FITCH AFFIRMS CHINA STATE CONSTRUCTION ENGINEERING AT 'A'/STABLE

Fitch Ratings-Hong Kong-11 October 2018: Fitch Ratings has affirmed Chinese engineering and construction company China State Construction Engineering Corporation Ltd's (CSCECL) Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'A'. The Outlook on the IDR is Stable. A full list of rating actions is at the end of the commentary.

CSCECL is a subsidiary of China State Construction Engineering Corporation (CSCEC), which is wholly owned by China's State-owned Assets Supervision and Administration Commission (SASAC). CSCEC is the largest engineering and construction company in the world by revenue and the subsidiary accounted for almost all of the parent's revenue, debt and assets. The two entities have substantial overlap in their top management.

Fitch has used its Government-Related Entities (GRE) Rating Criteria to derive CSCECL's rating as we consider CSCEC an intermediate holding company with no material operations or substantial debt and we have therefore directly rated CSCECL one notch below China's sovereign rating of 'A+'/Stable using a top-down approach. The Stable Outlook reflects Fitch's expectation of continued state support for CSCECL.

KEY RATING DRIVERS

Strong Ownership, Support Record: Fitch assesses CSCECL's status, ownership and control as 'Strong' due to the state's 100% ownership of CSCEC, which in turn held 56.3% of CSCECL as of end-2017. CSCEC's board and key senior management have a strong influence over CSCECL's major strategies and investment decisions. Fitch assesses CSCECL's support record as 'Strong' as the company has received direct tangible state support in the form of government grants, capital injections and tax rebates as well as significant support from policy banks.

Incentive to Support Company: Fitch assesses the socio-political implications from a CSCECL default as 'Moderate'. The company operates in a more competitive sector as we believe the construction and real-estate development industry is more commercial in comparison with other central state-owned enterprises with dominant positions in critical and strategic sectors such as food, power, energy, telecommunications and resources. We assess the financial implications of a default as 'Strong'. CSCECL is an active domestic and international bond issuer and a default could harm access to capital markets for the sovereign and other GREs.

Largest Construction Company Globally: CSCECL is China's largest contractor and, according to Engineering News Record, also the world's biggest, with about USD150 billion in annual sales. CSCECL has a strong market position in different areas of China's construction industry. It has a monopoly in aerospace and is also the largest social-housing builder in China. The company's scale and market presence give it an advantage in the bidding process domestically and internationally. Its scale also limits its exposure to a single project failure or loss; the company's top five customers accounted for 2% of revenue in 2017. The customer diversification lowers the company's risk profile.

Diversifying Business Profile: CSCECL is diversifying its business from housing construction into infrastructure construction and property development with the aim of having the three segments account for 50%, 30%, and 20% of its revenue, respectively, by 2020. Infrastructure construction and property development were already at 22% and 17% of CSCECL's revenue in 2017, respectively. The company is also expanding geographically, with a presence in more than

100 countries and regions, and is more successful than its state-owned peers in building footholds overseas.

DERIVATION SUMMARY

CSCECL's 'A' ratings are notched down from China's sovereign rating of 'A+'/Stable under the GRE criteria. CSCECL, on a deconsolidated basis, has a scale advantage over Shanghai Construction Group Co., Ltd. (SCGC, BBB+/Stable). CSCECL's financial and business profile on a deconsolidated basis is stronger and more diversified than that of SCGC.

The Chinese company has a deeper pipeline of projects, a material scale advantage and more stable margins than global engineering and construction peers such as 'BBB' rated Ferrovial, S.A. CSCECL's net debt to EBITDA is slightly higher than Spain-based Ferrovial's in part due to CSCECL's higher leverage as concession projects in China are typically not ring-fenced and their debt cannot be deconsolidated from the parent company's balance sheet while concession projects in EMEA can have non-recourse terms and therefore their debt may not be consolidated.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
- Revenue to increase at around 10% annually in the next three years (after deconsolidating property-development subsidiary China Overseas Land & Investment Limited (COLI, A-/Stable))
- EBITDA margins of around 4.5%-5.0% in the next three years (after deconsolidating COLI)
- Capex of around CNY15 billion-CNY18 billion in the next three years (after deconsolidating COLI)

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
- Positive rating action on the Chinese sovereign
- Increasing likelihood of support from the Chinese sovereign

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Negative rating action on the Chinese sovereign
- Decreasing likelihood of support from the Chinese sovereign
- A downgrade in CSCECL's current standalone credit profile would lead to a change in the extent of notching under Fitch's GRE criteria

Standalone Credit Profile
Developments That May, Individually or Collectively, Lead to Positive Rating Action
- EBITDA margin of 6% or above for a sustained period (after deconsolidating COLI) (2017: 4.8%)
- Total adjusted net debt to EBITDAR sustained below 1x (after deconsolidating COLI) (2017: 1.7x)

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Total adjusted net debt to EBITDAR above 2x for a sustained period (after deconsolidating COLI)
- EBITDA margin below 4% for a sustained period (after deconsolidating COLI)

LIQUIDITY

Robust Liquidity: CSCECL (after deconsolidating COLI) had CNY54 billion in short-term debt at end-2017, which was well-covered by CNY169 billion in cash on its balance sheet. We expect the company's cash and undrawn bank facilities of CNY919 billion to provide more-than-adequate liquidity in the next three years.

FULL LIST OF RATING ACTIONS

China State Construction Engineering Corporation Ltd
- Long-Term IDR affirmed at 'A'; Outlook Stable
- Senior unsecured rating affirmed at 'A'
CSCEC Finance (Cayman) I Limited
- USD500 million 2.95% notes due 2020 affirmed at 'A'
CSCEC Finance (Cayman) II Limited
- USD500 million 2.25% notes due 2019 affirmed at 'A'
- USD500 million 2.70% notes due 2021 affirmed at 'A'
- USD500 million 2.90% notes due 2022 affirmed at 'A'
- USD500 million 3.50% notes due 2027 affirmed at 'A'

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Applicable Criteria
Corporate Hybrids Treatment and Notching Criteria (pub. 27 Mar 2018)
https://www.fitchratings.com/site/re/10024296
Corporate Rating Criteria (pub. 23 Mar 2018)
https://www.fitchratings.com/site/re/10023785
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)
https://www.fitchratings.com/site/re/10024585
Government-Related Entities Rating Criteria (pub. 07 Feb 2018)
https://www.fitchratings.com/site/re/10019302
Sector Navigators (pub. 23 Mar 2018)
https://www.fitchratings.com/site/re/10023790