

Qingdao Laoshan Science and Technology Innovation Development Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB+
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	25 April 2023

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

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Laoshan District, Qingdao City (“Laoshan government”) would provide strong support to QLSTI if needed, in light of its direct full ownership of QLSTI, QLSTI’s strategic importance as the key local investment and development company (“LIDC”) that is responsible for industrial park leasing and development, industrial investment and urban development in Laoshan District, Qingdao City (“Laoshan”), and the linkage between the Laoshan government and QLSTI, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing operational and financial support. In addition, the Laoshan government may face significant negative impact on its reputation and financing activities if QLSTI encounters any operational and financial difficulties.

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

Rating Rationale

Laoshan Government’s Ownership and Supervision: The Laoshan government directly holds the full ownership of QLSTI through the Finance Bureau of Laoshan District, Qingdao City (“Laoshan FB”), and is the actual controller of the company. The Laoshan government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Laoshan government has assessment mechanism over the company and it appoints auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Laoshan and Strategic Alignment: QLSTI, as an important innovation and industrial investment LIDC in Laoshan, is primarily responsible for the industrial park leasing and development, urban development and industrial investment within the region with strong franchised advantages. The company undertakes functions such as technology venture capital investment, technology finance, industrial park projects development and operation, industrial guidance and investment attraction, according to the industrial development plan of the Laoshan government. The company also undertakes part of the urban renewal and area development projects on behalf of the Laoshan government. QLSTI plays an important role in promoting the economic development and industrial upgrading of the region. Its business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: QLSTI received operational and financial support from the government. QLSTI had received a total subsidy amount of c. RMB188.7 million from 2019 to the first nine months of 2022, mainly including operating subsidies and rent subsidies.

Key Figures of Laoshan and QLSTI

(RMB billion)	2021	2022
Laoshan		
GDP	101.1	108.1
GDP growth rate (%)	10.1	5.7
Budgetary revenue	20.0	20.4
Government fund	13.8	7.7
Transfer payment	2.9	3.4
Budgetary expenditure	13.9	14.2
QLSTI	2021	2022.9
Assets	20.4	23.8
Equity	10.1	12.0
Revenue	0.6	0.7

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

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Applicable Criteria

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

The Laoshan government continued to inject cash and other assets into QLSTI to expand its asset size. Besides, the Laoshan government provides policy supports to QLSTI to ensure its business operation. We believe QLSTI is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

QLSTI's Financial Matrix and Liquidity Position: QLSTI's total assets showed a continuous growth trend in the past years and reached RMB23.8 billion at end-September 2022 mainly due to the increase of investment properties, which was driven by the transfer of some completed industrial park development projects. The non-current assets of QLSTI accounted for c. 81.4% of the total assets as of end-September 2022, and the overall assets were less liquid. QLSTI's financial leverage (total liabilities to total assets) was 49.7% and its adjusted debt increased to c. RMB6.6 billion at end-September 2022. The liquidity of QLSTI was moderate. QLSTI had an unrestricted cash balance and unused credit facilities of c. RMB1.1 billion and RMB2.3 billion at end-September 2022, respectively, compared with its debt due within one year of c. RMB2.8 billion. Besides, QLSTI has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

Economy and Fiscal Condition of Laoshan: Laoshan is located in the eastern of the Qingdao City ("Qingdao"). It is one of the seven urban districts of Qingdao. Laoshan recorded an economic growth in 2022, achieving a GDP of c. RMB108.1 billion, with a year-on-year growth of 5.7%. The growth rate has slowed down compared to previous years due to the impact from COVID-19. The aggregate fiscal revenue of the Laoshan government was mainly derived from the budgetary revenue and government fund income. In 2022, the budgetary revenue of the Laoshan government reached c. RMB20.4 billion, with a year-on-year increase of 8.3%. Having said that, the tax revenue decreased slightly due to the large-scale value-added tax credit refunds to support the economy. At the same time, the government fund income, which was mainly generated from land sales, dropped to c. RMB7.7 billion in 2022 from c. RMB13.8 billion in 2021, owing to the weak property market. The budget deficit of the Laoshan government was stable at c. 30% in the past three years, while the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Laoshan government was low. The special purpose debt constituted a high proportion of the total debt.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Laoshan

Laoshan is located in the eastern of Qingdao. It is one of the seven urban districts of Qingdao. It focuses on the development of modern finance, information technology, cultural tourism and medicine and healthcare. Laoshan has jurisdiction over 5 streets and 167 communities

with a total land area of c. 395.8 square kilometers and a sea area of c. 3,700 square kilometers. It had a residential population of c. 0.5 million with an urbanization rate of 86.9% at end-2022.

Laoshan realized a GDP of c. RMB108.1 billion in 2022, representing a growth rate of 5.7%. The growth rate has slowed down compared to previous years due to the impact from COVID-19. Laoshan's economic growth was mainly fueled by the secondary and tertiary industries, which accounted for 32.2% and 67.2% of Laoshan's GDP, respectively, in 2022. The fixed asset investment also recorded steady growth in the past three years. Meanwhile, Laoshan's GDP per capita reached c. RMB21,170 in 2022.

Laoshan's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	88.6	101.1	108.1
-Primary industry (%)	0.7	0.7	0.7
-Secondary industry (%)	29.8	30.6	32.2
-Tertiary industry (%)	69.5	68.7	67.2
GDP growth rate (%)	5.5	10.1	5.7
Fixed asset investment	32.4	36.4	43.0
Fixed asset investment growth rate (%)	20.9	12.1	18.2
Population (million)	0.5	0.5	0.5

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Laoshan

The aggregate fiscal revenue of the Laoshan government was mainly derived from the budgetary revenue and government fund income. The budgetary revenue of the Laoshan government maintained a steady growth in the past three years, reaching c. RMB20.4 billion with a year-on-year increase of 8.3% in 2022. Having said that, the tax revenue decreased slightly due to the large-scale value-added tax credit refunds to support the economy. In addition, Laoshan's government fund income, which was mainly generated from land sales, dropped to c. RMB7.7 billion in 2022 from c. RMB13.8 billion in 2021, owing to the weak property market.

The budget deficit of the Laoshan government was stable at c. 30% in the past three years, while the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Laoshan government was low. The local government's outstanding debt increased from c. RMB3.2 billion at end-2020 to c. RMB4.5 billion at end-2022, mainly due to the increase in special purpose debt.

Laoshan's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	16.2	20.0	20.4
Budgetary revenue growth rate (%)	3.0	23.7	8.3*
Tax revenue	12.7	16.9	16.1
Tax revenue (% of budgetary revenue)	78.5	84.4	79.1
Government fund income	13.1	13.8	7.7
Transfer payment	2.7	2.9	3.4
Aggregate revenue	32.0	36.8	31.5
Budgetary expenditure	11.5	13.9	14.2
Budget deficit ¹ (%)	-29.1	-30.7	-30.4

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

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

QLSTI was established in 2013 with an initial registered capital of RMB108 million, funded by Qingdao Laoshan District State-owned Assets Administration. In 2016, all of QLSTI's equity was transferred to the Laoshan FB. At end-2022, QLSTI had a shareholding structure in which the Laoshan FB, as the controlling shareholder, held 100% of the company's equity. The registered capital and paid-in capital were both c. RMB4.6 billion at the same time.

Strategic Importance and Government Linkage

Strategic Importance of QLSTI to Laoshan

QLSTI is an important innovation and industrial investment LIDC in Laoshan that primarily responsible for the urban development, industrial park development and industrial investment within the region with strong franchised advantages. The company undertakes functions such as technology venture capital investment, technology finance, industrial park projects development and operation, industrial guidance and investment attraction, according to the industrial development plan of the Laoshan government. The company also undertakes part of the urban renewal and area development projects on behalf of the Laoshan government. QLSTI plays an important role in promoting the economic development and industrial upgrading of the region. Its business operation and development have been aligned with the government's development plans.

Strong Linkage with the Local Government

QLSTI's linkage with the local government is strong as the Laoshan government directly holds the full ownership of QLSTI through the Laoshan FB. The Laoshan government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Laoshan government has assessment mechanism over the company and it appoints auditor to supervise the operating performance and financial position on a periodic basis.

Government Support

QLSTI continued to receive financial subsidies, mainly including operating subsidies and rent subsidies from the local government to maintain its business operation. QLSTI received subsidies of c. RMB100.8 million, RMB18.1 million, RMB69.5 million and RMB0.3 million in 2019, 2020, 2021 and first nine months of 2022, respectively, representing a fluctuating trend. The Laoshan government will also provide policy support to QLSTI to ensure its business operation. QLSTI received multiple capital injections in the form of cash and other assets, which reached RMB558.6 million, RMB1.8 billion and RMB262.6 million in 2019, 2020 and first nine months of 2022, respectively, from the Laoshan government, through the Laoshan FB, to expand its asset size. We believe QLSTI is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

Business Profile

The Key Entity Responsible for Industrial Park Development, Industrial Investment and Urban Development in Laoshan

QLSTI, as the key LIDC in Laoshan, is mainly responsible for industrial park development and rental, industrial technology investment and urban development within the region. It undertakes functions such as technology venture capital investment, technology finance, industrial park development and operation, and industrial guidance, according to the industrial development plan of the Laoshan government. Moreover, the Laoshan government has also entrusted the company with functions related to urban development and investment attraction in Laoshan. The company is supported by the financial resources of the Laoshan FB, and establishes good cooperative relations with government departments in various fields. Therefore, QLSTI has rich project resources, strong competitive advantages, and good development prospects within the region.

The primary sources of operating revenue for QLSTI are its industrial park leasing and trading business. The company experienced steady revenue growth over the past three years, with revenue reaching of c. RMB493.9 million, RMB574.5 million and RMB732.1 million for 2020, 2021 and the first nine months of 2022, respectively. The fast revenue growth in the first nine months of 2022 was primarily attributable to the expansion of trading business. The overall gross profit margin of QLSTI was 25.2%, 35.5% and 17.9% in 2020, 2021 and the first nine months of 2022, respectively. The decrease of gross profit margin in the first nine months of 2022 was mainly due to the increasing proportion of the low-margin trading segment, as well as the negative margin in the supply of electricity, refrigeration and heating services segment, resulting from delayed payment of electricity charges and collection of heating fees. In general, QLSTI's business was diversified, and it has regional advantages in its major businesses.



Industrial Park Leasing

QLSTI focuses on the strategic positioning of establishing important innovation centers in Laoshan and operating its industrial park projects to construct an industrial system, including smart industry, intelligent manufacturing, virtual reality, microelectronics, biomedicine, new

energy materials, and high-end productive service industries. QLSTI sells or leases office buildings to companies in the industrial parks and offers favorable policies to attract investment. The rent is collected semi-annually or annually based on the market price level, and a certain amount of security deposit is also charged. Most of the actual lessees are startup teams and enterprises. The typical lease contracts last for three years.

The revenue in this segment was stable over the past years, with RMB142.5 million, RMB196.2 million and RMB160.3 million generated in 2020, 2021 and the first nine months of 2022, respectively. The gross profit margin remained steady and high at c.65%-75%. QLSTI has 10 industrial parks under lease at end-September 2022, while it is working on several large-scale industrial parks' development at the same time. Therefore, QLSTI incurs high capital expenditure pressure.

Trading

As an important source of revenue for QLSTI, the trading segment makes the company's business more diversified and plays a complementary role to its main business. QLSTI is mainly engaged in the sales of zinc, copper and frozen meat. QLSTI's trading business is mostly conducted in a "demand-driven" model, where it determines the type and amount of products to be procured strictly based on the actual purchase orders placed by customers. The revenue generated from this segment reached c. RMB272.1 million, RMB232.7 million and RMB520.8 million in 2020, 2021 and the first nine months of 2022, respectively, representing an upward trend. The gross profit margin of the segment was relatively low, which was c. 0.6%-1.3% for the past three years. The suppliers and customers of the segment are concentrated, and most of them are private enterprises, indicating a relatively high counterparty risk.

Venture Capital

As the main platform for venture capital business in Laoshan, QLSTI is positioned as a comprehensive operator and service provider for the technology sector in the region with a "technology + finance" model, focusing on emerging industries such as smart industry, energy conservation and environmental protection, biomedicine, intelligent manufacturing, virtual reality and technology services. QLSTI provides integrated services and support for accelerating the conversion of new and old driving forces and promoting industrial upgrading and urban renewal in Laoshan. QLSTI carries out investment business externally through various methods such as direct investment (investing in non-listed companies' equity) and fund investment. QLSTI has established various investment management systems to manage the investment risks. The revenue in this segment reached RMB10.4 million, RMB5.7 million and RMB0.9 million in 2020, 2021 and the first nine months of 2022, respectively.

Other Businesses

Other businesses of QLSTI include supply of electricity, refrigeration and heating services, hotel, catering, cloud computing, parking and property services etc., with each segment accounted for a relatively small proportion of the company's total revenue. Other businesses mainly play the role of supplementing the revenue of the main business. In addition, QLSTI is now responsible for part of the Zhangcunhe Area urban renewal projects, including relocation compensation and resettlement, public service facility renewal, municipal infrastructure renewal, new industrial carrier, etc. within the area.

Financial Profile

Balance Sheet Structure and Quality

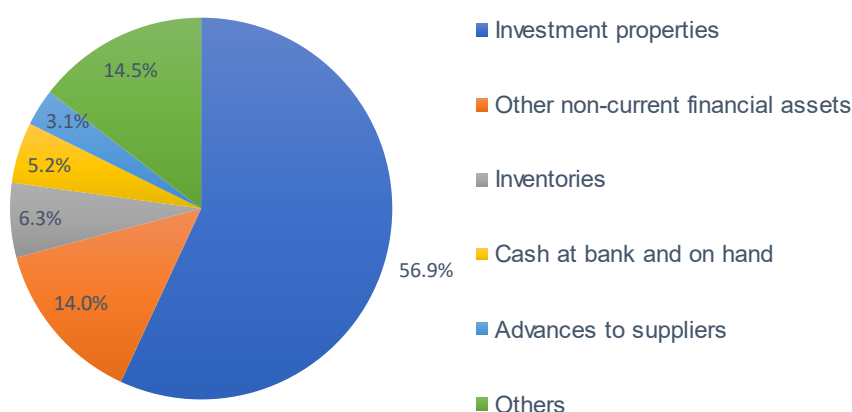
Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Sep 2022
Total Asset	10,493	12,015	20,429	23,773
Equity	6,340	6,400	10,091	11,959
Debt	1,988	3,126	5,084	6,573
Debt / (Debt + Equity) (%)	23.9	32.8	33.5	35.5
LT Debt	1,204	2,149	3,048	3,431
LT Debt / (LT Debt + Equity) (%)	16.0	25.1	23.2	22.3

Source: Company information and Lianhe Global's calculations

QLSTI's total assets showed a continuous growth in the past few years, with a growth rate of 14.5%, 70% and 16.4% at end-2020, end-2021 and end-September 2022, respectively, and reached RMB23.8 billion at end-September 2022. The increase of QLSTI's total assets was largely due to its investment properties, which was driven by the transfer of some completed industrial park development projects. At end-September 2022, QLSTI's assets mainly consisted of investment properties, other non-current financial assets, inventories, cash at bank and on hand and advances to suppliers. Investment properties primarily comprised of the industrial park projects developed by the company, such as the software park, the innovation park and other projects. Other non-current financial assets included investments in other units. As the scale of the company's external investments increases, its overall size is showing an upward trend. Inventories included development costs associated with QLSTI's core business operations, which increased in parallel with the growth of the relevant projects. Advances to suppliers were mainly aroused from prepaid trade accounts and other similar items. QLSTI's non-current assets accounted for a large proportion of total assets, reaching 81.4% at end-September 2022. Coupled with the high development costs, QLSTI's assets were relatively illiquid.

Asset Breakdown

(Total assets: RMB23.8 billion at end-September 2022)



Source: The company and Lianhe Global's calculation

QLSTI's financial leverage (total liabilities to assets) reached 39.6%, 46.7%, 50.6% and 49.7% at end-2019, end-2020, end-2021 and end-September 2022, respectively, which increased slightly but tended to be at a stable level. In view of the relevant guidelines of the Laoshan

government, we expect the financial leverage of QLSTI to stabilize at this level. QLSTI's adjusted total debt increased significantly from c. RMB2 billion at end-2019 to c. RMB6.6 billion at end-September 2022, with short-term debt accounting for c. 47.8% of the total debt. There was no significant change in the ownership equity structure of QLSTI at end-September 2022, compared with that at end-2021. The capital surplus increased to RMB1.5 billion at end-September 2022 from RMB537.9 million at end-2019. QLSTI mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its urban development and industrial park development projects under construction and to be constructed in the future.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	9M2022
Cash Inflows from Operation	563	1,427	1,326	1,054
Cash Outflows from Operation	491	1,300	1,159	1,124
Net CF from Operation	72	127	168	-69
Cash Inflows from Investment	190	441	986	137
Cash Outflows from Investment	1,164	1,865	1,960	1,552
Net CF from Investment	-974	-1,423	-975	-1,415
Cash Inflows from Financing	1,540	2,375	2,770	4,034
Cash Outflows from Financing	338	1,210	1,394	2,278
Net CF from Financing	1,202	1,165	1,377	1,756
Net Increase in Cash and cash equivalent	300	-132	569	272

Source: QLSTI's financial reports

Debt Servicing Capability

The liquidity of QLSTI was moderate. At end-September 2022, QLSTI had unrestricted cash balance and unused credit facilities of c. RMB1.1 billion and RMB2.3 billion, respectively, compared with its debt due within one year of c. RMB2.8 billion at the same time. Besides, QLSTI has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

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