

# Qingdao Military-Civilian Integration Development Group Co., Ltd

## Initial Issuer Report

### Summary

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

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

### Summary

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

The Stable Outlook reflects our expectation that QMIDG’s strategic importance would remain intact while the West Coast New Area government will continue to ensure QMIDG’s stable operation.

### Rating Rationale

**West Coast New Area government’s Ownership and Supervision:** The West Coast New Area government indirectly holds 100% ownership of QMIDG through the Qingdao West Coast New Area State-owned Assets Administration (“West Coast New Area SAA”), via Qingdao Economic and Technological Development Zone Investment Holding Group Co., Ltd. (“QETDZ”), and is the actual controller of the company. The West Coast New Area 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 West Coast New Area 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 West Coast New Area and Strategic Alignment:** QMIDG, as the main implementation body for infrastructure construction and innovative industries integration in West Coast New Area, is primarily responsible for the infrastructure construction projects in Qingdao West Coast New Area, especially the core area of Guzhenkou (“Guzhenkou”) and Qingdao Economic and Technological Development Zone (“Qingdao ETDZ”) among its ten functional areas, as well as the construction of industrial parks related to innovation integration and equity investment in related projects to promote the implementation of innovation integration strategy of the region, with strong franchised advantages. QMIDG plays an important role in promoting the economic development and innovation integration of the region. Its business operation and development have been aligned with the government’s development plans.

### Key Figures of West Coast New Area and QMIDG

(RMB billion)	2021	2022
West Coast New Area		
GDP	436.9	469.2
GDP growth rate (%)	10.3	4.8
Budgetary revenue	26.1	22.4
Government fund	25.6	19.5
Transfer payment	6.6	7.5
Budgetary expenditure	25.5	24.2
QMIDG	2021	2022.9
Assets	65.6	78.4
Equity	20.4	24.2
Revenue	15.1	15.2

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

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### Applicable Criteria

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

**Ongoing Government Support:** QMIDG received operational and financial support from the government. QMIDG had received a total subsidy amount of c. RMB108.3 million from 2019 to the first nine months of 2022, mainly including operating subsidies. Meanwhile, the West Coast New Area government continued to inject cash, project-specific funds, financial fund and other assets into QMIDG to expand its asset size. Besides, the West Coast New Area government provides policy supports to QMIDG to ensure its business operation. We believe QMIDG is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

**QMIDG's Financial Matrix and Liquidity Position:** QMIDG's total assets showed a continuous growth trend in the past years and reached RMB78.4 billion at end-September 2022 mainly due to the increase of inventories, which has increased in tandem with the company's construction projects. The current assets of QMIDG accounted for c. 67.1% of the total assets as of end-September 2022, but the overall assets were less liquid due to high development cost. QMIDG's financial leverage (total liabilities to assets) remained stable at c. 69% from end-2019 to end-September 2022, and 69.1% at end-September 2022. QMIDG's adjusted total debt increased to c. RMB43.77 billion at end-September 2022. The liquidity of QMIDG was moderate. At end-September 2022, QMIDG had unrestricted cash balance and unused credit facilities of c. RMB4.85 billion and RMB14.04 billion, respectively, compared with its debt due within one year of c. RMB15.96 billion at the same time. Besides, QMIDG 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 West Coast New Area:** The West Coast New Area is located in the southwest of the Qingdao City ("Qingdao"). It is one of the seven urban districts of Qingdao. West Coast New Area recorded an economic growth in 2022, achieving a GDP of c. RMB469.2 billion, with a year-on-year growth of 4.8%. Its total GDP ranks first among all districts and counties in Qingdao. The aggregate fiscal revenue of the West Coast New Area government was mainly derived from the budgetary revenue and government fund income. In 2022, the budgetary revenue of the West Coast New Area government reached c. RMB22.4 billion, but the tax revenue decreased due to the large-scale value-added tax credit refunds to support the economy. At the same time, the government fund income was more volatile, dropping to c. RMB19.5 billion in 2022 from c. RMB25.6 billion in 2021. The fiscal self-sufficiency rate of the West Coast New Area government was sufficient, but it recorded budget deficit of 8.0% in 2022, the first budget deficit in the past few years. Given the West Coast New Area government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 107.8% at end-2022.

### Rating Sensitivities

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

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

## Operating Environment

### Economic Condition of West Coast New Area

West Coast New Area, also known as Huangdao District, is an administrative district of Qingdao City, Shandong Province ("Qingdao"), located in the southwest of Qingdao. By the end of 2021, West Coast New Area had a total area of 2,128 square kilometers, jurisdiction over 10 functional areas, 13 streets, and a residential population of 2.0 million, with an urbanization rate of 82.8%.

West Coast New Area maintained steady economic growth in the past three years. West Coast New's GDP reached c. RMB469.2 billion, representing a year-over-year (y-o-y) growth rate of 2.0% in 2022, and its GDP ranked the first among all districts and counties under the administration of Qingdao. West Coast New's economic growth was entirely fueled by the secondary and tertiary industries in the past few years, which accounted for 35.9% and 62.1% in 2022, respectively. GDP per capita of West Coast New Area was c. RMB238,900 in 2022, which was higher than the GDP per capita of China (c. RMB85,700) as well as that of Qingdao's (c. RMB145,400).

<b>West Coast New's GDP and Fixed Asset Investment</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
GDP	372.2	436.9	469.2
-Primary industry (%)	2.2	2.1	2.0
-Secondary industry (%)	37.6	37.5	35.9
-Tertiary industry (%)	60.2	60.4	62.1
GDP growth rate (%)	3.9	10.3	4.8
Fixed asset investment	343.0	358.8	377.1
Fixed asset investment growth rate (%)	1.5	4.6	5.1
Population (million)	1.9	2.0	2.0

Source: Public information and Lianhe Global's calculations

### Fiscal Condition of West Coast New Area

The West Coast New Area government's aggregate fiscal revenues are mainly derived from budgetary revenue and government fund income. The tax revenue accounted for 70-78% of its budgetary revenue between 2020 and 2022. The fiscal self-sufficiency rate of the West Coast New Area government was sufficient, but it recorded budget deficit of 8.0% in 2022, the first budget deficit in the past few years. Moreover, the government fund income was fluctuant, of which the growth rate was -25.1%, 7.5% and -23.9% in 2020, 2021 and 2022, respectively.

The outstanding debt of the West Coast New Area government continued to grow. At end-2022, the West Coast New Area government's outstanding debt was c. RMB53.3 billion, including RMB4.3 billion of general obligations and RMB49.0 billion of special debt. Given the West Coast New Area government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 107.8% at end-2022 from 19.6% at end-2018.

<b>West Coast New's Fiscal Condition</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Budgetary revenue	25.7	26.1	22.4
Budgetary revenue growth rate (%)	0.9	1.5	2.7*

Tax revenue	19.7	20.2	15.8
Tax revenue (% of budgetary revenue)	76.5	77.5	70.4
Government fund income	23.8	25.6	19.5
Transfer payment	5.1	6.6	7.5
<b>Aggregate revenue</b>	<b>54.6</b>	<b>58.3</b>	<b>49.4</b>
Budgetary expenditure	22.2	25.5	24.2
Budget deficit <sup>1</sup> (%)	13.5	2.1	-8.0

<sup>1</sup> 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

QMIDG was established in April 2014 with an initial registered capital of RMB3 billion, funded by Qingdao Huangdao Development (Group) Co., Ltd. (holding 90% of the shares) and Qingdao Lingshanwan Development and Construction Co., Ltd. (holding 10% of the shares). As of end-March 2022, all the company's equity has been transferred to QETDZ after the reduction of its registered capital and multiple equity transfers, after which QETDZ has become the sole shareholder of the company.

As of end-September 2022, the major shareholder of QETDZ is Qingdao West Coast New Area Integration Holdings Group Co., Ltd. ("QWIH") (holding 51% of the shares, while the remaining 49% is held by the West Coast New Area SAA, and the actual controller is the West Coast New Area SAA. At the same time, the West Coast New Area SAA is the actual controller of QMIDG through the indirect holding of 100% of the company's equity via QWIH and QWTDZ. The ultimate controller of the company is the West Coast New Area government. The company's registered capital was c. RMB2.38 billion, while the paid-in capital was c. RMB1.87 billion as of end-September 2022.

## Strategic Importance and Government Linkage

### Strategic Importance of QMIDG to West Coast New Area

QMIDG, as the main implementation body for infrastructure construction and integration of innovative industries in West Coast New Area, is primarily responsible for the infrastructure construction projects in Guzhenkou and Qingdao ETDZ among the ten functional areas of West Coast New Area, as well as the construction of industrial parks, office buildings, R&D center, security center and other projects related to innovation integration and equity investment in related projects to promote the implementation of innovation integration strategy of the region, with strong franchised advantages. QMIDG plays an important role in promoting the economic development and innovation integration of the region. Its business operation and development have been aligned with the government's development plans.

### Linkage with the Local Government

QMIDG's linkage with the local government is strong as the West Coast New Area government indirectly holds 100% ownership of QMIDG through the West Coast New Area SAA, via the QETDZ. The West Coast New Area 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 West Coast New Area 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**

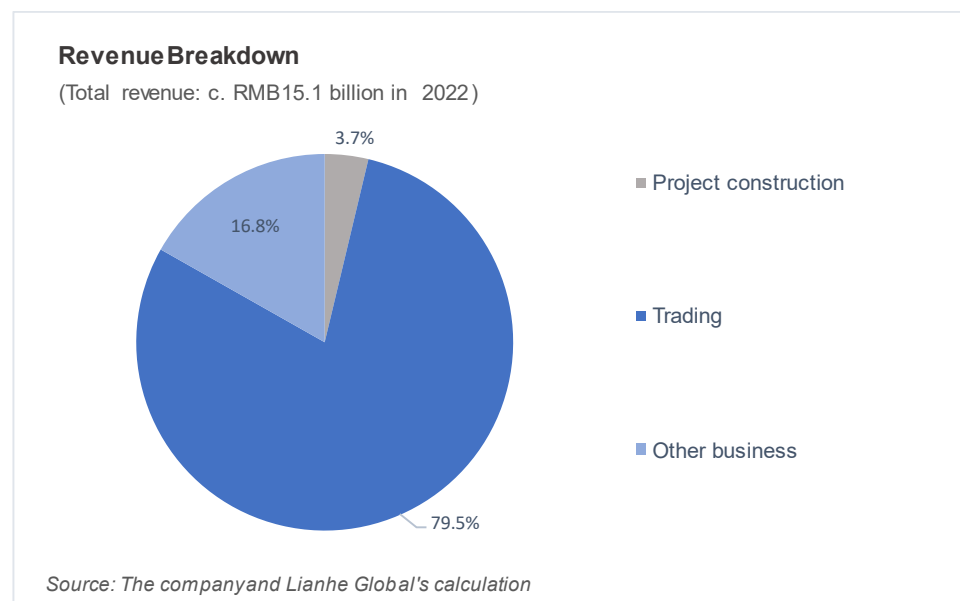
QMIDG continued to receive financial subsidies, mainly including operating subsidies from the local government to maintain its business operation. QMIDG received subsidies of c. RMB8.3 million, RMB4.9 million, RMB48.4 million and RMB46.7 million in 2019, 2020, 2021 and first nine months of 2022, respectively. Meanwhile, the West Coast New Area government continued to inject cash, project-specific funds, financial fund and other assets into QMIDG to expand its asset size, which reached RMB3.4 billion, RMB3.2 billion, RMB5.3 billion and RMB2.1 billion in 2019, 2020, 2021 and first nine months of 2022, respectively. Besides, the West Coast New Area government provides policy supports to QMIDG to ensure its business operation. We believe QMIDG is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation. We believe QMIDG 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 innovative industries integration in West Coast New Area**

QMIDG, as the key LIDC in West Coast New Area, is mainly responsible for infrastructure construction in Guzhenkou and Qingdao ETDZ. It undertakes the construction of municipal projects and surrounding environment construction projects in the area according to the development plan of the West Coast New Area government. Moreover, as the main body of the implementation of the innovation integration strategy of the West Coast New Area, QMIDG also undertakes the construction of industrial parks related to innovation integration and equity investment in related projects. The company is supported by the financial resources of the West Coast New Area government, and establishes good cooperative relations with government departments in various fields. Therefore, QMIDG has rich project resources, strong franchised advantages in infrastructure construction and innovation integration industries, and good development prospects within the region.

The primary sources of operating revenue for QMIDG are its project construction and trading business. The company's revenue was relatively stable over the past three years, with revenue reaching of c. RMB7.4 billion, RMB14.5 billion, RMB15.2 billion and RMB15.1 billion for 2019, 2020, 2021 and the first nine months of 2022, respectively. The fast revenue growth in the 2020 was primarily attributable to the expansion of trading business. The overall gross profit margin stayed stable as well and it remains at 4.9%-5.4% from 2019 to the first nine months of 2022. In general, QMIDG's business was diversified, and it has regional advantages in its major businesses.



## Project Construction

QMIDG focuses on the infrastructure construction in the two of West Coast New Area's functional areas, Guzhenkou and Qingdao ETDZ, as well as core start-up area of Wangtai New Functional Industrial Base, mainly including municipal projects construction, roads construction, surrounding environment projects construction and some area renovation projects. The company adopts an agent construction mode for the project construction business, where it signs construction agreements with its entrusted party (such as the management committees of each functional area) and is responsible for financing and construction of the projects. The company settles the construction costs with an additional profit of approximately 8% with the entrusted party based on the completion time of the projects. In addition, the company also undertakes highway construction projects.

The revenue in this segment was RMB1.3 billion, RMB2.2 billion, RMB2.0 billion and RMB0.6 billion in 2019, 2020, 2021 and the first nine months of 2022, respectively. The lower revenue in the first nine months of 2022 was mainly due to the fact that most projects have not yet reached the completion settlement standard, resulting in less collection. The gross profit margin remained steady at c.7.2%-8.1%. The number of agent construction projects of the company is increasing year by year. As of end-September 2022, QMIDG had a large-scale of infrastructure and district renovation projects that were either under construction or planned to be built. Therefore, QMIDG incurs high capital expenditure pressure.

## Trading

As an important source of revenue for QMIDG, the trading segment makes the company's business more diversified and plays a complementary role to its main business. The trading business contributes significantly to the company's revenue, but the profit margin is relatively small. QMIDG mainly engages in the trading of coal, steel, cement, timber, copper and non-ferrous metals. It usually manages business risks by locking in upstream and downstream customers and product prices (such as adopting a "demand-driven" mode, which 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. RMB5.1 billion, RMB10.5 billion, RMB10.8 billion and RMB11.5 billion in 2019, 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. 1.5%-2% for the past three years. The suppliers and customers of the segment are concentrated, and most of them are private enterprises, indicating a counterparty risk.

### Innovation Integration

As the main body of the implementation of the innovation integration strategy of the West Coast New Area, QMIDG is responsible for the construction of related projects and participates in integrated innovation industry projects through equity investment to promote the implementation of the innovation integration strategy and attracting investment in the region. This segment has a strong franchised advantage in the region. The company gathers capital through innovation integration special funds, bonds issuance, financing leases, and other means, and mainly realizes returns through rental income or equity investment income. The overall funding cycle of this segment is long and the income realization is relatively uncertain.

### Other Businesses

Other businesses of QMIDG include ship manufacturing and sales, commercial housing business, concrete production and sales, casting production and sales, engineering construction and installation and property leasing 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. The commercial housing development mainly includes residential houses, stores and garages, which are mainly concentrated in the West Coast New Area.

## Financial Profile

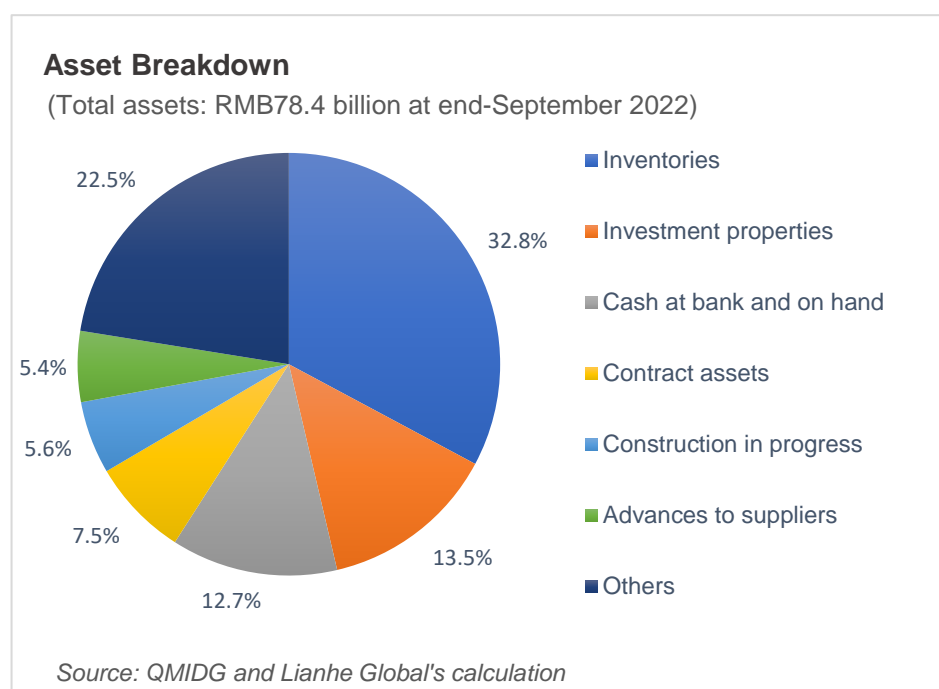
### Balance Sheet Structure and Quality

<b>Balance Sheet Structure and Quality</b>				
<b>(RMB million)</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>Sep 2022</b>
Total Asset	32,069	44,625	65,632	78,449
Equity	9,874	13,916	20,401	24,228
Debt	15,002	24,058	33,782	43,774
Debt / (Debt + Equity) (%)	60.3	63.4	62.3	64.4
LT Debt	9,287	15,781	21,915	27,816
LT Debt / (LT Debt + Equity) (%)	48.5	53.1	51.8	53.4

*Source: Company information and Lianhe Global's calculations*

QMIDG's total assets showed a continuous growth in the past few years, with a growth rate of 39.2%, 47.1% and 19.5% at end-2020, end-2021 and end-September 2022, respectively,

and reached RMB78.4 billion at end-September 2022. The increase of QMIDG's total assets was largely due to its inventories, which has increased in tandem with the company's construction projects. At end-September 2022, QMIDG's assets mainly consisted of inventories, investment properties, cash at bank and on hand, contract assets, construction in progress and advances to suppliers. The inventories included development costs associated with QMIDG's core business operations, which increased in parallel with the growth of the relevant projects. The investment properties included buildings and land use rights used for rental or appreciation. The contract assets are a newly added accounting item from 2021. According to the new accounting standards, part of the project receivable of agent construction projects were reclassified from inventories to contract assets. The construction in progress primarily comprised of the costs of projects, such as the Qingdao Science and Education Park of Chinese Academy of Sciences, the Rongfa Xuhai New Materials Science and Technology Park and equipment, and the 35,000 tons lifting force floating dock, with the construction of the ongoing projects progresses and the investment in the projects increased, the overall scale showed an upward trend. The advances to suppliers were mainly aroused from advance payments for project, equipment, and goods. QMIDG's current assets accounted for a relatively large proportion of total assets, reaching 67.1% at end-September 2022, but due to its high development costs, QMIDG's overall assets were less liquid.



QMIDG's financial leverage (total liabilities to assets) remained stable at c. 69% from end-2019 to end-September 2022, and 69.1% at end-September 2022. QMIDG's adjusted total debt increased significantly from c. RMB15.0 billion at end-2019 to c. RMB43.77 billion at end-September 2022, mainly due to the increase in long-term borrowings, bonds payable and finance leases, of which short-term debt and long-term debt accounted for c. 36.5% and 63.5% of the total debt at end-September 2022, respectively. There was no significant change in the ownership equity structure of QMIDG at end-September 2022, compared with that at end-2021. The capital surplus increased to RMB16.83 billion at end-September 2022 from RMB6.47 billion at end-2019. QMIDG mainly relies on external financing to support its





capital expenditures and debt repayments, which we expect to increase in the future given its infrastructure projects under construction and to be constructed in the future.

### **Debt Servicing Capability**

The liquidity of QMIDG was moderate. At end-September 2022, QMIDG had unrestricted cash balance and unused credit facilities of c. RMB4.85 billion and RMB14.04 billion, respectively, compared with its debt due within one year of c. RMB15.96 billion at the same time. Besides, QMIDG 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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