CORPORATES

MOODY'S
INVESTORS SERVICE

CREDIT OPINION

8 June 2018

Update

Rate this Research

RATINGS

China State Construction Engineering Corp Ltd

Domicile	China
Long Term Rating	A2
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Chenyi Lu, CFA, CPA +852.3758.1353
VP-Sr Credit Officer
chenyi.lu@moodys.com

Karen Guo +86.21.2057.4018
AVP-Analyst
karen.guo@moodys.com

Li Ma +86.21.2057.4015
MD-Corporate Finance
li.ma@moodys.com

Gary Lau +852.3758.1377
MD-Corporate Finance
gary.lau@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

China State Construction Engineering Corp Ltd

Update after 2017 annual results

Summary

China State Construction Engineering Corp Ltd's (CSCECL) A2 issuer rating reflects its fundamental credit profile, which is equivalent to the Baa2 level, as well as a three-notch uplift based on our expectation that the company will receive high support from its parent, China State Construction Engineering Corporation (CSCEC), in the event of financial distress. CSCEC benefits in turn from the high likelihood of extraordinary support from the Government of China (A1 stable).

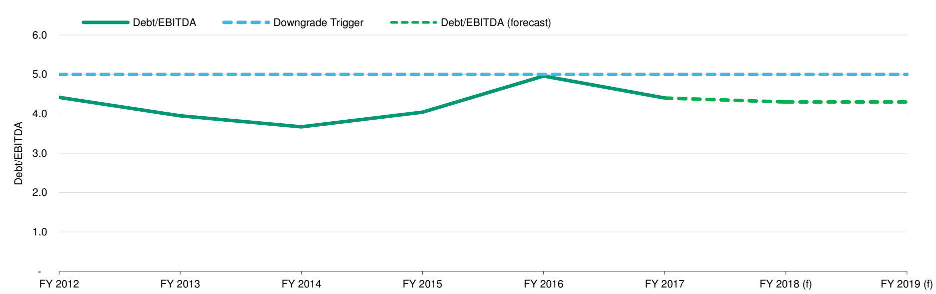
CSCECL's fundamental credit profile mainly reflects the company's (1) large scale and leadership position in building construction, (2) enhanced profitability from property development business, and (3) prudent financial management and significant cash balance.

The company's fundamental credit profile also takes into consideration (1) its large exposure to the slowing real estate sector and fixed-asset investments; (2) potential higher leverage due to increased infrastructure construction, and (3) the execution risks associated with its overseas expansions.

The high parental support reflects CSCECL's substantial contribution to the parent in terms of earnings and assets, its high reputational relevance to the government given its large business scale, and its important role in urban development and infrastructure projects.

Exhibit 1

Moderate debt leverage, with adjusted debt/EBITDA of 4.4x in 2017



Source: Moody's Financial Metrics™

Credit strengths

» Status as a large-scale construction contractor, with a leading market position in building construction

» Enhanced profitability from property development

» A strong order backlog, underpinned by robust new orders

» Strong parental support

Credit challenges

» Uncertainties related to future construction earnings as China shifts its growth driver to consumption

» Potential higher leverage related to increased infrastructure construction

» Execution risks associated with large-scale projects and overseas expansion

Rating outlook

The stable outlook reflects our expectation that in the next 12 to 18 months, CSCECL will (1) maintain its market leadership and profitability, (2) remain prudent in its operating and financial management while expanding its infrastructure construction activities and business overseas, and (3) continue to receive the similar level of parental support from CSCEC.

Factors that could lead to an upgrade

» We would upgrade CSCECL's issuer rating if the company's standalone credit profile improves without any material changes in the support assessment.

» The company's standalone credit profile could improve if it (1) successfully expands its infrastructure construction and overseas business to balance its exposure to the property sector, while minimizing execution risks; (2) maintains a prudent investment strategy when investing in infrastructure projects; and (3) improves its debt leverage, so that its adjusted debt/EBITDA remains below 3.5x or its adjusted EBITDA/interest stays above 7.0x on a sustained basis.

» An upgrade of China's sovereign rating to Aa3 would not have an immediate effect on CSCECL under the current level of policy roles it plays without an improvement in its standalone credit profile.

Factors that could lead to a downgrade

» We would downgrade CSCECL's issuer rating if there is a material deterioration in its business and financial profile, without any material changes in our support assessment.

» CSCECL's issuer rating will be downgraded if (1) it makes aggressive investments in infrastructure projects, resulting in a deterioration in its financial profile; (2) substantial decline in its new contracts causes its order backlog to fall below 1.5x of revenue; and (3) there are large cost overruns and project delays.

» Credit metrics indicative of downward rating pressure include adjusted debt/EBITDA above 5.0x and adjusted EBITDA/interest below 4.0x on a sustained basis.

» We could also downgrade CSCECL's issuer rating without a decline in the company’s standalone credit profile if we expect the support from its parent or government to weaken.

Key indicators

Exhibit 2
China State Construction Engineering Corp Ltd

RMB' Mil	2012	2013	2014	2015	2016	2017	2018 (f)	2019 (f)
Total Revenue	571,516	681,792	800,029	880,577	959,765	1,054,107	1,145,814	1,226,021
EBITA	36,514	47,096	58,729	65,327	69,262	83,456	83,884	85,969
EBITA / Interest Expense	4.5x	4.2x	4.3x	4.5x	4.8x	4.4x	4.4x	4.4x
Debt / EBITDA	4.4x	3.9x	3.7x	4.0x	5.0x	4.4x	4.4x	4.4x
FFO / Debt	12.8%	14.2%	15.7%	14.1%	11.0%	11.3%	14.3%	14.4%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Sources: Moody's Financial Metrics™, Moody's Investors Service estimates

Profile

China State Construction Engineering Corp Ltd. (CSCECL) is one of the largest construction companies in China. It engages in the construction of residential and commercial buildings, infrastructure construction and investment, property development, and engineering design and survey.

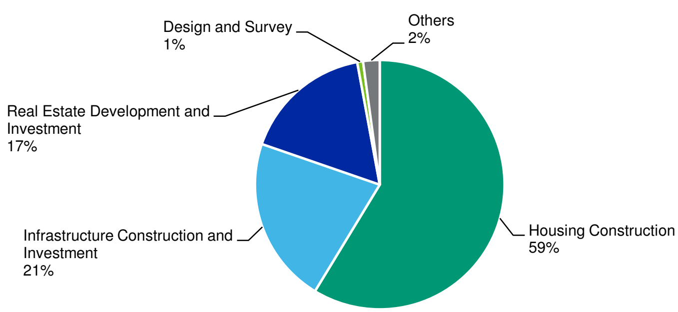
CSCECL undertakes construction projects mainly through eight construction bureaus based in Beijing, Wuhan, Guangzhou, Changsha, Tianjin, Zhengzhou and Shanghai. It also covers Hong Kong and Macau through its Hong Kong-based subsidiaries, China Overseas Land and Investment Limited (COLI, Baa1 stable) and China State Construction Int'l Holdings Ltd (CSCI, Baa2 stable).

CSCECL generated about 92% of its total revenue from mainland China in 2017.

The company was listed on the Shanghai Stock Exchange in July 2009. It was 56.26% controlled by China State Construction Engineering Corp (CSCEC) as of year-end 2017, which is in turn 100% owned by the State-owned Assets Supervision and Administration Commission of the State Council of China.

CSCECL accounts for almost all of CSCEC's total assets and revenue.

Exhibit 3
CSCECL's 2017 revenue breakdown by business segment



Source: Company information (CSCECL 2017 Annual Report)

Detailed credit considerations

A large-scale construction contractor, with a leading market position in building construction

CSCECL was the largest global contractor by revenue in 2017 according to Engineering News-Record. The company has almost doubled its revenue during the past five years to RMB1,054 billion in 2017 from RMB571.5 billion in 2012 owing to strong domestic housing needs and urbanization trends.

CSCECL's long operating track record, sound reputation and well-established regional footprint help it win new projects in different regions across China. Its large business scale and geographic exposure to many provinces in China provide the benefit of diversification, because each project represents a very small share of total revenue and the idiosyncratic risk of each project is unlikely to materially affect CSCECL as a whole. Its top five customers accounted for only around 2.2% of consolidated revenue in 2017.

To leverage its scale benefits over small contractors, the company has been targeting big projects from large customers, including local governments, real estate developers and private companies.

The company holds comprehensive licenses and certificates for general contracting. It is also certified to carry out complex engineering design work, and construct and install technologies in high-rise and complex steel structures and nuclear island construction.

The company commands a dominant market share in the construction of buildings over 300 meters tall. It has undertaken the construction of most of the highest buildings in China.

CSCECL has also been pursuing a market-oriented business and financing strategy. Its offshore subsidiaries, COLI and CSCI, listed in 1992 and 2005, respectively, in Hong Kong, have been helping secure its access to offshore funding for business expansion over many years.

Enhanced profitability from property development

We expect CSCECL's gross margins to be stabilized at 10%-12% over the next one to two years because the pricing pressure from a slower economy will be mitigated by CSCECL's high-margin property development businesses. Its gross margin increased by 0.3% to 11.7% in 2017 from the prior year, mostly owing to the property development businesses' enhanced gross margin.

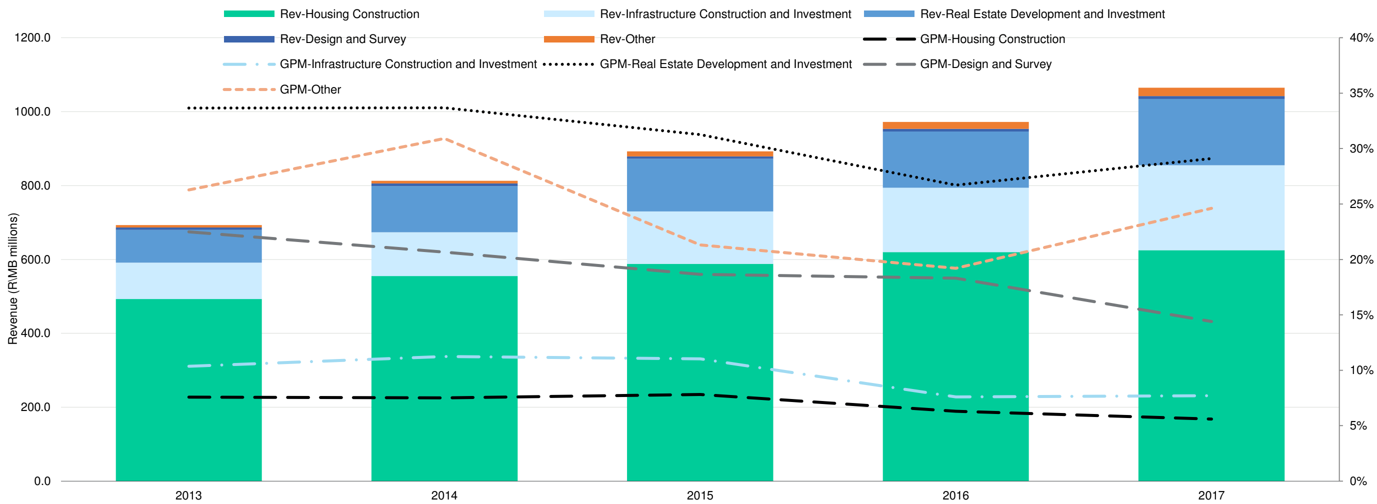
CSCECL's property development segment, through COLI, has grown faster than building construction during recent years. Against a background of rising domestic property prices, COLI's well-established brand name and large, low-cost land bank have led to strong property sales and earnings growth. The segment's gross margin and net profit margin were at 25%-35% and 20%-30%, respectively, between 2013 and 2017, versus CSCECL's aggregate gross margin of 10%-14% and net margin of 3%-4% over the same period. In 2017, property development contributed 17% of CSCECL's revenue and 49% of the gross profit.

The company's debt/EBITDA decreased to 4.4x in 2017 from 5.0x in 2016. We expect CSCECL's adjusted EBITDA to likely increase to about RMB92 billion in 2018 from RMB91 billion in 2017. Consequently, we expect CSCECL's adjusted debt/EBITDA to stay aligned with that in 2017 over the next 12-18 months, which still positions the company well in its current standalone rating category.

On a standalone basis, COLI has a strong branding and a leading market position in the domestic property sector and its credit profile is strong. It further strengthened its flagship status in the real estate business by taking over China State Construction Land from its parent in 2015, and CITIC Limited's (A3 negative) property assets in 2016.

However, building construction segment is among the most competitive industries in which CSCECL competes with many other companies on pricing and services. In line with the industry average, the gross margin of building construction segment was 5.6% in 2017, which was lower than the 7.7% gross margin of the infrastructure segment during the same period. A shift in China's growth driver to consumption will likely result in slowing growth in revenue and earnings from this segment.

Exhibit 4
Increasing earnings contribution from high-margin property development businesses



Source: Company information (CSCECL 2017 Annual Report)

A strong order backlog underpinned by robust new orders

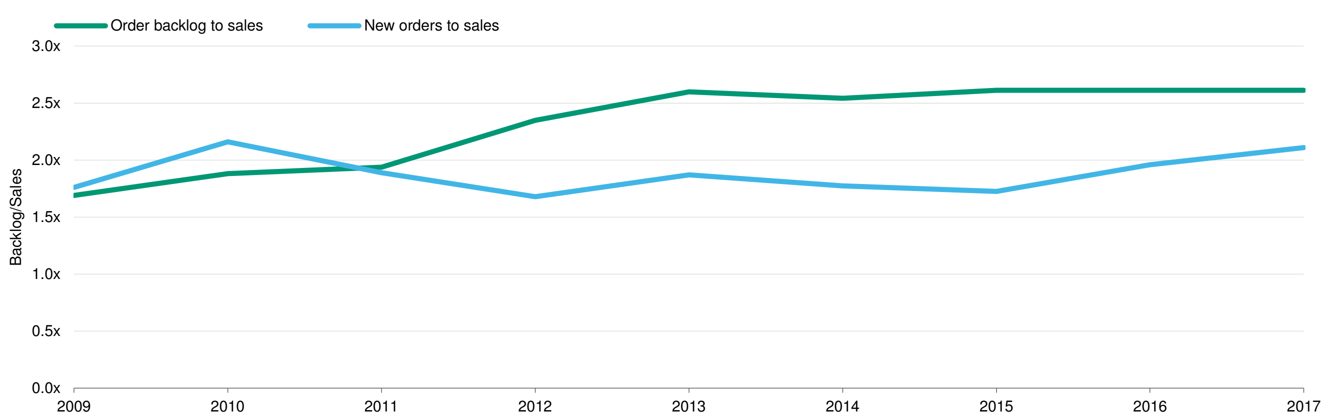
The company has a strong order backlog equivalent to more than twice its 2017 revenue, which provides good sales visibility over the next few years. We also expect its new order wins to remain stable, owing to its strong domestic position and its targeting of large customers with good credit profiles.

The company reported new contracts of RMB2,225 billion in 2017, up 18.4% from that in 2016. New contracts for each business segment recorded stable growth. Contracts for building construction increased 13.8%, those for infrastructure construction increased 28.2%, and those for design and survey increased 54.8%.

The total new contract growth tempered to 18% in 2017 from the 24% surge in 2016 owing to the slowdown in infrastructure construction because of the regulations imposed on public-private partnership (PPP)-related projects by the government in 2017.

Nevertheless, we expect the company to grow its revenue by around 8% in 2018 and 7% in 2019, given its large order backlog at year end of 2017. The company's capability to gain big projects from large customers and dominate the market help mitigate the impact from industry regulations.

Exhibit 5
A large order backlog supports revenue visibility



Source: Company information (CSCECL 2017 Annual Report)

Strong parental support

CSCECL's A2 issuer rating incorporates a three-notch uplift, reflecting our expectation that the influence and support from the government will be channeled through CSCEC to CSCECL.

CSCEC is the only construction company among China's top state-owned key backbone companies; it is 100% owned by China's State-owned Assets Supervision and Administration Commission. Since its founding in 1982, CSCEC has consolidated a large number of central and local state-owned construction companies, and plays an important role in the urban development and infrastructure projects in China. It is also one of only two contractors qualified to construct nuclear islands and has signed more than 50 strategic cooperation agreements with provincial and municipal governments.

CSCECL comprises almost all of the earnings and assets of CSCEC and they share the same senior management team; therefore, we believe their credit profiles are closely linked and the government support to CSCEC will likely be passed on to CSCECL owing to the potential significant reputational damage to the Chinese government should CSCECL default.

CSCECL received RMB183 million, RMB339 million and RMB266 million in government subsidies — including tax rebates, enterprise support funds and funding for scientific research — in 2017, 2016 and 2015, respectively.

Potential higher leverage related to increased infrastructure construction

CSCECL's increased infrastructure construction will likely add pressure to CSCECL's leverage due to long-term capital commitment.

CSCECL's infrastructure construction revenue expanded to 22% of total revenue in 2017 from 16% in 2015. The company targets to have around 30% of total revenue from infrastructure construction by the end of 2020.

Since the infrastructure construction projects, whether in the form of public private partnership (PPP) or Build-Operate-Transfer(BOT), usually require long-term capital commitment, but operating cash flow will usually remain negative during the construction and early years of operation, the leverage at the project level is likely to increase in the near term.

The company's sizable cash balance could help mitigate the risk of its increased financing needs for the projects' debt level. Its RMB253 billion total cash balance accounted for 62% of reported gross debt as of year-end 2017.

We also expect management to maintain financial discipline when undertaking an increasing amount of infrastructure projects in the next few years. The company's deep experience in construction industry will also help it mitigate potential risks embedded in the projects.

Execution risks associated with overseas expansion

We expect the company's overseas expansion to support China's “one belt one road” initiative and this will expose it to higher credit and execution risks and increase its earnings volatility. These overseas projects will face different regulatory, operating and geopolitical environments, which could lead to cost overruns and project delays.

Such execution risks are mitigated by the following factors:

(1) Risks arising from overseas projects are likely to be shared with Chinese policy banks, which are lenders to many overseas projects.

(2) CSCECL's overseas businesses only accounted for 8% of total revenue as of 2017.

(3) The company has rich overseas experience; it is one of the first four companies approved in 1978 to expand overseas. It is now the largest construction contractor in Singapore, Hong Kong and Macao.

(4) To control credit risks, the company requests advance payments of at least 10% of the total contract price, or up to 30% for projects requiring early-stage equipment, the involvement of large numbers of its employees and high-cost temporary facilities.

Liquidity analysis

CSCECL's liquidity profile is strong. The company had a strong cash balance of RMB253 billion, which well covered its RMB80.8 billion of short-term debt as of year-end 2017. It also has sizable unused credit facilities from onshore and offshore banks.

As the largest construction company in China by revenue, CSCECL has good access to domestic bank loans. For example, it has been cooperating with China Development Bank (A1 stable) and the Export-Import Bank of China (A1 stable), and has policy-related concessional loans to support its business development.

Structural considerations

Structural subordination risk is mitigated by parental support. We consider the risk of structural subordination at CSCECL as mitigated by parental support. Priority debt, which mostly constitutes debt at its operating subsidiaries, accounted for about 20% of total assets.

Methodology and scorecard

When mapped to our Construction Industry rating methodology, CSCECL scores a Baa1, based on its 2017 actual financials. The company's Aaa score for revenue and EBITA is the highest available score, owing to its large size as well as the high profitability of its property development business.

However, the company's rating is constrained by its debt leverage, interest coverage and cash flow generation, with EBITA/interest at Ba, debt/EBITDA at Ba and funds from operations/debt at B.

Exhibit 6

China State Construction Engineering Corp. Ltd

Construction Industry Grid [1][2]	Current FY 12/31/2017		Moody's 12-18 Month Forward View as of May 2018	
Factor 1: Scale (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Total Revenue (USD Billion)	$156	Aaa	$175~$190	Aaa
b) EBITA (USD Billion)	$12	Aaa	$12.4~$13.5	Aaa
Factor 2: Business Profile (25%)				
a) Diversity	Baa	Baa	Baa	Baa
b) Expected Revenue & Margin Stability	A	A	A	A
Factor 3: Leverage and Coverage (30%)				
a) EBITA / Interest Expense	4.4x	Ba	4.0~4.5x	Ba
b) Debt/EBITDA	4.4x	Ba	4.0~4.5x	Ba
c) FFO / Debt	11.3%	B	12%~15%	B
Factor 4: Financial Policy (20%)				
a) Financial Policy (10%)	Baa	Baa	Baa	Baa
Rating:				
Indicated Rating from Grid		Baa1		Baa1
Actual Rating Assigned		A2		A2

[1]All ratios are based on "Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2017.
Source: Moody's Financial Metrics™

Ratings

Exhibit 7

Category	Moody's Rating
CHINA STATE CONSTRUCTION ENGINEERING CORP LTD	
Outlook	Stable
Issuer Rating	A2
CHINA STATE CONSTRUCTION INT'L HOLDINGS LTD	
Outlook	Stable
Issuer Rating	Baa2
CHINA STATE CONSTRUCTION FIN (CAYMAN) II LTD	
Outlook	Stable
Bkd Senior Unsecured	Baa2

Source: Moody's Investors Service

REPORT NUMBER 1112288

Contacts

Chenyi Lu, CFA, CPA +852.3758.1353
VP-Sr Credit Officer
chenyi.lu@moodys.com

Li Ma +86.21.2057.4015
MD-Corporate Finance
li.ma@moodys.com

Karen Guo +86.21.2057.4018
AVP-Analyst
karen.guo@moodys.com

Gary Lau +852.3758.1377
MD-Corporate Finance
gary.lau@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454