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

Hong Kong, 16 July 2024 -- China Chengxin (Asia Pacific) Credit Ratings Company Limited ("CCXAP") has affirmed Shandong Luqiao Group Co., Ltd. ("SDLQ" or the "Company") long-term credit rating at A_g-, with stable outlook.

The A_g- long-term credit rating of SDLQ reflects the Company's (1) solid market position in Shandong Province, particularly 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 public-private partnership ("PPP") projects; and (3) heightened debt burden 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 and controlled 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 is an expert in the construction of roads and bridges. As of 31 March 2024, the Company was wholly owned by SHRB, a Shenzhen listed E&C company (stock code: 000498. SZ) that was 49.8% owned by SDHS. SDHS is the largest state-owned enterprise ("SOE") by total assets in Shandong Province and is ultimately owned and controlled by the State-owned Assets Supervision and Administration Commission of Shandong Province ("Shandong SASAC"). SDLQ reported a total revenue of RMB52.2 billion in 2023 and total assets of RMB88.7 billion as of 31 December 2023.

Rating Rationale

Credit Strengths

Strong market position in road and bridge construction market in Shandong Province. SDLQ is a leading E&C company in Shandong Province, particularly in the area of road and bridge construction. The Company maintains high regional status as it owns more than 50% market share in highway construction in Shandong Province. It participates in multiple major road and bridge projects in Shandong Province. It has also gained market recognition through earning a series of meaningful engineering and construction prizes.

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's EBITDA margin was

7.8% in 2023, which was still good compared to its peers, mainly driven by its good cost control and earning power in its engineering contracting business. Besides, the Company's road repair and maintenance business is a good complement to its profitability, which provides a recurring revenue stream with a higher gross margin of over 15% in 2023.

Good access to funding. SDLQ has good access to funding including its parent company, banks and the capital market with low costs. As of 31 March 2024, the Company obtained total bank credit facilities of RMB69.9 billion, of which the available part was RMB43.9 billion, providing good financial flexibility. It also has good access to the onshore bond market. 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 Company's business growth is highly associated with the local construction needs in the province and its investment planning. In 2023, more than 70% of newly signed contracts came from Shandong Province. At the same time, the Company actively expands business outside Shandong Province, but the amount of newly signed contracts in other provinces fluctuate amid intensive market competition.

Higher investment risk from 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 2023, 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 capital expenditure pressure and higher investment risk with ongoing investment in these projects.

Heightened debt burden with rapid business growth. The Company relies on external financing to meet its financial needs and debt repayment. The Company's debt burden grew with its rapid business expansion as total debt (including perpetual debt) increased from RMB14.2 billion at end-2022 to RMB15.1 billion as of the end of 2023. Despite this, SDLQ's leverage reduced slightly as the total capitalization ratio decreased to 44.7% from 47.7% during the same period.

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).

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