

Qingdao Jiaozhou Bay Development Group Co., Ltd.

Initial Issuer Report

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB+’ global scale Long-term Issuer Credit Rating with Stable Outlook to Qingdao Jiaozhou Bay Development Group Co., Ltd. (“JZBD” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the Jiaozhou People’s Government (“the Jiaozhou government”) would provide strong support to JZBD if needed, in light of its indirectly full ownership of JZBD, JZBD’s strategic importance as the most important local investment and development company (“LIDC”) responsible for infrastructure construction and primary land development in China-SCO Local Economic and Trade Cooperation Demonstration Area (“SCODA”), and the linkage between the Jiaozhou government and JZBD, including the appointment of the senior management, strategic alignment, supervision of major financing plan and investment decisions and ongoing operational and financial support. In addition, the Jiaozhou government may face significant negative impact on its reputation and financing activities if JZBD encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: State-owned Assets Service Center of Jiaozhou (“Jiaozhou SASC”) holds 100% shares of JZBD through Qingdao Shanghe Holding Development Group Co., Ltd. (“Shanghe Holding”), an LIDC in Jiaozhou. The local government has strong control over the company, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government has formulated a performance assessment policy for the company, and regularly appoints auditors to review the company’s operating performance and financial position.

Strategic Importance and Strategic Alignment: JZBD’s development plan has been aligned with the local government’s economic and social policies. The company is the most important LIDC responsible for infrastructure construction and primary land development in SCODA, which is located on the north coast of Jiaozhou Bay in Qingdao. The development of SCODA, aiming at promoting international trade, two-way investment and business tourism culture exchange between SCO countries, is a prioritized task of Qingdao and Jiaozhou. JZBD’s ultimate controller is the Management Committee of SCODA (“SCODA MC”), a branch of the Qingdao Municipal Government, carrying out day-to-day supervision over the company.

Ongoing Government Support: JZBD received ongoing operational subsidies from the local government, amounting to RMB712 million between 2019 and the first nine months of 2022. In addition, the government reimbursed a part of JZBD’s financial costs relating to development projects in SCODA. The local government also injected a series of assets amounting to RMB10.3 billion between 2019 and the first nine months of 2022. That mainly includes 51% shares of Qingdao Shanghe Cornerstone Investment Development Group Co., Ltd. (“Shanghe Cornerstone”), another important LIDC in Jiaozhou, of RMB7.4 billion

Summary

Issuer Rating	BBB+
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	3 April 2023

Key Figures of Jiaozhou and JZBD (RMB billion)

Jiaozhou	2021	2022
GDP	145.6	154.1
GDP growth rate (%)	11.2	5.0
Budgetary revenue	11.5	11.3
Government fund	10.0	6.6
Transfer payment	5.2	3.9
Budgetary expenditure	12.9	14.0
JZBD	2020	2021
Assets	40.6	49.6
Equity	16.4	18.1
Revenue	1.5	2.5

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

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Applicable Criteria

China Local Investment and Development Companies Criteria (5 December 2022)

and water area use rights of RMB2.3 billion, which generated rental incomes of RMB94 million and RMB71 million in 2021 and the first nine months of 2022, respectively.

Economy and Fiscal Condition of Jiaozhou: Jiaozhou, a county-level city under the jurisdiction of Qingdao, is an important processing and manufacturing base in Jiaodong Peninsula with a strong industrial foundation. Jiaozhou realized a GDP of RMB154.1 billion in 2022. The GDP growth rate slowed to 5.0% in 2022, mainly caused by the COVID disruption during the year. Yet both its GDP scale and GDP growth rate were ranked 2nd among ten jurisdictions in Qingdao in 2022.

The Jiaozhou government's budgetary revenue decreased slightly to RMB11.3 billion in 2022 from RMB11.5 billion in 2021 due to the value-added tax credit refunds to support the economy. Its government fund income, mainly generated by land sales, dropped sharply to RMB6.6 billion in 2022 from RMB10.0 billion in 2021, owing to the weak property market. As a result, the Jiaozhou government recorded aggregate revenue of RMB21.8 billion in 2022, down from RMB26.8 billion in 2021. In contrast, its government debt grew significantly in 2022, lifting the government debt ratio, as measured by total government debt/aggregate revenue, to 140.7% from 100.5% over the same period.

JZBD's Financial and Liquidity Position: JZBD's asset size grew significantly by 109.3% to RMB69.1 billion at end-September 2022 from RMB33.0 billion at end-2019. This was mainly attributed to the company's active involvement in infrastructure construction and primary land development projects in SCODA. In addition, the local government also injected assets such as water area use rights, equities of SOEs and LIDCs and properties into JZBD, enlarging its equity base to RMB25.0 billion from 13.5 billion over the same period. JZBD also relied on debts to finance its asset expansion. The company's total debt grew by 121.2% to RMB38.1 billion at end-September 2022 from RMB17.2 billion at end-2019, pushing its financial leverage, as measured by debt/capitalization, to 60.4% from 56.1%.

The liquidity of JZBD was moderately weak. At end-September 2022, JZBD had a cash balance of RMB4.8 billion (including restricted cash of RMB1.5 billion) compared with its debts due within one year of RMB10.9 billion. JZBD has access to various financing channels, including bank borrowings, bond issuances and other non-traditional financings, to support its debt repayments and business operations. The company had unused bank credit lines of RMB13 billion at end-September 2022. Nevertheless, the company needs to successfully roll over its short-term bank borrowings (RMB3.2 billion at end-September 2022) and obtain additional financing sources or government support to maintain its liquidity.

Rating Sensitivities

We would consider downgrading JZBD's rating if (1) there is perceived weakening in support from the Jiaozhou government, particularly due to its reduced strategic importance with diminished government functions, or (2) there is a significant reduction of the Jiaozhou government's ownership of JZBD, or (3) there is a downgrade in our internal credit assessment on the Jiaozhou government.

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

Operating Environment

Economic Condition of Jiaozhou

Jiaozhou, a county-level city under the jurisdiction of Qingdao City, is an important processing and manufacturing base in Jiaodong Peninsula with a strong industrial foundation. Jiaozhou administers Jiaozhou Economic and Technological Development Zone, a state-level economic and technological development zone now known as SCODA. Jiaozhou had a total land area of 1,324 square kilometers and a residential population of 1.0 million and an urbanization rate of 63.1% at end-2022.

Jiaozhou is focusing on the development of SCODA, intending to build a pilot area for innovation of two-way investment and trade systems among the relevant localities across the SCO states, an agglomeration area for business entrepreneurship and development, and a pioneering area for local economic and trade cooperation along the “Belt and Road”.

Jiaozhou realized a GDP of RMB154.1 billion in 2022. The GDP growth rate slowed to 5.0% in 2022, mainly caused by the COVID disruption during the year. Yet both its GDP scale and GDP growth rate were ranked 2nd among ten jurisdictions in Qingdao in 2022. Jiaozhou's economic structure mainly consisted of secondary and tertiary industries, accounting for 48.0% and 47.7% of Jiaozhou's aggregate GDP, respectively, in 2022.

Jiaozhou's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	122.6	145.6	154.1
-Primary industry (%)	4.7	4.4	4.3
-Secondary industry (%)	46.3	48.6	48.0
-Tertiary industry (%)	49.0	47.0	47.7
GDP growth rate (%)	5.5	11.2	5.0
Fixed asset investment	132.8	143.4	149.7
Fixed asset investment growth rate (%)	4.5	8.0	9.1
Population (million)	1.0	1.0	1.0

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Jiaozhou

The Jiaozhou government's budgetary revenue decreased slightly to RMB11.3 billion in 2022 from RMB11.5 billion in 2021 due to the value-added tax credit refunds to support the economy. In contrast, its budgetary expenditure increased to RMB14.0 billion from RMB12.9 billion. Therefore, the Jiaozhou government's budget deficit was enlarged to -23.5% from -12.2% over the same period.

In addition, Jiaozhou's government fund income, mainly generated by land sales, dropped sharply to RMB6.6 in 2022 billion from RMB10.0 billion in 2021 owing to the weak property market. As a result, the Jiaozhou government recorded aggregate revenue of RMB21.8 billion in 2022, down from RMB26.8 billion in 2021. However, its government debt grew significantly in 2022, lifting the government debt ratio, as measured by total government debt/aggregate revenue, to 140.7% from 100.5% over the same period.

Jiaozhou's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	10.3	11.5	11.3
Budgetary revenue growth rate (%)	1.5	12.0	8.0*
Tax revenue	7.8	8.7	7.1
Tax revenue (% of budgetary revenue)	75.3	75.6	62.8
Government fund income	13.5	10.0	6.6
Transfer payment	4.6	5.2	3.9
Aggregate revenue	28.4	26.8	21.8
Budgetary expenditure	12.3	12.9	14.0
Budget deficit ¹ (%)	-19.3	-12.2	-23.5

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

Source: Public information and Lianhe Global's calculations

Note*: Excluding the influence of value-added tax credit refund

Ownership Structure

Government's Ownership

JZBD was established in 2007 with initial registered capital of RMB200 million. In 2019, the registered capital of JZBD was enlarged to RMB2 billion from RMB200 million. After completing a cash capital injection of RMB450 million in the fourth quarter of 2022, the company's paid-in capital increased to RMB1.65 billion. According to the company, the remaining RMB350 million is expected to be injected by 2052.

In July 2022, Jiaozhou SASC transferred 100% equity of JZBD and three other companies to Shanghe Holding. Although the Jiaozhou SASC holds 100% equity of Shanghe Holding, its ultimate controller is SCODA MC, who supervises Shanghe Holding daily. SCODA MC is also responsible for reviewing the company's organizational structure, strategic positioning, performance and salary assessment mechanism, etc.

On 24 February 2023, JZBD announced that its ultimate controller was changed from Jiaozhou SASC to SCODA MC, while the shareholder structure remained unchanged.

Strategic Importance and Government Linkage

Strategic Importance of JZBD to Jiaozhou

JZBD's development plan has been aligned with the local government's economic and social policies. The company is the most important LIDC responsible for infrastructure construction and primary land development in SCODA, which is located on the north coast of Jiaozhou Bay in Qingdao. The development of SCODA, aiming at promoting international trade, two-way investment and business tourism culture exchange between SCO countries, is a prioritized task of Qingdao and Jiaozhou. JZBD's ultimate controller is SCODA MC, a branch of the Qingdao Municipal Government, carrying out day-to-day supervision over the company.

Strong Linkage with the Local Government

JZBD has a strong linkage with the local government. Jiaozhou SASC holds 100% shares of JZBD through Shanghe Holding. The local government has strong control over the company, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government has formulated a performance assessment policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

Ongoing Government Support

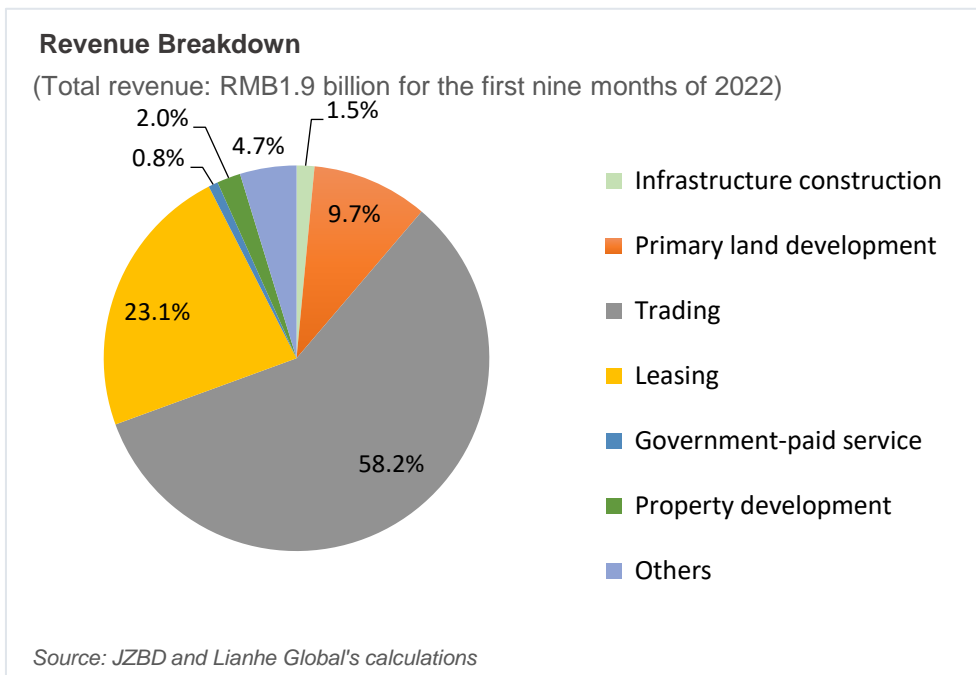
JZBD received ongoing operational subsidies from the local government, amounting to RMB261 million, 138 million, 207 million and 106 million in 2019, 2020, 2021 and the first nine months of 2022, respectively. In addition, the government reimbursed a part of JZBD's financial costs relating to development projects in SCODA.

The local government also injected a series of assets amounting to RMB10.3 billion between 2019 and the first nine months of 2022. That mainly includes 51% shares of Shanghe Cornerstone, another LIDC focusing on infrastructure construction and primary land development in SCODA, of RMB7.4 billion and water area use rights of RMB2.3 billion, which generated rental incomes of RMB94 million and RMB71 million in 2021 and the first nine months of 2022, respectively.

Business Profile

The most important LIDC responsible for infrastructure construction and primary land development in SCODA

JZBD is the most important LIDC responsible for infrastructure construction and primary land development in SCODA. In addition, the company has diversified its business into trading, leasing, property development, etc. JZBD also provides cleaning services, conference services, staff canteen services and other government-paid services for SCODA MC and other government units. JZBD realized revenue of RMB0.8 billion, 1.5 billion, 2.5 billion and 1.9 billion in 2019, 2020, 2021 and the first nine months of 2022, respectively.



Infrastructure Construction and Primary Land Development

JZBD is the major LIDC responsible for infrastructure construction projects in SCODA. Its project scope mainly includes road construction, river management, as well as land expropriation and demolition. The infrastructure construction projects were undertaken under the Build-Transfer ("BT") mode, in which JZBD raises funds for the projects

independently and transfers them to SCODA MC upon completion. According to the agreement, the Finance Bureau of Jiaozhou transfers project funds to SCODA MC, and it is responsible for the settlement with JZBD after accepting the projects. JZBD also undertakes primary land development projects in SCODA entrusted by the Jiaozhou government, including shanty town renovation and other land consolidation projects. JZBD recognizes construction costs plus the agreed-upon margin (e.g., 8-15%, varying from project to project) as revenue.

JZBD has an abundant project pipeline to support the segment's development in the next two to three years. However, the company is often subject to project and payment delays. At end-September 2022, the company had unsettled payments for infrastructure construction projects of RMB4.0 billion, of which over 90% were expected to be paid by 2027.

Leasing

JZBD also engages in the leasing business. The company leases office buildings and industrial parks to SCODA MC and other companies, providing business, operation and conference spaces in SCODA. The leasing business includes self-built project leasing and BT project leasing. JZBD leases the self-built projects to SCODA MC until the projects enter the market operation stage and are leased to the market tenements.

Regarding BT project leasing, JZBD doesn't transfer some completed BT projects to SCODA MC after the acceptance but maintains their ownership and leases them back to SCODA MC. JZBD usually receives annual rentals equivalent to 10% of the project construction costs for ten years to cover the construction costs.

Trading, Property Development and Others

The trading business is the largest revenue driver of JZBD. The trading products are mainly steel, aquatic products, grain and oil. Despite the strong revenue growth, the trading business's gross margin stayed at a low level of 0.8-2.7% in the past three years.

JZBD is also involved in the property development business. JZBD has only one project under construction and on sale, yet it realized negative gross margins in the past three years due to the high land acquisition price.

JZBD's other businesses mainly include government-paid services, labor dispatching and property management. These activities only generated a small fraction of revenue for JZBD and had a limited impact on the company's overall financial condition and solvency.

Financial Profile

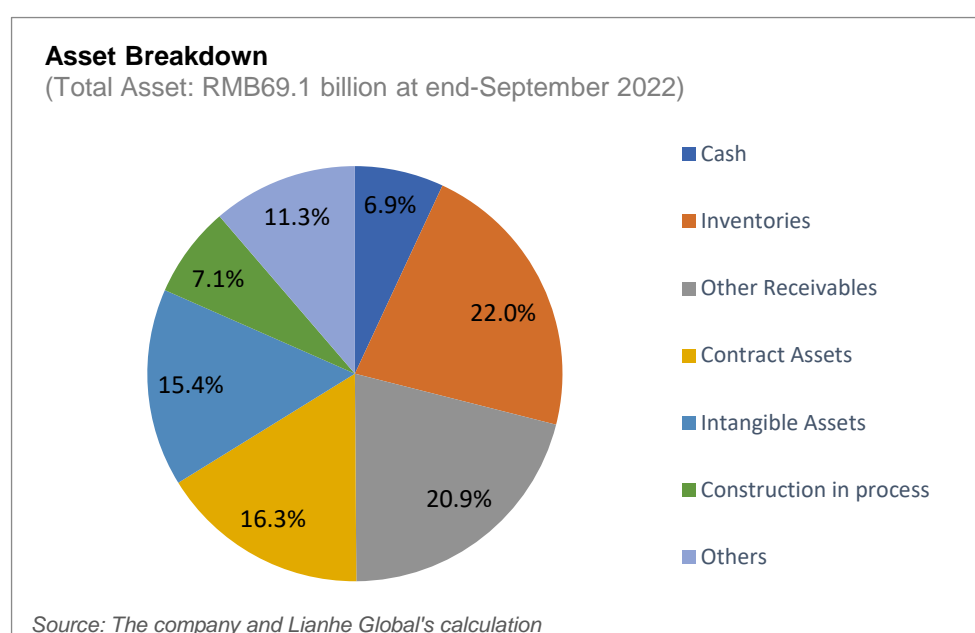
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Sep 2022
Total Asset	32,995	40,560	49,578	69,057
Equity	13,457	16,377	18,056	24,964
Debts	17,227	22,077	29,286	38,108
Debt / (Debt + Equity) (%)	56.1	57.4	61.9	60.4
LT Debts	14,040	16,380	19,720	27,158
LT Debt / (LT Debt + Equity) (%)	51.1	50.0	52.2	52.1

Source: The company's financial reports and Lianhe Global's calculations

JZBD's asset size grew significantly by 109.3% to RMB69.1 billion at end-September 2022 from RMB33.0 billion at end-2019. This was mainly attributed to the company's active involvement in infrastructure construction and primary land development projects in Jiaozhou. The local government also injected assets such as water area use rights, equities of SOEs and LIDCs, properties and roads into JZBD, enlarging its equity base to RMB25.0 billion from 13.5 billion over the same period.

In addition, JZBD relied on debts to finance its asset expansion. The company's total debts grew by 121.2% to RMB38.1 billion at end-September 2022 from RMB17.2 billion at end-2019, pushing its financial leverage, as measured by debt/capitalization, to 60.4% from 56.1% over the same period. The company intends to maintain its total liability/total asset ratio at c. 60% level, which was 59.2%, 59.6%, 63.6% and 63.9% at end-2019, 2020, 2021 and end-September 2022, respectively



JZBD's asset liquidity was moderately weak, with a significant portion of its assets related to its infrastructure construction activities, mainly including contract assets (mostly construction costs) of RMB11.3 billion and construction in process of RMB4.9 billion, representing 16.3% and 7.1% of the company's total asset at end-September 2022, respectively. At the same time, JZBD had inventories of RMB15.2 billion, representing 22.0% of the company's total asset. Its inventories mainly comprised consolidated lands to be delivered. The above assets usually take a prolonged time to monetize owing to long construction and recognition time, as well as potential delay payments. In addition, JZBD had other receivables of RMB14.5 billion, mainly due from government agencies and other LIDCs in Jiaozhou without a specific repayment schedule.

At end-September 2022, JZBD had intangible assets of RMB10.6 billion, mainly including land use rights and water area use rights allocated by the government. The latter generated rental incomes of RMB94 million and 71 million in 2021 and the first nine months of 2022, respectively. Yet we believe its liquidity is low as it is hard to value and lacks an active market. JZBD's other assets mainly included investments in properties and equities, and JZBD intends to hold these assets for the long run.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	9M2022
Cash Inflows from Operation	2,408	8,385	11,232	20,677
Cash Outflows from Operation	6,416	10,605	12,934	24,576
Net CF from Operation	-4,008	-2,220	-1,702	-3,899
Cash Inflows from Investment	0	0	109	72
Cash Outflows from Investment	403	2,764	3,173	2,408
Net CF from Investment	-403	-2,764	-3,064	-2,336
Cash Inflows from Financing	7,523	8,915	13,007	15,370
Cash Outflows from Financing	2,694	3,686	6,602	8,318
Net CF from Financing	4,829	5,229	6,405	7,052
Net Increase in Cash and cash equivalent	437	245	1,639	817

Source: The company's financial reports

Debt Servicing Capability

The liquidity of JZBD was moderately tight. At end-September 2022, JZBD had a cash balance of c. RMB4.8 billion (including restricted cash of RMB1.5 billion) compared with its debt due within one year of c. RMB10.9 billion. JZBD has access to various financing channels, including bank borrowings, bond issuances and other non-traditional financings, to support its debt repayments and business operations. The company had unused bank credit lines of RMB13.0 billion at end-September 2022. Nevertheless, the company needs to successfully roll over its short-term bank borrowings (RMB3.2 billion at end-September 2022), and obtain additional financing sources or government support to maintain its liquidity.

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