

Credit Opinion

23 March 2023

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB _g +
Outlook	stable

Analyst Contacts

Kelly Liang +852-2860 7127

Credit Analyst

kelly_liang@ccxap.com

Christy Liu +852-2860 7130

Credit Analyst

christy_liu@ccxap.com

Elle Hu +852-2860 7120

Executive Director of Credit Ratings

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

Qingdao Shibe Construction Investment Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Qingdao Shibe Construction Investment Group Co., Ltd., with stable outlook.

Summary

The BBB_g+

Our assessment of Shibe District Government's capacity to provide support reflects Shibe District's sound economic and fiscal strength, with a gross regional production ("GRP") of over RMB100 billion.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) important policy role as an urban operator of Shibe District; (2) good track record of receiving government support; and (3) good access to diversified funding sources.

However, the Company's rating is constrained by its (1) medium exposure to commercial activities; and (2) high debt leverage level and weak asset liquidity.

The stable outlook on SBCI's rating reflects our expectation that Shibe District Government's capacity to provide support will be stable; and the Company will maintain its important policy role as an urban operator in Shibe District over the next 12 to 18 months.

Rating Drivers

- Important policy role as an urban operator of Shibe District
- Medium exposure to commercial activities
- Good track record of receiving government support
- High debt leverage and weak asset liquidity
- Good access to diversified funding sources

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Shibe District Government's capacity to support materially strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support such as reduced exposure to commercial activities, or improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Shibe District Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to support, such as a reduction in the importance of its policy role, weakened government payments, or a deterioration in its financing ability.

Key Indicators

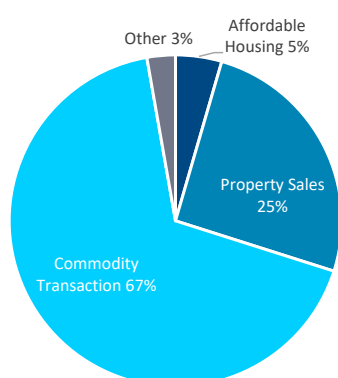
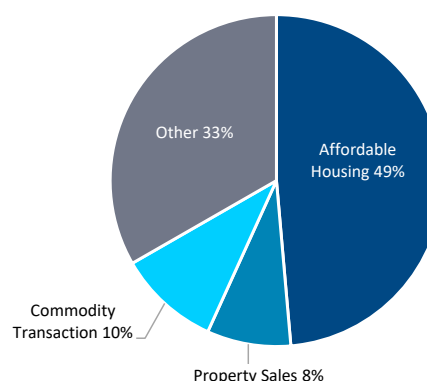
	2019FY	2020FY	2021FY	2022H1
Total Asset (RMB billion)	36.1	40.6	45.3	48.5
Total Equity (RMB billion)	10.0	12.7	14.0	14.3
Total Revenue (RMB billion)	0.5	0.5	1.6	1.6
Total Debt/Total Capital (%)	70.3	66.8	67.7	68.8

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

Source: CCXAP research

Corporate Profile

Established in 2016, SBCI is the one of the primary local infrastructure investment and financing companies ("LIIFCs") that focuses on urban operations and investment in Shibe District, Qingdao City. SBCI plays an important role in public activities in Shibe District, such as land consolidation and development, affordable housing, and urban renewal projects. The Company also undertakes commercial activities such as property development, property leasing and trading. As of 30 June 2022, SBCI was directly and wholly-owned by the State-owned Assets Operation and Development Center of Qingdao Shibe District.

Exhibit 1. Revenue Structure in 2021**Exhibit 2. Gross Profit Structure in 2021**

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe that Shibe District Government has a strong capacity to provide support, based on its sound economic fundamentals and fiscal strength.

Shibe District is one of the districts in Qingdao City, Shandong Province. In 2021, Shandong is the third largest province in China by GRP, with a solid industrial foundation in industries such as logistics, shipbuilding and marine technology, chemicals, automotive and agri-food. Qingdao City is one of the five cities that under separate state planning in China and the city with the biggest economic size and strongest average income level in Shandong. Its GRP and GRP per capita ranked among the top in Shandong over the past five years. From 2019 to 2021, its GRP demonstrated an upward trend, reaching RMB1.4 trillion. According to preliminary statistics, the city realized GRP of RMB1.5 trillion in 2022, with a year-over-year ("YoY") growth of 3.9%. Qingdao Municipal Government has strong fiscal strength and good fiscal metrics. In the past five years, its general budgetary revenue covered around 80% of its general budgetary expenditure and tax incomes accounted for more than 70% of its general budgetary revenue. As of the end of 2021, its outstanding direct government debt amounted to RMB255.9 billion, or 18.1% of the GRP.

Exhibit 3. Key Economic and Fiscal Indicators of Qingdao City

	2019FY	2020FY	2021FY
GRP (RMB billion)	1,174.1	1,240.1	1,413.6
GRP Growth (%)	6.5	3.7	8.3
General Budgetary Revenue (RMB billion)	124.2	125.4	136.8
General Budgetary Expenditure (RMB billion)	157.7	158.5	170.7
Local Government Debt (RMB billion)	158.2	205.8	255.9

Source: Statistics Bureau of Qingdao City, CCXAP research

Located along the coast of Jiaozhou Bay, Shibe District is one of the urban areas with relatively concentrated population in Qingdao City. Thanks to its abundant human resources and a vast consumer market, tertiary industries such as beer and textiles industry have developed rapidly and contributed significantly to the local economy. With good business environment for privately-owned companies, the number of listed companies in Shibe District ranks top among districts and counties in Qingdao City. These companies include Tsingtao

Brewery Company Limited, Qingdao Eastsoft Communication Technology Co., Ltd. and Qingdao Guolin Technology Group Co.,Ltd. From 2019 to 2021, Shibei District's economy has strengthened, and its GRP increased from RMB91.3 billion to RMB106.4 billion. In 2022, it reported GRP of RMB112.4 billion, according to preliminary statistics, a YoY increase of 4.6%. Moreover, Shibei District Government's fiscal strength increased, with good fiscal metrics. Over the past three year, the fiscal balance ratio (general budgetary revenue/general budgetary expenditure) exceeded 100%. In 2021, the fiscal stability ratio recorded was 83.6%. As of the end of 2021, its outstanding direct government debt amounted to RMB7.4 billion, accounting for 7.0% of the GRP.

Exhibit 4. Key Economic and Fiscal Indicators of Shibei District

	2019FY	2020FY	2021FY
GRP (RMB billion)	91.3	96.2	106.4
GRP Growth (%)	5.5	2.4	6.5
General Budgetary Revenue (RMB billion)	9.7	9.2	10.4
General Budgetary Expenditure (RMB billion)	6.5	6.7	6.9
Local Government Debt (RMB billion)	4.1	7.2	7.4

Source: Statistics Bureau of Shibei District, CCXAP research

Government's Willingness to Provide Support

Important policy role as an urban operator of Shibei District

SBCI is one of the major LIIFCs in Shibei District, focusing on urban investment and operations according to government planning. It plays an important role in land consolidation, affordable housing, shantytown and urban renewal projects, and its government-related assets such as shantytown, land, and affordable housing account for a relatively large proportion of the Company's total assets.

SBCI is mandated by the local government to engage in primary land development business through its subsidiaries, including house demolition, residents relocation, land clearing and levelling. After land transfer is completed and government payment is received, the Company will recognize the total revenue for the projects within the Shibei CBD; while for the projects outside the Shibei CBD, only pre-determined management fee will be recognized to offset against inventories costs. The revenue from land consolidation projects in Shibei CBD will decrease as the work is completed and awaits settlement. As of 30 June 2022, the Company has invested around RMB7.4 billion in key land development projects, with a total planned investment of RMB9.1 billion, which mainly including the Dagangwei Fourth Road Project and the Zhengzhou Road Project.

According to the urban planning of Shibei District, SBCI actively undertakes affordable housing, urban renewal and dilapidated housing renovation projects to help improve people's livelihood and beautify the image of the city. For example, the Company has completed the 2017 Shantytown Project, which was one of the national shantytown renovation plans and annual shantytown renovation projects. To undertake the shantytown project, the Company signs a repurchase agreement with the local government or relevant parties, and raises the initial funds itself. After these projects are completed, the local government will pay the Company based on the actual cost plus a markup as management fee. As of 30 June 2022, all shantytown projects, low-cost housing and resettlement housing projects have been completed and there are no similar projects under construction or planning.

Medium exposure to commercial activities

SBCI also engages in commercial activities such as commodity transaction, property development and property leasing, which provide supplemental revenue for the Company. However, such activities may expose the Company to certain business risks and the local government seldom provide direct support for these activities. Based on our analysis, the Company is exposed to medium business risks, with commercial assets accounting for less than 30% of total assets.

SBCI's property development business includes development of commercial housing, shops and office building. As of 30 June 2022, the Company has completed several property development projects, of which most of the commercial housing has been sold, but some commercial networks have not been sold. These unsold commercial buildings will be used for leasing purpose in the future. As of mid-2022, the Company had two property development projects under construction with a total investment of RMB2.2 billion and outstanding amount of RMB655 million. The Company is also engaged in property leasing business, with around 68,600 square meters of leasable assets. Under the guidance of the local government to attract investment, the rent may be lower than the market price. With the continuous investment in urban renewal projects such as Taidong Pedestrian Street and Historical Memory Cultural Area, the Company's exposure to such commercial activities will increase in the future.

Relying on the advantages of port resources in Shibe District, SBCI engages in trading business mainly focusing on crude oil, cold chain frozen products and agricultural products. The trading business represents a large portion of its revenue stream but generates a minimal profit margin. Its clients include central enterprises, state-owned enterprises and large private companies. Since its Top 5 suppliers and downstream customers represent more than 80% of total trade volume, there is a certain degree of concentration risk. SBCI's trading business has low price risk as most orders are fulfilled on an on-demand basis and prices are fixed at a certain level.

Good track record of receiving government support

As a major entity undertaking public activities in Shibe District, SBCI has a proven track record of receiving government support in various forms such as capital injection, financial subsidies, asset injections and government payment for construction projects.

Since its inception, SBCI has received continuous government support from the government. For example, in 2020, SBCI received around RMB602.8 million in cash as initial project capital to carry out the Historical Memory Cultural Area Project. Moreover, the Company has received capital and government special bonds of around RMB2.1 billion and RMB2.0 billion in 2019 and 2020, respectively, which reduced its financing pressure. From 2019 to 2022H1, the local government has provided financial subsidies of around RMB30.0 million in total to support the operations of the Company.

The Company's public projects are expected to receive government payments on an ongoing basis, with the total payment and annual payment become visible when payment contracts were signed. For example, for the 2017 Shantytown Project, the Company signed a government repurchase agreement with the Real Estate Development Management Bureau of Qingdao City ("Qingdao RDMB"), appointing annual repayment started from 2020 to 2042. The payment will be arranged in the annual financial budget of Qingdao City.

High debt leverage and weak asset liquidity

SBCI's debt leverage remains high due to its continuous investment in land consolidation and shantytown projects, as well as long government repayment periods. Its total capitalization ratio recorded a high level of

68.8% at mid-2022. From 2019 to 2022H1, the Company's total debt increased from RMB23.7 billion to RMB31.5 billion. Most of its total debt was due to shantytown projects it has undertaken in the past, especially the 2017 Shantytown project. The Company raised around RMB15.3 billion from China Development Bank for the 2017 Shantytown project and repaid the loan from 2020. The source of debt repayment is secured by the payment of government service purchases. The debt structure was reasonable, with short-term debt percentage of around 20.0%. Given its continuous investment plans in land consolidation and commercial activities, we expect the Company's total debt leverage will remain high in the next 12 to 18 months.

The Company has relatively weak balance-sheet liquidity and requires refinancing for its operations. As of 30 June 2022, its cash to short-term debt ratio was around 0.4x, indicating that its cash balance was insufficient to cover short-term debt. In addition, according to the contract, all rights and benefits from the 2017 Shantytown projects were pledged for the loan from the China Development Bank.

Good access to diversified funding sources

SBCI has good access to various sources of funding including banks and the bond market, which could help it refinance and meet capital expenditure needs. The company has maintained a good relationship with large domestic banks such as policy banks and joint-stock commercial banks. China Development bank, a Chinese policy bank, has provided long-term bank loans to the Company to undertake the public activities, accounting for the majority of its bank borrowing. As of 30 June 2022, it had total credit facilities of approximately RMB29.1 billion with unutilized portion of around RMB5.5 billion, which were provided by diversified banks. Moreover, SBCI also has good access to debt capital market. In 2022, the Company and its subsidiary issued a total of 5 tranches of onshore bonds, raising around RMB3.0 billion in total. In addition, SBCI has manageable exposure to non-standard channels, accounting for less than 10% of total debt at mid-2022.

ESG Considerations

SBCI bears environmental risks through its land consolidation, infrastructure, and property development projects. Such risks could be moderated by conducting environmental studies and detailed planning before the commencement of projects and close supervision during the construction phase.

The Company is also exposed to social risks as a public services provider in Shibe District. Demographic changes, public awareness, and social priorities shape government targets for SBCI, which can affect the government's propensity to support the Company.

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

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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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

Email: info@ccxap.com

Tel: +852-2860 7111

Fax: +852-2868 0656