

Credit Opinion

23 April 2024

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

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Qingdao Shibe Construction Investment Group Co., Ltd.

Surveillance credit rating report

CCXAP affirms Qingdao Shibe Construction Investment Group Co., Ltd.'s long-term credit rating at BBB_g+, with stable outlook.

Summary

The BBB_g+ long-term credit rating of Qingdao Shibe Construction Investment Group Co., Ltd. ("SBCI" or the "Company") reflects Shibe District Government's very strong capacity to provide support and its very high willingness to provide support based on our assessment of the Company's characteristics.

Our assessment of Shibe District Government's capacity to provide support reflects Shibe District's sound economic and fiscal strength, with a gross regional product ("GRP") of over RMB100 billion.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) important policy role as an urban operator of Shibe District; (2) good track record of receiving government support; and (3) good access to diversified funding sources.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities; and (2) high debt leverage level and weak asset liquidity.

The stable outlook on SBCI's rating reflects our expectation that Shibe District Government's capacity to provide support will be stable; and the Company will maintain its important policy role as an urban operator in Shibe District over the next 12 to 18 months.

Rating Drivers

- Important policy role as an urban operator of Shibe District
- Medium exposure to commercial activities
- Good track record of receiving government support
- High debt leverage and weak asset liquidity
- Good access to diversified funding sources

Rating Sensitivities

What could upgrade the rating?

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

What could downgrade the rating?

The rating could be downgraded if (1) Shibe District 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 a reduction in the importance of its policy role, weakened government payments, or a deterioration in its financing ability.

Key Indicators

| | 2020FY | 2021FY | 2022FY | 2023Q3 |
|------------------------------|--------|--------|--------|--------|
| Total Asset (RMB billion) | 40.6 | 45.3 | 49.8 | 55.2 |
| Total Equity (RMB billion) | 12.7 | 14.0 | 15.2 | 15.9 |
| Total Revenue (RMB billion) | 0.5 | 1.6 | 6.2 | 6.9 |
| Total Debt/Total Capital (%) | 66.8 | 67.7 | 67.4 | 68.8 |

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

Source: Company data, CCXAP research

Corporate Profile

Established in 2016, SBCI is the one of the primary local infrastructure investment and financing companies ("LIIFCs") that focuses on urban operations and investment in Shibe District, Qingdao City. SBCI plays an important role in public activities in Shibe District, such as land consolidation and development, affordable housing, and urban renewal projects. The Company also undertakes commercial activities such as property development, property leasing and trading. As of 30 September 2023, SBCI was directly and wholly-owned by the State-owned Assets Operation and Development Center of Qingdao Shibe District.

Exhibit 1. Revenue structure in 2022

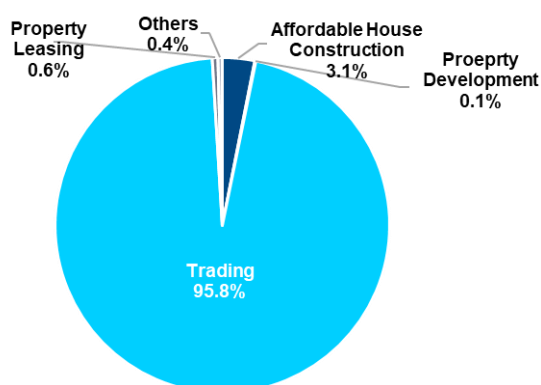
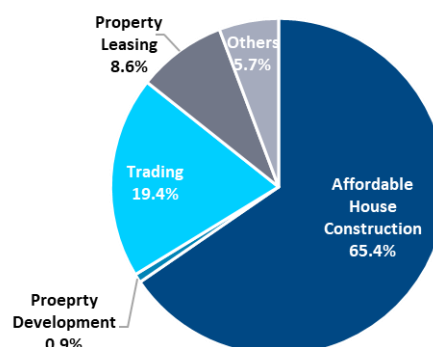


Exhibit 2. Gross profit structure in 2022



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe that Shibei District Government has a very strong capacity to provide support, based on its sound economic fundamentals and fiscal strength.

Shandong Province is the third largest province in China by GRP, with a solid industrial foundation in industries such as logistics, shipbuilding and marine technology, chemicals, automotive and agri-food. Qingdao City is one of the five cities under separate state planning in China and is the city with the biggest economic size and strongest average income level in Shandong. Its GRP and GRP per capita ranked among the top in Shandong over the past five years. Its GRP demonstrated an upward trend, reaching RMB1.6 trillion in 2023. Qingdao Municipal Government has strong fiscal strength and good fiscal metrics. In the past three years, its general budgetary revenue covered over 70% of its general budgetary expenditure, and tax incomes accounted for more than 70% of its general budgetary revenue on average. As of the end of 2023, its outstanding direct government debt amounted to RMB362.0 billion, or 23.0% of the GRP.

Exhibit 4. Key economic and fiscal indicators of Qingdao City

| | 2021FY | 2022FY | 2023FY |
|---|---------|---------|---------|
| GRP (RMB billion) | 1,413.6 | 1,492.1 | 1,567.0 |
| GRP Growth (%) | 8.3 | 3.9 | 5.9 |
| General Budgetary Revenue (RMB billion) | 136.8 | 127.3 | 133.8 |
| General Budgetary Expenditure (RMB billion) | 170.7 | 169.6 | 171.9 |
| Local Government Debt (RMB billion) | 255.9 | 308.0 | 362.0 |

Source: Statistics Bureau of Qingdao City, CCXAP research

Located along the coast of Jiaozhou Bay, Shibei District is one of the urban areas with relatively concentrated population in Qingdao City. Benefited from its abundant human resources and a vast consumer market, tertiary industries such as beer and textiles industry have developed rapidly and contributed significantly to the local economy. With good business environment for privately-owned companies, the number of listed companies in Shibei District ranks first among districts and counties in Qingdao City, such as Tsingtao Brewery Company Limited, Qingdao Eastsoft Communication Technology Co., Ltd. and Qingdao Guolin Technology Group Co., Ltd. In 2023, it reported GRP of RMB120.3 billion, a Year-on-Year increase of 6.2%. Moreover, Shibei District

Government's fiscal strength increased, with good fiscal metrics. Over the past three year, the fiscal balance ratio (general budgetary revenue/general budgetary expenditure) exceeded 100%. It's average fiscal stability ratio (tax revenue/general budgetary revenue) over the past three years was recorded at 83.8%. As of the end of 2023, its outstanding direct government debt amounted to RMB10.4 billion, accounting for 8.6% of the GRP.

Exhibit 5. Key economic and fiscal Indicators of Shibe District

| | 2021FY | 2022FY | 2023FY |
|---|--------|--------|--------|
| GRP (RMB billion) | 106.4 | 112.4 | 120.3 |
| GRP Growth (%) | 6.5 | 4.6 | 6.2 |
| General Budgetary Revenue (RMB billion) | 10.4 | 7.4 | 9.6 |
| General Budgetary Expenditure (RMB billion) | 6.9 | 5.9 | 6.0 |
| Local Government Debt (RMB billion) | 7.4 | 8.4 | 10.4 |

Source: Shibe District Government, CCXAP research

Government's Willingness to Provide Support

Important policy role as an urban operator of Shibe District

SBCI is the one of the primary LIIFCs in Shibe District, with a strong strategic position under the local government's planning. There are other LIIFCs including Qingdao Ronghui Fortune Investment Holding Group Co., Ltd. ("QDRH") and Qingdao Huanhaiwan Investment and Development Group Co., Ltd. ("Huanhaiwan Group"). QDRH mainly undertakes financial investment, industrial investment, as well as urban development and construction in Shibe District. Huanhaiwan Group is responsible for infrastructure construction and operation in the Cruise Port Core Area with 4.2 square kilometers. SBCI is positioned as the main urban operator that specializes in the urban renewal, investment, and operations. It plays an important role in land consolidation, affordable housing, shantytown and urban renewal projects, and its government-related assets such as shantytown, land, and affordable housing account for a relatively large proportion of the Company's total assets.

SBCI is mandated by the local government to engage in primary land development business through its subsidiaries, including house demolition, residents' relocation, land clearing and levelling. After land transfer is completed and government payment is received, the Company will recognize the total revenue for the projects within the Shibe CBD; while for the projects outside the Shibe CBD, only pre-determined management fee will be recognized to offset against inventories costs. The revenue from land consolidation projects in Shibe CBD will decrease as the work is completed and awaits settlement. As of 30 September 2023, the Company had an outstanding investment of RMB557.6 million in major land development projects under consolidation with a total investment of RMB9.1 billion, mainly including the Dagangwei Fourth Road Project.

According to the urban planning of Shibe District, SBCI actively undertakes affordable housing, urban renewal, and dilapidated housing renovation projects to help improve people's livelihood and beautify the image of the city. For example, the Company has completed the 2017 Shantytown Project, which was one of the national shantytown renovation plans and annual shantytown renovation projects. To undertake the shantytown project, the Company signs a repurchase agreement with the local government or relevant parties, and raises the initial funds itself. After these projects are completed, the local government will pay the Company based on the actual cost plus a markup as management fee. As of 30 September 2023, all shantytown projects, low-cost housing, and resettlement housing projects have been completed and there are no similar projects under construction or planning.

Medium exposure to commercial activities

SBCI also engages in commercial activities such as commodity transaction, property development and property leasing, which provide supplemental revenue for the Company. However, such activities may expose the Company to certain business risks and the local government seldom provide direct support for these activities. Based on our analysis, the Company is exposed to medium business risks, with commercial assets accounting for less than 30% of total assets.

SBCI's property development business includes development of commercial housing, shops, and office building. As of 30 September 2023, the Company has completed 6 main property development projects, of which most of the commercial housing has been sold, and the unsold commercial buildings will be used for leasing purposes in the future. At the same time, the Company had 3 property development projects under construction, with a total investment of RMB4.3 billion and outstanding investment of RMB1.3 billion. 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. The cash collection and investment return of these property development projects are uncertain, especially during the downturn of the real estate market. The Company is also engaged in property leasing business, with around 42,000 square meters of leasable assets, including office buildings and shops. The leasing business generated recurring leasing revenue of around RMB34 million in both 2021 and 2022. Under the guidance of the local government to attract investment, the rent may be lower than the market price. With the continuous investment in urban renewal projects such as Taidong Pedestrian Street and Historical Memory Cultural Area, the Company's exposure to such commercial activities will increase in the future.

Relying on the advantages of the port resources in Shibei District, SBCI also engages in trading business, mainly focusing on oil and gas energy and agricultural products. There is a significant increase in trading revenue from RMB812.1 million in 2021 to RMB6.0 billion in 2022, thus may occupy more capital. The trading business represents a large portion of its revenue stream but generates a minimal profit margin. The Company conducted credit evaluation on its customers in advance. Its clients include central state-owned enterprises, local state-owned enterprises, and large private-owned companies. SBCI's trading business has low price risk as most orders are fulfilled on an on-demand basis and prices are fixed at a certain level.

Good track record of receiving government support

As a major entity undertaking public activities in Shibei District, SBCI has a proven track record of receiving government support in various forms such as capital injection, financial subsidies, asset injections and government payment for construction projects.

Since its establishment, SBCI has received continuous support from the government. From 2020 to 2023Q3, the Company received government special bonds of around RMB2.8 billion, which helped moderate its financing pressure. The Company also received shareholding transfer of some state-owned enterprises in 2022 and 2023. SBCI received shareholdings of 7 state-owned enterprises from QDRH under the government guidance at the end of 2023, aiming to focus on urban renewal and operation business in the future. From 2020 to 2023Q3, the local government has provided operating subsidies of around RMB34.3 million in total to support the Company's operations.

The Company's public projects are expected to receive government payments on an ongoing basis, with the total payment and annual payment becoming visible when payment contracts were signed. For example, for the 2017 Shantytown Project, the Company signed a government repurchase agreement with the Real Estate

Development Management Bureau of Qingdao City, appointing annual repayment started from 2020 to 2042. The payment will be arranged in the annual financial budget of Qingdao City.

High debt leverage and weak asset liquidity

SBCI's debt leverage remains high due to its continuous investment in land consolidation and shantytown projects, as well as long government repayment periods. Its total capitalization ratio reached a high level of 68.8% at the end of the third quarter of 2023. From 2020 to 2023Q3, the Company's total debt increased from RMB25.5 billion to RMB35.0 billion. Most of its total debt was arising from shantytown projects that it undertook in the past, especially the 2017 Shantytown project. The Company raised around RMB15.3 billion from China Development Bank for the 2017 Shantytown project and started to repay the loan from 2020. The source of debt repayment is secured by the payment of government service purchases. The Company's short-term debt burden has been increasing, with short-term debt accounting for 37.4% of its total debt as of 30 September 2023. The cash to short-term debt ratio was around 0.2x as of the same date. Given its continuous investment plans in land consolidation and commercial businesses, we expect the Company's total debt leverage will remain high in the next 12 to 18 months.

In addition, the liquidity of SBCI's assets was relatively weak. As of 30 September 2023, the Company's inventories accounted for 69% of total assets. The Company's inventories mainly include cost of land development and shantytown renovation which are considered to have low liquidity.

Good access to diversified funding sources

SBCI has good access to various sources of funding including banks and the bond market, which could help it refinance and meet capital expenditure needs. The Company has maintained good relationships with large domestic banks including national joint-stock commercial banks and state-owned large commercial banks. China Development bank, a Chinese policy bank, has provided long-term bank loans to the Company to undertake the public activities, accounting for the majority of its bank borrowing. As of 30 September 2023, it had total credit facilities of approximately RMB40.0 billion with an unused portion of around RMB6.9 billion, which were provided by various commercial banks. Moreover, SBCI also has good access to debt capital market. From January 2023 to March 2024, the Company and its subsidiary issued 4 tranches of onshore bonds, raising around RMB3.6 billion. In addition, SBCI's exposure to non-standard channels is manageable, accounting for less than 10% of total debt as at 30 September 2023.

ESG Considerations

SBCI bears environmental risks through its land consolidation, infrastructure, and property development projects. Such risks could be moderated by conducting environmental studies and detailed planning before the commencement of projects and close supervision during the construction phase.

The Company is also exposed to social risks as a public services provider in Shibe District. Demographic changes, public awareness, and social priorities shape government targets for SBCI, which can affect the government's propensity to support the Company.

SBCI'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 \(July 2022\)](#).

Appendix

Exhibit 6. Peer Comparison

| | Qingdao Shibe i Construction Investment Group Co., Ltd. | Qingdao Ronghui Fortune Investment Holding Group Co., Ltd. |
|-----------------------------|--|--|
| Long-Term Credit Rating | BBB _g + | BBB _g + |
| Shareholder | State-owned Assets Operation and Development Center of Qingdao Shibe | State-owned Assets Operation and Development Center of Qingdao Shibe |
| | District (100%) | District (90%) and Shandong Caixin Asset Operating Co., Ltd. (10%) |
| Positioning | Key urban operator, focusing on urban investment and operations in Shibe | Key entity in the industrial and urban development in Shibe |
| | District | District |
| Total Asset (RMB billion) | 49.8 | 66.0 |
| Total Equity (RMB billion) | 15.2 | 27.9 |
| Total Revenue (RMB billion) | 6.2 | 11.5 |

All ratios and figures are calculated using CCXAP's adjustments based on financial data as of 31 December 2022.

Source: Company information, CCXAP research

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