies albeit there are uncertainties on promulgation and implementation of these policies.
- While most of the policies implemented in recent years are unfavorable to toll road companies, the toll road companies will continue to receive support from local governments in considering the industry’s

<sup>1</sup> Passenger vehicles are vehicles with nine seats or less (except motorcycle)

<sup>2</sup> Commercial vehicles are vehicles with more than nine seats and all other kinds of road vehicles (except motorcycles)

contribution to the social infrastructure. In addition, China plans to invest about CNY 2.5 trillion in constructing new national highways in 2013-2030. The profit from toll road companies will support the expense of new highway construction. In our opinion, the government would not issue unfavorable policy on toll roads in 2015. The policy outlook in the industry is expected to remain stable.

#### Exhibit 8: Major Policies Implemented

Name of Policy	Date of Implementation	Details
<b>“Green Channel” toll-free policy</b>	2009.01.01	<p>Toll-free green passage for vehicles carrying fresh and live agricultural products.</p> <p>Implication for the toll road companies:</p> <ul style="list-style-type: none"> <li>Toll revenue decreased under the implementation of Green Channel program. No direct compensation was made to the toll road companies by the government.</li> </ul>
<b>Relocation and removal of toll gates</b>	2011.06.10	<p>The five governmental bodies, including the Ministry of Transport (MOT), the National Development and Reform Commission (NDRC), the Ministry of Finance (MOF), the Ministry of Supervision, and the State Council, announced a campaign to relocate and remove certain toll stations which are beyond their designated toll collection period. The departments also plan to lower the toll fees in some regions. This could be considered a response to the public’s reaction to high toll rates.</p> <p>Implication for the toll road companies:</p> <ul style="list-style-type: none"> <li>For the toll roads classified as beyond its designated toll collection period, the toll road companies will not receive compensation on the expected loss of toll fee.</li> <li>For other toll roads being removed from toll collection, the toll road companies may be compensated by the government on a negotiated amount.</li> </ul>
<b>Toll-free policy for passenger vehicles during four national holidays</b>	2012.07.24	<p>The State Council issued the “toll-free highways on holidays” policy in August 2012. It was further amended in 2013. The policy states that toll fees of passenger vehicles shall be waived on the four major Chinese public holidays: Spring Festival, Tomb Sweeping Day, Labor Day and the National Day.</p> <p>Implication for the toll road companies:</p> <ul style="list-style-type: none"> <li>Toll road companies lose the toll fees on passenger vehicles during these four national holidays. No direct compensation was made to the toll road companies by the government.</li> </ul>

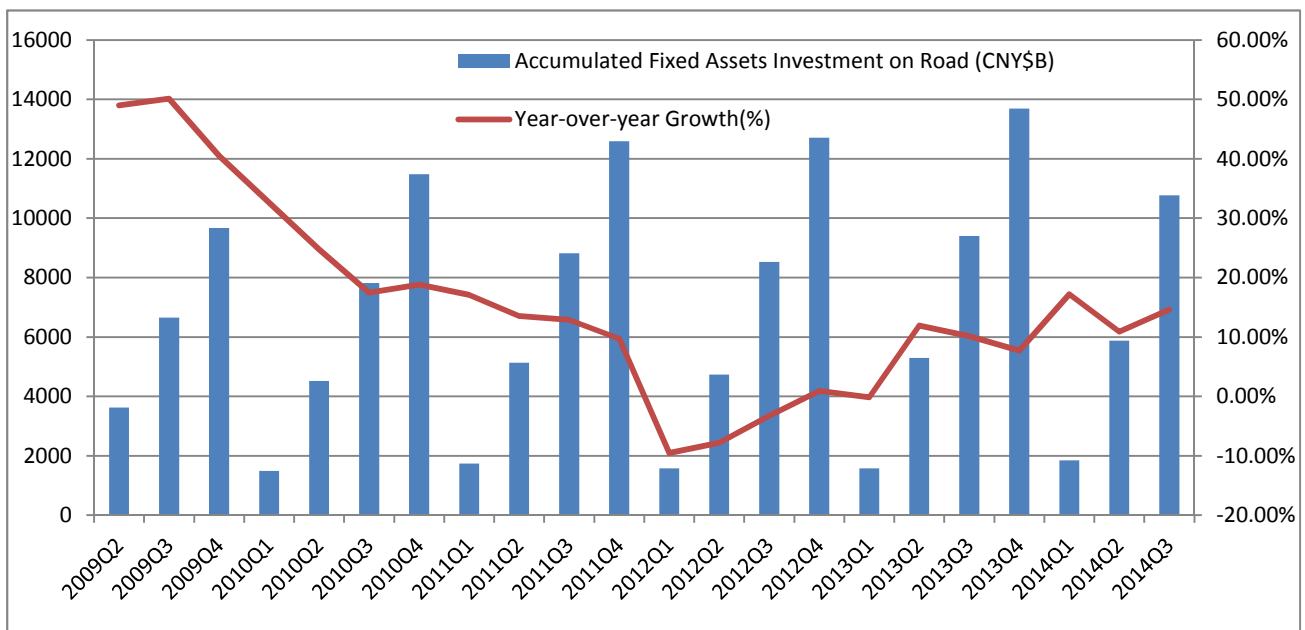
### 3. Investments

- Fixed assets investment in road had been increased since 2012, and continued its double digit growth since 2013. In the first three quarters of 2014, it amounted to CNY 10,771.36 billion, up 14.6% year-on-year. This growth was the second highest growth since Q2 of 2011. The fast growth of fixed assets investment caused an outflow of cash, exerting pressure on the financial profile of toll road

companies.

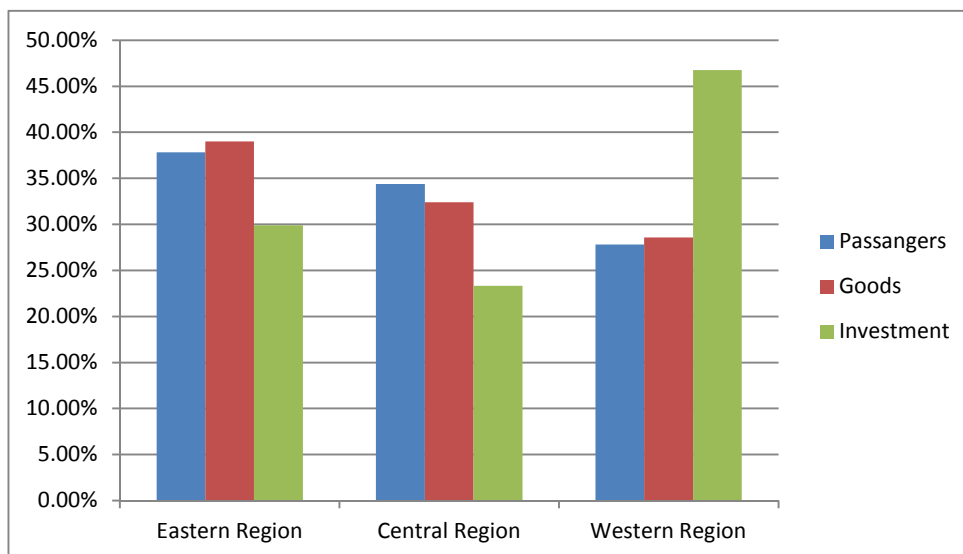
- According to the report issued by China Ministry of Transport in December 2014, for the accumulated total fixed assets investment in roads, the capital amounted at CNY 1,688 billion and the borrowings amounted at CNY 3,756 billion, accounting for 31% and 69% of the total amount, respectively. Of the accumulated total borrowings, bank loans account for CNY 3,516 billion, or 93.6% of the total borrowings.
- Geographically, the largest share of the investment was shown in the western region which was 46.77%, followed by the eastern region at 29.9% and the central region at 23.33%.
- In our opinion, the toll road companies in the eastern region will face cash outflow pressure due to the need of continuous investments. The traffic volume of the western region is smaller than the central region and eastern region, hence less toll revenue.
- The investment in roads will continue increasing in 2015 in the light of the “One Belt, One Road” policy. Certain toll road companies, such as those located in the western region, will increase their investment in constructing new toll roads. Their debt level will increase accordingly.

**Exhibit 9: Investment of Fixed Assets in Road**



Source: Ministry of Transport of China, CCXAP Research

Exhibit 10: Geographical Distribution of Investment of fixed assets, road passengers and goods (2014Q1-Q3)



Source: Ministry of Transport of China, CCXAP Research

#### 4. Company Analysis

- In this report, we selected six Chinese toll road companies to analyze their financial positions. Their total amount of outstanding debts increased by 10.28% to CNY 37.93 billion and the total amount of toll fees increased by 4.18%, which weakened the coverage of toll revenue on outstanding debts.
- EBITDA interest coverage of four companies out of the six decreased, reflecting their weakening in repayment capability.
- In our view, the credit quality of major toll road companies will be stable. A pick-up in traffic volume amid economic recovery in the second half of 2014 and a continuous rise in passenger vehicles ownership will support earnings that the toll road companies will grow modestly in 2015.

Exhibit 11: Demographics of the Selected Companies

	Toll Length (km)	Toll Fees (CNY \$Bn)		Total Debts(CNY \$Bn)		Total Assets(CNY \$Bn)	
		2014H1	Y-o-Y Growth	2014H1	Y-o-Y Growth	2014H1	Y-o-Y Growth
Sichuan Expressway	573	1.28	10.6%	12.39	37.36%	26.61	21.42
Jiangsu Expressway	850	2.64	3.3%	6.02	13.86%	26.77	1.37
Shenzhen Expressway	413	1.47	7.6%	9.71	-4.39%	25.59	9.29
Zhejiang Expressway	533	2.04	6.2%	1.70	75.26%	34.56	8.95
Yuexiu Transport	301	0.88	6.4%	5.39	-14.59%	17.63	-5.72
Anhui Expressway	484	1.08	-8.8%	2.73	2.63%	12.73	9.41

Source: Annual Reports of the Selected Companies, CCXAP Research

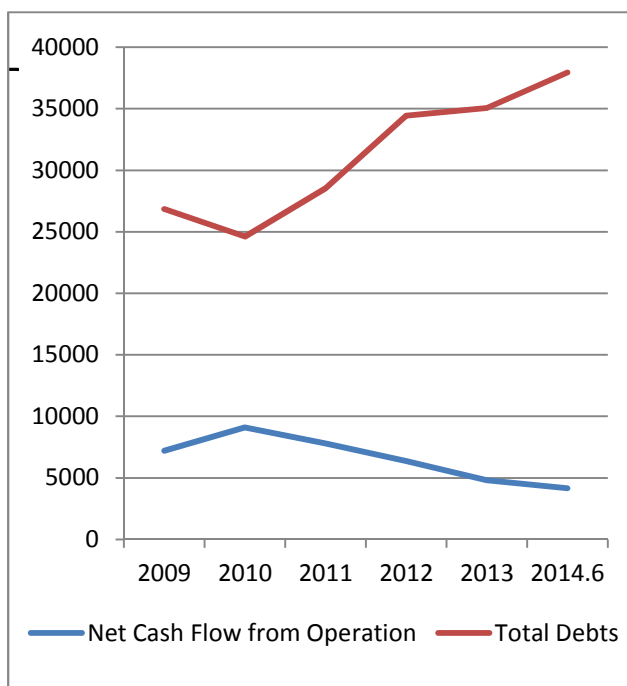
Exhibit 12: Financial Information of the Selected Companies

	Operating Margin (%)		Debt/Capital		EBITDA Interest Coverage		Net Cash Flow from Operation (CNY \$Bn)	
	2014H1	Y-o-Y Growth	2014H1	Y-o-Y Growth	2014H1	Y-o-Y Growth	2014H1	Y-o-Y Growth
Sichuan Express	16.60	-2.92	109.56	27.16	3.97	-10.72	-0.53	-62.12

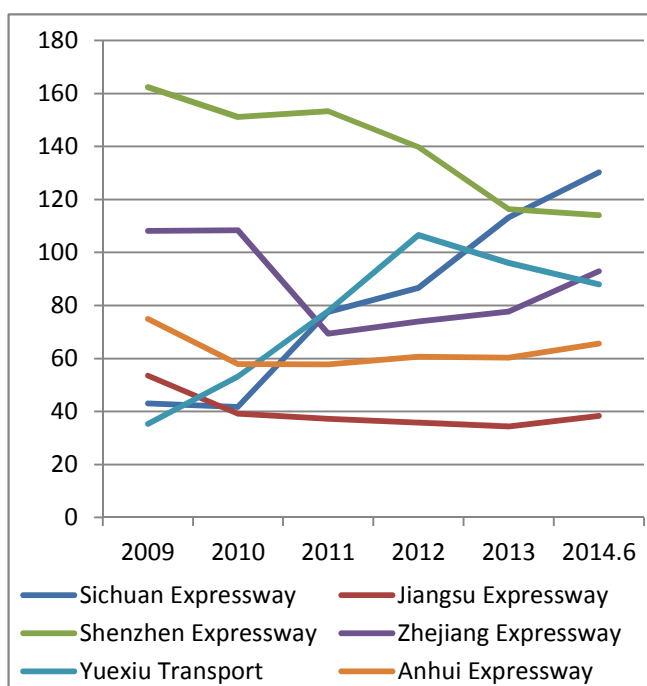
<b>Jiangsu Express</b>	46.04	-7.94	31.66	9.66	16.17	-14.84	1.64	10.57
<b>Shenzhen Express</b>	40.28	14.47	85.80	-18.60	10.31	-77.67	0.78	-3.09
<b>Zhejiang Express</b>	40.11	2.11	10.66	67.61	50.43	11.60	1.40	33.46
<b>Yuexiu Transport</b>	56.24	1.04	64.45	-16.17	4.89	12.44	0.50	-10.37
<b>Anhui Expressway</b>	46.75	2.43	37.80	-3.79	11.22	-23.95	0.36	136.59

Source: Annual Reports of the Selected Companies, CCXAP Research

**Exhibit 13: Total Debts and Total Net Cash Inflow from Operation of the Selected Companies (CNY \$Bn)**



**Exhibit 14: Total Debts and Total Net Cash Inflow from Operation of the Selected Companies (%)**



Sources: Annual Reports of the Selected Companies, CCXAP Research

## 5. Conclusion

After enjoying a high growth for almost a decade, the Chinese toll road companies are facing the “New Norm” which can be interpreted as the phenomenon of economy slowdown. In such phenomenon, divergence in credit quality among the toll road companies will become more obvious. Toll road companies in the more developed places, such as the eastern region, are more resilient to economic slowdown and will enjoy the benefits of the growth in automobile sales. On the other side, the toll road companies in the less-developed places, such as the western region, which are facing cash outflow due to the need to continuous investment in building roads. The “One Belt, One Road” policy will help the toll companies to grow in the medium to long term. Our outlook of the Chinese toll road industry is therefore moderately stable.

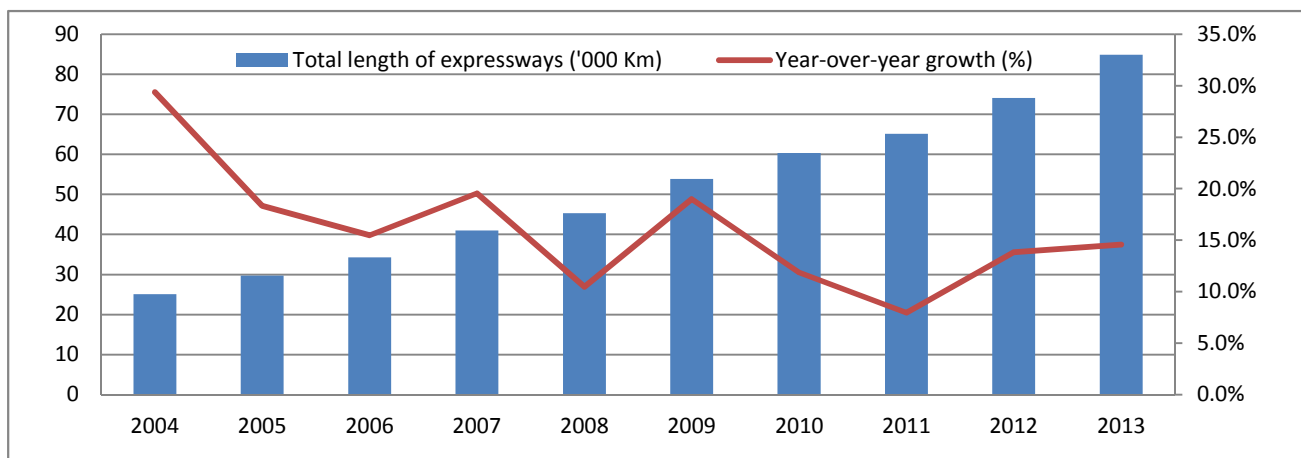


## 6. Appendix

### National Highway System of China

National Trunk Highway System (“NTHS”) was launched in 1990. After over two decades of development, the expressway network has transformed the efficiency and effectiveness of inter-regional road transport in China. Today, the total length of expressways of China’s expressway system is the longest in the world, which is ahead of US. The 12th Five-Year Plan has outlined its further expansion, targeting an increase in the NTHS to 83,000 km by 2015, linking at least 90 percent of cities with population of over 200,000. The proportion of Class II highways or above<sup>3</sup> is expected to increase from 62% of the total highway network to 70% comprising a total of 650,000 km by 2015, an increase of 45 percent from 2010 levels.

Exhibit 15: Total Length of Expressways in China



Sources: China Statistic Year Book 2013 and Ministry of Transport of China, CCXAP Research

<sup>3</sup> Class II highways or above are roads with daily traffic of 3000 cars or above

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