

Credit Opinion

22 September 2023

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

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Shandong Public Holdings Limited

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g + to Shandong Public Holdings Limited, with stable outlook.

Summary

The BBB_g + long-term credit rating of Shandong Public Holdings Limited. (“SDPH” or the “Company”) reflects (1) Jining Municipal Government’s very strong capacity to support, and (2) the local government’s very high willingness to support, based on our assessment of the Company’s characteristics.

Our assessment of Jining Municipal Government’s capacity to support reflects its status as the 6th largest prefecture-level city ranked by gross regional production (“GRP”) in Shandong Province over the past three years, with improving economic and fiscal strength.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) strong regional franchise in the public utility services of Jining City; (2) good access to diversified funding; and (3) solid track record of government support.

However, the Company’s rating is constrained by its (1) high exposure to commercial activities; and (2) increasing debt burden driven by large capital expenditure.

The stable outlook on SDPH’s rating reflects our expectation that the Jining Municipal Government’s capacity to provide support will be stable, and the Company’s important role in the public utility services of Jining City will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Strong position in the public utility services of Jining City
- High exposure to commercial activities
- Solid track record of government support
- Good access to diversified funding
- Increasing debt burden driven by large capital expenditure

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the Jining Municipal Government's capacity to provide support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as lower exposure to risky commercial activities.

What could downgrade the rating?

The rating could be downgraded if (1) the Jining Municipal Government's capacity to provide support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to provide support, such as reduced regional significance or deteriorated refinancing ability.

Key Indicators

	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	33.5	46.5	58.5	63.1
Total Equity (RMB billion)	8.8	12.7	15.9	16.8
Total Revenue (RMB billion)	5.1	6.9	12.0	7.3
Total Debt/Total Capital (%)	63.0	61.3	61.8	64.6

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

Source: Company information, CCXAP research

Corporate Profile

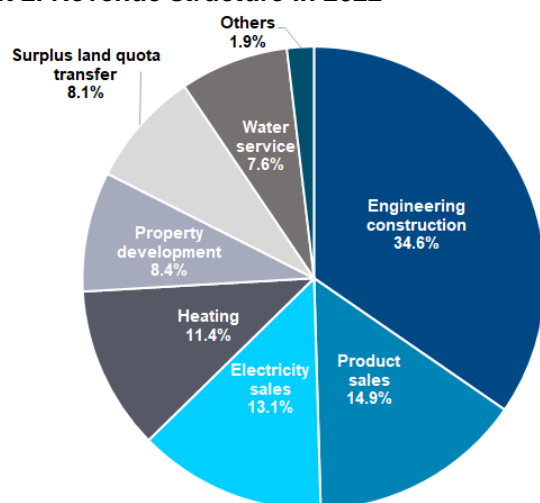
Founded in 1993, SDPH is one of the key local infrastructure investment and financing companies ("LIIFCs") in Jining City. The Company has a strong position in the public utility services of Jining City, including water supply, sewage treatment, and heat supply. It also conducts other businesses including surplus land quota transfer, engineering construction, and property development. As of 30 June 2023, the Company was wholly owned and controlled by the State-owned Assets Supervision and Administration Commission of Jining Municipal Government.

Exhibit 1. Shareholding chart as of 30 June 2023



Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2022



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe Jining Municipal Government has a very strong capacity to provide support given its status as the 6th largest prefecture-level city ranked by GRP in Shandong Province over the past three years, with improving economic and fiscal strength.

Shandong Province is the third largest province in China by GRP in 2022, with a solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive and agri-food. Jining City is located in the southern part of Shandong Province, which is one of the core cities in the Huaihai Economic Zone approved by the Shandong Provincial Government. Thanks to its diversified industrial structure such as coal mining, machinery and equipment manufacturing, paper and paper products, chemical industry goods, and textiles, Jining City's economic strength and fiscal strength steadily improved over the past three years. In 2022, it reported a GRP of RMB531.7 billion, representing a year-over-year ("YoY") growth of 4.4%. Its general budgetary revenue was recorded at RMB44.8 billion in 2022. However, Jining City has moderate fiscal metrics and a debt profile. The Jining Municipal Government's fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was around 60% over the past three years. Tax incomes decreased to RMB30.2 billion in 2022 from RMB33.2 billion in 2021 because of the tax refund policy, accounting for 67.4% of its general budgetary revenue. The local government's debt burden has been increasing over the past three years. As of

31 December 2022, Jining City's outstanding government debt amounted to RMB151.4 billion, accounting for 28.5% of its GRP.

Exhibit 3. Key economic and fiscal indicators of Jining City

	2020FY	2021FY	2022FY
GRP (RMB billion)	449.4	507.0	531.7
GRP Growth (%)	3.6	8.5	4.4
General Budgetary Revenue (RMB billion)	41.2	44.1	44.8
General Budgetary Expenditure (RMB billion)	69.6	72.7	74.7
Local Government Debt (RMB billion)	109.5	134.5	151.4

Source: Statistics of Bureau of Jining City, CCXAP research

Government's Willingness to Provide Support

Strong position in the public utility services of Jining City

SDPH is one of the major LIIFCs in Jining City under the control of Jining Municipal Government, and has a strong position in the public utility services in Jining City. The Company primarily engages in public utility services, including water supply, sewage treatment, and heat supply, which plays a key role in the public welfare of the residents in Jining City.

SDPH is the most important and largest water supply company in Jining City, responsible for water supply and sewage treatment in urban area of Jining City and the surrounding districts and counties. The water is supplied to residents in Jining City at prices set by the local government. As of 31 March 2023, the Company had 20 water plants with a total water supply capacity of 782.5 thousand cubic meters per day, servicing 1.8 million residents within a service area of 265.2 square kilometers. SDPH also had 2 water plants under construction, with a total investment of RMB1.4 billion and an outstanding investment of RMB632 million. It is expected that the water supply capacity will improve in the near future. SDPH is also responsible for sewage collection and treatment in Jining City. As of 31 March 2023, the Company owned 19 sewage treatment plants, with a total sewage treatment capacity of 991 thousand tons per day. The Company is planning to expand its water supply business to more districts by purchasing more water plants in Jining City, demonstrating strong business stability.

SDPH has a dominant position in heat supply business in Jining City. It is the main provider of heat and industrial gas in the main urban area and the five surrounding districts and counties of Jining City. As of 31 March 2023, the Company had 745 heat exchange stations, serving a population of 467.2 thousand households over a service area of around 54.4 million square meters. As the selling prices of heating and water supply and sewage treatment are controlled by the local government, the Company enjoys subsidies from the local government to compensate for any losses incurred. For example, in 2020, the Company received a subsidy of RMB28.4 million from the local government for heat supply.

The Company also engages in the surplus land quota transferring business. The Company is the designated entity to carry out land acquisition and storage operations, and land quota development in Jining City. It conducts works on fields, water, roads, forests, and villages based on the overall land use plan in order to improve the usable land area and effective cultivated land area. The Company obtains revenue by purchasing land quotas from different local governments and reselling them to local governments and enterprises.

High exposure to commercial activities

Apart from public-related activities, SDPH also engages in commercial activities such as engineering construction and property development businesses. While the commercial activities generate supplemental income, they may also pose higher operational and business risks than its public-policy businesses. The Company's exposure to commercial businesses is relatively high, accounting for more than 30% of its total assets, based on our estimation.

SDPH's engineering construction business focuses on municipal engineering and water pipeline installation in Jining City and the surrounding areas. As a state-owned entity, the Company has certain advantages in obtaining key projects from the local government such as viaduct and highway construction, and some of the projects are co-conducted with central state-owned enterprises. As of 31 March 2023, the Company had 3 projects under construction, with a total investment of RMB23.0 billion and an uninvested amount of RMB11.4 billion. From January to March 2023, the company signed 3 new contracts, with a contract value of RMB270.0 million.

SDPH's property development business mainly focuses on development of residential properties. It conducts property development with some private-owned enterprises, and is concentrated in Jining City. The Company mainly relies on external financing for the construction of commercial housing, and the local government is less likely to provide direct support for these activities. This may expose the Company to certain business risks. As of 31 March 2023, the Company had 8 property projects under construction, with a total investment amount of RMB 16.3 billion and an uninvested amount of RMB7.1 billion. Considering its current and future investment in property development for commercial housing construction, the Company may face a certain capital expenditure burden. Moreover, under the recent downturn and weak sentiment of housing market, the Company may face more operating uncertainties. Affected by pandemic situation and changes in local regulatory policies, the sales of the Company's commercial housing are sluggish and the profit margin in this business sector has been decreasing over the past two years.

Solid track record of government support

As the urban operator of Jining City, SDPH serves an important public policy function and is strategically important to local social and economic development. The Company has a strong track record of receiving government support, mainly in operating subsidies, capital injections and specialized government bond. From 2020 to June 2023, the Company received government capital injection with a total value of RMB6.8 billion from Jining Municipal Government, substantially enhancing the capital strength of the Company.

In addition, from January 2020 to June 2023, the Company continuously received operating subsidies from the local government, with a total value of RMB949.6 million. At the same time, the Company also obtained government special-purpose bonds with a total value of around RMB2.0 billion for its public service business and engineering construction projects. We believe that given SDPH's significant position and its close relationship with the local government, the Company is expected to receive ongoing government support as needed in the next 12-18 months.

Increasing debt burden driven by large capital expenditure

SDPH shows rising debt burden owing to its expansion in the construction of engineering construction and property development projects over the past few years. As of 30 June 2023, the Company's total debt increased to RMB30.6 billion from RMB20.2 billion as of end-2021. At the same time, the total capitalization ratio, as

measured by total debt to total capital, maintained at a relatively high level of 64.6%. The Company also showed a relatively large proportion of short-term debt burden with short-term debt accounting for 33.5% of the total debts. The cash to short-term debt ratio was around 0.6x as of 30 June 2023, indicating that its cash balance was insufficient to cover its short-term debt.

Furthermore, the Company has large capital expenditure plans in its engineering construction and property development. We believe the Company's ongoing investment will be mostly funded by external debts, and its debt leverage will be maintained at a high level in the next 12 to 18 months.

Good access to diversified funding

SDPH has a good access to diversified financing channels, including bank loans and bond issuance. Bank borrowing accounts for the majority of total debts and the Company maintains long-term relationships with a number of domestic banks, including policy banks, national joint-stock commercial banks and large state-owned banks. As of 30 June 2023, the Company's total bank credit was RMB29.9 billion, with the undrawn portion of RMB12.8 billion. The Company is also an active issuer in the onshore debt capital market. It has issued different financial products in the domestic bond market such as CPs, corporate bonds, MTNs and PPNs. From January to August 2023, the Company issued several tranches of onshore bonds, raising RMB3.2 billion. The Company also has access to non-standard financial products mainly from financial leasing companies, accounting for less than 10% of the total. The risk exposure to non-standard financing is generally controllable.

ESG Considerations

SDPH faces environmental risks because it has undertaken engineering construction in Jining City. Such risks could be moderated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

As a public services provider in Jining City, the Company also faces social risks. Demographic changes, public awareness and social priorities shape government's target for SDPH, or affect the government's propensity to support the Company.

SDPH's governance considerations are also material as the Company is subject to oversight by the Jining Municipal Government and has to meet several reporting requirements, 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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