

Qingdao Haike Holdings Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	11 May 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB’ global scale Long-term Issuer Credit Rating with Stable Outlook to Qingdao Haike Holdings Co., Ltd. (“QHH” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Jimo District, Qingdao City (“Jimo government”) would provide strong support to QHH if needed, in light of its indirect full ownership of QHH, QHH’s strategic importance as the key local investment and development company (“LIDC”) that is responsible for infrastructure construction and asset maintenance and management in Jimo District, Qingdao City (“Jimo”), especially in the Qingdao Oceanec Valley (“Oceanec Valley”), and the linkage between the Jimo government and QHH, 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 Jimo government may face significant negative impact on its reputation and financing activities if QHH encounters any operational and financial difficulties.

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

Rating Rationale

Jimo government’s Ownership and Supervision: The Jimo government indirectly holds 100% ownership of QHH through the Qingdao Oceanec Valley Authority (“Qingdao OVA”), and is the actual controller of the company. The Jimo 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 Jimo 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 Jimo and Strategic Alignment: QHH, as the main implementation body for infrastructure construction and asset maintenance and management in Jimo, is primarily responsible for the infrastructure construction projects in Jimo, especially in the Oceanec Valley, as well as the management, operation, value maintenance and appreciation of state-owned asset within the area, with strong franchised advantages. QHH plays an important role in promoting the economic and social development and of Jimo and Oceanec Valley. Its business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: QHH received operational and financial support from the government. QHH received subsidies from the local government from 2020 to 2022, mainly including operating subsidies. Meanwhile, the Jimo government continued to inject cash, engineering assets, equity and other assets into QHH through the Qingdao OVA to expand its asset size. Besides, the government will repurchase some infrastructure construction projects and provide policy supports to QHH to ensure its business operation. Given the franchise advantages in infrastructure construction in Oceanec Valley, QHH has advantage

Key Figures of Jimo and QHH

(RMB billion)	2021	2022
Jimo		
GDP	145.3	151.3
GDP growth rate (%)	6.9	2.6
Budgetary revenue	11.6	10.0
Government fund	12.2	5.8
Transfer payment	4.5	4.5
Budgetary expenditure	12.8	13.3
QHH		
Assets	31.6	37.6
Equity	16.4	20.5
Revenue	1.1	1.2

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

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Applicable Criteria

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

to obtain the major projects. We believe QHH is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

QHH's Financial Matrix and Liquidity Position: QHH's total assets showed a continuous growth trend in the past years and reached RMB37.6 billion at end-2022 mainly due to the increase of long-term equity investment. The current assets of QHH accounted for c. 73.1% of the total assets at end-2022, but the overall assets were less liquid due to high development cost and large-scale receivables. QHH's financial leverage (total liabilities to assets) remained stable at c. 45.6%-48.1% from end-2019 to end-2022. QHH's adjusted total debt increased to c. RMB14.4 billion at end-2022. The liquidity of QHH was tight. At end-2022, QHH had unrestricted cash balance and unused credit facilities of c. RMB129.3 million and c. RMB310 million, respectively, compared with its debt due within one year of c. RMB4.5 billion at the same time. Having said that, QHH 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 Jimo: Jimo is located in the north of the Qingdao City ("Qingdao"). It is one of the seven urban districts of Qingdao. Jimo recorded an economic growth in 2022, achieving a GDP of c. RMB151.3 billion, with a year-on-year growth of 2.6%. Its total GDP ranks third among all districts and counties in Qingdao. The aggregate fiscal revenue of the Jimo government was mainly derived from the budgetary revenue and government fund income. In 2022, the budgetary revenue of the Jimo government decreased to c. RMB10 billion due to the large-scale value-added tax credit refunds to support the economy. At the same time, the government fund income dropped to c. RMB5.8 billion in 2022 from c. RMB12.2 billion in 2021. The budget deficit increased to -33.5%, while the debt ratio (i.e., total government debt divided by aggregate revenue) of the Jimo government increased to 80.4% at end-2022.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Jimo

Jimo is a municipal district of Qingdao City, Shandong Province ("Qingdao"), and is located in the north of the central urban areas of Qingdao. Jimo has jurisdiction over 4 towns and 11 streets, with a total area of 1,793 square kilometers. Besides, it owns one provincial economic development zone, one provincial high-tech industrial zone, and one provincial tourism resort. At end-2021, Jimo had a resident population of c. 1.4 million, with an urbanization rate of 59.1%.

Jimo maintained steady economic growth in the past three years. Jimo's GDP reached c. RMB151.3 billion, representing a year-over-year growth rate of 2.6% in 2022, and its GDP ranked the 3rd among all districts and county-level cities under the administration of Qingdao. Featured with "marine economy", Jimo focused on the development of high-tech industries,

equipment manufacturing, textile and clothing in recent years. Jimo's economic growth was mainly fueled by the secondary and tertiary industries in the past few years, which accounted for 50.3% and 43.9% in 2022, respectively.

Qingdao Oceantec Valley, formerly known as Jimo Provincial High-tech Industrial Zone, was established in January 2001 and renamed as the present one in November 2017. With a total planned land and sea area of 443 square kilometers, Qingdao Oceantec Valley features marine high-tech R&D and industrial clusters.

Jimo's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	127.8	145.3	151.3
-Primary industry (%)	6.0	5.8	5.9
-Secondary industry (%)	49.3	50.8	50.3
-Tertiary industry (%)	44.7	43.4	43.9
GDP growth rate (%)	5.8	6.9	2.6
Fixed asset investment	147.5	156.1	163.7
Fixed asset investment growth rate (%)	4.4	5.8	4.9
Population (million)	1.3	1.4	1.4

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Jimo

The Jimo government's aggregate fiscal revenues are mainly derived from budgetary income and government fund income. The Jimo government's budgetary revenue decreased to c. RMB9.96 billion in 2022 from c. RMB11.6 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. In contrast, its budgetary expenditure increased to RMB13.3 billion from RMB12.8 billion. Therefore, the Jimo government's budget deficit was enlarged to -33.5% over the same period.

Jimo's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	11.2	11.6	10.0
Budgetary revenue growth rate (%)	0.1	3.6	1.0
Tax revenue	8.0	9.1	6.4
Tax revenue (% of budgetary revenue)	71.3	78.6	64.4
Government fund income	16.5	12.2	5.8
Transfer payment	2.0	4.5	4.5
Aggregate revenue	29.7	28.3	20.3
Budgetary expenditure	12.8	12.8	13.3
Budget deficit ¹ (%)	-14.5	-10.2	-33.5

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

In addition, Jimo's government fund income, mainly generated by land sales, dropped to c. RMB5.8 billion in 2022 from c. RMB12.2 billion, owing to the weak property market. As a result, the Jimo government recorded aggregate revenue of RMB20.3 billion in 2022, downed from RMB28.3 billion in 2021. Besides, its government debt grew significantly in 2022, lifting the government debt ratio, as measured by total government debt/aggregate revenue, to 80.4% from 39.7% over the same period, mainly due to the increase in special purpose debt.

Ownership Structure

Government's Ownership

QHH, formerly known as Qingdao New Aoshan Industrial Development Co., Ltd., was established in December 2012 with an initial registered capital of RMB10 million. In June 2022, the original shareholder, Aoshanwei Street Planning and Construction Service Center, transferred 100% of the company's equity to Qingdao OVA without compensation, and the shareholder of the company changed to Qingdao OVA. In addition, the company was renamed as the present one and the registered capital of the company increased to RMB 3.0 billion, of which Qingdao OVA contributed RMB0.99 billion by the way of cash and equity.

At end-2022, QHH's registered and paid-in capital of QHH were RMB3.0 billion and RMB1.0 billion, respectively. QHH is wholly owned by Qingdao OVA.

Strategic Importance and Government Linkage

Strategic Importance of QHH to Jimo

QHH, as the main implementation body for infrastructure construction and asset maintenance management in Jimo, is primarily responsible for the infrastructure construction projects in Jimo, especially in the Oceantec Valley, as well as the asset management, operation, value maintenance and appreciation of state-owned asset within the area, with strong franchised advantages. QHH plays an important role in promoting the economic and social development and of Jimo and Oceantec Valley. Its business operation and development have been aligned with the government's development plans.

Linkage with the Local Government

QHH's linkage with the local government is strong as the Jimo government indirectly holds 100% ownership of QHH through the Qingdao OVA. The Jimo 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 Jimo 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

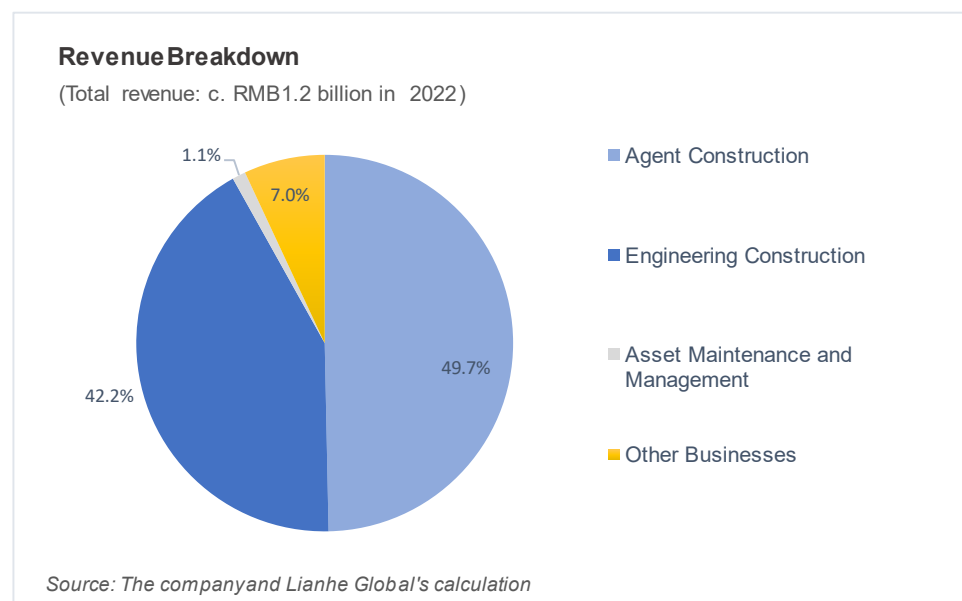
QHH continued to receive financial subsidies, mainly including operating subsidies from the local government to maintain its business operation. QHH received subsidies from the local government in 2020 and 2022. Meanwhile, the Jimo government continued to inject cash, engineering assets, equity and other assets into QHH through the Qingdao OVA to expand its asset size. In June 2022, Qingdao OVA transferred 100% of the equity of Qingdao Ocean Science and Technology Investment and Development Group Co. Ltd., to the company without compensation. Besides, the government will repurchase some infrastructure construction projects and provide policy supports to QHH to ensure its business operation. Given the franchise advantages in infrastructure construction in Oceantec Valley, QHH has advantage to obtain the major projects. We believe QHH 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 Infrastructure Construction and Asset Maintenance and Management in Jimo and Qingdao Ocean Tec Valley

QHH, as an important LIDC in Jimo and Qingdao Ocean Tec Valley, is mainly responsible for infrastructure construction and asset maintenance and management in the area. The company's strong franchise advantage enables it to undertake important land consolidation and infrastructure construction projects under the instruction of the Jimo government and Qingdao OVA. As the core platform designated by the Jimo to implement its infrastructure construction and had an important role in the construction of Qingdao Ocean Tec Valley, QHH has received strong support from shareholders and the government in terms of capital injection, asset transfer and government subsidies, driving the rapid growth of owner's equity year by year.

The primary sources of operating revenue for QHH are agent construction, while it also engaged in real estate sales and leasing, labor dispatch, catering and hotel services. The company's total revenue reached c. RMB1.2 billion, RMB1.2 billion, RMB1.1 billion and RMB1.2 billion in 2019, 2020, 2021 and 2022, respectively, representing a steady trend. The overall gross profit margin of QHH remained stable at c. 12%-13% from 2019 to 2022. In general, QHH's business was relatively concentrated, and it has regional advantages in its major businesses.



Agent Construction

QHH is designated by the Jimo government and Qingdao OVA to undertake the infrastructure construction business in the region, including infrastructure construction, resettlement housing and school projects. The company's monopoly on infrastructure construction in Jimo gives it a strong franchise advantage in the region. The projects in this segment are generally conducted under the agent construction model, where the revenue recognition includes construction costs incurred plus a certain percentage of profit. Its revenue in this segment was relatively stable over the past years, with c. RMB573.7 million, RMB547.4 million, RMB543.9 million and RMB583.9 million in 2019, 2020, 2021 and 2022, respectively. Its revenue in this segment was relatively stable, with 13%-23% between 2019

and 2022. Currently, the company is working on several large-scale projects, thus it incurs high capital expenditure pressure.

Asset Maintenance and Management

The asset maintenance management business of QHH is mainly handled by its subsidiary Qingdao Haike Group Co., Ltd. (“Haike Group”), which is authorized by Qingdao OVA to maintain and manage the allocated assets. Qingdao OVA allocated some assets to Haike Group, including housing buildings, parks, internal roads, pipeline networks and supporting facilities in the park, and agreed with Haike Group, that Haike Group shall pay the funds required for the construction, maintenance and management of the relevant assets, and can receive a fixed management fee annually from the Qingdao OVA. Haike Group recognized the income from asset maintenance and management in accordance with the agreement, and the relevant cost includes depreciation of fixed assets and expenses of asset maintenance and management.

Other Businesses

Other businesses of QHH include real estate sales and leasing, property management, merchandise sales, catering and hotel, technical and consulting services and labor dispatch service, 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 and make the revenue structure more diversified.

Financial Profile

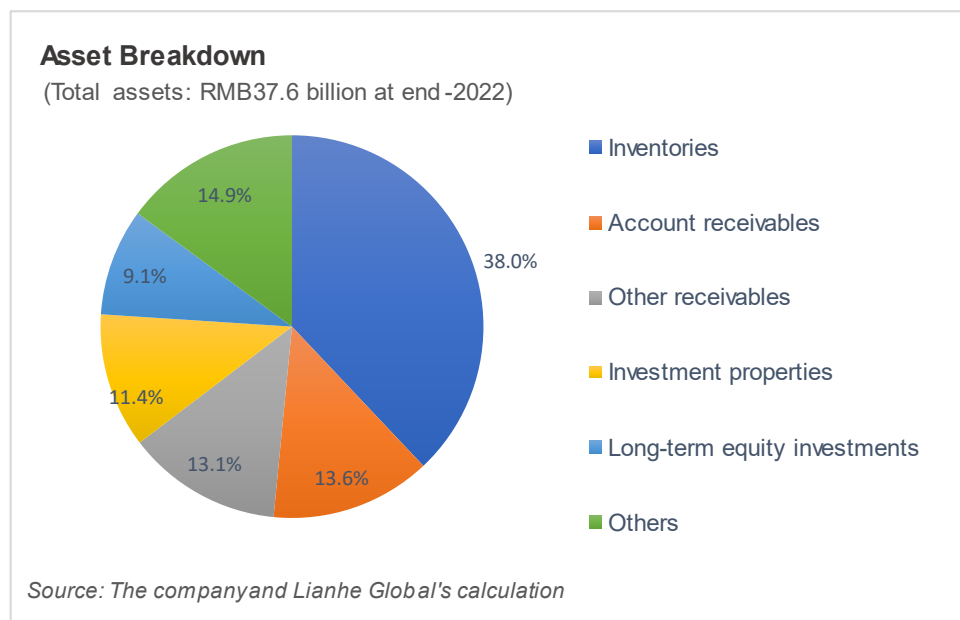
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality			
(RMB million)	2020	2021	2022
Total Asset	28,144	31,580	37,605
Equity	14,751	16,375	20,454
Debt	11,028	13,578	14,397
Debt / (Debt + Equity) (%)	42.8	45.3	41.3
LT Debt	7,565	9,487	10,007
LT Debt / (LT Debt + Equity) (%)	33.9	36.7	32.9

Source: Company information and Lianhe Global's calculations

QHH's total assets showed a continuous growth in the past few years, with a growth rate of 12.2% and 19.1% at end-2021 and end-2022, respectively, and reached RMB37.6 billion at end-2022. The increase of QHH's total assets in 2022 was largely due to its long-term equity investment, which increased due to the transfer of sea use rights from Qingdao OVA to Qingdao Aoshan Bay Marine Ecological Technology Co., Ltd. (“QABME”), an associate that QHH holds 49% of its shares. At end-2022, QHH's assets mainly consisted of inventories, account receivables, other receivables, investment properties and long-term equity investment. The inventories included development costs associated with QHH's core business operations, which increased in parallel with the growth of the relevant projects. Account receivables mainly included project settlement payments from Qingdao OVA, which increased with the development of the company's agent construction business. Other receivables were mainly transactions with Qingdao OVA and other government agencies, such as land reservation fees. QHH's account receivables and other receivables had both an aging period of mostly more than 1 year, with high concentration of indebted party,

controllable counterparty risk and low bad debt provision. The investment properties included buildings and land use rights, some of which had not completed the title certificate. QHH's current assets accounted for a relatively large proportion of total assets, reaching 73.1% at end-2022. Its assets were illiquid, primarily due to the significant proportion of costs associated with construction projects and receivables.



QHH's financial leverage (total liabilities to assets) remained stable at c. 45.6%-48.1% from end-2020 to end-2022, its adjusted total debt increased moderately from c. RMB11 billion at end-2020 to c. RMB14.4 billion at end-2022, mainly due to the increase in long-term borrowings and bonds payable. The short-term debt and long-term debt accounted for c. 30.5% and 69.5% of the total debt at end-2022, respectively. There was no significant change in the ownership equity structure of QHH at end-2022, compared with that at end-2020. The capital surplus and paid-in capital increased to RMB17.3 billion and RMB1 billion at end-2022 from RMB13.1 billion and RMB10 million at end-2020, respectively. QHH mainly relies on external financing to support its capital expenditures and debt repayments, which we expect to increase in the future given its agent construction projects under construction and to be constructed in the future.

Debt Servicing Capability

The liquidity of QHH was tight. At end-2022, QHH had unrestricted cash balance and unused credit facilities of c. RMB129.3 million and RMB310 million, respectively, compared with its debt due within one year of c. RMB4.5 billion at the same time. Having said that, QHH 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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