

Credit Opinion

27 March 2024

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

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Linyi City Construction Investment Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of A_g- to Linyi City Construction Investment Group Co., Ltd., with stable outlook.

Summary

The A_g- long-term credit rating of Linyi City Construction Investment Group Co., Ltd. (“LCCI” or the “Company”) reflects Linyi Municipal Government’s very strong capacity and the local government’s very high willingness to provide support to the Company, based on our assessment of the Company’s characteristics.

Our assessment of Linyi Municipal Government’s capacity to support reflects Linyi City’s status as the largest city in Shandong Province in terms of population and area, with ongoing economic growth.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) strategic policy role in the regional development of Linyi City, with regional dominance in infrastructure construction and public transportation; (2) solid track record of receiving government support; and (3) good access to funding.

However, the rating is constrained by the Company’s (1) high exposure to commercial activities with large capital expenditure needs; (2) increasing debt burden with short-term refinancing pressure; and (3) moderate asset liquidity.

The stable outlook on LCCI’s rating reflects our expectation that the local government’s capacity to support will remain stable, and the Company will maintain its strategic importance position in Linyi City over the next 12-18 months.

Rating Drivers

- Strategic policy role in regional development of Linyi City
- High exposure to commercial activities with large capital expenditure needs
- Solid track record of receiving government support
- Increasing debt burden and moderate asset liquidity
- Good access to funding with sufficient bank facilities

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Linyi Municipal 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 lower exposure to risky commercial activities.

What could downgrade the rating?

The rating could be downgraded if (1) Linyi Municipal 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 or weakened funding ability.

Key Indicators

	2020FY	2021FY	2022FY	2023Q3
Total Asset (RMB billion)	71.8	77.1	86.1	90.9
Total Equity (RMB billion)	36.2	36.3	36.0	36.0
Total Revenue (RMB billion)	5.3	7.1	7.4	6.2
Total Debt/Total Capital (%)	37.5	45.6	53.1	55.5

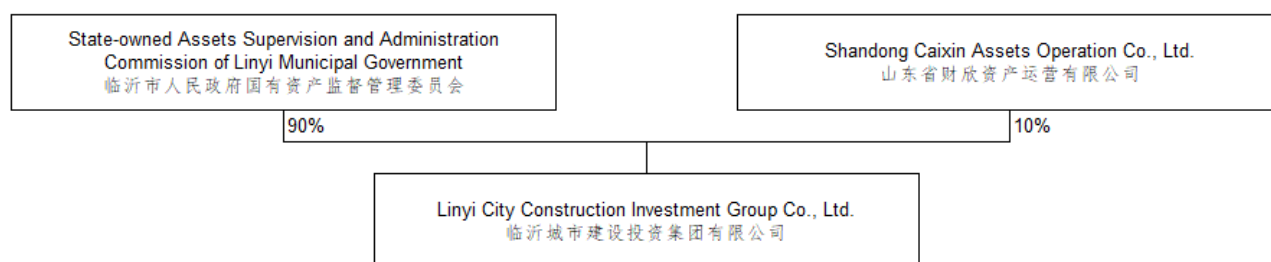
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

Corporate Profile

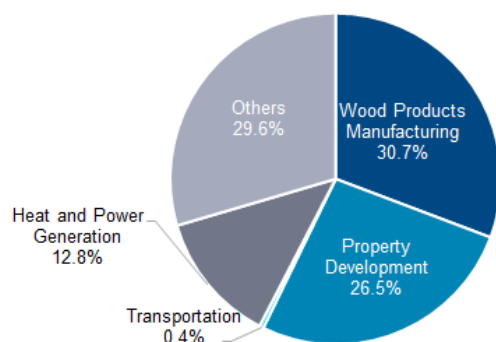
Established in May 2013, LCCI is the largest local infrastructure investment and financing company ("LIIFC") in terms of asset size in Linyi City and plays the most important role in the economic development of Linyi City. The Company is primarily responsible for local key public-policy activities, such as infrastructure construction and public transportation. In addition, the Company is also engaged in commercial activities such as property development, heat and power generation, wood products manufacturing and trading businesses. As of 30 September 2023, the State-owned Assets Supervision and Administration Commission of Linyi Municipal Government ("Linyi SASAC") directly held 90% of the Company's shares. The remaining 10% of the shares were held by Shandong Caixin Assets Operation Co., Ltd ("Shandong Caixin"). The Linyi Municipal Government is the ultimate controller of LCCI.

Exhibit 1. Shareholding chart as of 30 September 2023



Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2022



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe Linyi Municipal Government has a very strong capacity to provide support given its location advantage in Shandong Province with ongoing economic growth.

Shandong Province is the third largest province in terms of gross regional product ("GRP") in China over the past three years, with a solid industrial foundation in logistics, shipbuilding, and marine technology, chemical, automotive and agri-food. Shandong Province recorded a GRP of RMB8.7 trillion in 2022. In 2023, Shandong Province's GRP further increased to RMB9.2 trillion, a year-over-year ("YoY") increase of 6.0%. At the same time, it recorded a general budgetary revenue of RMB746.5 billion, representing a YoY increase of 5.1%.

Linyi City is the largest city by population and area in Shandong Province, with rich water and land resources. It is a pivotal central city in southern Shandong Province, situated at the intersection of the Eurasia Land Bridge's bridgehead, the Yangtze River Delta Economic Area, and the Bohai Economic Rim. Characterized by industries such as agriculture and food processing, manufacturing, logistics, and high-end chemicals, Linyi City has achieved sustained economic growth. The GRP of Linyi City increased by 6.3% YoY to RMB610.5 billion in 2023, ranking 5th among prefecture-level cities in Shandong Province. Linyi Municipal Government's general budgetary revenue has also recorded consecutive growth for several years. However, Linyi City's fiscal self-sufficiency ability was relatively weak as its general budgetary revenue only cover around half of general budgetary expenses over the past three years. Tax revenue is a stable source of general budgetary revenue with a high portion of 77.3% on average over the past three years. As of 31 December 2023, Linyi City reported a government debt of RMB169.1 billion, accounting for 27.7% of its GRP.

Exhibit 3. Key Economic and Fiscal Indicators of Linyi City

	2021FY	2022FY	2023FY
GRP (RMB billion)	546.6	577.9	610.5
GRP Growth (%)	8.7	4.2	6.3
General Budgetary Revenue (RMB billion)	40.9	42.0	44.6
General Budgetary Expenditure (RMB billion)	80.7	87.5	92.0
Local Government Debt (RMB billion)	125.7	146.3	169.1

Source: Linyi Municipal Government, CCXAP research

Government's Willingness to Provide Support

Strategic policy role in regional development of Linyi City

LCCI is the largest LIIFC in Linyi City by total assets and mandated by the government to promote both economic development and human well-being of Linyi City. The Company's infrastructure construction, public transportation business, heat and power generation business are all crucial to the local urbanization and infrastructure development in Linyi City. The other two major LIIFCs in Linyi City are Linyi City Development Group Co., Ltd. ("LYCG") and Linyi Investment Development Group Co., Ltd., undertaking infrastructure construction in different areas of Linyi City. LYCG, as the second largest LIIFC in terms of total assets, also provides urban heat and water supply to enterprises and residents in Linyi City. We believe that the important strategic position of the Company to Linyi City's economic development and public welfare is unlikely to be replaced in the short-to-medium term.

LCCI is the core entity for infrastructure construction in Linyi City. The Company takes part in infrastructure construction business through agency construction model and self-constructed mode. Under the agency construction model, the Company signs an entrusted construction contract with the Finance Bureau of Linyi City ("Linyi Finance Bureau") in relation to its infrastructure construction projects. The Company is responsible for financing and construction of the projects assigned by the local government and receives project repayments from the government based on the total cost plus a few percentage markups, generally around 5%, according to the project progress. As of 30 September 2023, the Company had completed 3 key infrastructure projects, including roads and bridges, with a total investment of RMB914.7 million. These projects are public policy projects which are essential to local urbanization and public welfare. At the same time, the Company had 2 projects under construction and 2 projects under planning, such as schools and shanty town renovation, with a total planned investment of RMB3.0 billion and uninvested amount of RMB2.3 billion.

The Company also had some infrastructure construction under self-constructed model. The Company is responsible for the investment and construction of the railway station area, including the construction of square in Linyi North Station of Lunan High-Speed Railway, with a total investment of RMB1.8 billion. LCCI is expected to achieve fund balancing through government subsidies and operating revenue, such as leasing, car parks, and advertisement. As of 30 September 2023, the Company had 4 construction projects under construction, including roads and transport facilities renovation, with a total investment of RMB10.2 billion and outstanding investment of RMB1.5 billion. Large-scale projects in the pipelines can ensure the sustainability of the business, but also bring great pressure on the Company's capital expenditure.

LCCI also engages in providing public services including public bus transportation. The Company operates city bus transportation service through its wholly-owned subsidiary, which is a sole operator providing city bus transportation services within Linyi City. As of 30 September 2023, LCCI had more than 2,000 public vehicles operating in approximately 133 routes. The Company's public transportation service has strong public welfare

attributes and is currently experiencing gross profit losses. The Company also receives government subsidies from Linyi Municipal Government for its operation of city bus transportation service.

Overall, considering the Company's strong strategic significance to the regional development of Linyi City, we believe the Company will not be easily replaced by other local state-owned enterprises in the foreseeable future.

High exposure to commercial activities with large capital expenditure needs

Apart from public services, LCCI has also been engaged in commercial activities, including self-operating projects, property development, heat and power generation services, wood products manufacturing, and trading businesses. Some of the Company's commercial businesses are policy-driven which align with the local development policies of the Linyi Municipal government. At the same time, large expenditures will be incurred, which will exert financing pressure on the Company. This is mainly due to the large-scale of construction projects such as commercial housing and self-operated construction. We consider LCCI's commercial business exposure to be relatively high with large capital expenditure needs, accounting for more than 30% of its total assets.

As the main developer and operator of Linyi City, LCCI also engages in a series of self-operated construction projects, such as civil service center, sports center, and industrial parks. The Company is expected to achieve fund balancing through future operating income, such as leasing and ticketing. As of 30 September 2023, there were 4 key self-operating projects under construction and one project under planning, with a total estimated investment of RMB13.7 billion and uninvested amount of RMB6.8 billion. Most of these projects are policy-driven with the aim to simulate the economic growth and social benefit of Linyi City. The Company is expected to receive government subsidies and government special-purpose bonds to support the construction of these projects. For instance, the Linyi Olympic Sports Centre project mainly includes the construction of stadium, cultural center, and national fitness center. The Company has received special financial allocation from the local government for the Linyi Olympic Sports Centre project. After the completion, it would be used to host national large-scale sports events. We believe the riskiness of the business is manageable as the development of these self-operating projects is aligned with the blue print of the local government.

In addition, LCCI also participates in property development business. All the Company's commercial housing projects under construction are in core areas of Linyi City. As of 30 September 2023, the Company had completed 2 commercial housing projects, with a total investment of RMB5.6 billion, most of which had been sold. At the same time, the Company has 5 major property development projects under construction with a total investment of RMB13.2 billion and an outstanding investment of RMB6.8 billion. LCCI also took over 3 commercial housing projects through government transfer. However, increasing investment in property development may bring more operating uncertainties and financial risks to the Company as the property sales are easily affected by the market conditions, particularly during the economic downturn in China.

Moreover, LCCI takes part in wood products manufacturing business, which has contributed a relatively large proportion to the Company's total revenue. This business segment involves research, development, manufacture and sales of wooden furniture, home decoration materials, prefabricated housing and aluminum alloy doors and windows. The customers are concentrated in real estate enterprises, which may bring more operating uncertainties and recovery risks to the Company especially during the recent downturn in the China's property market. LCCI has further strengthened its internal control measures, such as increasing the proportion of prepayments and payment on delivery from customers, and stopping the cooperation with risky real estate enterprises.

LCCI also participates in heat and power generation services, mainly providing heat to wood enterprises in Linyi City. As of 30 September 2023, the Company owned pipe network with a length of 380 kilometers, with heating capacity of around 3 million tons per year. The Company also had one thermal station construction project under planning, with a total investment of RMB40.6 million. LCCI mainly uses coal to produce heat energy, making it vulnerable to changes in the international energy market, and resulting some uncertainty in the profitability of this business segment in the future.

Moreover, the Company engages in trading business, including the supply of coal, steel, and aluminum ingots. The Company adopts demand-on-purchase mode which means orders to upstream suppliers would be placed only when the sale contracts are signed with downstream customers. Although this segment can provide the Company with additional income, the Company is exposed to certain concentration risks. The top 5 suppliers accounted for 100% and 57.4% of the total procurement in 2022 and the first three quarters of 2023, respectively. Apart from that, the Company is also exposed to certain degree of counterparty risk relating to its downstream customers.

Solid track record of receiving government support

As the core operating entity carrying out municipal development activities and providing public services in Linyi City, LCCI has a solid track record of receiving government support from Linyi Municipal Government, including government subsidies, capital injection, asset transfer, and payment for infrastructure construction projects, which could help the Company meet its policy objectives and financial obligations. Since its establishment, the local government has injected various assets into the Company, including land, properties, and equity interest. For example, the local government has transferred its shareholding in some state-owned enterprises to LCCI from 2013 to 2018, such as Linyi Public Transportation Group Co., Ltd., enlarging the Company's capital strength. In 2021, the Company received 80% of shares in Shandong Yimeng High Quality Agricultural Exchange Center Co., Ltd., which increased the Company's capital reserve by RMB14.3 million.

In addition, the Company received ongoing government subsidies for carrying out construction projects such as Linyi Olympic Sports Centre, square in Linyi North Station of Lunan High-Speed Railway, and public transportation business. From 2020 to 2023Q3, LCCI has received government subsidies with a total amount of approximately RMB2.1 billion. Moreover, the Company also has a track of obtaining the repayments for its agency construction projects. As of 30 September 2023, the Company had received project repayments of RMB960.4 million. Considering LCCI's irreplaceable role in the development and public welfare of Linyi City and its close relationship with Linyi Municipal Government, we expect that the Company will continue to receive government support over the next 12 to 18 months.

Increasing debt burden and moderate asset liquidity

Due to the ongoing financing for its infrastructure construction and property development projects in recent years, LCCI demonstrates a rapid debt growth. As of 30 September 2023, the Company's total debt rose to RMB44.9 billion from RMB21.7 billion as of end-2020, while its total capitalization ratio increased to 55.5% from 37.5% over the same period. In addition, the Company faces certain liquidity pressure as its short-term debt accounted for 43.5% of total debt at the end of September 2023. Meanwhile, the cash to short-term debt ratio was 0.3x as of the same date, indicating short-term refinancing pressure. Given the Company's large capital expenditure needs for its infrastructure construction and property development projects, we expect that the Company's debt level will continue to grow in the next 12 to 18 months.

In addition, LCCI has moderate asset liquidity, which may undermine its financial flexibility. The Company's total asset mainly consists of inventories, receivables accounts, fixed assets and construction in progress, accounting for more than 60% of its total asset as of 30 September 2023. The inventories and construction in progress are mainly cost of infrastructure construction, property development, and self-operating construction projects, while receivables were mainly receivables from the local government and other state-owned enterprises, all of which are considered low liquidity. Moderate asset liquidity may also undermine the Company's financing flexibility.

Good access to funding with sufficient bank facilities

LCCI has good access to different sources of funding including bank loans, onshore and offshore bond issuances, and non-standard financing products, which may partially release capital expenditure pressure and liquidity profile. The Company has built a close relationship with large domestic banks, such as Agricultural Development Bank of China, Evergrowing Bank Co., Ltd., and China CITIC Bank. As of 30 September 2023, the Company has obtained total credit facilities of RMB49.8 billion, with an unutilized amount of RMB19.3 billion, indicating sufficient standby liquidity.

The Company also has a track record of fund-raising activities in both onshore and offshore debt capital markets. It has issued several types of debt products such as medium-term notes ("MTNs"), private placement notes ("PPNs") and corporate bonds. From 2023 to February 2024, the Company has raised RMB9.0 billion on the onshore debt market through 10 tranches of debt instruments. In terms of the offshore debt market, the Company issued 3 tranches of offshore bonds over the same period, raising RMB960 million and USD310 million. However, the Company has a relatively high reliance on direct financing, accounting for around half of the total debt. The refinancing stability of the Company may be easily affected by the fluctuations in the capital market. LCCI's exposure to non-standard financing is manageable, accounting for around 10%-15% of the total debts.

Overall, in the view of LCCI's important status in the regional development of Linyi City, we expect the Company would maintain stable funding access to bank loans and capital markets.

ESG Considerations

LCCI is exposed to 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.

LCCI bears social risks as it implements public policy initiatives by undertaking infrastructure construction and providing public transportation service in Linyi 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.

LCCI's governance considerations are also material as the Company is subject to oversight and reporting requirements of 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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