

## Credit Opinion

16 July 2024

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	A <sub>g</sub> -
Outlook	Stable

### Analyst Contacts

Olivia Feng +852-2860 7133

Senior Credit Analyst

[olivia\\_feng@ccxap.com](mailto:olivia_feng@ccxap.com)

Iris Chen +852-2860 7132

Credit Analyst

[iris\\_chen@ccxap.com](mailto:iris_chen@ccxap.com)

Elle Hu +852-2860 7120

Executive Director of Credit Ratings

[elle\\_hu@ccxap.com](mailto:elle_hu@ccxap.com)

*\*The first name above is the lead analyst for this rating and the last name above is the person primarily responsible for approving this rating.*

### Client Services

Hong Kong +852-2860 7111

## Shandong Luqiao Group Co., Ltd.

### Surveillance credit rating report

### CCXAP affirms Shandong Luqiao Group Co., Ltd.'s long-term credit rating at A<sub>g</sub>-, with stable outlook.

#### Summary

The A<sub>g</sub>- long-term credit rating of Shandong Luqiao Group Co., Ltd. ("SDLQ" or the "Company") 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.

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.

## Rating Drivers

- Very high likelihood of support from its parent company when necessary
- Strong market position in road and bridge construction market in Shandong Province
- Good project backlogs but having a geographic concentration
- Moderate business diversification and improving construction mix
- Higher investment risk from PPP projects
- Heightened debt burden with rapid business growth
- Good access to funding

## Rating Sensitivities

### 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.

## Key Indicators

	2021FY	2022FY	2023FY
Total Assets (RMB billion)	56.0	71.7	88.7
Total Equity (RMB billion)	12.0	16.7	19.5
Total Revenue (RMB billion)	42.9	50.2	52.2
Net Profits (RMB billion)	2.2	2.7	2.5
EBITDA/Revenue (%)	9.0	8.8	7.8
Return on Net Assets (%)	20.4	18.9	13.6
Total Debt/Total Capital (%)	50.6	47.7	44.7
Total Debt/EBITDA (x)	3.1	3.2	3.7
EBITDA/Interest (x)	4.1	6.0	5.3

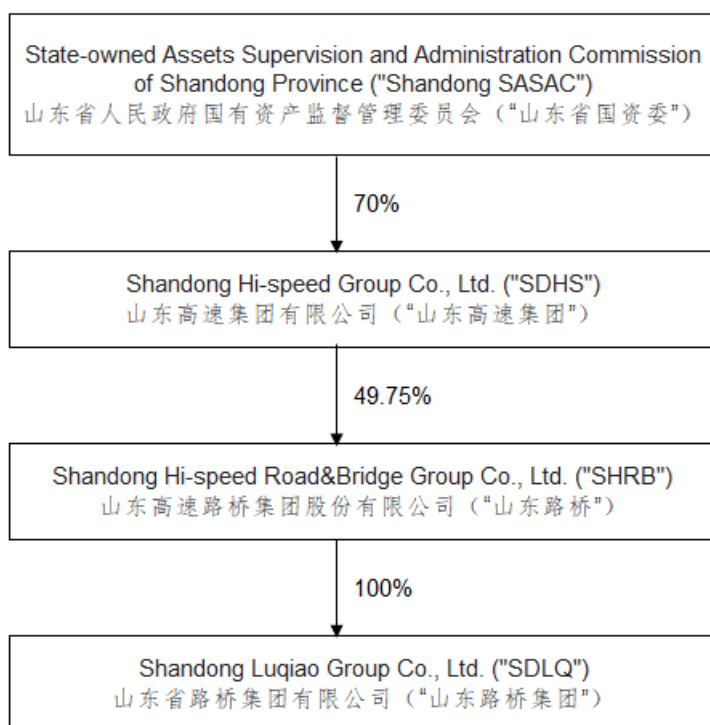
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

## Corporate Profile

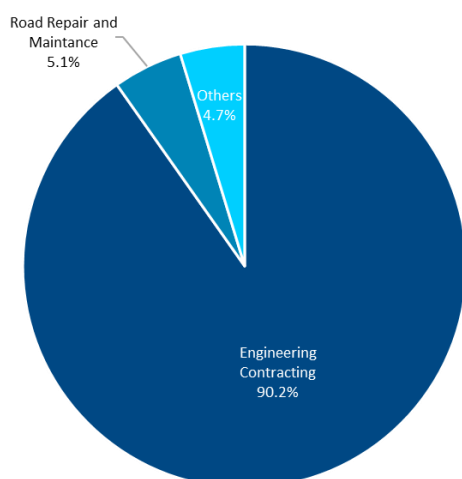
Established in 1948, SDLQ is one of the leading engineering and construction ("E&C") company in Shandong Province that is an expert in the construction of roads and bridges. As of 31 March 2024, the Company was wholly owned by SHRB, a Shenzhen listed E&C company (stock code: 000498.SZ) that was 49.8% 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.

### Exhibit 1. Shareholding chart as of 31 March 2024



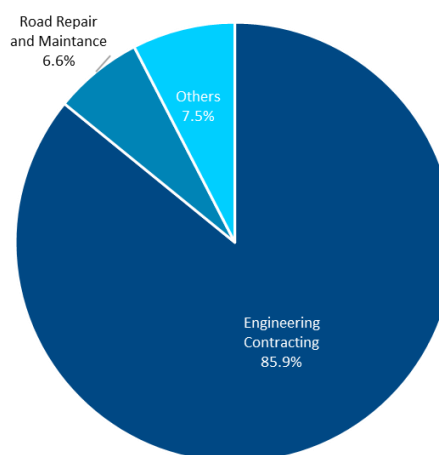
Source: Company information, CCXAP research

### Exhibit 2 Revenue structure in 2023FY



Source: Company information, CCXAP research

### Exhibit 3 Gross profit structure in 2023FY



## Rating Considerations

### Business Profile

#### 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, such as Weishan Lake Bridge and Zaozhuang-Heze Expressway. It has also gained market recognition through earning

a series of meaningful engineering and construction prizes including the China Construction Engineering Luban Prize and Tien-yow Jame Civil Engineering Prize.

SDLQ possesses strong technical advantages and is equipped with sufficient industry qualifications and patents, which enable it to be more competitive in the tendering market and access to quality projects. At present, it has 2 top-grade qualifications of general contracting for highway engineering and 1 top-grade qualification for municipal utility works as well as 2 Class-A qualifications for engineering design of highway and municipal utility. It has accumulatively owned 1,406 authorized patents, including 221 invention patents.

In addition, SDLQ's market position is enhanced by the strong business support from SDHS, the largest road and bridge owner in Shandong Province with substantial needs for road and bridge construction. In 2023, SDLQ's newly signed projects from SDHS accounted for approximately 35%, facilitating the rapid development of the Company's business.

### **Good project backlogs but having geographic concentration**

Underpinned by the order support from SDHS as well as its expansion in other construction fields and outside Shandong Province, SDLQ demonstrates good project reserves with good project quality that help support its future business growth. The Company also has a strong capacity to acquire new projects. The Company's newly signed contract amount increased by 27.9% year-on-year ("YoY") from RMB82.9 billion in 2022 to RMB106.0 billion in 2023. However, affected by the postponement of bidding progress of highway projects across the nation, the Company's growth of newly signed contracts slowed down in the first quarter of 2024, which amounted to RMB5.0 billion. As of 31 March 2024, the Company's unfinished contracts value amounted to RMB117.6 billion. In addition, more than 70% of new projects have a contract size of over RMB500 million in the past three years, which could benefit cost control and help maintain a better project margin. SDLQ's project quality is considered high given most of the Company's clients are SOEs that have lesser payment risk.

However, 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. The Company also explores the overseas market along with the national "Belt and Road" layout while the overseas contract still contributes a small proportion to overall newly signed contracts. Moreover, the overseas projects would expose the Company to higher legal, operational, and execution risks.

### **Moderate business diversification and improving construction mix**

SDLQ has a strong local market position in highway construction with moderate business diversification. In 2023, benefiting from the internal collaboration of SDHS and the Company's vigorous expansion outside Shandong province, the value of newly signed contracts increased significantly by 79.8% YoY in the highway sector, accounting for 56.7% of total value of newly signed contracts. However, given that the domestic road network has entered the advanced stage and the growth rate of highway investment is slowing down, we expect the newly signed contracts in the highway sector will gradually decline. In addition, the Company has actively expanded its municipal construction business, including roads and pipe corridors, and housing construction business, including shanty town renovation and affordable housing construction. The Company also plans to further broaden its business scope into contracting urban renewal and franchise projects, tilting its resources to

business sectors such as railways, subways, and water conservancy to strive to form a comprehensive competitive business layout.

#### Exhibit 4 Value of newly signed construction contracts by business sector from 2021 to 2024Q1

(RMB billion, %)	2021FY		2022FY		2023FY		2024Q1	
	value	percentage	value	percentage	value	percentage	value	percentage
Highway	46.1	58.4	33.4	40.3	60.1	56.7	1.2	23.0
Municipal construction	18.5	23.5	22.8	27.5	21.2	20.0	1.1	41.9
Housing construction	3.8	4.8	14.3	17.2	14.6	13.8	1.6	32.6
Railways	3.1	4.0	2.2	2.7	-	-	-	-
Others	7.4	9.3	10.2	12.3	10.1	9.5	0.1	2.5
<b>Total</b>	<b>79.0</b>	<b>100.0</b>	<b>82.9</b>	<b>100.0</b>	<b>106.0</b>	<b>100.0</b>	<b>5.0</b>	<b>100.0</b>

Source: Company information, CCXAP research

#### Exhibit 5 Value of newly signed construction contracts by geographic location from 2021 to 2024Q1

(RMB billion, %)	2021FY		2022FY		2023FY		2024Q1	
	value	percentage	value	percentage	value	percentage	value	percentage
Within Shandong Province	50.2	63.6	51.6	62.3	76.2	71.9	1.6	32.4
Outside Shandong Province	26.1	33.1	24.2	29.2	29.3	27.7	3.4	67.6
Overseas	2.6	3.3	7.0	8.5	4.4	0.41	-	-
<b>Total</b>	<b>79.0</b>	<b>100.0</b>	<b>82.9</b>	<b>100.0</b>	<b>106.0</b>	<b>100.0</b>	<b>5.0</b>	<b>100.0</b>

Source: Company information, CCXAP research

#### Higher investment risk from PPP projects

Besides the engineering contracting business, SDLQ makes some investments in 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. Among them, 16 projects were held by the Company as the controlling shareholder, with a total planned investment of around RMB12.8 billion and an uninvested amount of RMB7.7 billion, 8 of which have entered the operation period and achieved a total operating return of RMB540 million. They were mainly road and bridge projects such as municipal roads and highways with operation periods of 8-10 years and mainly balanced under the mode of government repayment. The Company took part in the other 12 projects as the minority shareholder, with a total investment of around RMB2.4 billion and an uninvested amount of RMB1.2 billion. Participating in PPP projects is expected to have a good effect on the growth of the construction business. The PPP projects are expected to bring construction contracts of around RMB22.0 billion to the Company. However, the Company faces capital expenditure pressure and higher investment risk with ongoing investment in these projects. Considering the relatively large initial investment and long payback period of the PPP projects, we expect it will be difficult for the Company to achieve fund balancing in the short term.

## Financial Profile

### Strong profitability compared with peers

SDLQ's total revenue increased to RMB52.2 billion in 2023 from RMB50.2 billion in 2022. The revenue from engineering contracting contributed 90.2% of SDLQ's revenue in 2023. Due to the expansion of contract assets and the extension of the settlement period, the Company's period expenses and impairment loss of contract assets enlarged, diminishing the Company's operating profit slightly despite improving revenue scale in 2023. 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.

### 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. Due to the increase in capital from minority shareholders of its subsidiary, the minority shareholders' equity increased significantly at the end of 2023, and the scale of the Company's total equity further increased. As of the end of 2023, the short-term debt amounted to RMB9.4 billion, accounting for around 62.3% of total debt, indicating relatively large short-term debt repayment pressure. The Company's total debt/EBITDA ratio dipped to 3.7x in 2023 from 3.2x in 2022, but was mitigated by its strong financial flexibility and sound access to low-cost funding from banks and the capital market.

In addition, the Company's capacity to generate cash flow is weak, affected by an extended settlement period and ongoing project investment. Its CFO is unable to fully cover interest expenses. In addition, the contract assets and account receivables totally accounted for a large portion of around 50% of total assets as of the end of 2023, which were mainly unsettled amounts of completed projects.

### 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. From July 2023 to June 2024, the Company raised RMB2.0 billion from the onshore bond market with average coupon rates of 3.0%, most of which are long-term bonds up to 10 years, alleviating the Company's short to medium-term repayment pressure. 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. For example, SHRB has provided money lending of around RMB2.0 billion to the Company in 2023 with market-level lending rates.

### External Support

SDLQ is very likely to receive support from SHRB when necessary, given its (1) status as the core subsidiary of SHRB in the E&C business; and (2) close business and financial linkages with SHRB. We believe that SHRB has a strong capacity to support the Company because of its (1) status as a key subsidiary of 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.

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. Ultimately owned and controlled by the Shandong SASAC, SDHS is the largest SOEs by total assets and the largest toll road operator in Shandong Province, following its merger with Qilu Transportation Development Group Co., Ltd. in November 2020. As of 31 March 2024, SDHG owned a toll road portfolio spanning 8,072 kilometers, of which more than 80% of the operating mileage is within Shandong province.

## Rating Methodology

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

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**China Chengxin (Asia Pacific) Credit Ratings Company Limited**

Address: Suites 1904-1909, 19/F, Jardine House,  
1 Connaught Place, Central, Hong Kong

Website: [www.ccxap.com](http://www.ccxap.com)

Email: [info@ccxap.com](mailto:info@ccxap.com)

Tel: +852-2860 7111

Fax: +852-2868 0656