

Weihai Wendeng District Bluesea Investment and Development Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	4 April 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Weihai Wendeng District Bluesea Investment and Development Co., Ltd. (“WWBID” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Wendeng District, Weihai City (“Wendeng government”) would provide strong support to WWBID if needed, in light of its full ownership of WWBID, WWBID’s strategic importance as the major local investment and development company (“LIDC”) that is responsible for infrastructure construction and affordable housing construction in Wendeng District, Weihai City (“Wendeng”), and the linkage between the Wendeng government and WWBID, 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 Wendeng government may face significant negative impact on its reputation and financing activities if WWBID encounters any operational and financial difficulties.

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

Rating Rationale

Wendeng Government’s Ownership and Supervision: The Wendeng government holds full ownership of WWBID through the Weihai Wendeng District State-owned Assets Service Center (“Wendeng SASC”), and is the ultimate shareholder of the company. The Wendeng 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 Wendeng 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 Wendeng and Strategic Alignment: WWBID is an important LIDC in Wendeng that is primarily responsible for the infrastructure construction and affordable housing construction within the region with strong franchised advantages. The company has been tasked to implement government policies relating to shanty town reconstruction and urban districts construction and has undertaken a number of key project construction projects within Wendeng. As the key entity for infrastructure and affordable housing construction in Wendeng, WWBID plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: WWBID received operational and financial support from the government. WWBID had received a total subsidy amount of c. RMB3.6 billion from 2019 to the first nine months of 2022, mainly including daily operating subsidies. The Wendeng government, through the Wendeng SASC, continued to inject cash, equity and other assets

Key Figures of Wendeng and WWBID

(RMB billion)	2021	2022
Wendeng		
GDP	54.0	50.9
GDP growth rate (%)	6.5	1.5
Budgetary revenue	4.7	4.0
Government fund	15.3	12.6
Transfer payment	2.0	2.7
Budgetary expenditure	5.4	7.5
WWBID	2021	2022.9
Assets	55.5	55.2
Equity	30.4	30.3
Revenue	3.1	2.4

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

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Applicable Criteria

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

into WWBID to expand its asset size and enhance its financial strength. The Wendeng government will repurchase some infrastructure and affordable housing construction projects and provide policy supports to WWBID to ensure its business operation. Given the franchise advantage in infrastructure and affordable housing construction in Wendeng, WWBID has advantages to obtain land resources and major projects. We believe WWBID is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

WWBID's Financial and Liquidity Position: WWBID's total assets showed a continuous growth trend in 2019-2021, and reached RMB55.2 billion at end-September 2022. The increase of WWBID's total assets was mainly due to the increase in inventories as a result of increasing infrastructure construction and affordable housing construction projects. Although WWBID had considerable current assets, its assets were illiquid, primarily due to the significant proportion of costs associated with construction projects and the receivables. WWBID's financial leverage (total liabilities to total assets) was 45.1% and its adjusted debt increased to c. RMB21.5 billion at end-September 2022. The liquidity of WWBID was tight. WWBID had an unrestricted cash balance and unused credit facilities of c. RMB0.2 billion and RMB1.2 billion at end-September 2022, respectively, compared with its debt due within one year of c. RMB6.9 billion. Having said that, WWBID 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 Wendeng: Wendeng is a district of Weihai City ("Weihai") of Shandong Province, and is located in the central of Weihai. Wendeng realized a GDP of RMB50.9 billion in 2022, representing a growth rate of 1.5%.

The aggregate fiscal revenue of the Wendeng government was mainly derived from the budgetary revenue and government fund income. The budgetary revenue of the Wendeng government was volatile and dropped by 13.7% to c. RMB4 billion in 2022. At the same time, the government-managed fund income was volatile and dropped by 18.1% in 2022. The Wendeng government's debt ratio (total outstanding debt/ aggregate fiscal revenue) was high and the outstanding government debt increased to RMB20.3 billion at end-2022.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Wendeng

Wendeng is a district of Weihai of Shandong Province, and is located in the central of Weihai. Wendeng has a total land area of c. 1,364 square kilometers. Wendeng had a residential population of c. 0.5 million with an urbanization rate of 57.1% at end-2021.

Wendeng realized a GDP of RMB50.9 billion in 2022, representing a growth rate of 1.5%. Wendeng's economic growth was mainly fueled by the secondary and tertiary industries, which accounted for 37.6% and 49.5% of Wendeng's GDP, respectively, in 2022. The fixed asset investment dropped by 13.7% in 2022. Meanwhile, Wendeng's GDP per capita reached c. RMB99,000 in 2022.

Wendeng's GDP and Fixed Asset Investment (RMB billion)	2020	2021	2022
GDP	47.5	54.0	50.9
-Primary industry (%)	12.1	11.7	12.9
-Secondary industry (%)	38.8	40.4	37.6
-Tertiary industry (%)	49.1	47.9	49.5
GDP growth rate (%)	3.2	6.5	1.5
Fixed asset investment	21.8	23.8	20.5
Fixed asset investment growth rate (%)	10.2	12.7	-13.7
Population (million)	0.5	0.5	0.5

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Wendeng

The aggregate fiscal revenue of the Wendeng government was mainly derived from the budgetary revenue and government-managed fund income. The budgetary revenue of the Wendeng government was volatile and dropped by 13.7% to c. RMB4 billion in 2022. The tax revenue accounted for 63-72% of the budgetary revenue in 2020-2022. The government-managed fund income was volatile and dropped by 18.1% in 2022.

The budget deficit of the Wendeng government increased to 84.7% in 2022, due to the decrease in the budgetary revenue and increase in the budgetary expenditure. The debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Wendeng government was high. The local government's outstanding debt increased from c. RMB17 billion at end-2020 to c. RMB20.3 billion at end-2022, mainly due to the increase in special purpose debt.

Wendeng's Fiscal Condition (RMB billion)	2020	2021	2022
Budgetary revenue	4.4	4.7	4.0
Budgetary revenue growth rate (%)	-2.0	5.8	-13.7
Tax revenue	3.1	3.4	2.5
Tax revenue (% of budgetary revenue)	70.3	71.7	62.7
Government fund income	14.8	15.3	12.6
Transfer payment	2.7	2.0	2.7
Aggregate revenue	22.0	22.0	19.4
Budgetary expenditure	5.9	5.4	7.5
Budget deficit¹ (%)	-32.4	-14.6	-84.7

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

WWBID was established in April 2012 with an initial registered capital of RMB100 million. At end-2022, WWBID's registered and paid-in capital was both RMB500 million. WWBID is wholly owned by Wendeng SASC.

Strategic Importance and Government Linkage

Strategic Importance of WWBID to Wendeng

WWBID is an important LIDC in Wendeng that is primarily responsible for the infrastructure construction and affordable housing construction within the region with strong franchised advantages. The company has been tasked to implement government policies relating to shanty town reconstruction and urban districts construction and has undertaken a number of key project construction projects within Wendeng. As the key entity for infrastructure and affordable housing construction in Wendeng, WWBID plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government's development plans.

Linkage with the Local Government

WWBID's linkage with the local government is strong as the Wendeng government holds full ownership of WWBID through the Wendeng SASC. The Wendeng 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 Wendeng 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

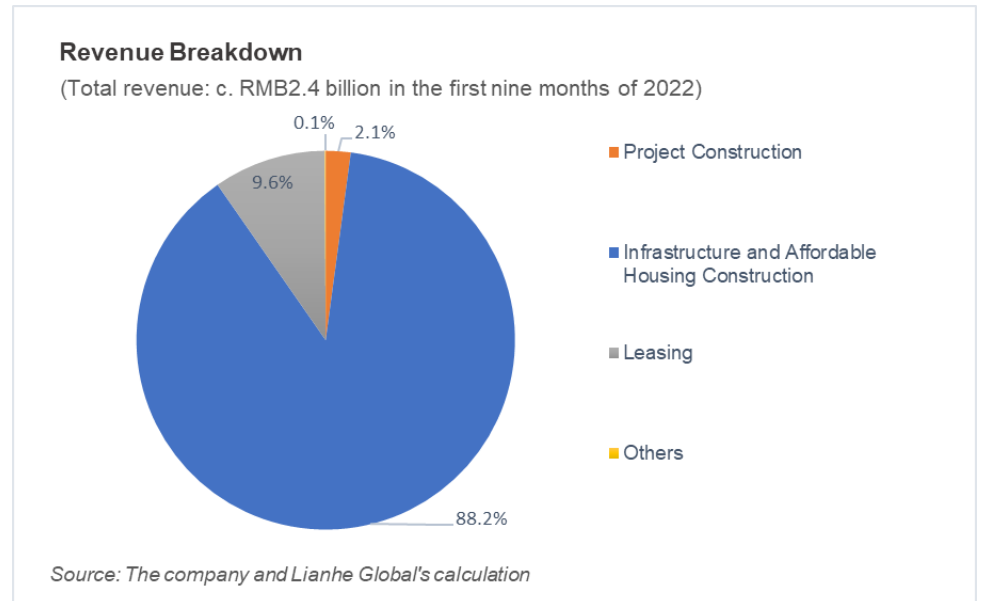
WWBID continued to receive financial subsidies, mainly including daily operating subsidies, from the local government to maintain its business operation. WWBID received subsidies of c. RMB888.4 million, RMB851.5 million, RMB897.7 million and RMB934.1 million in 2019, 2020, 2021 and the first nine months of 2022, respectively. The Wendeng government will repurchase some infrastructure and affordable housing projects and provide policy supports to WWBID to ensure its business operation. In addition, the Wendeng government, through the Wendeng SASC, continued to inject capital and equities into WWBID to enhance its financial strength and expand its asset size. Given the franchise advantages in infrastructure and affordable housing construction in Wendeng, WWBID has an advantage in acquiring land resources and major projects. We believe WWBID is likely going to receive government support in the form of operational and/or financial subsidies in the future.

Business Profile

The Key Entity Responsible for Infrastructure Construction and Affordable Housing Construction in Wendeng

WWBID, as an important LIDC in Wendeng, is mainly responsible for infrastructure and affordable housing construction, as well as the leasing of pipeline and sea area use right within the region. The company's strong franchise advantage enables it to undertake important infrastructure construction projects, shanty town reconstruction and urban districts construction under the instruction of the Wendeng government. Per management, the company will further engage in some urban renewal projects. As the key infrastructure and affordable housing construction entity in Wendeng, WWBID plays an important role in promoting economic and social development within the region.

The primary sources of operating revenue for WWBID included its project construction and infrastructure and affordable housing construction. The company experienced steady revenue growth over the past years, with revenue reaching of c. RMB2.9 billion, RMB3.1 billion and RMB2.4 billion in 2020, 2021 and the first nine months of 2022. The overall gross profit margin of WWBID remained stable at c. 23% in 2020 and 2021, but declined to 12.8% in the first nine months of 2022 due to the decreased gross margin from the affordable housing construction segment. In general, WWBID's business was relatively concentrated, and it has regional advantages in its major businesses.



Infrastructure and Affordable Housing Construction

The Wendeng government has entrusted the construction of affordable housing and related supporting infrastructure projects in the district to WWBID. The affordable housing construction business primarily involves the construction, development, management and sale of affordable housing in Wendeng, while the government pays for the project costs and a certain percentage of additional margin as the project revenue (agent construction model), or repurchase the affordable housing at the market price (self-operated model). Per management, WWBID plans to focus more on the latter mode in the future. The company's strategic importance regarding to this segment gives it a strong franchise advantage in Wendeng.

The segment revenue reached RMB1.9 billion, RMB2.3 billion and RMB2.1 billion in 2020, 2021 and the first nine months of 2022, respectively, with gross profit margins of 32.4%, 29.1% and 13.2% in the corresponding period. Most of the revenue of this segment was generated from the affordable housing construction. At end-September 2022, the company still had ongoing housing construction projects, where the scale of project under construction is large. Besides, the company may engage in some urban renewal projects, thus it may face a high capital expenditure pressure in the future.

Project Construction

WWBID is responsible for the construction and management of a number of key construction projects in Wendeng, including river improvement projects, water conservancy projects and cultural tourism investment and development projects. The company is mainly

commissioned by other state-owned enterprises in Wendeng. The project fee mainly includes construction costs incurred plus a mark-up percentage. The revenue in this segment was RMB625.1 million, RMB527 million and RMB0.5 million in 2020, 2021 and the first nine months of 2022, respectively. The revenue decrease in the first nine months of 2022 was mainly due to the reduction of related construction projects, as well as the timing of the revenue recognition process. Currently, the company is working on several large-scale projects, thus it incurs high capital expenditure pressure.

Leasing

WWBID's leasing business mainly comprises two sub-segments, namely leasing of sea area use right and pipeline leasing, where the former is the major source of revenue in this segment. The company leases the sea use rights it owns to state-owned enterprises in the region and recognizes the rental fee on a yearly basis. It also leases its pipeline assets to the Finance Bureau of Wendeng District and receives the maintenance and management fee. The segment revenue reached RMB303.3 million, RMB308 million and RMB227.2 million in 2020, 2021 and the first nine months of 2022, respectively, with a stable gross profit margin of 7-10%.

Other Businesses

Other businesses of WWBID include surveying and mapping and other related business in Wendeng, 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 and make the revenue structure more diversified.

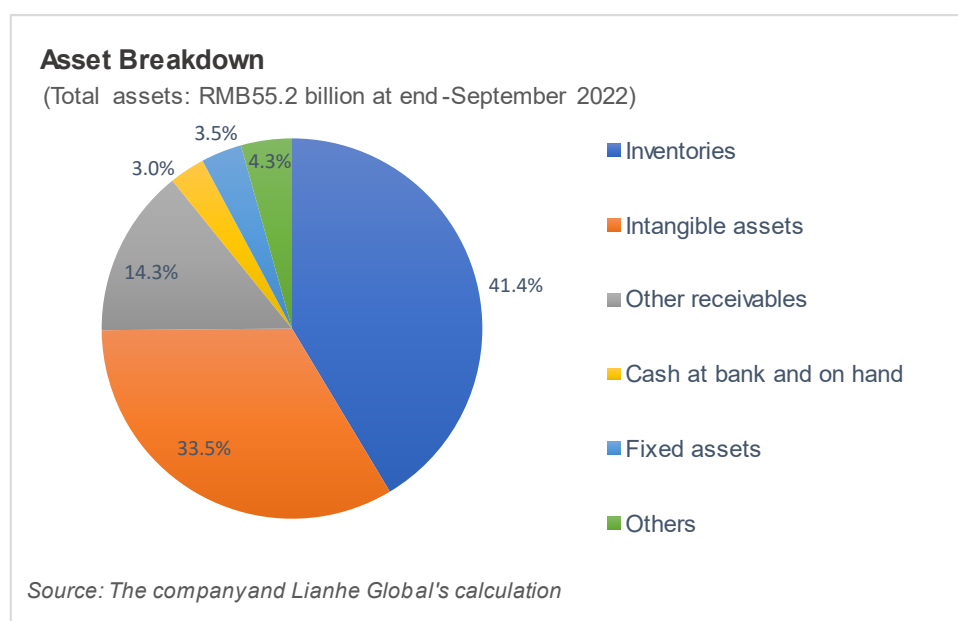
Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	2022.9
Total Asset	42,430	51,098	55,517	55,163
Equity	25,228	29,227	30,380	30,291
Debt	15,303	19,760	22,189	21,498
Debt / (Debt + Equity) (%)	37.8	40.3	42.2	41.5
LT Debt	11,685	16,206	15,363	14,634
LT Debt / (LT Debt + Equity) (%)	31.7	35.7	33.6	32.6

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

WWBID's total assets showed a continuous growth in 2019-2021, with a growth rate of 20.4% and 8.6% at end-2020 and end-2021, respectively, but decreased 0.6% to RMB55.2 billion at end-September 2022. The increase of WWBID's total assets was largely due to its inventories, which has steadily increased in tandem with the company's infrastructure and affordable housing construction projects. At end-September 2022, current assets accounted for c. 61.5% of its total assets. WWBID's assets mainly consisted of inventories, intangible assets, other receivables, cash at bank and on hand and fixed assets. Inventories included development costs associated with WWBID's core business operations, which increased in parallel with the growth of the relevant projects. Intangible assets mainly consisted of land use rights and sea use rights. Other receivables primarily comprised transactions with other state-owned enterprises in Wendeng, which had an aging period of mostly within two years, with controllable counterparty risk and low bad debt provision. Fixed assets were mainly houses and buildings for self-operating construction projects. Though WWBID had considerable current assets, its assets were illiquid, primarily due to the significant proportion of costs associated with construction projects and the receivables.



WWBID's financial leverage (total liabilities to assets) reached 40.5%, 42.8%, 45.3% and 45.1% at end-2019, end-2020, end-2021 and end-September 2022, respectively, indicating a relatively stable leverage level. In view of the relevant guidelines of the Wendeng government, we expect the financial leverage of WWBID to continue to stabilize at this level. WWBID's adjusted total debt increased slightly from c. RMB19.8 billion at end-2020 to c. RMB21.5 billion at end-September 2022, with short-term debt accounting for c. 31.9% of the total debt. There was no significant change in the equity structure of WWBID at end-September 2022, compared with that at end-2021, the majority of which was capital surplus, reaching RMB27.1 billion at end-September 2022. WWBID mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure and affordable housing related projects under construction and to be constructed in the future.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	9M2022
Cash Inflows from Operation	6,701	7,961	5,473	3,487
Cash Outflows from Operation	7,032	8,377	6,062	2,930
Net CF from Operation	-331	-416	-589	557
Cash Inflows from Investment	1,084	2,197	2,008	2,651
Cash Outflows from Investment	2,490	8,649	3,409	1,431
Net CF from Investment	-1,406	-6,452	-1,401	1,221
Cash Inflows from Financing	5,681	11,988	10,480	5,671
Cash Outflows from Financing	3,884	4,860	9,099	7,518
Net CF from Financing	1,797	7,128	1,381	-1,847
Net Increase in Cash and cash equivalent	62	257	-609	-66

Source: WWBID's financial reports

Debt Servicing Capability

The liquidity of WWBID was tight. At end-September 2022, WWBID had a cash balance and unused credit facilities of c. RMB1.7 billion and RMB1.2 billion, respectively, but a relatively high proportion of cash of RMB1.5 billion was restricted, compared with its debt due within one year of c. RMB6.9 billion at the same time. Having said that, per management, WWBID can borrow funds from other state-owned enterprises within the region through the unified allocation by the Wendeng SASC, which can help alleviate their liquidity pressures when necessary. Besides, WWBID 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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