

Shandong Shouguang Jinxin Investment Development Holding Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	18 January 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Shandong Shouguang Jinxin Investment Development Holding Group Co., Ltd. (“SSJID” or “the Company”)

Summary

The Issuer Credit Rating reflects a high possibility that the Shouguang people’s government (“the Shouguang government”) would provide strong support to SSJID if needed, in light of its full ownership of SSJID, SSJID’s strategic importance as an important local investment and development company (“LIDC”) that is responsible for state-owned capital investment, project construction, and state-owned assets operation in Shouguang City (“Shouguang”), and the strong linkage between the Shouguang government and SSJID, including management supervision, strategic alignment, and ongoing operational and financial support. In addition, the Shouguang government may face significant negative impact on its reputation and financing activities should SSJID encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that SSJID’s strategic importance would remain intact while the Shouguang government will continue to ensure SSJID’s stable operation.

Rating Rationale

Government’s Ownership and Supervision: The Shouguang government is SSJID’s ultimate controller, holding 100% equity in SSJID and supervising the company’s senior management appointment, major operation, investment and financing plans through Shouguang State-owned Assets Operating Center (“Shouguang SAOC”). In addition, Shouguang SAOC has an annual assessment mechanism for SSJID and appoints auditors to review its operating performance and financial position regularly.

Strategic Importance and Strategic Alignment: SSJID is an important LIDC that is responsible for state-owned capital investment, project construction, and state-owned assets operation in Shouguang. SSJID invested in manufacturing companies and financial institutions in Shouguang to support local economic development. The company also participated in infrastructure development and shanty town renovation projects.

SSJID’s business operations and strategic planning have been aligned with the local government’s economic and social development policies. According to the company, SSJID will be responsible for developing the Shouguang East Railway Station, which is one of the twelve railway stations to be built for the proposed Tianjin-Weifang high-speed rail line, an important section of the proposed second line of the Beijing-Shanghai high-speed railway.

Ongoing Government Support: SSJID received stable financial subsidies of RMB203 million, 303 million, 677 million and 550 million in 2019, 2020, 2021 and the first nine months of 2022, respectively, mainly from the people’s government of Hou town (“Hou town government”) to support SSJID developing infrastructures in Hou Town. In addition, the Shouguang government transferred 70% equity of Shouguang Kefa Investment Limited and

Key Figures of Shouguang and SSJID

(RMB billion)	2020	2021
Shouguang		
GDP	78.7	95.4
GDP growth rate (%)	3.1	10.5
Budgetary revenue	9.4	10.3
Government fund	7.5	8.9
Transfer payment	2.8	2.8
Budgetary expenditure	10.9	12.4
SSJID		
Assets	12.8	17.6
Equity	4.6	5.0
Revenue	1.0	4.4

Source: Public information, SSJID and Lianhe Global’s calculations

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Applicable Criteria

[China Local Investment and Development Companies Criteria \(5 December 2022\)](#)

49% equity of Shouguang Guangheng Landscaping Engineering Co., Ltd. (“Guangheng Landscaping”) to SSJID free of charge. However, these companies lack visible operating history.

The Shouguang government has no additional capital injection to SSJID since the government enlarged both the registered capital and paid-in capital of SSJID to RMB360 million from RMB110 million in February 2014. Yet the Shouguang government had injected water and heat supply networks into SSJID, which could generate stable leasing incomes for the company.

Economy and Fiscal Conditions of Shouguang: Renowned as China Vegetable Capital, and listed on China’s Top 100 counties, Shouguang has a well-developed vegetable industry based on greenhouse vegetable production and integrated with automation technologies. It is also an important production place of sea salt, providing food condiments and chemical materials countrywide. In addition, Shouguang has a manufacturing industry dominated by petrochemical, steel and papermaking. Shouguang’s GDP rebounded by 10.5%, compared with compared Shandong Province’s 8.3% and China’s 8.1% in 2021.

The Shouguang government’s budgetary revenue rebounded to RMB10.3 billion in 2021, representing a solid growth rate of 10.2%, after slightly dropping in 2020 mainly due to the Covid-related tax cut. The government fund income grew fast in the past three years, becoming increasingly essential to the Shouguang government. However, the government fund income, mainly generated by land use right transfers, is vulnerable to the property market downturn. Moreover, the government debt has approached the government debt ceiling (99.8% in 2021), which may restrict its debt financing capacity in the coming years.

SSJID’s Financial Matrix and Liquidity Position: SSJID’s asset size grew significantly by 133.7% to RMB22.7 billion at end-September 2022 from RMB9.7 billion at end-2019, mainly owing to the company’s consolidation of Shandong Molong Petroleum Machinery Company Limited (“Shandong Molong”) (002490.SZ/00568.HK), as well as its active participation in equity investment and project construction activities. The company’s total debts surged by 278.0% to RMB10.1 billion from RMB2.7 billion over the same period, lifting its financial leverage level, as measured by total debts/capitalization, to 52.2% from 36.8%, and the total liabilities/total assets ratio to 59.2% from 52.8%.

SSJID’s asset liquidity and quality were moderately weak, as non-current assets accounted for the majority of the company’s total assets (57.8%), and some lacked an active market for determining fair value. At end-September 2022, SSJID had cash of RMB2.1 million (including restricted cash of RMB1.7 billion) and available bank credit lines of RMB562 million, compared with its debts due within one year of RMB5.1 billion. Therefore, the company must successfully roll over its short-term bank loans (c. RMB1.9 billion at end-September 2022) and obtain additional financing sources or government supports to relieve the liquidity pressure.

SSJID’s contingent liability risk was high as it provided financial guarantees of RMB2.8 billion to external parties at end-September 2022, representing 30.4% of the company’s equity. Moreover, SSJID had restricted assets of RMB4.2 billion at end-September 2022, representing 18.7% of the company’s total assets, which were mainly pledged to banks for obtaining bank facilities.

Rating Sensitivities

We would consider downgrading SSJID’s rating if (1) there is perceived weakening in support from the Shouguang government, particularly due to its reduced strategic importance with diminished government functions, or (2) there is a significant reduction of

the Shouguang government's ownership of SSJID, or (3) there is a downgrade in our internal credit assessment on the Shouguang government.

We would consider upgrading SSJID's rating if (1) there is strengthened support from the Shouguang government, or (2) there is an upgrade in our internal credit assessment on the Shouguang government.

Operating Environment

Economic Condition of Shouguang

Shouguang is a county-level city under the direct jurisdiction of Shandong Province and administered by Weifang City, with a total land area of 2,072 square kilometers, a residential population of 1.16 million, and an urbanization rate of 63.1% in 2021. Renowned as China Vegetable Capital, Shouguang has a well-developed vegetable industry based on greenhouse planting and integrated with automation technologies. It is also an important production place of sea salt, providing food condiments and chemical materials countrywide. In addition, Shouguang has a manufacturing industry dominated by petrochemical, steel and papermaking.

As one of China's Top 100 Counties, Shouguang recorded a GDP of RMB95.4 billion in 2021, which was ranked 2nd among all 12 districts, county-level cities and counties under the administration of Weifang City. Its growth rate jumped to 10.5% in 2021 from 3.1% in 2020. The economic growth was mainly fueled by the secondary and tertiary industries, accounting for 41.9% and 44.8% of Shouguang's aggregate GDP, respectively, in 2021. The fixed asset investment also recovered quickly to support Shouguang's economic development. Its fixed asset investment growth rate turned positive in 2020, with a rate of 4.5%, up from -25.4% in 2019. It then increased by 17.8% in 2021.

Shouguang's GDP and Fixed Asset Investment

(RMB billion)	2019	2020	2021
GDP	76.8	78.7	95.4
-Primary industry (%)	13.2	13.5	13.3
-Secondary industry (%)	42.8	41.6	41.9
-Tertiary industry (%)	44.0	44.9	44.8
GDP growth rate (%)	3.7	3.1	10.5
Fixed asset investment	44.0	46.0	54.2
Fixed asset investment growth rate (%)	-25.4	4.5	17.8
Population (million)	1.2	1.2	1.2

Source: Statistics Bureau of Shouguang and Lianhe Global's calculations

Fiscal Condition of Shouguang

The Shouguang government's budgetary revenue rebounded to RMB10.3 billion in 2021, representing a solid growth rate of 10.2%, after slightly dropping in 2020 mainly due to the Covid-related tax cut. The contribution of the tax revenue also raised to 77.4% in 2021 from 70.0% in 2020.

The government fund income grew fast in the past three years, becoming increasingly essential to the Shouguang government, contributing c. 29.1%, 36.0% and 39.6% to its aggregate revenue in 2019, 2020 and 2021, respectively. However, the government fund income, mainly generated by land use right transfers, is vulnerable to the property market downturn.

The Shouguang government's fiscal self-sufficiency rate was manageable. It recorded budget deficits of -7.3%, -15.9% and -20.1% in 2019, 2020 and 2021, respectively. However, its government debt increased significantly to RMB16.9 billion at end-2021 from RMB13.2 billion at end-2019, mainly due to the increase in special debt to support a series of major projects. Moreover, the government debt has approached the government debt ceiling (99.8% in 2021), which may restrict its debt financing capacity in the coming years.

Shouguang's Fiscal Condition			
(RMB billion)	2019	2020	2021
Budgetary revenue	9.4	9.4	10.3
Budgetary revenue growth rate (%)	1.0	2.8	10.2
Tax revenue	6.8	6.6	8.0
Tax revenue (% of budgetary revenue)	72.5	70.0	77.4
Government fund income	5.0	7.5	8.9
Transfer payment	2.6	2.8	2.8
Aggregate revenue	17.3	20.8	22.5
Budgetary expenditure	10.1	10.9	12.4
Budget deficit¹ (%)	-7.3	-15.9	-20.1

¹ Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%

Source: Finance Bureau of Shouguang and Lianhe Global's calculations

Ownership Structure

Government's Full Ownership

SSJID, formerly known as Shouguang Xinyu Guarantee Co., Ltd., was established in 2005 by several state-owned enterprises ("SOEs") and public institutions with initial registered capital of RMB100 million. It was mainly engaged in financial guarantee activities at that time.

The company's name was changed to SSJID in 2014. After a series of equity transfers and capital injections, it is wholly owned by Shouguang SAOC, and its registered capital was RMB360 million as of end-September 2022.

Strategic Importance and Government Linkage

Strategic Importance of SSJID to Shouguang and Strategic Alignment

SSJID is an important LIDC that is responsible for state-owned capital investment, project construction, and state-owned assets operation in Shouguang. SSJID invested in manufacturing companies and financial institutions in Shouguang to support local economic development. The company also participated in infrastructure development and shanty town renovation projects.

SSJID's business operations and strategic planning have been aligned with the local government's economic and social development policies. According to the company, SSJID will be responsible for developing the Shouguang East Railway Station, which is one of the twelve railway stations to be built for the proposed Tianjin-Weifang high-speed rail line, an important section of the proposed second line of the Beijing-Shanghai high-speed railway.

Linkage with the Local Government

The Shouguang government is SSJID's ultimate controller, holding 100% equity in SSJID and supervising the company's senior management appointment, major operation, investment and financing plans through Shouguang SAOC. In addition, Shouguang SAOC has an annual assessment mechanism for SSJID and appoints auditors to review its operating performance and financial position regularly.

Government Support

SSJID received stable financial subsidies of RMB203 million, 303 million, 677 million and 550 million in 2019, 2020, 2021 and the first nine months of 2022, respectively, mainly from the Hou town government to support SSJID developing infrastructures in Hou Town. In addition, the Shouguang government transferred 70% equity of Shouguang Kefa Investment Limited and 49% equity of Guangheng Landscaping to SSJID free of charge. However, these companies lack visible operating history.

The Shouguang government has no additional capital injection to SSJID since the government enlarged both the registered capital and paid-in capital of SSJID to RMB360 million from RMB110 million in February 2014. Yet the Shouguang government had injected water and heat supply networks into SSJID, which could generate stable leasing incomes for the company.

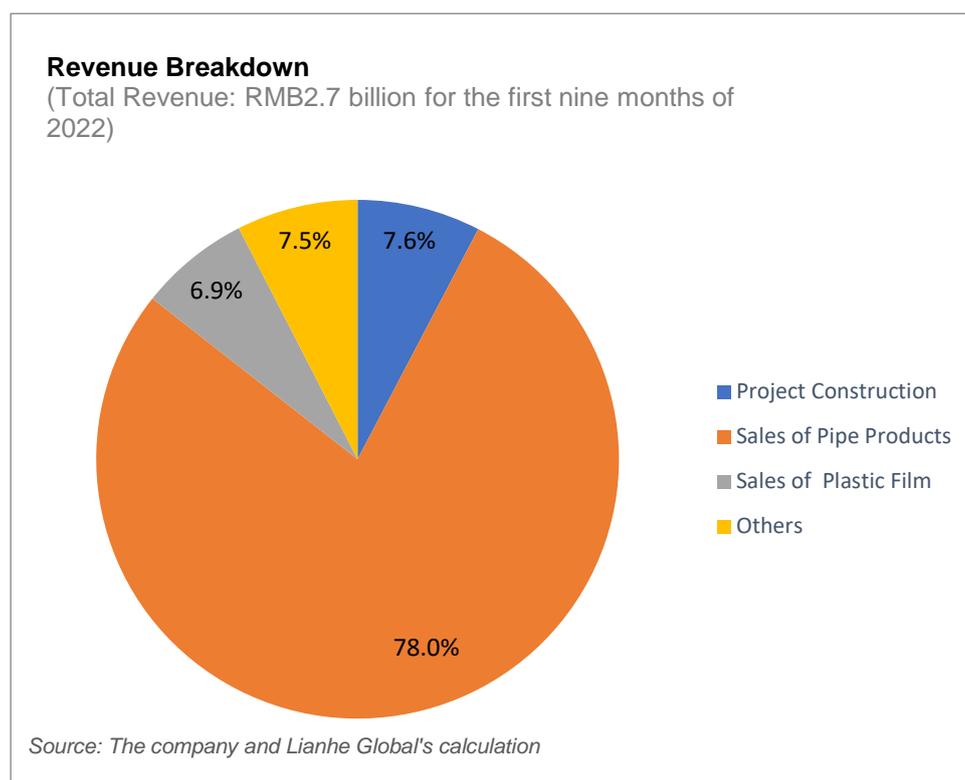
Business Profile

An Important LIDC Responsible for State-owned Capital Investment, Project Construction, and State-owned Assets Operation in Shouguang

SSJID is an important LIDC that is responsible for state-owned capital investment in Shouguang. The company mainly invests in manufacturing companies and financial institutions in Shouguang to support local economic development. SSJID also invested in some distressed local companies which encountered short-term liquidity crunch or operational difficulties, such as Shandong Molong. SSJID usually tries to restore these companies' viability by providing liquidity assistance and improving their management. Other invested companies mainly include Chenming Holdings Limited, the largest shareholder of Shandong Chenming Paper Holdings Limited (000488.SZ/1812.HK), which is a leading papermaking company in China, Shandong Aerospace Weineng Technology Co., Ltd., ("Weineng Technology"), as well as Shandong Shouguang Rural Commercial Bank Co., Ltd., ("Shouguang Rural Commercial Bank") and Shouguang Zhangnongshang Village Bank Co., Ltd., ("Zhangnongshang Village Bank"), etc.

SSJID also participates in infrastructure development and shanty town renovation projects. SSJID has entered manufacturing and sales of pipe and plastic film products since acquiring the controlling interest of Shandong Molong and Shandong Longxing Plastic Film Technology Co., Ltd. ("Longxing Plastic Film") in 2021 and 2018, respectively. In addition, SSJID holds water and heat supply networks in Shouguang for leasing.

SSJID realized revenue of RMB881 million, 1,024 million, 4,356 million and 2,743 million in 2019, 2020, 2021 and the first nine months of 2022, respectively. The company also recorded investment income of RMB114 million, 53 million, 152 million and -5 million over the same period.



Project Construction

SSJID mainly participates in project construction in Hou Town of Shouguang City. The project scope includes infrastructure construction (including roads, water and heat supply networks and other public facilities) and shanty town renovation. The project construction segment recorded revenue of RMB369 million, 527 million, 515 million and 209 million in 2019, 2020, 2021 and the first nine months of 2022, respectively.

SSJID entered agent construction agreements with the Hou town government for infrastructure construction projects, mainly in Hou Town Chemical Engineering Industrial Park. According to these agreements, SSJID was responsible for the design, fundraising, construction and acceptance inspection of entrusted projects. SSJID charged 8%-18% (depending on project types) management fees and construction costs (including financing costs) upon project completion. SSJID also signed agreements of the government's purchasing of services with Housing and Urban-Rural Development Bureau of Shouguang to conduct two shanty town renovation projects in Hou Town in 2018. SSJID recognized 8% of annual management fees and actual construction costs during the respective year as revenue.

At end-September 2022, SSJID had four infrastructure and two shanty town renovation projects under construction with a total investment of RMB2.3 billion, of which RMB569 million was to be invested. In addition, the company is developing self-operated projects such as car parks, heat supply and other facilities in Hou Town Chemical Engineering Industrial Park and Shouguang High-tech Industrial Park for leasing and management fee incomes. The total investment of self-operated projects amounted to RMB1,250 million, of which RMB1,128 million was to be invested at end-September 2022. We expect these projects to support the segment's development in the next one to two years.

Sales of Pipe Products

SSJID indirectly holds c. 29.5% shares of Shandong Molong, and is its controlling shareholder. Shandong Molong mainly manufactures and sells pipe products for oil and gas drilling, and its clients include major petroleum producers, such as China National Petroleum and Shaanxi Yanchang Petroleum. The segment generated revenue of RMB3.1 billion and RMB2.1 billion in 2021 and the first nine months of 2022, respectively, becoming SSJID's largest revenue source.

Nevertheless, due to management issues and adverse market conditions, Shandong Molong recorded net losses of RMB225 million and RMB368 million in 2019 and 2021, respectively. SSJID has been trying to restore Shandong Molong's profitability by integrating its production plants and optimizing the production process. In addition, a new chairman and CFO were appointed to improve Shandong Molong's corporate governance.

Sales of Plastic Film

SSJID acquired 51% shares of Longxing Plastic Film, a manufacturer of plastic film for agricultural and industrial usages, in 2018. It is a major supplier of plastic film for local planting greenhouses. Currently, SSJID holds 86.8% shares of Longxing Plastic Film and has strong control over Longxing Plastic Film, especially in its strategy and financial decisions. The segment's revenue demonstrated an upward trend after the acquisition, realizing revenue of RMB239 million, 244 million, 267 million and 188 million in 2019, 2020, 2021 and the first nine months of 2022, respectively.

Leasing and others

SSJID holds water and heat supply networks in Shouguang for leasing, generating a stable rental income of c. RMB65 million annually. In addition, SSJID participates in heat supply, gas supply, agricultural product transaction platform and software development activities. SSJID also operates Shouguang Polar Ocean World, an important tourist attraction of Shouguang. These activities contributed a small fraction of SSJID's revenue. Yet they enhanced SSJID's strategic importance to some extent.

Financial Profile

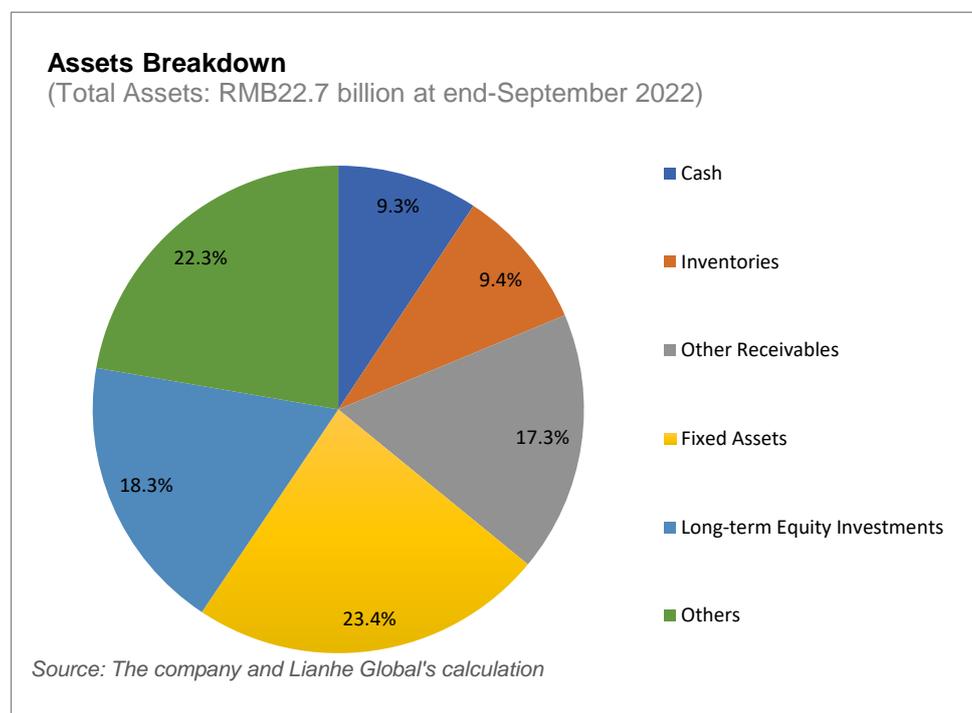
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Sept 2022
Total Asset	9,727	12,771	17,572	22,729
Equity	4,595	4,581	4,971	9,275
Debt	2,680	5,917	9,061	10,130
Debt / (Debt + Equity) (%)	36.8	56.4	64.6	52.2
LT Debt	856	3,446	5,118	5,008
LT Debt / (LT Debt + Equity) (%)	15.7	42.9	50.7	35.1

Source: SSJID and Lianhe Global's calculations

SSJID's asset size grew significantly by 133.7% to RMB22.7 billion at end-September 2022 from RMB9.7 billion at end-2019, mainly owing to the company's consolidation of Shandong Molong, as well as its active participation in equity investment and project construction activities. The company's total debts surged by 278.0% to RMB10.1 billion from RMB2.7 billion over the same period, lifting its financial leverage level, as measured by total

debts/capitalization, to 52.2% from 36.8%, and the total liabilities/total assets ratio to 59.2% from 52.8%. SSJID aims to maintain the total liabilities/total assets ratio below 65%.



SSJID's asset liquidity and quality were moderately weak, as non-current assets accounted for the majority of the company's total assets (57.8%), and some lacked an active market for determining fair value.

SSJID's non-current assets mainly consisted of fixed assets of RMB5.3 billion and long-term equity investments of RMB4.2 billion at end-September 2022. Its fixed assets were mainly water and heat supply networks, as well as production plants of Shandong Molong and equipment of Shouguang Polar Ocean World. While the long-term equity investments mainly included the equity of Shouguang Guangheng Landscaping Engineering Co., Ltd. ("Guangheng Landscaping"), Chenming Holding Limited and Weineng Technology, and SSJID intended to hold these equities for the long run. Nevertheless, the 49% shares of Guangheng Landscaping alone, which were transferred to SSJID free of charge in 2022, amounted to RMB3 billion and represented 71.4% of the company's long-term equity investments at end-September 2022. Guangheng Landscaping was established in 2019 with registered capital of RMB20 million, and mainly engages in road, pipe networks and afforesting projects.

The company had current assets of RMB9.6 billion at end-September 2022, accounting for 42.2% of its total assets. Its current assets included cash of RMB2.1 billion, but with restricted cash of RMB1.7 billion, mainly pledged for obtaining bank facilities. At the same time, SSJID also had inventories of RMB2.1 billion. Yet RMB1.2 billion were generated by its project construction activities, which could take a long time to be converted to cash due to the prolonged construction, recognition and cash collection period. In addition, SSJID had other receivables amounting to RMB3.9 billion, mainly due from other LIDCs and SOEs in Shouguang, and a substantial part of them were technically loans, which usually take two to three years to collect.

At end-September 2022, SSJID's other assets mainly included receivables, prepayment for purchasing equities, investments in banks and assets management companies, as well as other financial investments.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	9M2022
Cash Inflows from Operation	2,175	1,831	5,802	3,693
Cash Outflows from Operation	2,005	3,190	5,023	3,638
Net CF from Operation	170	-1,359	779	55
Cash Inflows from Investment	227	93	200	0
Cash Outflows from Investment	465	855	792	233
Net CF from Investment	-237	-762	-592	-233
Cash Inflows from Financing	2,024	5,758	4,539	5,677
Cash Outflows from Financing	1,942	3,360	4,535	5,673
Net CF from Financing	82	2,398	4	4
Net Increase in Cash and cash equivalent	15	277	189	-174

Source: SSJID and Lianhe Global's calculations

Debt Servicing Capability

SSJID's liquidity was tight. At end-September 2022, SSJID had cash of RMB2.1 million (including restricted cash of RMB1.7 billion) and available bank credit lines of RMB562 million, compared with its debts due within one year of RMB5.1 billion. Therefore, the company must successfully roll over its short-term bank loans (c. RMB1.9 billion at end-September 2022) and obtain additional financing sources or government supports to relieve the liquidity pressure.

In addition, non-traditional borrowings' contribution was moderately high at end-September 2022, amounting to c. RMB2.4 billion and representing 24.5% the company's total debts. This could put additional refinancing pressure on SSJID, given the high financing costs and heightened regulation over non-traditional borrowings.

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