

## Haiyang Haifa Water Group Co., Ltd.

### Initial Issuer Report

#### Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	19 June 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Haiyang Haifa Water Group Co., Ltd. (“HHWG” or “the company”)

#### Summary

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

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

#### Rating Rationale

**Haiyang Government’s Ownership and Supervision:** The Haiyang government holds the full ownership of HHWG through Haiyang Finance Bureau. The Haiyang 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 Haiyang government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

**Strategic Importance to Haiyang and Strategic Alignment:** HHWG is primarily responsible for infrastructure construction and utilities operation within the region. HHWG 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:** HHWG received operational and financial support from the government. HHWG received a total subsidy amount of c. RMB276.9 million from 2020 to 2022, mainly including operating subsidies. We believe HHWG is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

**HHWG’s Financial Matrix and Liquidity Position:** HHWG’s total assets showed a continuous growth in the past few years, with a growth rate of 31.1% and 24.8% at end-2021 and end-2022, respectively, and reached RMB10.9 billion at end-2022. The increase of HHWG’s total assets in 2022 was largely due to its construction in progress. HHWG had large proportion of non-current assets (68.7% at end-2022), its overall asset liquidity was weak. HHWG’s financial leverage (total liabilities to assets) reached 22.6%, 30.1% and 41.8% at end-2020, end-2021 and end-2022, respectively, representing an upward trend due to the increasing Long-term payable. HHWG’s total adjusted debt increased to c.

#### Key Figures of Haiyang and HHWG (RMB billion)

	2021	2022
<b>Haiyang</b>		
GDP	46.0	49.8
GDP growth rate (%)	6.0	4.5
Budgetary revenue	3.1	3.0
Government fund	2.6	2.6
Transfer payment	1.5	1.7
Budgetary expenditure	4.4	4.6
<b>HHWG</b>	<b>2021</b>	<b>2022</b>
Assets	8.8	10.9
Equity	6.1	6.4
Revenue	0.4	0.4

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

#### Analysts

Ben Yau  
 +852 3462 9586  
[ben.yau@lhratingsglobal.com](mailto:ben.yau@lhratingsglobal.com)

Toni Ho  
 (852) 3462 9578  
[toni.ho@lhratingsglobal.com](mailto:toni.ho@lhratingsglobal.com)

#### Applicable Criteria

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

RMB2.8 billion at end-2022. The liquidity of HHWG was tight. At end-2022, HHWG had unrestricted cash balance and unused credit facilities of c. RMB0.15 billion and RMB0.33 billion, respectively, compared with its debt due within one year of c. RMB0.77 billion at the same time. Therefore, the company must successfully roll over its short-term bank borrowings (end-2022: c. RMB0.53 billion) and obtain additional financing sources or government support to maintain its liquidity.

**Economy and Fiscal Condition of Haiyang:** Haiyang is a county-level city of Yantai City, Shandong Province, and is located in the southern end of Jiaodong Peninsula. Haiyang's economic growth fluctuated in the past three years due to the COVID-19 pandemic, with a year-over-year growth rate of -1.5%, 6.0% and 4.5% in 2020, 2021 and 2022, respectively. Haiyang's GDP reached RMB49.8 billion in 2022, and ranked the 7th among all districts and county-level cities under the administration of Yantai. The Haiyang government's aggregate fiscal revenues are mainly derived from budgetary income and government fund income. The Haiyang government's budgetary revenue decreased to c. RMB3.0 billion in 2022 from c. RMB3.1 billion in 2021. In contrast, its budgetary expenditure increased to RMB4.6 billion in 2022 from RMB4.4 billion in 2021. Therefore, the Haiyang government's budget deficit was enlarged to -52.3% over the same period. The debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 160.6% at end-2022 from 125.4% at end-2020, mainly due to the increase in special debt.

### Rating Sensitivities

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

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

### Operating Environment

#### Economic Condition of Haiyang

Haiyang is a county-level city of Yantai City, Shandong Province, and is located in the southern end of Jiaodong Peninsula. Haiyang has jurisdiction over 18 towns and streets, with a land area of 1,909 square kilometers and a sea area of 1,829 square kilometers. Besides, it owns one national tourism resort, one provincial economic development zone, and one provincial industrial park. At end-2020, Haiyang had a resident population of c. 0.6 million, with an urbanization rate of 50.3%.

Haiyang's economic growth fluctuated in the past three years due to the COVID-19 pandemic, with a year-over-year growth rate of -1.5%, 6.0% and 4.5% in 2020, 2021 and 2022, respectively. Haiyang's GDP reached RMB49.8 billion in 2022, and ranked the 7th among all districts and county-level cities under the administration of Yantai. Haiyang's economic growth was mainly fueled by the secondary and tertiary industries in the past few years, which accounted for 35.6% and 44.5% in 2022, respectively. Apart from traditional industries like sweater production and equipment manufacturing, Haiyang focused on the

development of marine engineering, IT, biochemical engineering, automobile, nuclear and wind power, aerospace industry in recent years.

<b>Haiyang's GDP and Fixed Asset Investment</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
GDP	42.0	46.0	49.8
-Primary industry (%)	19.9	19.8	19.9
-Secondary industry (%)	33.4	34.0	35.6
-Tertiary industry (%)	46.7	46.2	44.5
GDP growth rate (%)	-1.5	6.0	4.5
Fixed asset investment	56.0	52.1	54.2
Fixed asset investment growth rate (%)	0.1	-7.0	4.0

*Source: Public information, the company and Lianhe Global's calculations*

## Fiscal Condition of Haiyang

The Haiyang government's aggregate fiscal revenues are mainly derived from budgetary income and government fund income. The Haiyang government's budgetary revenue decreased to c. RMB3.0 billion in 2022 from c. RMB3.1 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. In contrast, its budgetary expenditure increased to RMB4.6 billion in 2022 from RMB4.4 billion in 2021. Therefore, the Haiyang government's budget deficit was enlarged to -52.3% over the same period. Meanwhile, Haiyang's government fund income and transfer payment remained relatively stable in 2022, recording at RMB2.6 billion and RMB1.7 billion, respectively.

The debt ratio of the Haiyang government was high. At end-2022, the Haiyang government's outstanding debt was c. RMB11.8 billion, including c. RMB6.9 billion of general obligations and c. RMB4.8 billion of special debt. The debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 160.6% at end-2022 from 125.4% at end-2020, mainly due to the increase in special debt.

<b>Haiyang's Fiscal Condition</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Budgetary revenue	3.0	3.1	3.0
Budgetary revenue growth rate (%)	7.0	3.2	6.3*
Tax revenue	1.5	2.0	1.6
Tax revenue (% of budgetary revenue)	50.6	65.5	54.0
Government fund income	1.4	2.6	2.6
Transfer payment	1.9	1.5	1.7
<b>Aggregate revenue</b>	<b>6.3</b>	<b>7.2</b>	<b>7.3</b>
Budgetary expenditure	4.5	4.4	4.6
Budget deficit <sup>1</sup> (%)	<b>-48.0</b>	<b>-42.4</b>	<b>-52.3</b>

<sup>1</sup> Budget deficit = (1-budgetary expenditure / budgetary revenue) \* 100%

\*Excluding the influence of value-added tax credit refund

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

## Ownership Structure

### Government's Ownership

HWG was established in March 2019 with an initial registered capital of RMB100 million, funded by Haiyang Finance Bureau. The registered capital of the company increased by RMB 400 million and RMB300 million in June and September 2021, respectively, with the authorization of Haiyang State-owned Assets Supervision and Administration Bureau.

By the end of 2022, HHWG's registered capital and paid-in capital were RMB800.0 million and RMB732.4 million, respectively. HHWG is wholly owned by Haiyang Finance Bureau.

## Strategic Importance and Government Linkage

### Strategic Importance of HHWG to Haiyang

HHWG is primarily responsible for infrastructure construction and utilities operation within the region. HHWG 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.

### Strong Linkage with the Local Government

The Haiyang government holds the full ownership of HHWG through Haiyang Finance Bureau. The Haiyang 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 Haiyang government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

### Government Support

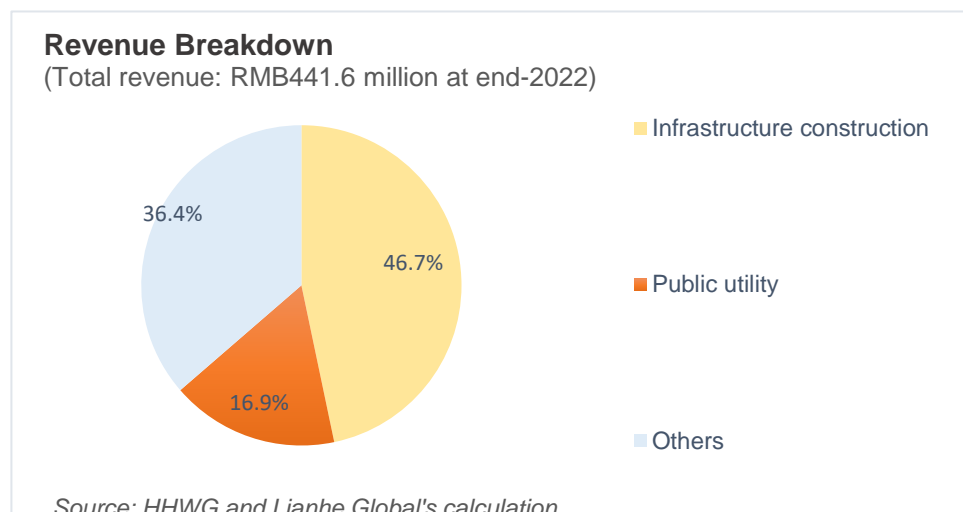
HHWG continued to receive financial subsidies, mainly including operating subsidies, from the local government to maintain its business operation. HHWG received subsidies of c. RMB85 million, RMB80 million and RMB111.9 million in 2020, 2021 and 2022, respectively. We believe HHWG is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

## Business Profile

### The important Entity Responsible for Infrastructure Construction and State-owned Asset Operation in Haiyang

As an important LIDC in Haiyang, HHWG is mainly responsible for infrastructure construction, public utility operation, industrial park development and operating, industrial investment, etc. Besides, the company also undertakes the task of non-performing assets disposal under the instruction of the Haiyang government. As the important infrastructure construction and state-owned asset operating entity in Haiyang, HHWG plays a vital role in promoting economic and social development within the region.

The primary source of operating revenue for HHWG is infrastructure construction, and it also engaged in nuclear heating, water supply, landscape maintenance, port service, power supply installation, etc. The company's total revenue reached RMB394.9 million, RMB407.8 million and RMB441.6 million in 2020, 2021 and 2022, respectively. The overall gross profit margin of HHWG increased to c. 20% in 2022 from c. 15% in 2020. In general, HHWG's business was relatively concentrated, and it has regional advantages in its major businesses.



### Infrastructure Construction

HHWG is designated by the Haiyang government to undertake the infrastructure construction projects, including infrastructure investment, industrial park development and operating and industrial investment, with a strong franchise advantage within the region. The company adopts both agent construction and self-operated models. Under the agent construction model, the company signs the agent construction agreements with the entrusting party (e.g., Haiyang government and related state-owned enterprises) and is responsible for fundraising and construction of entrusted projects. The company settles construction costs plus a percentage of management fees annually with the entrusting party according to the project's progress. Under the self-operated model, the company constructs the projects with internal and external funds, and operates them for rental income upon completion. Currently, the company is working on several large-scale projects, thus it incurs high capital expenditure pressure.

### Public Utility

HHWG's public utility business mainly includes nuclear heating in urban areas and water supply in rural areas of Haiyang, and has a strong franchise advantage within the region. By leveraging the nuclear power resources in Haiyang, the company is responsible for the construction of nuclear heating pipelines and supporting facilities connecting the nuclear power plants with heating companies. As the sole water supplier in rural areas of Haiyang, the company is responsible for the integrated operation of urban and rural water supply as well as the construction and operation of drinking water safety projects in rural areas. The revenue in this segment was limited in the past three years, with a very low gross profit margin.

### Other Businesses

Other businesses of HHWG include landscape maintenance, port services and power supply installation, 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.

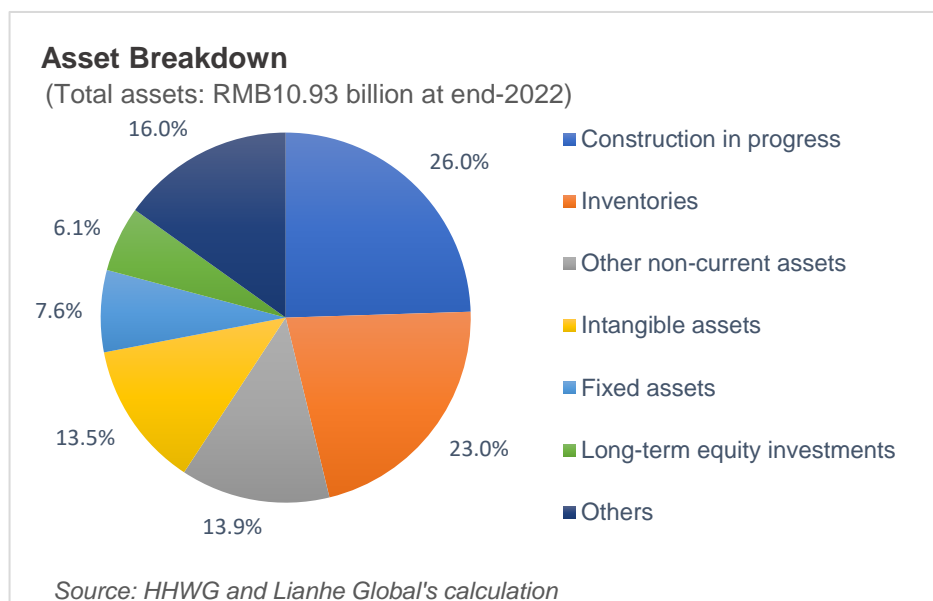
## Financial Profile

### Balance Sheet Structure and Quality

<b>Balance Sheet Structure and Quality</b>			
<b>(RMB million)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Total Asset	6,681	8,759	10,928
Equity	5,174	6,122	6,361
Debt	510	1,233	2,834
Debt / (Debt + Equity) (%)	9.0	16.8	30.82
LT Debt	436	953	2,064
LT Debt / (LT Debt + Equity) (%)	7.8	13.5	24.50

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

HHWG's total assets showed a continuous growth in the past few years, with a growth rate of 31.1% and 24.8% at end-2021 and end-2022, respectively, and reached RMB10.9 billion at end-2022. The increase of HHWG's total assets in 2022 was largely due to its construction in progress. HHWG's assets mainly consisted of construction in progress, inventories, other non-current assets, intangible assets, fixed assets and long-term equity investments. The construction in progress mainly included the cost of rural water supply integration project and nuclear heating project (Phase I and II). Inventories mainly included construction cost of infrastructure construction projects, which increased in parallel with the growth of the relevant projects. Other non-current assets was the obligatory right purchased by the company from Haiyang Rural Commercial Bank. Intangible assets was mainly land use rights, which increased 71% over 2021, mainly due to the company obtained the mining rights for mine projects. Fixed assets primarily comprised of houses and buildings as well as non-performing assets recovered buildings. The long-term equity investments is an investment in the associate company, Dongfang Aerospace Port (Shandong) Development Group Co., Ltd. HHWG had large proportion of non-current assets (68.7% at end-2022), its overall asset liquidity was weak.



HHWG's financial leverage (total liabilities to assets) reached 22.6%, 30.1% and 41.8% at end-2020, end-2021 and end-2022, respectively, representing an upward trend due to the increasing Long-term payable. HHWG's total adjusted debt increased by 456.0% from c. RMB0.5 billion at end-2020 to c. RMB2.8 billion at end-2022, mainly due to the increase of new projects with the rapid development of the company in recent years. The short-term debt and long-term debt accounting for c. 27.2% and c. 72.8% of the total debt at end-2022. There was no significant change in the ownership equity structure of HHWG at end-2022, compared with that at end-2020. HHWG mainly relies on external financing to support its capital expenditures and debt repayment, which we expect to increase in the future given its infrastructure related projects under construction and to be constructed in the future.

### Debt Servicing Capability

The liquidity of HHWG was tight. At end-2022, HHWG had unrestricted cash balance and unused credit facilities of c. RMB0.15 billion and RMB0.33 billion, respectively, compared with its debt due within one year of c. RMB0.77 billion at the same time. Therefore, the company must successfully roll over its short-term bank borrowings (end-2022: c. RMB0.53 billion) and obtain additional financing sources or government support to maintain its liquidity.





## Disclaimer

Credit rating and research reports published by Lianhe Ratings Global Limited (“Lianhe Global” or “the Company” or “us”) are subject to certain terms and conditions. Please read these terms and conditions at the Company’s website: [www.lhratingsglobal.com](http://www.lhratingsglobal.com)

A credit rating is an opinion addresses the creditworthiness of an entity or security. Credit ratings are not a recommendation to buy, sell, or hold any security. Credit ratings do not address market price, marketability, and/or suitability of any security nor its tax implications or consequences. Credit ratings may be subject to upgrade or downgrade or withdrawal at any time for any reason at the sole discretion of Lianhe Global.

All credit ratings are the products of a collective effort by accredited analysts through rigorous rating processes. No individual is solely responsible for a credit rating. All credit ratings are derived by credit committee vesting processes. The individuals identified in the reports are solely for contact purpose only.

Lianhe Global conducts its credit rating services based on third-party information which we reasonably believe to be true. Lianhe Global relies on information including, but not limited to, audited financial statements, interviews, management discussion and analysis, relevant third-party reports, and publicly available data sources to conduct our analysis. Lianhe Global has not conducted any audit, investigation, verification or due diligence. Lianhe Global does not guarantee the accuracy, correctness, timeliness, and/or completeness of the information. Credit ratings may contain forward-looking opinions of Lianhe Global which may include forecasts about future events which by definition are subject to change and cannot be considered as facts.

Under no circumstance shall Lianhe Global, its directors, shareholders, employees, officers and/or representatives or any member of the group of which Lianhe Global forms part be held liable to any party for any damage, loss, liability, cost, expense or fee in connection with any use of the information published by the Company.

Lianhe Global receives compensation from issuers, underwriters, obligors, or investors for conducting credit rating services. None of the aforementioned entity nor its related party participate in the credit rating process aside from providing information requested by Lianhe Global.

Credit ratings included in any rating report are solicited and disclosed to the rated entity (and its agents) prior to publishing. Credit rating and research reports published by Lianhe Global are not intended for distribution to, or use by, any person in any jurisdiction where such use would infringe local laws and regulations. Any user relies on information available through credit rating and research reports is responsible for consulting the relevant agencies or professionals accordingly to comply with the applicable local laws and regulations.

All published credit rating and research reports are the intellectual property of Lianhe Global. Any reproduction, redistribution, or modification, in whole or parts, in any form by any means is prohibited unless such user has obtained prior written consent from us.

Lianhe Global is a subsidiary of China Lianhe Credit Rating Co., Ltd. The credit committee of Lianhe Global has the ultimate power of interpretation of any methodology or process used in the Company’s independent credit ratings and research.

Copyright © Lianhe Ratings Global Limited 2023.