

Credit Opinion

18 January 2024

Ratings

Senior Unsecured Debt Rating	BBB _g +
Long-Term Credit Rating	BBB _g +
Outlook	Stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

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Pingdu City Development Group Co Ltd

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Pingdu City Development Group Co Ltd, with stable outlook.

Summary

The BBB_g+

Our assessment of the local government's capacity to provide support reflects the status of Pingdu City as the advanced manufacturing base in northern part of Qingdao City and the continued economic growth of Pingdu City, but constrained by moderate fiscal metrics.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) pivotal role in infrastructure construction and state-owned asset operation in Pingdu City; (2) good track record of receiving government supports; and (3) good access to funding.

However, the rating is constrained by the Company's (1) moderate risk to commercial businesses with relatively high investment pressure; and (2) increasing debt burden driven by capital expenditures on construction projects.

The stable outlook on PDCD's rating reflects our expectation that the local government's capacity to provide support will be stable, and that the Company will maintain its important role in infrastructure construction and state-owned asset operation of Pingdu City over the next 12 to 18 months.

Rating Drivers

- Pivotal role in infrastructure construction and state-owned asset operation in Pingdu City
- Good track record of receiving government supports
- Moderate risk to commercial businesses with relatively high investment pressure
- Increasing debt burden driven by capital expenditures on construction projects
- Good access to funding

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Pingdu City Government's capacity to provide support strengthens; or (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as lowers the exposure to risky commercial activities, and improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Pingdu City Government's capacity to provide support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to provide support, such as reduced strategic significance, decreased government support, or weakened financing capabilities.

Key Indicators

	2020FY	2021FY	2022FY	2023Q3
Total Asset (RMB billion)	25.5	50.2	53.5	56.1
Total Equity (RMB billion)	22.3	41.0	41.8	42.0
Total Revenue (RMB billion)	1.7	2.3	2.3	1.7
Total Debt/Total Capital (%)	8.2	11.4	17.3	20.9

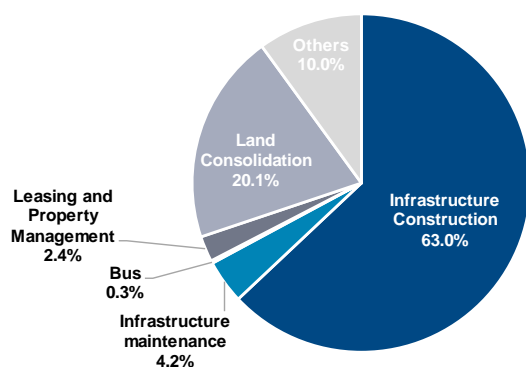
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

Corporate Profile

Founded in June 2018, PDCD is one of the key local infrastructure investment and financing companies ("LIIFCs") in Pingdu City. The Company is mainly responsible for infrastructure construction and maintenance, land consolidation, resettlement housing construction in the southern new area and western new city of Pingdu City. The Company also provides essential public services in Pingdu City, such as water supply and bus operation. In addition, PDCD is involved in commercial businesses including industrial parks construction, property leasing, as well as trading. As of 30 September 2023, the Company was directly and wholly owned by Pingdu State-owned Assets Management Service Centre.

Exhibit 1. Revenue structure in 2022



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Pingdu City Government has a strong capacity to provide support given the status of Pingdu City as the advanced manufacturing base in northern part of Qingdao City and the continued economic growth of Pingdu City, but constrained by moderate fiscal metrics.

Shandong Province is the third largest province in China by gross regional products ("GRP"), with a solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive, and agri-food. Qingdao City is one of the five cities in China that are under separate state planning and is the strongest city in Shandong in terms of economic size and average income level. It reported a GRP of RMB1.5 trillion in 2022, increasing by 3.9% year-over-year and ranking 1st among all prefecture-level cities in Shandong Province and 13th among all municipalities in China. Qingdao City's fiscal strength remained strong although its general budgetary revenue dropped from RMB136.8 billion in 2021 to RMB127.3 billion in 2022 due to the tax refund; tax income accounted for nearly 70% of its general budgetary revenue in 2022. Qingdao City had a relatively good fiscal balance ratio, where its general budgetary revenue covered more than 75% of its general budgetary expenditure over the past three years. Its direct government debt/GRP was 20.6% as of 31 December 2022. In the first three quarters of 2023, Qingdao City's GRP amounted to RMB1.2 trillion, with a year-on-year ("YoY") growth rate of 6.0%.

Exhibit 2. Key economic and fiscal indicators of Qingdao City

	2020FY	2021FY	2022FY
GRP (RMB billion)	1,240.1	1,413.6	1,492.1
GRP Growth (%)	3.7	8.3	3.9
General Budgetary Revenue (RMB billion)	125.4	136.8	127.3
General Budgetary Expenditure (RMB billion)	158.5	170.7	169.6
Local Government Debt (RMB billion)	205.8	255.9	308.0

Source: Qingdao Municipal Government, CCXAP research

Pingdu City is the largest county-level city in Shandong Province in terms of area, accounting for around 30% of the total area of Qingdao City. As the advanced manufacturing base in northern part of Qingdao City, Pingdu City has established four pillar industries, including intelligent home appliance, high-end chemicals, food and beverages and high-end equipment, and three strategic emerging industry systems, including new energy, new materials, and biotechnology. Supporting by its solid industrial foundation, Pingdu City recorded a continuous economic growth over the past three years. In 2022, its GRP was RMB84.6 billion, increasing by 2.3% YoY. However, Pingdu City's fiscal metrics were moderate. In 2022, the local government's general budgetary revenue decreased to RMB6.1 billion, due to the reduction in tax revenue resulted by the government tax refund policy. After deducting the effect of tax refund, its general budgetary revenue would have recorded an increase of 5.6% YoY. The average general budgetary revenue/general budgetary expenditure ratio was moderate at 54.5% over the past three years. Pingdu City Government highly relied on the transferred income from higher tier government with an average amount over the past three years of RMB5.8 billion. As of end-2022, Pingdu City Government's outstanding direct debt amounted to RMB13.2 billion, accounting for about 15.6% of GRP.

Exhibit 3. Key economic and fiscal indicators of Pingdu City

	2020FY	2021FY	2022FY
GRP (RMB billion)	71.6	82.1	84.6
GRP Growth (%)	3.5	9.7	2.3
General Budgetary Revenue (RMB billion)	6.1	6.6	6.1
General Budgetary Expenditure (RMB billion)	11.6	11.7	11.3
Local Government Debt (RMB billion)	9.4	10.6	13.2

Source: Pingdu City Government, CCXAP research

Government's Willingness to Provide Support**Pivotal role in infrastructure construction and state-owned asset operation in Pingdu City**

As one of the core LIIFCs of Pingdu City, PDCD was mainly involved in local public projects such as infrastructure construction and land consolidation in the western and southern new areas of Pingdu City. The Company takes part in infrastructure construction mainly through agency construction model and self-construction model. Under the agency construction model, the Company is entrusted to be responsible for financing and constructing the projects. The Company receives project repayments from the entrusting parties based on the total cost plus a few percentage markups after examination. As of 30 September 2023, the Company had 9 infrastructure construction projects under construction, such as infrastructure supporting projects, infrastructure upgrading project, rural water supply pipeline network rehabilitation projects, and water plant expansion project, with a total investment of approximately RMB2.5 billion and uninvested amount of RMB2.0 billion. Meanwhile, the Company has one proposed project with a total planned investment of RMB220.0 million. The Company has sufficient project reserves to support the good stability and sustainability

of the infrastructure construction business, but also creates relatively high investment pressure. PDCD also participated in infrastructure maintenance business in Pingdu City, covering a total of 217 items, such as water conservancy facilities, watercourse and roads, with a management period from 1 August 2018 to 31 August 2028, and the management fee is RMB100 million annually. As at 30 September 2023, the infrastructure maintenance business has received the project repayments totaling RMB294.0 million.

Moreover, PDCD undertakes the land consolidation projects also through agent construction model. Meanwhile, the Company is also responsible for the resettlement housing construction on the consolidated land parcels. Under the agent construction model, the Company signs construction agreements with Finance Bureau of Pingdu City and the local state-owned enterprise (“SOE”), the entrusting parties will pay the total cost plus generally 15% markups after examining the projects. As at 30 September 2023, the Company had 7 land consolidation projects (including resettlement housing construction) under construction, with a total estimated investment of approximately RMB11.5 billion and an outstanding amount of RMB7.0 billion.

Provision of essential public services

PDCD provides essential public services in Pingdu City such as water supply and bus operation. PDCD acquired the majority of the water supply business in Pingdu City through acquisitions and government asset transfers in 2021. The Company's water supply business has a certain degree of monopoly and sustainability. The Company's water supply business covers almost whole Pingdu City (excluding Nancun Town). In addition, a water plant expansion project is under construction with an estimated investment of RMB480.0 million and an outstanding amount of RMB259.0 million as of 30 September 2023. This project, when completed, will further increase the Company's water supply capacity. The Company is also engaged in bus operation business. Due to the public welfare characteristics of the bus operation business, the gross profit margin has been consistently negative, with a strong reliance on government subsidies over the past few years. From 2020 to 2022, the Company received a total of RMB25.6 million in government subsidies for bus operation business. We expect that the Company will continue to receive relevant government subsidies to support its public services in the future.

Overall, PDCD has a large scope for development and a strong capacity for business sustainability in Pingdu City, as well as an essential role in the provision of public services. In our view, the Company is unlikely to be replaced by other local SOEs in the foreseeable future.

Good track record of receiving government support

As a pivotal infrastructure construction and state-owned asset operation entity in Pingdu City, PDCD has a good track record of receiving government supports. The Company has received project payments, operating subsidies, and asset and cash injections from the local government to support its business operations. From 2020 to 2023Q3, the local government injected RMB396 million of cash into the Company, increasing its paid-in capital from around RMB670 million to RMB1.1 billion. In addition, the Company's capital reserves increased from RMB20.9 billion to RMB38.5 billion over the same period, including asset injection from the local government, such as sand mining rights, water rights, land, and buildings.

In addition, from 2020 to 2023Q3, the Company continuously received subsidies from the local government with total amount of RMB946 million. Meanwhile, the Company received special bond from local government with total amount of around RMB1.5 billion to support its infrastructure construction and land consolidation business. In addition, PDCD also received ongoing project repayments from local government. Given PDCD's strong

public policy role and large scale of public projects under construction and planning, we expect local government would continuous to provide support to the Company over the next 12 to 18 months.

Moderate risk to commercial businesses with relatively high investment pressure

Apart from public activities, PDCD is also involved in a diversified range of commercial activities that contribute part of its revenue, including construction of self-operated projects, property leasing, as well as trading. These commercial activities may also entail higher operational and business risks than public policy activities. At the same time, large amount of self-operated projects will exert capital expenditure pressure on the Company. We estimate that PDCD's risk to commercial activities is moderate because some of commercial assets are transferred by the government, such as sand mining rights, and the majority of its commercial activities are policy-driven, which aim to promote local industry and economic development.

The Company participated in self-operated projects construction business in Pingdu City to promote local urban development. Under self-construction model, the Company undertakes the responsibilities of financing, construction, operation of the projects, and would achieve fund balancing through leasing and selling. As of 30 September 2023, there were 7 projects under construction and planning, with a total investment amount of approximately RMB5.9 billion and uninvested amount of RMB4.8 billion. The major self-operated projects are industrial parks, apartment, and commercial estate. The large uninvested amount of self-operated projects would bring relatively large capital expenditure to the Company. Moreover, the operating income of self-operated projects has a certain degree of uncertainty, which is closely related to local economic development.

PDCD also engaged in leasing business mainly through its self-construction projects and purchased leasehold assets. The main leasable assets are industrial parks, schools, office buildings, as well as nursing home. The lessees are mainly enterprises related to pillar industries of Pingdu City and local government agencies. As of 30 September 2023, the Company owned leasable assets with total available area for rent of 663.3 thousand square meters and comprehensive occupancy rate of 77%. The revenue of leasing business increased from RMB6.0 million in 2020 to RMB57.1 million in 2022. We estimate the leasing revenue would further increase with the increase in leased assets and the increase in occupancy rate. However, this business would occupy a certain amount of PDCD's funds since most of the leasable assets are self-construction or purchased. We should pay close attention to subsequent operation of the leasing business.

In addition, the Company adopts demand-on-purchase mode to conduct trading business. Under demand on purchase mode, the Company confirms the volumes and prices with downstream customers before placing orders from upstream customers. The Company generally sell to customers at price with a markup of 2.5%~4.0% of purchase price. The main trading product is steel, water meters, pipes, and municipal materials. Meanwhile, the main customers are construction units of PDCD's infrastructure construction. The concentration risk from downstream customers is relatively high, with the top 5 customers accounting for around 89% of the total sales.

Increasing debt burden driven by capital expenditures on construction projects

PDCD's debt had grown rapidly over the past three years due to continuous investment in infrastructure construction and self-construction projects. As of 30 September 2023, the Company's total debt increased to RMB11.1 billion from RMB2.0 billion at end-2020. Although, its capitalization ratio increased from 8.2% to 20.9%, it was still deemed as reasonable level. However, the Company had a relatively high short-term debt burden, with short-term debt representing 42.5% of total debt at the end of September 2023. The cash to short-term debt ratio was around 0.6 x, indicating its cash balance was insufficient to cover its short-term debt. We expect the Company may rely on external financing for its future infrastructure construction, land consolidation, and

self-operated projects, and its debt level will further increase in the next 12 to 18 months.

In addition, PDCD's asset liquidity was relatively weak. As of 30 September 2023, PDCD's intangible assets, inventories, investment real estates, and other receivables accounted for 86% of the total assets. Majority of these assets were considered low liquidity. Intangible assets accounted for nearly 40% of the total assets, which were mainly sand mining rights and water rights.

Good access to funding

PDCD has multiple financing channels such as bank loans, onshore and offshore bond issuance, and non-standard financing. Bank loans and bond issuances accounted for the majority of total debt. The Company maintains good and long-term relationships with large domestic banks such as Agricultural Development Bank of China, Industrial and Commercial Bank of China Limited, and Agricultural Bank of China Limited. As of 30 September 2023, the Company had total bank facilities of RMB9.0 billion, with the available portion being around RMB1.9 billion. Meanwhile, the Company has access to the onshore and offshore bond market. From January 2023 to September 2023, the Company issued 2 tranches of onshore bonds and 1 tranche of offshore bond with a total amount of RMB1.9 billion and reasonable coupon rate at the range of 4.18% to 5.5%. We consider PDCD's exposure to non-standard financing was controllable, accounting for below than 10% of total debt as of 30 September 2023.

ESG Considerations

PDCD assumes environmental risks through its infrastructure construction projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

PDCD bears social risks in implementing public policy initiatives through the building of public infrastructure in Pingdu City. Demographic changes, public awareness and social priorities shape the Company's development targets and ultimately affect the local government's propensity to support the Company.

PDCD's governance considerations are also material as the Company is subject to local government oversight and reporting requirements, reflecting its public-policy role and status as a government-owned entity.

Structural considerations

PDCD's senior unsecured debt rating is equal to its long-term credit rating. We believe that government support will flow through the Company given its important role in infrastructure construction and state-owned asset operation of Pingdu City, thereby mitigating any differences in an expected loss that could result from structural subordination.

Rating Methodology

The methodology used in this rating is the Rating Methodology for [China's Local Infrastructure Investment and Financing Companies \(July 2022\)](#).

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