

CCXI & CCXAP – Research & Commentary

Debt Roll-Over Pressure at Peak of Debt Repayment as Differentiation of Belief in Urban Construction Investment Intensifies Transformation

Hong Kong, 2 November 2020 -- China Chengxin International Credit Rating Co., Ltd. (“CCXI”) issued a report entitled *“Debt Roll-Over Pressure at Peak of Debt Repayment as Differentiation of Belief in Urban Construction Investment Intensifies Transformation”*, presenting a systematic analysis of the urban construction investment bonds in the primary and second markets, credit status of urban construction investment enterprises in the first three quarters of 2020, and the development trend in the future. According to the report, benefiting from the favorable policies such as the comprehensive roll-out of the registration system, urban construction investment enterprises have been enjoying a better environment since the beginning of this year, greatly expanding the capacity of urban construction investment bonds. However, the issue volume and net financing of urban construction investment bonds fell after a rise in the third quarter QoQ obviously due to the impact of the crowding out effect as trillions of special treasury bonds and special bonds were issued in a concentrated manner. Looking into the next stage, in the context of the relieved epidemic and economic recovery, policies will continue to return normal, and the issue size of urban construction investment bonds might decline to approximately RMB3.7 trillion next year. Besides, the report also reminds that the belief in urban construction investment might be further differentiated with the peak in urban construction investment bonds drawing near, and thus investors should pay attention to the risk.

As pointed out in the report, urban construction investment enterprises have embraced a better and better financing environment benefiting from favorable policies since the beginning of this year. The issue size and transaction scale of urban construction investment bonds increased significantly in the first three quarters, but the issue size dropped QoQ in the third quarter. At the same time, the issuance costs and yield to maturity fell after rise on the whole. Judging from the primary market, under the progressive influence of policies including the registration system comprehensively rolled out at the beginning of this year, the financing environment of urban construction investment enterprises was generally loose. In the first three quarters, the issue volume of urban construction investment bonds exceeded RMB3.40 trillion, a surge of about 40% YoY. In terms of the situation in the third quarter, the issue volume of urban construction investment bonds declined QoQ due to the impact of concentrated issuance of trillions of special treasury bonds and special bonds; the issue volume of corporate bonds took up over 30%, and the proportion of reextension grew to 75% compared with that in the same period and the second quarter of last year; the interest rates of urban construction investment bonds issued went up amid fluctuations, approaching the level at the end of September 2019. From the perspective of the secondary market, in the first three quarters, the transaction scale of existing urban construction investment bonds was nearly RMB7.5 trillion, an increase of 25% YoY, where the transaction scale in the third quarter was approximately RMB2.7 trillion, representing continuous growth YoY and QoQ; the yield to maturity started to increase after it fell to the bottom at a certain stage in April and was near the level at the end of 2019 by the end of

September; meanwhile, the credit spread of urban construction investment bonds widened and then narrowed on the whole with intensifying structural differentiation, such as relatively large credit spread of urban construction investment bonds in Guizhou and Liaoning; additionally, there were frequent abnormal fluctuations in bond trading prices of urban construction investment of relatively poor qualifications in remote areas with weak financial strength and at low administrative levels.

Judging from the credit status of urban construction investment enterprises, most of them saw upgrading of their ratings and the number of credit incidents decreased YoY in the first three quarters. As the epidemic was relieved gradually, the profitability of these enterprises improved but remained weak in the third quarter. In the first three quarters, the ratings of urban construction investment enterprises were mainly upgraded, an increase of 16% YoY. Among them, credit ratings of a total of 38 urban construction investment enterprises were upgraded, mainly from AA to AA+, in the third quarter due to the development of the local economic industry, important role of urban construction investment in the region, and increasing government support in 2019, most of which were enterprises in prefecture-level cities with robust financial strength. In addition, Jilin Communication Investment Group Co., Ltd. was downgraded for the second time this year due to declining profitability, great pressure on short-term solvency, collection of non-performing entrusted loans, and contingency risk, its rating was downgraded from AA at the beginning of this year to AA- and then A+, and its outlook was adjusted to negative; the outlook for Zunyi Bozhou Urban Construction Investment Operation Group Co., Ltd. in Guizhou Province was adjusted to negative as a result of poor operation cashing and a large proportion of external security. As mentioned in the report, the number of non-standard credit incidents of urban construction investment decreased by 40% YoY in the first three quarters, where there were only two credit incidents in the third quarter possibly because of loose financing policies, progressive elimination of local government debts, and more diversified channels for eliminating debts via urban construction investment in favor of short-term credit risk mitigation. Yet it should be noted that the profitability of urban construction investment enterprises was still weak compared with that at the end of last year despite improvement over the first quarter and relief of the epidemic in China. Moreover, these enterprises carried a heavier burden of debts and nearly half of them had to pay debts by themselves under huge pressure as their cash flows from operating activities could not cover interest-bearing debts.

Looking into the future, in the context of the relieved epidemic and continuous economic recovery, as well as ongoing regular policies, the issue size of urban construction investment bonds might decline to approximately RMB3.7 trillion in the coming year. The overall risk in urban construction investment bonds is under control, but investors still need to pay attention to the potential risk in the differentiated belief in the transformation of urban construction investment and the debt roll-over pressure at the peak of debt repayment. First, investors should pay attention to the contingent debt risk likely to be triggered by debt repayment of urban construction investment enterprises. Against a backdrop of the COVID-19 and intensifying economic downturn pressure this year, many enterprises are faced with challenges, their solvency weakens, and they have higher debt risk. If there is guarantee provided by urban construction investment enterprises, investors should remain alert of the upward transmission of default risk, and prevent risk outbreak in different regions at the same time, especially the contingent debt risk of urban construction investment

enterprises in provinces with a large proportion of external security such as Qinghai and Jilin. **Second, investors should pay attention to risk differentiation of urban construction investment enterprises in transformation and development in the process of new infrastructure construction and new-type urbanization.** The urban construction investment enterprises, which participate in new infrastructure construction and new-type urbanization, might have stronger credit status due to expanded applications and business scopes of new technologies and new knowledge. That means, there will be a wider gap between such enterprises and others. **Third, investors should pay attention to the impact of the withdrawal of property ownership in parks on urban construction investment enterprises as stipulated in the *Regulations for the Implementation of the Budget Law*.** As per the *Regulations*, property ownership is withdrawn from parks, which might intensify the differentiation between urban construction investment enterprises in different parks. The credit standing of important urban construction investment enterprises of public benefits and those with a high market-oriented level in key parks might improve. Yet the credit standing of marginal urban construction investment enterprises might weaken. **Fourth, investors should pay attention to the differentiated credit status of urban construction investment enterprises in the context of implicit debt elimination and transformation.** More abundant measures for debt elimination are conducive to relieving the debt roll-over pressure and reducing the debt costs for urban construction investment enterprises. However, debt elimination is promoted at different paces in regions, and thus there might be differentiated impact of different debt risks on the credit status of enterprises. **In the end, the report reminds us that the average scale of debts due in the coming three years will exceed RMB2.5 trillion and investors should mainly pay attention to the debt roll-over pressure on urban construction investment enterprises at the peak of debts due.**

To obtain the full report, please call our Customer Service Hotline +852-2860 7111.

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