

Credit Opinion

8 February 2024

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	A _g +
Outlook	Stable

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Quanzhou Urban Construction Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of A_g+ to Quanzhou Urban Construction Group Co., Ltd., with stable outlook.

Summary

The A_g+ long-term credit rating of Quanzhou Urban Construction Group Co., Ltd. (“QUCG” or the “Company”) reflects (1) Quanzhou Municipal Government’s very strong capacity to provide support; and (2) the local government’s extremely high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of Quanzhou Municipal Government’s capacity to provide support reflects the Quanzhou City’s economic importance in Fujian Province, ranking 2nd among 9 prefecture-level cities in Fujian Province by gross regional product (“GRP”) in 2022, with ongoing growth in economic and fiscal strength.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) important policy role as the most important urban development and operation entity in Quanzhou City; (2) dominant role in local public activities with high sustainability; and (3) track record of receiving government support.

However, the rating is constrained by the Company’s (1) medium exposure to commercial business activities; (2) rapid debt growth; and (3) moderate asset liquidity.

The stable outlook on QUCG’s rating reflects our expectation that Quanzhou Municipal Government’s capacity to provide support will remain stable, and the Company will maintain its important public role in infrastructure construction in Quanzhou City over the next 12 to 18 months.

Rating Drivers

- Important policy role as the most important urban development and operation entity in Quanzhou City
- High sustainability of local public activities
- Medium exposure to commercial activities
- Track record of receiving government support
- Rapid debt growth and asset liquidity

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Quanzhou Municipal Government's capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Quanzhou Municipal Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to support, such as decrease in importance of its policy role, or material decrease in government payments.

Key Indicators

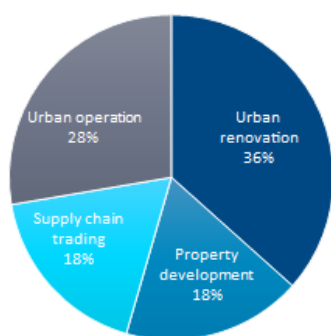
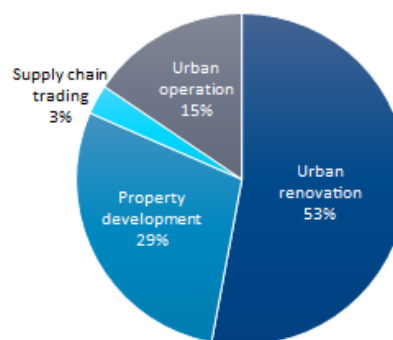
	2020FY	2021FY	2022FY	2023Q3
Total Asset (RMB billion)	90.2	124.6	159.3	175.9
Total Equity (RMB billion)	51.6	62.5	75.8	76.5
Total Revenue (RMB billion)	3.6	4.7	8.6	6.9
Total Debt/Total Capital (%)	32.3	33.3	38.3	43.8

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

Source: Company data, CCXAP research

Corporate Profile

Founded in 2016, QUCG is the most important local infrastructure investment and financing company ("LIIFC") in Quanzhou City with the largest asset size. It plays an important public role in land consolidation, infrastructure construction, resettlement housing construction, water supply, and shantytown renovation. The Company also engages in some commercial activities such as supply chain trading, urban operation, and property development. As of 30 September 2023, State-owned Assets Supervision and Administration Commission of Quanzhou Municipal Government ("Quanzhou SASAC") held 90% and Fujian Province Finance Bureau held the remaining 10% of the Company's shares, respectively. It is ultimately controlled by Quanzhou SASAC.

Exhibit 1. Revenue structure in 2022**Exhibit 2. Gross profit structure in 2022**

Source: Company information, CCXAP research

Exhibit 3. Shareholding chart as of 30 September 2023

Source: Company information, CCXAP research

Rating Considerations**Government's Capacity to Provide Support**

We believe the Quanzhou Municipal Government has a strong capacity to provide support given its economic importance in Fujian Province, as well as ongoing growth in economic and fiscal strength.

Fujian Province is located in the southeastern coast of China and is recognized as one of the provinces with the fastest economic development in China. In 2023, Fujian recorded a gross regional product ("GRP") of RMB5.4 trillion, with a GRP growth rate of 4.5% year-on-year ("YoY"), ranking 8th in terms of GRP among all provinces in China. Its GRP recorded RMB5.3 trillion and general budgetary revenue achieved RMB333.9 billion in 2022.

Located in the southeast of Fujian Province, Quanzhou City connects Putian and Fuzhou in the north and Xiamen in the south. It is one of the "reforms and opening-up" area in China. The pillar industries in Quanzhou City include textiles, petrochemicals, machinery and equipment, building materials and home furnishing. With the ongoing industrial development, the economic strength of Quanzhou City has continuously grown. The GRP of Quanzhou City increased from RMB1,015.9 billion in 2020 to RMB1,210.3 billion in 2022, ranking 2nd among 9 prefecture-level cities in Fujian Province. Quanzhou Municipal Government recorded a public budgetary revenue of RMB52.7 billion, of which tax revenue accounted for 64.5%. However, its fiscal balance is moderate with general budgetary revenue/general budgetary expenditure ratio of 65.4%. Its debt burden is also moderate. In 2022, the local government's outstanding debt grew to RMB211.2 billion, accounting for 17.5% of GRP and 194.3% of its total fiscal income. In the first nine months of 2023, the GRP of Quanzhou City increased 4.1% YoY to RMB903.1 billion; while its general budgetary revenue amounted to RMB46.7 billion.

Exhibit 4. Key economic and fiscal indicators of Quanzhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	1,015.9	1,130.4	1,210.3
GRP Growth (%)	2.9	8.1	3.5
General Budgetary Revenue (RMB billion)	45.4	50.5	52.7
General Budgetary Expenditure (RMB billion)	71.5	67.2	80.6
Local Government Debt (RMB billion)	154.8	186.6	211.3

Source: Statistic Bureau of Quanzhou City, CCXAP research

Government's Willingness to Provide Support

Important policy role as the most important urban development and operation entity in Quanzhou City

There are 5 main LIIFCs in Quanzhou City, each with different positioning, including urban development and operation, transportation construction, water conservancy, cultural and tourism, and financial services. QUCG is the largest LIIFC by total assets and the most important urban development and operation entity in Quanzhou City. The Company focuses on four major business sectors: urban renovation, property development, urban operation, and supply chain trading. It has completed a large amount of land consolidation, infrastructure construction, and resettlement housing construction projects in Quanzhou City, making great contributions to the urbanization of the region. Considering its strategic significance to the development of Quanzhou City, we believe the Company is unlikely to be replaced by other local state-owned enterprises in the foreseeable future.

After the consolidation of Quanzhou Quangang District State-owned Capital Investment and Operation Co., Ltd. in 2021 and Quanzhou Licheng District State-owned Capital Investment Group Co., Ltd. in 2022, the Company has enhanced its capital strength and broadened its business scope. However, the company has limited control over their actual operations and financial aspects.

High sustainability of local public activities, with large capital expenditure pressure

Positioned as an urban construction and operation service provider, QUCG's public activities mainly include urban renovation, resettlement housing construction, and water supply. The Company has considerable projects in the pipeline, which can ensure the sustainability of the business, but exert large capital expenditure pressure.

QUCG is entrusted by the local government to undertake the urban renovation projects, including land acquisition, demolition, compensation and resettlement. The business scope of the urban renovation projects covers 5 main areas in Quanzhou City, with a total area of over 20,000 mu. The local government authorized the Company to carry out the urban renovation projects. The local government would make payments to the Company based on the project progress or after the land sold in public market. For the projects started before 2016, the local government would return the land-transferring fees to the Company after deduction of taxes, while for the projects started after 2016, the payment is based on construction cost plus an agreed return. As of 30 September 2023, the Company had 5 major urban renovation projects with an estimated total investment amount of around RMB191.8 billion. Fortunately, the large capital expenditure pressure can be partly supported by government special funds. In 2022, the Company received government special funds of RMB3.0 billion.

The Company is also responsible for the infrastructure construction projects in Quanzhou City, such as roads, and embankment projects. Most of the infrastructure construction projects are incorporated into urban renovation, and achieve fund balance through land transfer, while some of the infrastructure projects are conducted by signing agency construction agreements with the entrusting parties, which would repurchase the constructions upon project completion. The repurchase payment is based on the construction cost plus an

agreed return (about 5%). However, the payment collection for some of the infrastructure construction projects is lag behind, which may undermine the Company's liquidity. As of 30 September 2023, the book value of the infrastructure construction projects in the Company's inventory and other non-current assets was approximately RMB49.8 billion.

Furthermore, the Company is also responsible for the safety control area project in Quangang Petrochemical Industrial Park, involving demolition and land leveling of residential areas within the area, as well as the improvement of the green landscape. The project is conducted under government purchase service model, under which the local government will repurchase the project and make payment within 25 years. To support the project construction, the local government has provided special funds, special bond funds, and bond swap funds to the Company. As of 30 September 2023, the Company had totally invested RMB32.8 billion into the project.

QUCG is also responsible for the construction of resettlement housing in the 5 main areas of Quanzhou City. The Company mainly obtained the land through government allocation and self-acquisition. The completed resettlement housings are mainly used for resettlement. As of 30 September 2023, the Company had 13 resettlement housing projects, with a total planned investment of RMB11.2 billion and an outstanding amount of RMB6.4 billion, exerting large capital expenditure pressure.

In addition, QUCG is the sole water supply and water installation entity in Quangang District via its pipe networks of 1,258.5 kilometers. As of 30 September 2023, the Company had 3 water plants with a daily water supply capacity of 200,000 tons. Benefited by the rapid development of Quangang District, the total water sales of Quangang District have increased steadily over the past few years, which ensure the sustainability of the business.

Medium exposure to commercial activities

In addition to public activities, QUCG is also involved in various commercial activities such as supply chain trading, property development, property leasing, and engineering construction. We consider QUCG's commercial business exposure to be medium, as its market-driven businesses account for around 15-20% of its total assets.

QUCG's supply chain trading business includes domestic and international trading. Its international trading business mainly involves trading of handicrafts, textiles, and clothing, while domestic trading business mainly involves trading of commodity products. To cope with the decrease in trading revenue caused by the international trade frictions and exchange rate fluctuations, the Company has expanded its domestic trading business since 2023, and the revenue from trading increased significantly. The domestic trading is conducted under demand-driven model, with relatively diversified suppliers and customers. For the first three quarters of 2023, the top 5 customers and suppliers accounted for 36.0% and 55.6% of the total sales and procurement. In addition, the supply chain trading business recorded a low gross profit rate of 3.4% in 2022.

Despite for the construction of resettlement housing, the Company also participated in the construction of commercial housing. The Company primarily acquires land through public bidding and carries out the projects using a pre-sale model. As of 30 September 2023, the Company had 5 commercial housing projects, with a total planned investment of RMB11.0 billion and an outstanding amount of RMB5.2 billion, exerting large capital expenditure pressure. However, it faces a certain destocking pressure as the sales progress is lower than 50%. Moreover, the property development business is subject to the slowdown of property market in China and may exert certain business risks to the Company.

In addition, the urban operation business mainly consists of project management, property leasing, engineering construction. The Company primarily obtains project management through public bidding, and it only responsible for project management and does not engage in project investment or construction. The Company also owns a large amount of leasable state-owned properties, such as car parks, office buildings, and shopping malls. In 2022, the Company recorded a property leasing income of RMB98 million. Moreover, the Company undertakes the engineering construction and mainly acquire the project through public bidding. As of 30 September 2023, the Company held a total contract amount of RMB1.2 billion, which most of it located in Licheng District of Quanzhou City. In 2022, the Company recorded an engineering construction income of RMB610 million. Although their business scale is relatively small, they provide supplemental income to the Company.

Track record of receiving government support

As the most important urban development and operation entity in Quanzhou City, QUCG has a track record of receiving payments from the Quanzhou Municipal Government. These payments take various forms, such as government subsidies, capital injections, and equity transfers. From 2020 to 2022, the local government injected capital of more than RMB36 billion to the Company, mainly cash, assets, and equity interests of other state-owned enterprises in Quanzhou City, significantly enhancing its capital strength and broadening its business scope. In addition, the local government has provided total subsidies of RMB137 million to the Company over the same period. The local government also regularly makes project payments to the Company for its public policy projects. Overall, given its important position and contribution to regional economic development, we believe that QUCG will receive ongoing government support to support its business operations.

Rapid debt growth driven by large capital expenditure needs

With ongoing financing for its construction projects in recent years, QUCG demonstrates a rapid debt growth. The Company's total debt increased from RMB24.6 billion at end-2020 to RMB59.6 billion as of 30 September 2023, while its total capitalization increased from 32.3% to 43.8% over the same period. The Company faces certain liquidity pressure as short-term debt accounted for 27.6% of total debt as of 30 September 2023. We expect that, given its large future capital needs, the Company's debt burden will continue to grow in the next 12 to 18 months.

Moderate asset liquidity

Furthermore, QUCG has moderate asset liquidity, which may undermine its financial flexibility. The Company's total asset mainly consists of inventories and other non-current assets, which accounted for 80.8% of its total asset as of 30 September 2023. The inventories are mainly investment costs for its public policy projects and resettlement housing projects, while the other non-current assets are mainly the investment cost of its infrastructure construction projects, all of which are considered low liquidity. In addition, the Company's restricted asset accounted for 0.5% of total asset.

In terms of contingent liability, as of 30 September 2023, the Company's external guarantee amount was RMB4.0 billion, accounting for 5.3% of its net assets. All of the external guarantees are provided to local state-owned enterprises in Quanzhou City.

Good access to funding

QUCG has good access to funding as reflected by its good banking relationships and access to the onshore debt capital market. Bank loans are the main financing channel of the Company, accounting for about 51% of

its total debt. It has sufficient standby liquidity. As of 30 September 2023, the Company obtained total credit facilities of RMB55.6 billion from large domestic commercial and policy banks, with available credit facilities of RMB28.6 billion.

The Company has a track record of fund-raising activities in onshore debt capital market, including issuance of MTNs, SCPs, and corporate bonds. The Company have raised about RMB14.2 billion in onshore debt market from January 2020 to January 2024. However, a relatively large amount of bond financing may make the Company vulnerable to the fluctuations of capital market. Additionally, non-standard financing accounted for around 15% of its total debt, such as financial leasing and trust financing.

ESG Considerations

QUCG bears environmental risks through its infrastructure projects. Such risks could be moderated by conducting environmental studies and detailed planning before the commencement of projects and close supervision during the construction.

The Company is also exposed to social risks as a public services provider in Quzhou City. Demographic changes, public awareness and social priorities shape government's target for QUCG, or affect the government's propensity to support the Company.

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

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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