

Lianhe Global has assigned ‘A-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Qingdao City Construction Investment (Group) Limited

HONG KONG, 10 June 2019 – Lianhe Ratings Global Limited (“Lianhe Global”), an international credit rating company, has assigned ‘A-’ global scale Long-term Issuer Credit Rating to Qingdao City Construction Investment (Group) Limited. The Outlook is Stable.

The Issuer Credit Rating reflects a high possibility that Shandong’s Qingdao municipal 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 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 significant negative impact on its reputation and business and financing activities should QCCI encounter any operational or financial difficulties.

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

QCCI’s business expansion has targeted to benefit Qingdao’s development rather than pure commercial decisions, although this has increased its business complexity and the difficulty of effective monitoring by the Qingdao municipal government, especially in QCCI’s financial services segment primarily operated by its subsidiary Qingdao Chengtou Financial Holding Group Co., Ltd. (“QCFH”). We believe that in extremely stressed scenarios, QCCI would still receive strong support from the Qingdao government, while extension of the support to its commercially operated subsidiaries would be constrained.

Key Rating Rationales

Qingdao Government’s Full Ownership: The Qingdao municipal 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 at end-2018 from the initial capital of RMB3 billion (when it was established in 2008) after several capital injections.

High Strategic Importance: QCCI, Qingdao’s largest and most important state-owned investment and financing platform, was the largest local government financing vehicle (“LGFV”) in Shandong or ranked 11th by total assets as of end-2018 among all the LGFVs in China¹.

¹ According to QCCI’s information.

With advantages in capital, financing and other resources as well as management strength, QCCI has been in a better position to take on major public projects among all LGFVs in Qingdao to support the city's development. It has completed more than 60 infrastructure construction projects, including municipal roads, public housing, health care, education, and drainage pipe network. QCCI has been also actively seeking cooperation with the local governments within Qingdao and renowned enterprises to support Qingdao's industrial transformation and upgrading. To alleviate the financing difficulties of small- and medium-sized enterprises in Qingdao and maintain the regional financial market stability, QCCI has been developing its financial services business since 2014.

Government Supervision and Strategic Alignment: The Qingdao municipal 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. QCCI's strategic planning and development have been aligned with the government's economic and social policies, aiming to develop Qingdao into one of the most inhabitable, modern and international cities.

Ongoing Government Support: QCCI has received ongoing operational and financial support from the Qingdao government mainly in the form of land and other fixed-asset transfers and capital injections. QCCI has also continuously obtained important public projects from the Qingdao government and persistently received financial subsidies from the government mainly for supporting projects related to public infrastructure and social welfare services.

Strong Economy and Fiscal Strength Underpin Qingdao: Ongoing economic and industrial structural transformation and modernisation have supported Qingdao's high GDP growth rate which was 7.4% in 2018 (Shandong: 6.4% and China: 6.6%), with the service industry being the main growth driver in the recent years. We expect Qingdao's geographic advantage owning one of the ten largest ports in the world and the government's economic policies and planning (such as China's Belt and Road Initiative) to underpin its future growth momentum.

Qingdao's aggregate fiscal revenues are mainly derived from stable budgetary revenues with the tax revenue accounting for about 70% between 2016-2018 and more volatile government fund income. Subsidies from higher government authorities have been minimal. Qingdao's strong stand-alone fiscal strength with small budget deficits helps the government maintain a moderate debt ratio (i.e. total government debt divided by aggregate revenue) of 54.0%, compared with 74.2% of Shandong at end-2018. Qingdao government had RMB127.2 billion outstanding debt at end-2018. Debt maturities were adequately distributed with no significant concentration in any single year.

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. The financial services business has grown rapidly since the establishment of QCFH in 2014 and has mainly

focused on providing credit lending and guarantees to small- and medium-sized enterprises and individuals of a high-risk nature in general. The short operating history of its financial service business may expose QCCI to potential ineffective risk management due to lack of sufficient relevant experience. We also note that QCFH has significantly relied on its parent QCCI for funding as QCCI has been mainly conducting debt financing at the parent level for cost efficiency and effective debt monitoring. QCFH's consolidated assets were RMB72.7 billion at end-2018, including some public funds such as the Qinggang fund for a steel factory moving project.

Moderately Weak Financial Matrix: QCCI's large debt-funded capital expenditure has resulted in continuous negative cash flow from its investment and high leverage, mitigated by its sufficient liquidity with cash on hand and standby credit facilities. QCCI's financial leverage (total liabilities to assets) was 66.3% at end-2018. RMB20 billion of outstanding debt will be due by 2019 at end-September 2018, compared with QCCI's unrestricted cash position of RMB13.9 billion and unused bond quota of RMB6.5 billion at end-2018, and available credit lines of RMB35.1 billion at end-September 2018. The management has indicated to slow the growth in its financial services segment and moderately reduce its leverage.

Rating Sensitivities

We would consider downgrading QCCI's rating if (1) there is perceived weakening in support from Shandong's Qingdao government, particularly due to its reduced strategic importance with diminished government functions, or (2) commercial-oriented operations may significantly jeopardise 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 municipal government.

We would consider upgrading QCCI's rating if there is an upgrade in our internal credit assessment on the Qingdao municipal government.

About Lianhe Global

Lianhe Global is an international credit rating company that provides credit ratings to corporations, banks, non-bank financial institutions, local government financing vehicles, and other asset classes around the globe. Lianhe Global also provides credit risk research and other services related to credit ratings.

Rating Methodology

The principal methodology used in this QCCI's rating is Lianhe Global's China Local Government Financing Vehicle Criteria published on 16 July 2018, which can be found at the website www.lhratingsglobal.com.

Note: The above Issuer/Issuance Credit Ratings are solicited at the request of the rated entity or a related third party.

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