

CCXAP assigns Shandong Luqiao Group Co., Ltd.'s long-term credit rating at A_g-, with stable outlook

Hong Kong, 25 July 2023 -- China Chengxin (Asia Pacific) Credit Ratings Company Limited ("CCXAP") has assigned first-time long-term credit rating of A_g- to Shandong Luqiao Group Co., Ltd. ("SDLQ" or the "Company"), with stable outlook.

The A_g- long-term credit rating of SDLQ reflects the Company's (1) solid market position in Shandong Province, particular in the area of road and bridge construction; (2) good order backlogs and profit margin; and (3) good access to funding. However, the rating is constrained by the Company's (1) geographic concentration; (2) higher investment risks from increasing public-private partnership ("PPP") projects; and (3) rising debt levels with rapid business growth.

The rating also reflects our expectation of a very high likelihood of support from SDLQ's parent, namely Shandong Hi-speed Road & Bridge Group Co., Ltd. ("SHRB"), given SDLQ's (1) status as the core subsidiary of SHRB in engineering and construction business; and (2) close business and financial linkages with SHRB. We believe that SHRB has a strong capacity to support the Company by dint of SHRB's (1) status as a key subsidiary of Shandong Hi-Speed Group Co., Ltd. ("SDHS") which is ultimately owned by the Shandong Provincial Government; (2) strong strategic role for SDHS in the development of construction business; and (3) good track record of strong shareholder and government support.

Corporate Profile

Established in 1948, SDLQ is one of the leading engineering and construction ("E&C") company in Shandong Province that experts in the construction of roads and bridges. As of the end of December 2022, the Company was wholly owned by SHRB, a Shenzhen listed construction company (000498.SZ) that was 49.76% owned by SDHS. SDHS was the largest SOEs by total assets in Shandong Province and was owned and controlled by the State-owned Assets Supervision and Administration Commission of Shandong Province ("Shandong SASAC"). SDLQ reported total revenue of RMB50.2 billion in 2022 and total assets of RMB71.7 billion as of 31 December 2022.

Rating Rationale

Credit Strengths

Strong market position in road and bridge construction market in Shandong Province.

SDLQ is a leading construction company in Shandong Province, particular in the area of road and bridge construction. The Company has more than 50% market share in highway construction in Shandong Province. It demonstrates a good track record in the construction of transportation infrastructure and has participated in multiple major road and bridge projects in Shandong Province.

Good order backlogs and profit margin. Underpinned by the order support from SDHS and its expansion in other construction fields and outside Shandong Province, SDLQ demonstrates good project reserves that help support its future business growth. SDLQ has a good EBITDA



margin, which is mainly driven by its good cost control and margins in its engineering contracting business. Besides, the Company's road repairment and maintenance business is a good complement to its profitability, which provides a recurring revenue stream with a higher gross margin.

Good access to funding. SDLQ has good access to funding including its parent company and banks with low costs. As of the end of 2022, the Company obtained total bank credit facilities of RMB60.6 billion, of which the available part was RMB35.9 billion, providing good financial flexibility. In addition, SDLQ has a track record of receiving capital and funding support from its parent company, SHRB, including providing money lending and guarantees when needed.

Very high likelihood of support from its parent company when necessary. SDLQ has a very important position in SHRB's operations as the primary operating subsidiary in roads and bridges construction business. It contributes most of the revenue stream and profit for SHRB. Given SDLQ's important business position, SHRB has provided strong funding support to SDLQ for business expansion and maintaining its financial health. SHRB's capacity to provide support is largely underpinned by SDHS. SDHS is the largest toll road operator in Shandong Province.

Credit Challenges

Having a geographic concentration. SDLQ's rating is constrained by its geographically concentrated operation in Shandong Province. The business growth is highly associated with the local construction needs in the province and SDHS's investment planning. Affected by the postponement of SDHS's bidding, the growth pace in newly signed contracts of SDLQ slowed down in 2022.

Higher investment risk from increasing PPP projects. Besides the engineering contracting business, SDLQ makes some investments in public-private partnership (PPP) projects that are capital-intensive and require a longer return period. As of the end of 2022, the Company totally had 28 PPP projects in hand, all of which have been listed in the project management database of the Ministry of Finance. The Company faces pressure on future capital expenditure with ongoing investment in these projects and will undertake higher investment risk.

Rising debt levels with rapid business growth. SDLQ has moderate leverage compared to its peers and has continued to reduce its leverage by increasing earnings while controlling its capital spending and debt growth. However, the Company's debt grew fast with rapid business expansion. It had total debt (including perpetual capital) of RMB 14.2 billion at end-2022, with an average annual growth rate of around 22% over the past three years.

Rating Outlook

The stable outlook on SDLQ's rating reflects our expectation that the Company's important position to its parent company is unlikely to change. We also expect the Company to maintain stable credit metrics and sufficient liquidity over the next 12 to 18 months.

What could upgrade the rating?



The rating could be upgraded if (1) the credit quality of SHRB improves, given the close business and financial linkages between SHRB and SDLQ; or (2) SDLQ's standalone credit quality improves significantly, including stronger market position, diversified operating scale, and improved credit metrics.

What could downgrade the rating?

The rating could be downgraded if (1) the credit quality of SHRB deteriorates or parental support is expected to be weakened; or (2) SDLQ's standalone credit quality worsens significantly, including a material drop in market share, deterioration in credit metrics, and poor liquidity management.

Rating Methodology

The methodology used in this rating is the Rating Methodology for [Engineering and Construction Companies \(December 2016\)](#).

Regulatory Disclosures

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