

Qingdao City Construction Investment (Group) Limited

Surveillance Report

Summary

Issuer Rating	A
Outlook	Stable
Location	China
Industry	Local Government
	Financing Vehicle
Date	31 March 2022

Lianhe Ratings Global Limited (“Lianhe Global”) has upgraded the global scale Long-term Issuer and Issuance Credit Rating of Qingdao City Construction Investment (Group) Limited (“QCCI”) to ‘A’ from ‘A-’. The Outlook is Stable.

Summary

The Issuer Rating upgrade reflects our internal assessment on Shandong’s Qingdao municipal government (“Qingdao government”), and the increased strategic importance of QCCI to Qingdao and strengthened relationship between QCCI and the Qingdao government, as demonstrated by the continued transfer of strategic state assets to QCCI in 2021. We believe there continues to present a high possibility that the 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.

Lianhe Global has also upgraded the global scale Long-term Issuance Credit Rating of the senior unsecured USD bonds issued by QCCI’s wholly-owned subsidiary Hong Kong International (Qingdao) Company Limited (“HKIQD”) to ‘A’ from ‘A-’ at the same time. QCCI shows strong willingness to support HKIQD in meeting its debt obligations by offering a keepwell deed, a deed of equity interest purchase undertaking and an irrevocable standby facility agreement. A full list of issuance ratings is included in this report.

The Issuer Rating Outlook reflects our expectation that QCCI’s strategic importance would remain intact while the Qingdao government will continue to ensure QCCI’s stable operation.

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, continued to take on key strategic assets in addition to undertaking various major businesses including infrastructure construction, building affordable housing, primary land and property development, financial services and transportation sector to support the economic and urban development in Qingdao. It is also responsible for financing and management of public projects such as road infrastructure and reconstruction.

Key Figures of Qingdao and QCCI

(RMB billion)	2020	2021
Qingdao		
GDP	1,240.1	1,413.6
GDP growth rate (%)	3.4	8.3
Budgetary revenue	125.4	136.8
Government fund	117.0	119.3
Transfer payment	31.4	31.4
Budgetary expenditure	158.5	170.6
QCCI		
	2020	3Q2021
Assets	350.5	383.2
Equity	131.6	126.3
Revenue	32.9	28.5

Note: Transfer payment in 2021 is estimated given the lack of information

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 (31 December 2021)

With an increasing number of strategic assets housing under it, QCCI's strategic importance to the Qingdao government increased since 2020 and strengthened in 2021 with several equity transfer of state-owned assets.

Government Supervision and Ongoing Support: The Qingdao government and Qingdao SASAC have strong control and supervision over QCCI, including appointments of members of the board of directors, the supervisory committee, and senior managers, and approvals of major operating and financing plans. To optimize management structure, QCCI adds five external directors to strengthen external supervision under the approval of the Qingdao SASAC in 2021.

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, and has been transferred other state-owned equities in 2021. QCCI has also continuously obtained important public projects from the Qingdao government and persistently received financial subsidies and rewards mainly for supporting projects related to public infrastructure and social welfare services. In addition, QCCI also enjoy favorable income tax rate and VAT rate as its subsidiaries have been classified as preferential industries.

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 Chengtuo Financial Holding Group Co., Ltd. ("QCFH") and does not plan to increase contribution or investment in the financial services segment. QCCI's financial services revenue was RMB2.8 billion in the first nine months of 2021, contributing c. 9.7% to its total revenue, compared with c. 13.4% in 2020.

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 c. 67% at end-September 2021. Liquidity was sufficient to support QCCI's debt repayments, as it had total credit facilities of RMB163.5 billion with unused amount of c. RMB98.6 billion and the unused onshore bond quota was RMB23.5 billion at end-September 2021, compared with its outstanding debt of RMB47.2 billion to be due within one year.

Economy and Fiscal Fundamentals Underpin Qingdao: Ongoing economic and industrial structural transformation and modernization have supported Qingdao's GDP growth rate, which was 8.3% in 2021 compared with Shandong province's 8.3% and China's 8.1%. The total GDP of Qingdao was still the highest among all cities in Shandong Province in 2021. Qingdao's aggregate fiscal revenues were mainly derived from stable budgetary revenues with the tax revenue accounting for above 70% during the past few years and to a lesser extent from the more volatile government fund income. Qingdao had stable stand-alone fiscal strength with moderate budget deficit. However, Qingdao had RMB256.0 billion outstanding debt at end-2021, representing an increase of c. 24% from end-2020, mainly due to the increase in special debt, resulting in the government's moderately high debt ratio at c. 89% (i.e. total government debt divided by aggregate revenue).

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 (1) there is an upgrade in our internal credit assessment on the Qingdao government, or (2) there is strengthened support from the Qingdao government.

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 [青岛东奥开发建设集团有限公司], Qingdao Development and Investment Co., Ltd. and Qingdao Urban Development and Investment Centre [青岛市城市建设投资中心] attributable to the Qingdao SASAC. 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. 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 2021, 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. QCCI also is looking into further expansion into the new energy sector. 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 transfers, capital injections, financial subsidies and rewards.

The board of directors consists of nine members, including four members appointed by the Qingdao government who are the final decision-making authority of QCCI and are primarily responsible for determining QCCI's strategic and operating plans, investment and financing proposals, financial budget as well as management appointments, and five external directors to strengthen external supervision under the approval by the Qingdao SASAC. The supervisory team of QCCI consists of three members to oversee different aspects of daily operations.

Full List of Issuance Ratings

A full list of 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 upgraded to 'A' from 'A-'
- USD300 million 3.9% senior unsecured bonds due 2022 upgraded to 'A' from 'A-'
- USD300 million 3.99% senior unsecured bonds due 2023 upgraded to 'A' from 'A-'

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