

Qingdao City Construction Investment (Group) Limited

Surveillance Report

Summary

Issuer Rating	A-
Outlook	Positive
Location	China
Industry	Local Government Financing Vehicle
Date	7 April 2021

Lianhe Ratings Global Limited (“Lianhe Global”) has affirmed ‘A-’ global scale Long-term Issuer and Issuance Credit Rating to Qingdao City Construction Investment (Group) Limited (“QCCI”). Outlook Revised to Positive.

Summary

The Issuer Credit Rating reflects a high possibility that Shandong’s Qingdao municipal government (“Qingdao government”) would provide strong support to QCCI if needed, in light of the Qingdao government’s full ownership of QCCI, the high strategic importance of QCCI to Qingdao and the increasingly strong linkage between the Qingdao government and QCCI, including management supervision, strategic alignment, and ongoing operational and financial support. In addition, the Qingdao government may face a significant negative impact on its reputation and business and financing activities should QCCI encounter any operational or financial difficulties.

The Positive Outlook reflects QCCI’s increasing strategic importance to and linkage with the Qingdao government, and our expectation that such would remain intact while the Qingdao government will continue to ensure QCCI’s stable operation. QCCI, under the Qingdao government’s mandate, took on a number of key strategic assets in 2020, in addition to undertaking various major businesses including infrastructure construction, primary land and property development, and financial services to support the economic development in Qingdao. We view such initiatives as a reflection of a strengthening relationship between QCCI and the Qingdao government.

Rating Rationale

Qingdao Government’s Full Ownership: The Qingdao government has 100% ownership of QCCI via the State-owned Assets Supervision and Administration Commission of Qingdao (“Qingdao SASAC”), which is appointed by the government to supervise state-owned entities. QCCI increased its registered capital to RMB6.9 billion from the initial capital of RMB3 billion (when it was established in 2008) after several capital injections.

High Strategic Importance: QCCI remains Qingdao’s largest and most important state-owned investment and financing platform. QCCI, as the biggest of the four local government-owned entities that launched the pilot reform of state-owned assets capital investment and operation, took on key strategic assets in addition to undertaking various major businesses including infrastructure construction, building affordable housing, primary land and property development, and financial services to support the economic development in Qingdao. It is also responsible for financing and management of public projects such as road infrastructure and reconstruction.

With an increasing number of strategic assets housing under it, QCCI’s strategic importance to the Qingdao government increased in 2020. The Qingdao government may face an even more significant negative impact on its reputation and business and financing activities should QCCI encounter any operational or financial difficulties.

Government Supervision and Ongoing Support: The Qingdao government and Qingdao SASAC have strong control and supervision over QCCI, including appointments of members

Key Figures of Qingdao and QCCI

(RMB billion)	2019	2020
Qingdao		
GDP	1,174.1	1,240.1
GDP growth rate (%)	3.5	3.4
Budgetary revenue	124.2	125.4
Government fund	120.5	117.0
Transfer payment	25.4	31.4
Budgetary expenditure	157.6	158.5
QCCI		
Assets	242.5	299.4
Equity	82.5	95.9
Revenue	13.3	16.1

Source: Qingdao Bureau of Statistics, Qingdao Finance Bureau, QCCI and Lianhe Global’s calculations

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Applicable Criteria

China Local Government Financing Vehicle Criteria (16 July 2018)

of the board of directors, the supervisory committee, and senior managers, and approvals of major operating and financing plans. QCCI has received ongoing operational and financial support from the Qingdao government mainly in the form of asset transfers and capital injections. QCCI has consolidated a number of strategic assets in 2020 approved by Qingdao SASAC. QCCI has also continuously obtained important public projects from the Qingdao government and persistently received financial subsidies mainly for supporting projects related to public infrastructure and social welfare services.

Economy and Fiscal Fundamentals Underpin Qingdao: Ongoing economic and industrial structural transformation and modernization have supported Qingdao's GDP growth rate, which was 3.7% in 2020 compared with Shandong province's 3.6% and China's 2.3%, although the local economy was affected by COVID-19. Qingdao's aggregate fiscal revenues are mainly derived from stable budgetary revenues with the tax revenue accounting for about 70% between 2016-2020 and to a lesser extent from the more volatile government fund income. Subsidies from higher government authorities have slightly increased. Qingdao had decent stand-alone fiscal strength with moderate budget deficit. However, Qingdao had RMB205.8 billion outstanding debt at end-2020, representing an increase of c. 30% from end-2019, resulting in the government's moderately high debt ratio (i.e. total government debt divided by aggregate revenue) of 74.8% at end-2020.

Increasing Business Complexity and Risks: QCCI's operations have become more complex following the ongoing business expansion into various industries, which would increase the difficulty of implementing its management and effective risk controls. QCCI targets maintaining a stable scale for its financial services segment operating subsidiary Qingdao Chengtou Financial Holding Group Co., Ltd. ("QCFH") and does not plan to significant increase contribution or investment in the financial services segment. QCCI's financial services revenue was RMB3.2 billion in the first nine months of 2020, contributing c. 20% to total revenue, compared with c. 33% in 2019. With the slowdown of macroeconomic growth in the past two years, QCFH's credit exposure to its main business lines also showed a moderate increase.

Moderately Weak Financial Matrix: QCCI's largely debt-funded capital expenditure has resulted in continuous negative cash flow from its investment and high financial leverage, mitigated by its sufficient liquidity with cash on hand and standby credit facilities. QCCI's financial leverage (total liabilities to assets) was 68.0% at end-September 2020. Liquidity is sufficient to support QCCI's debt repayments, as it had unrestricted cash of RMB17.5 billion and credit facilities of RMB116.3 billion (RMB68.2 billion unused) at end-September 2020, compared with its outstanding debt of RMB46.4 billion to be due within one year. In addition, the unused onshore bond quota was RMB16.4 billion at end-2020.

Rating Sensitivities

We would consider downgrading QCCI's rating if (1) there is perceived weakening in support from the Qingdao government, particularly due to its reduced strategic importance with diminished government functions, or (2) commercial-oriented operations may significantly jeopardize QCCI's overall credit profile, or (3) there is a significant reduction of the Qingdao government's ownership of QCCI, or (4) there is a downgrade in our internal credit assessment on the Qingdao government.

We would consider upgrading QCCI's rating if there is an upgrade in our internal credit assessment on the Qingdao government, or there is a continuing demonstration of the strengthening of QCCI's strategic importance in Qingdao.

Any rating action on QCCI's rating would result in a similar rating action on the USD bonds.

Company Profile

QCCI was established in May 2008 under the No. 11 [2008] of the Qingdao government and was funded by the net assets of Qingdao Dongao Development and Construction Group Limited [青島東奧開發建設集團有限公司], Qingdao Development and Investment Co., Ltd. and Qingdao Urban Development and Investment Centre [青島市城市建設投資中心] attributable to the Qingdao SASAC. QCCI has increased its registered capital to RMB6.9 billion from the initial capital of RMB3 billion (when it was established in 2008) after several capital injections. Qingdao SASAC is the only shareholder with 100% ownership, and the Qingdao government is the ultimate controller.

QCCI had a number of primary wholly-owned or controlled subsidiaries that were consolidated into its financial statements at end-September 2020, with operations across various industries, including large-scale public infrastructure, primary land development, urban area sewage treatment, financial services, photovoltaic power generation and trading businesses. As the most important state-owned asset management and infrastructure investment and operation entity in Qingdao, QCCI has played an important role for the economic development of Qingdao, and has received ongoing support from the Qingdao government in terms of asset transfer, capital injection and financial subsidies.

The board of directors with five members appointed by Qingdao government is the final decision-making authority of QCCI and is primarily responsible for determining QCCI's strategic and operating plans, investment and financing proposals, financial budget as well as management appointments. The supervisory team of QCCI consists of four members (one leader and three members) whom are also appointed by Qingdao SASAC to oversee different aspects of daily operations.

Full List of Issuance Ratings

A full list of affirmed issuance ratings is included below. Any rating action on QCCI's rating would result in a similar rating action on the USD bonds:

- USD300 million 4.0% senior unsecured bonds due 2024
- USD300 million 3.9% senior unsecured bonds due 2022
- USD300 million 3.99% senior unsecured bonds due 2023

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