

Credit Opinion

22 December 2023

Ratings

| | |
|------------------------------|--------------------|
| Senior Unsecured Debt Rating | BBB _g - |
| Long-Term Credit Rating | BBB _g - |
| Outlook | Stable |
| Category | Corporate |
| Domicile | China |

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Shouguang City Construction Investment Development Co., Ltd.

Surveillance credit rating report

CCXAP affirms Shouguang City Construction Investment Development Co., Ltd.'s long-term credit rating at BBB_g-, with stable outlook.

Summary

The BBB_g- long-term credit rating of Shouguang City Construction Investment Development Co., Ltd. ("SGCC" or the "Company") reflects Shouguang City Government's strong capacity and very high willingness to provide support to the Company, based on our assessment of the Company's characteristics.

Our assessment of the local government's capacity to provide support reflects Shouguang City's status as one of the top 100 counties in China, with rapid economic growth and good fiscal metrics.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) dominant role in local infrastructure construction, operation of land resources, and provision of essential public services; (2) good track record of receiving government payments; and (3) good access to diversified funding channels.

However, the rating is constrained by the Company's (1) high exposure to commercial activities; (2) increasing debt leverage driven by large capital expenditure; and (3) medium contingent risks resulting from external guarantees.

The stable outlook on SGCC's rating reflects our expectation that Shouguang City Government's capacity to provide support will remain stable, and the Company's characteristics, such as its business profile and financial risks and controls will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Dominant role in local infrastructure construction, operation of land resources, and provision of essential public services
- Good track record of receiving government payments
- High exposure to commercial activities
- Increasing debt leverage driven by large capital expenditure
- Medium contingent risks resulting from external guarantees
- Good access to diversified funding channels

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local 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 materially lowered exposure to risky commercial activities and increased public policy status.

What could downgrade the rating?

The rating could be downgraded if (1) the local 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, weakened funding ability, or decreased government payments.

Key Indicators

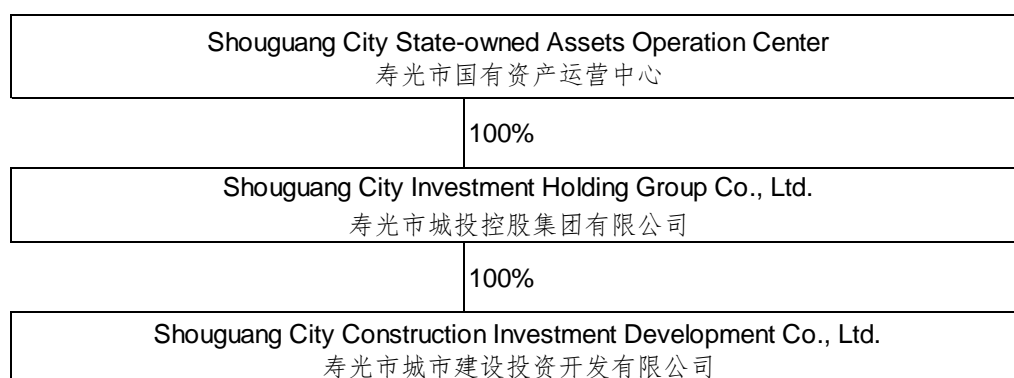
| | 2020FY | 2021FY | 2022FY | 2023H1 |
|------------------------------|--------|--------|--------|--------|
| Total Asset (RMB billion) | 19.5 | 21.1 | 27.8 | 29.3 |
| Total Equity (RMB billion) | 6.1 | 7.1 | 10.2 | 10.3 |
| Total Revenue (RMB billion) | 1.7 | 2.5 | 2.5 | 1.4 |
| Total Debt/Total Capital (%) | 61.5 | 58.1 | 56.5 | 60.2 |

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

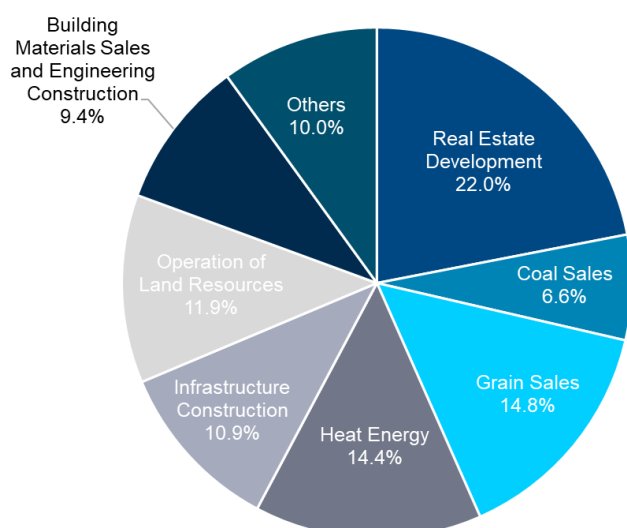
Source: Company information, CCXAP research

Corporate Profile

Founded in February 2008, SGCC is one of the key local infrastructure investment and financing companies ("LIIFCs") in Shouguang City, Weifang City, Shandong Province. The Company engages in the public policy projects under the entrusted construction model, including infrastructure construction, affordable and resettlement housing development, operation of land resources, as well as the provision of heat energy services. The Company also has commercial operations, including residential housing development, property leasing, production and sales of commercial concrete, engineering construction, as well as grain sales. As of 30 June 2023, SGCC was wholly-owned by Shouguang City Investment Holding Group Co., Ltd. and was ultimately controlled by the Shouguang City State-owned Assets Operation Center.

Exhibit 1. Shareholding chart as of 30 June 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 Shouguang City Government has a strong capacity to provide support given its good economic fundamentals and fiscal strengths, with a moderate financial sufficiency.

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. Weifang City is located in the east-central part of Shandong Province and is a famous old industrial city in China. In 2022, Weifang City reported a GRP of RMB730.6 billion, a year-over-year ("YoY") increase of 3.7%, ranking the 4th among prefecture-level cities in Shandong Province. Over the past three years, Weifang City demonstrated relatively strong fiscal strength. Its general budgetary revenue covered more than 70% of its general budgetary expenditure. As of 31 December 2022, Weifang City's government debt balance was RMB191.0 billion, accounting for 26.1% of GRP. It is necessary to pay attention to the debt situation of Weifang City and the impact of negative news on the overall financing environment of the region.

Exhibit 3. Key Economic and Fiscal Indicators of Weifang City

| | 2020FY | 2021FY | 2022FY |
|---|--------|--------|--------|
| GRP (RMB billion) | 587.2 | 701.1 | 730.6 |
| GRP Growth (%) | 3.6 | 9.7 | 3.7 |
| General Budgetary Revenue (RMB billion) | 57.4 | 65.7 | 60.8 |
| General Budgetary Expenditure (RMB billion) | 79.6 | 88.0 | 84.2 |
| Local Government Debt (RMB billion) | 143.6 | 167.3 | 191.0 |

Source: Statistics Bureau of Weifang City, CCXAP research

Shouguang City is located in the middle of Shandong Peninsula. It is one of the top 100 counties in China and is known as the “Vegetable Capital of China” and “Sea Salt Capital of China”. Shouguang City has formed leading industries structure with marine chemicals, building materials, automobiles and parts, paper products and printing and beverages. In 2022, Shouguang City reported a GRP of RMB100.2 billion and general budgetary revenue of RMB9.8 billion, ranking first among all administrative districts of Weifang City. It has good fiscal metrics with a fiscal balance ratio (general budgetary revenue/general budgetary expenditure) of 76.6%, while tax contributed 56.8% of its general budgetary revenue in 2022. As of 31 December 2022, Shouguang City reported a total debt balance of RMB18.6 billion and a government debt/GRP ratio of 18.6%. In 2023H1, the GRP of Shouguang City was RMB50.9 billion, a YoY increase of 4.8%, still ranking first in Weifang City.

Exhibit 4. Key Economic and Fiscal Indicators of the Shouguang City

| | 2020FY | 2021FY | 2022FY |
|---|--------|--------|--------|
| GRP (RMB billion) | 78.7 | 95.4 | 100.2 |
| GRP Growth (%) | 3.1 | 10.5 | 4.0 |
| General Budgetary Revenue (RMB billion) | 9.4 | 10.3 | 9.8 |
| General Budgetary Expenditure (RMB billion) | 10.8 | 12.4 | 12.8 |
| Local Government Debt (RMB billion) | 15.8 | 16.9 | 18.6 |

Source: Statistics Bureau of Shouguang City, CCXAP research

Government’s Willingness to Provide Support**Dominant role in local infrastructure construction, operation of land resources, and provision of essential public services**

SGCC is one of the major LIIFCs in Shouguang City that undertakes the role of city development and public construction as well as provision of utility services. The Company is commissioned to carry out various key infrastructure construction and land resource operation projects that are crucial to local economic development and to provide public utility services that benefit the general public.

SGCC carries out infrastructure construction projects under entrusted construction model, and projects mainly include roads, bridges, stadiums, swimming pools and other facilities. The Shouguang City Government will recognize the project settlement price after SGCC has completed the construction and development of such infrastructure projects, and the price will cover the construction costs incurred plus a certain degree of investment return. As of 30 June 2023, the Company had completed 3 infrastructure construction projects with a total investment of approximately RMB770.3 million. It also had 3 projects under construction, with a planned investment of RMB2.3 billion and an uninvested amount of RMB641 million. Among them, the Jinguang Street Across Mi River Bridge PPP Project was constructed under the PPP model and was adopted under the government repayment system, with an operation and maintenance period of 10 years.

SGCC has a dominant role in the operation of land resources business. The Company is the designated entity with the right to invest in rural land remediation projects in Shouguang City. It conducts works on deserted salt pans or house sites within the pilot areas, including demolition of existing attachments, resettlement of original residents and finally reclaiming the deserted salt pans or house sites into arable land. The Natural Resources and Planning Bureau of Shouguang City and related authorities will determine the surplus land quotas based on the inspection and measurement of the completed land and distribute them to parties who file the applications. The parties who acquire such surplus land quotas have to pay fees to the Company at guided prices. As of 30 June 2023, the Company was reclaiming and resettling an area of 4543.5 square meters of land, with a total investment of RMB1.7 billion and an uninvested amount of RMB192.6 million.

Moreover, the Company has also shouldered the construction of resettlement houses and affordable houses, including the Xiliu Shanty Town (Resettlement) project and the Jingxin Yuan First Phase project. The resettlement houses and affordable houses were sold to qualified applicants at guidance prices set by the government. The Company has the advantage of obtaining local high-quality land banks at reasonable costs in these policy-driven projects, and is also expected to secure returns through the support of the local government including subsidies and development land compensation. As of 30 June 2023, these projects have been completed and sold. The difference between the construction costs and the sales revenue will be covered by the local government through subsidies.

In addition, the Company conducts heat energy business through wholly owned subsidiaries, principally engaging in the generation and supply of heat energy as well as the construction and operation of heat supply networks, with a relatively long concession. The Company's heat energy business covers the central and eastern regions of Shouguang City, and has a relatively high market share in the local heating supply market. The heat energy consumption in Shouguang City is subject to seasonal changes, which means the heat energy demand typically peaks in cooler periods and reduces in the warm season. Moreover, the Company is expanding its business scale by developing and updating the heating facilities, with a relatively large capital expenditure of RMB1.4 billion. However, due to the nature of public welfare business, the government may provide continuous subsidies to the Company.

Good track record of receiving government payments

SGCC has a proven track record of receiving recurring support from the Shouguang City Government, such as capital injections, proceeds from government bond issuance, free injections of operating state-owned assets, and subsidies. From 2020 to 2022, the Company's capital reserves increased by RMB4.0 billion in total after continuous injections of operational asset, equity of companies, and land resources from the local government. SGCC also received government subsidies of more than RMB1.1 billion over the same period. Furthermore, the local government transferred the equity of Shouguang ShengDu Grain Reserve Co., Ltd. ("Shengdu Grain") and Shouguang Guangheng Landscaping Engineering Co., Ltd. ("Guangheng Landscaping") to the Company, with a total value of RMB3.0 billion. Given the Company's strategic importance in the region, we expect the Company will continue to receive government cash payments and allocations from proceeds of the provincial government's special purpose bonds to support its capital expenditure in public policy-related investments.

Exhibit 5. Government supports from 2020 to 2022

| (RMB million) | 2020FY | 2021FY | 2022FY |
|--------------------------|--------------|--------------|--------------|
| Government Subsidies | 252 | 351 | 458 |
| Government Payments | 120 | 520 | - |
| Capital Injections | | | |
| - Cash | 240 | - | - |
| - Assets | 473 | 998 | 3,022 |
| Government Special Bonds | 197 | - | - |
| Total | 1,282 | 1,869 | 3,480 |

Source: Company information, CCXAP research

High exposure to commercial activities

Apart from public-related activities, SGCC also engages in diversified commercial activities including real estate development, property leasing, production and sales of commercial concrete, engineering construction, and grain sales. As the majority of the Company's commercial businesses are subject to changes in the property market, subsequent project development and relevant income may experience higher volatility, particularly during the downturn of China's property market. Considering the difficulty in obtaining direct support from the government for commercial activities, the commercial activities may constrain the Company's credit profile and will inevitably expose the Company to more operational and financial risks.

SGCC's real estate development business accounted for a high proportion of its total revenue. Apart from resettlement housing and affordable housing, the Company mainly participates in real estate development projects including residential and commercial buildings, as well as rehabilitation centers. It is noteworthy that the Company's real estate development is highly concentrated in Shouguang City, which is easily affected by changes in local regulatory policies and economic conditions. As of 30 June 2023, most of the completed residential buildings had been sold. At the same time, the Company had 10 projects in construction, with a total investment of RMB7.5 billion and an uninvested amount of RMB3.2 billion. The combined effects of large-scale construction and high destocking pressure may increase its capital expenditure pressure amid the decelerated property market in China.

The Company's other commercial activities are closely related to the real estate industry. The property leasing business it operates includes some of its commercial properties in Shouguang City, such as office buildings located in the north of Shengcheng Street and west of East Ring Road, as well as the self-constructed commercial buildings. As of 30 June 2023, SGCC had a total leasable area of 4.2 million square meters, and around 90% has been leased out. The Company's anchor tenants include a number of governmental agencies, enterprises and public institutions. In addition, the Company participates in the production and sales of commercial concrete and engineering construction in the urban area of Shouguang City and surrounding areas through its subsidiaries, showing a high dependence in property projects in the region.

In addition, the Company started grain sale business in 2022 through its the subsidiary, Shengdu Grain, providing additional income to the Company. The grain sale business was adopted on a market-oriented operation model. The Company purchases the grain from the public and then sells nationwide according to the market demand. The customer and supplier concentration risks are high, accounting for 90% and 79% of the total sales and total procurements in 2022. Moreover, the customers of the grain sales business were mainly private-owned enterprises, and are easily affected by changes in the market. One of the top 5 customers is listed as judgement debtor for several times in 2023.

Increasing debt leverage driven by large capital expenditure

In the past few years, SGCC's total debt has increased with the continuous expansion of its businesses. The Company's total debt increased from RMB9.7 billion as of end-2020 to RMB15.6 billion in mid-2023, while the total capitalization ratio stayed at a relatively high level of 60.2%, as of 30 June 2023. Meanwhile, the Company's liquidity profile is moderate. As of 30 June 2023, the Company's short-term debt amounted to RMB5.8 billion, accounting for 37.3% of the total debt.

Furthermore, the Company has large investment plans in its diversified businesses including infrastructure construction, operation of land resources, supply of heat energy, and real estate development. As of 30 June 2023, it had multiple projects under construction or planning, with a main focus on real estate projects. We believe the Company's ongoing investment in real estate projects will be mostly funded by external debts, as it is more difficult to obtain direct financial support from the government for its commercial activities.

Medium contingent risks resulting from external guarantees

SGCC's credit profile is constrained by its relatively large external guarantees relative to its net assets. As of 30 June 2023, the Company's external guarantees amounted to RMB3.0 billion, accounting for 28.9% of its net assets, of which the majority were provided to four high-qualified state-owned enterprises. There were two private-owned enterprises, with total external guarantees of RMB159 million, accounting for 5.33% of the total external guarantees. These two private-owned enterprises have been listed as judgement debtors in 2023. The Company has not yet taken any compensation actions for external guarantees of these two enterprises as of 30 June 2023, and the Company will not provide new guarantees to private-owned enterprises in the future. Relatively large guarantee exposure may increase SGCC's financial risks, which are caused by the credit risk of guarantees, especially for privately-owned enterprises during the economic downturn. In case a credit event occurs, the Company may face certain contingent liability risks and cross default risks.

Good access to diversified funding channels

SGCC has relatively good access to various sources of funding, including bank loans and onshore and offshore bond financing. The Company maintains good long-term relationships with large domestic banks such as Agricultural Development Bank of China, China Construction Bank, Evergrowing Bank Co., Ltd., etc. As of 30 June 2023, the Company had total credit facilities of RMB12.6 billion, with the available portion being RMB1.7 billion. SGCC had moderate exposure to shadow banking lending, as its proportion in non-standard products such as financial leasing was less than 10%. The Company also participates in onshore and offshore bond markets, the differentiation of the bond market financing environment caused by regional risks is still a concern to the Company's financing costs. In 2023, the Company raised 5 tranches of onshore bonds, including commercial paper, medium-term notes, private placement notes, and corporate bonds, raising RMB3.6 billion.

Overall, considering the Company's important status and the key role in the local development of Shouguang City, we expect the Company to maintain access to stable funding from banks and bond markets.

ESG Considerations

SGCC assumes environmental risks through its infrastructure, real estate and land resources development projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

In terms of social awareness, SGCC has played a crucial role in the social welfare of Shouguang City by participating in the provision of heating services as well as the construction of public infrastructure projects including roads, bridges, stadiums, swimming pools, and other facilities.

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

Structural Considerations

SGCC's senior unsecured debt rating is equal to its long-term credit rating. We believe that government support will flow through the Company given its dominant role in the development of Shouguang City, thereby mitigating any differences in an expected loss that could result from structural subordination.

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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