

# Qingdao China Prosperity State-owned Capital Investment Operation Group Co., Ltd.

## Initial Issuer Report

### Summary

Issuer Rating	A
Outlook	Positive
Location	China
Industry	Local Investment and Development Companies
Date	5 June 2023

### Key Figures of Qingdao and QCP (RMB billion)

	2021	2022
<b>Qingdao</b>		
GDP	1,413.6	1,492.1
GDP growth rate (%)	8.3	3.9
Budgetary revenue	136.8	127.3
Budgetary expenditure	170.6	169.6
<b>QCP</b>		
Asset	46.6	51.9
Equity	20.9	21.3
Revenue	5.1	6.7

Source: Public information, QCP and Lianhe Global's calculations

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'A' global scale Long-term Issuer Credit Rating with Positive Outlook to Qingdao China Prosperity State-owned Capital Investment Operation Group Co., Ltd. ("QCP" or "the company")

### Summary

The Issuer Credit Rating reflects a high possibility that the Qingdao Municipal Government would provide strong support to QCP if needed, in light of its full ownership of QCP, QCP's strategic importance as the key local investment and development company ("LIDC") that is responsible for state-owned asset management and industry investment and operation in Qingdao City ("Qingdao"), and the linkage between the Qingdao Municipal Government and QCP, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing government support. In addition, the Qingdao Municipal Government may face significant negative impact on its reputation and financing activities if QCP encounters any operational and financial difficulties.

The Positive Outlook reflects QCP's increasing strategic importance in Qingdao and linkage with the Qingdao Municipal Government, and our expectation that the Qingdao Municipal Government will continue to ensure QCP's stable operation.

### Rating Rationale

**Government's Ownership and Supervision:** The Qingdao Municipal Government holds 100% shares of QCP through the State-owned Assets Supervision and Administration Commission of Qingdao ("Qingdao SASAC"). The Qingdao Municipal Government also has strong control over the company, including appointment and supervision of the senior management, strategic alignment, major investment and financing planning decisions. In addition, the Qingdao Municipal Government has formulated a performance assessment policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

**Strategic Importance and Strategic Alignment:** As a key state-owned assets operation and management entity in Qingdao, QCP is positioned as the major entity for strategic adjustment of state-owned capital layout structure and the transformation platform for supervision of state-owned capital operation. QCP is the pioneer to promote the reform of state-owned enterprises on behalf of the Qingdao Municipal Government. The Qingdao SASAC has endowed QCP with a large number of functional government functions, guided the company to actively carry out the integration and operation of state-owned capital, led the deepening reform of the state-owned assets system, and promoted the transformation and development of Qingdao's state-owned assets system. QCP plays an important role in promoting the economic and social development of the region. Its business

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### Applicable Criteria

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

operation and development have been aligned with the government's development plans.

**Ongoing Government Support:** QCP continues to receive capital and asset injections from the Qingdao Municipal Government. The injections include but not limited to cash, equity capital, right-of-use assets or other fixed assets. Especially, the Qingdao Municipal Government has transferred a large number of equities of state-owned entities to QCP as equity injections, including the transfer of Qingdao Municipal Government's ownership of Hisense Company Limited ("Hisense") in 2020. Also, QCP receives a wide variety of governmental subsidies from the Qingdao Municipal Government. QCP received government subsidies of c. RMB629 million in 2020-2022. We believe QCP is likely going to receive government support in the future.

**Economy and Fiscal Condition of Qingdao:** The total GDP of Qingdao remained the highest among all cities in Shandong Province in 2022. It realized GDP of c. RMB1,492.1 billion in 2022, representing a year-on-year growth rate of 3.9%. Qingdao's aggregate fiscal revenues are mainly derived from budgetary revenue and government fund income. In 2022, affected by the extraordinary value-added tax (VAT) credit refund policy, the budgetary revenue of Qingdao was c. RMB127.3 billion and the percentage of tax revenue decreased. Qingdao's had a total outstanding debt amount of approximately RMB308 billion at end-2022, including RMB102 billion of general obligations and RMB206 billion of special debt.

**QCP's Financial and Liquidity Position:** QCP's total assets showed a continuous growth trend in the past few years, with growth rate of 6.1% and 11.5% at end-2021 and end-2022, respectively. The asset increase was mainly due to the increase in financial assets and debt and equity investments. The asset structure was stable, with long-term equity investments, financial assets held for trading, other receivables, fixed assets and investment properties accounting for c. 54% of total assets at end-2022. QCP's financial leverage (total liabilities to total assets) increased steadily from 53.7% at end-2020 to 59.1% at end-2022. The total debt of the company was c. RMB20.8 billion, of which short-term debt accounted for c. RMB10.0 billion. QCP's liquidity was moderate. At end-2022, QCP had a total cash balance of c. RMB2.3 billion, of which unrestricted cash was c. RMB1.8 billion, and a total bank credit line of c. RMB39.6 billion, of which c. RMB23.0 billion was available, compared with its debt to be due within one year of c. RMB10.0 billion. QCP has access to multiple financing channels including bank borrowings, corporate bonds and other financing channels. Bank loans, corporate bonds and other financing channels accounted for c. 46%, 48% and 6% of QCP's total debt, respectively.

### Rating Sensitivities

We would consider downgrading QCP's rating if (1) there is perceived weakening in support from the Qingdao Municipal Government, particularly due to its reduced strategic importance with diminished government functions, or (2) commercial-oriented operations may significantly jeopardize QCP's overall credit profile, or (3) there is a significant reduction of the Qingdao Municipal Government's ownership of QCP, or (4) there is a downgrade in our internal credit assessment on the Qingdao Municipal Government.

We would consider upgrading QCP's rating if (1) there is an upgrade in our internal credit assessment on the Qingdao Municipal Government, or (2) there is strengthened support from the Qingdao Municipal Government, or (3) there is a continuing demonstration of the strengthening of QCP's strategic importance in Qingdao.

## Operating Environment

### Economic Condition of Qingdao

Qingdao is a municipality with an independent planning status enjoying provincial-level status in the economic planning and independent budgetary status directly linked to the central government. The total GDP of Qingdao remained the highest among all cities in Shandong Province in 2022. It realized GDP of c. RMB1,492.1 billion in 2022, representing a year-on-year growth rate of 3.9%. QCCI's economic structure was stable, of which the proportion of tertiary industry and secondary industry accounted for 62.0% and 34.8% of its GDP in 2022, respectively.

<b>Qingdao's GDP and Fixed Asset Investment</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
GDP	1,240.1	1,413.6	1,492.1
-Primary industry (%)	3.4	3.3	3.2
-Secondary industry (%)	35.2	35.6	34.8
-Tertiary industry (%)	61.4	61.1	62.0
GDP growth rate (%)	3.7	8.3	3.9
Fixed asset investment	1,053.1	1,096.2	1,145.6
Fixed asset investment growth rate (%)	3.2	4.1	4.5
Population (million)	10.1	10.1	10.1

Source: Public information and Lianhe Global's calculations

### Fiscal Condition of Qingdao

Qingdao's aggregate fiscal revenues are mainly derived from budgetary revenue and government fund income. In 2022, affected by the value-added tax (VAT) credit refund policy, the budgetary revenue of Qingdao was c. RMB127.3 billion and the percentage of tax revenue decreased to 69.2%. We expect that the subsidies from upper-level government will increase, due to the higher fiscal deficit in Qingdao in 2022. The government fund income was more volatile, due to the property market and policies. According to available information, the government fund income for the first 11 months of 2022 was c. RMB76.7 billion, representing a year-on-year decrease of 26.5%, mainly due to the property market and policy that resulting in a decrease of land transfer income.

Qingdao's had a total outstanding debt amount of approximately RMB308 billion at end-2022, including RMB102 billion of general obligations and RMB206 billion of special debt. The increase of total outstanding debt amount, mainly due to the increase in special debt, resulting in a higher debt ratio (i.e. total government debt divided by aggregate revenue) compared with last year.

<b>Qingdao's Fiscal Condition</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Budgetary revenue	125.4	136.8	127.3
Budgetary revenue growth rate (%)	1.0	9.1	15.5

Tax revenue	89.9	101.7	88.1
Tax revenue (% of budgetary revenue)	71.7	74.3	69.2
Government fund income <sup>2</sup>	117.0	119.3	-
Transfer payment <sup>2</sup>	31.4	25.9	-
<b>Aggregate revenue<sup>2</sup></b>	<b>275.0</b>	<b>284.0</b>	<b>-</b>
Budgetary expenditure	158.5	170.6	169.6
Budget deficit <sup>3</sup> (%)	-26.4	-24.7	-33.2

<sup>1</sup> Excluding the influence of value-added tax credit refund.

<sup>2</sup> Lack of Information for 2022

<sup>3</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

### Full Government Ownership

Established in 2008 with an initial registered capital of RMB2.0 billion, QCP is a state-owned enterprise ("SOE") in Qingdao of the Shandong Province with fully diversified industrial coverage. As a state-owned platform commissioned by the Qingdao Municipal Government to promote industrial development and SOE reform, QCP is wholly owned by, and under the direct supervision of, the Qingdao SASAC.

## Strategic Importance and Government Linkage

### Strategic Importance of QCP to Qingdao

As a key state-owned assets operation and management entity in Qingdao, QCP is positioned as the major entity for strategic adjustment of state-owned capital layout structure and the transformation platform for supervision of state-owned capital operation. QCP is the pioneer to promote the reform of state-owned enterprises on behalf of the Qingdao Municipal Government. Qingdao SASAC has endowed QCP with a large number of functional government functions, guided the company to actively carry out the integration and operation of state-owned capital, led the deepening reform of the state-owned assets system, and promoted the transformation and development of Qingdao's state-owned assets system.

### Linkage with the Local Government

Qingdao SASAC (which is appointed by the Qingdao Municipal Government to supervise state-owned entities) is the sole shareholder with 100% ownership. The Qingdao SASAC has strong control and supervision over QCP, including control of the board of directors and the supervisory committee, approvals of senior managers and major operating and financing plans. QCP's strategic planning and development have been aligned with the government's economic and social policies. As the sole controlling shareholder of QCP, the Qingdao SASAC, together with various authorities within the Qingdao Municipal Government, closely participates in and affects the decision-making of QCP's key investments and operations. The senior management of QCP are appointed by the Qingdao Municipal Government. QCP has regular discussions with the Qingdao SASAC and follows requisite appraisal procedures to ensure that informed and viable investment and other managerial decisions are made. Furthermore, the Qingdao

Development and Reform Commission has historically supported key projects, including facilitating the filing and approval process, providing guidance to the core businesses of QCP and assisting QCP in obtaining financing from policy banks.

### Ongoing Government Support

QCP continues to receive capital and asset injections from the Qingdao Municipal Government. The injections include but not limited to cash, equity capital, right-of-use assets or other fixed assets. Especially, the Qingdao Municipal Government has transferred a large number of equities of state-owned entities to QCP as equity injections, including the transfer of Qingdao Municipal Government's ownership of Hisense. QCP also receives a wide variety of governmental subsidies from the Qingdao Municipal Government.

### Business Profile

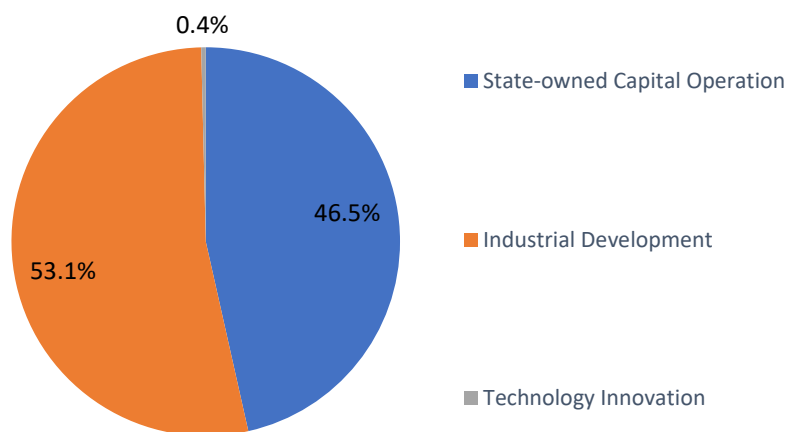
#### A key state-owned assets operation and management entity in Qingdao

Established in 2008, QCP has been the only operational platform of the state-owned assets in Qingdao and is designated to manage and operate the assets and manpower of the textile, machinery and light industries that were centrally managed by the Qingdao Municipal Government previously. Over the years, QCP has expanded its industrial coverage and has received strong financial and operational support from the Qingdao Municipal Government.

The total revenue of QCP amounted to c. RMB4,010 million, RMB5,140 million and RMB6,686 million in 2020-2022, respectively. The company's gross margin maintained moderate at c. 22.0%-27.5% during the past three years, resulted from the surge in revenue from the high-margin state-owned capital operation business. As the primary business segment which contributed c. 46.5% of QCP's total revenue in 2022, the revenue from state-owned capital operation increased sharply to c. RMB3.1 billion in 2022 from RMB1.1 billion in 2020.

#### Revenue Breakdown

(Total Revenue: RMB6.7 billion for 2022)



Source: The company and Lianhe Global's calculation



### State-owned Capital Operation

Since its inception, QCP has actively participated in the reform of state-owned capital and asset and SOE management system. Focusing on state-owned capital strategic deployment, economic transformation and upgrading and enhancing SOE reform, QCP has effectively promoted the reform, development and industrial transformation of the SOEs in Qingdao. The state-owned capital operation business consists of (i) financial services business and (ii) capital operation business.

The financial services business includes financing guarantees, small loans, entrusted loan, pawn services and financial leases. The financing guarantees business is mainly conducted by the Qingdao Guarantee Centre of Qingdao Co., Ltd., a wholly-owned subsidiary of the company. The business has an established relationship with more than 20 large domestic state-owned commercial banks, policy banks and joint stock banks, providing loan guarantees to key government projects as well as to state-owned, private-owned and high-tech companies. In terms of the financial leases, QCP conducts the business by providing clients with customized financial solutions, including direct financial leases and sale-leaseback. QCP provides leasing solutions and repayment arrangements customized for the clients' sales cycle and cash flow pattern thereby satisfying such corporate clients' fixed asset investment needs. In addition, QCP provides small loan and pawn services mainly to SOE clients. This business has been dedicated to support the community construction of the city and rural areas and service the financial and business need of the clients.

The capital operation business mainly includes distressed asset management. As the government debt restructuring platform and vehicle to eliminate the non-performing assets, QCP plays an important role in assuming distressed assets including non-performing debts, equities and liabilities, and replacing non-performing loans and bad debts from QCP's predecessors and its affiliates. The Qingdao Municipal Government also transfers distressed assets to QCP and designates QCP to operate such assets. QCP has developed a broad set of diversified and innovative methods in the disposal of non-performing assets, including consolidation, M&A, restructuring, transfer, replacement, debt-equity swap, debt repayment in real assets, lease, listing, auction, bankruptcy and liquidation. QCP generates the revenue from its capital operation business by disposing the distressed assets and such revenue is used to fund the working capital and repayment of the external facilities of QCP.

As the financial services are more sensitive to the economic cycle as cyclical businesses, we expect the counterparty risk of the financial services to be high.

### Capital Investment

Apart from the capital operation business, QCP also engages in capital investment activities as instructed by the Qingdao Municipal Government. As an important operational platform of the state-owned assets in Qingdao, QCP participated in equity investment in a large number of listed and unlisted enterprises, including Hisense Company Limited, Aucma Company Limited. The income generated was recognized in the consolidated income statement as Investment Income and Income From Changes In Fair Value instead of being

recognized as the company's total revenue, which may impose significant impact on QCP's net profit. The investment incomes were RMB3,340 million, RMB1,722 million and RMB1,805 million in 2020, 2021 and 2022, respectively, while the incomes from changes in fair value were RMB-31.3 million, RMB-172.0 million and RMB6 million in 2020, 2021 and 2022 respectively. Additionally, following the consolidation of Hisense, QCP recognized the equity investment income from Hisense Company Limited of over c. RMB1 billion annually, leading to a boost in the investment income during the same period. We expect the investment income from Hisense Company Limited to continue to play an important role in QCP's profitability in the future.

### **Industrial Development**

As the largest business segment of QCP, the industrial development business consists of (i) consumer goods manufacturing, (ii) equipment manufacturing, (iii) electronic information business, (iv) industrial investment business, (v) business, travel, and real estate businesses, (vi) professional technology services, (vii) shipbuilding, (viii) real estate leasing, (ix) transportation operation and (x) other manufacturing.

The consumer goods manufacturing includes food, electronics devices, plastic products, footwear, apparel, and art products. The equipment manufacturing includes casting machinery, steel castings, power station valves, dust cleaning equipment, automobile parts, vessel boilers, bearings, and turbines. The shipbuilding business of QCP is mainly carried out by Qingdao Shipyard Co., Ltd., which entered bankruptcy reorganization procedure in December 2016 and was consolidated into QCP in 2018.

The industrial development segment has maintained a stable gross margin of c. 12%-19% and steady growth in revenue in the past three years. The income generated from the industrial development segment of QCP was c. RMB2.8 billion, RMB3.4 billion and RMB3.6 billion in 2020-2022, respectively.

### **Technology Innovation**

To facilitate the technological advancement and high-end upgrading of the manufacturing industry, QCP engages in technology innovation business consisting of (i) venture capital, (ii) new energy and (iii) technology services. The income generated from the technology innovation business of QCP was c. RMB63.7 million, RMB25.7 million and RMB25.1 million in 2020-2022, respectively. Despite the small amount of revenue generated from the technology innovation segment, QCP has received timely financial supports and government grants from the Qingdao Municipal Government for the business.

## Financial Profile

### Balance Sheet Structure and Quality

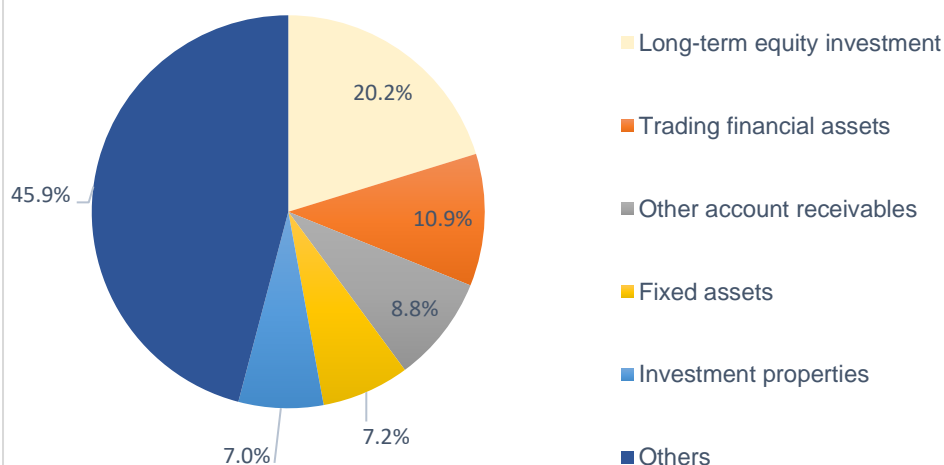
<b>Balance Sheet Structure and Quality</b>			
<b>(RMB million)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Total Asset	43,917	46,595	51,949
Equity	20,318	20,918	21,258
Debt	19,889	18,071	21,149
Debt / (Debt + Equity) (%)	49.5	46.3	49.9
LT Debt	7,506	11,087	11,527
LT Debt / (LT Debt + Equity) (%)	27.0	34.6	35.2

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

QCP's total assets showed a continuous growth trend in the past few years, with growth rate of 6.1% and 11.5% at end-2021 and end-2022, respectively. The asset increase was mainly due to the increase in financial assets and debt and equity investments. The asset structure was stable, with long-term equity investments, financial assets held for trading, other receivables, fixed assets and investment properties accounting for c. 54% of total assets at end-2022. The long-term equity investment balance was c. RMB10.5 billion at end-2022, mainly including Hisense Company Limited. The financial assets held for trading reached c. RMB5.6 billion at end-2022, mainly including equity investments of c. RMB5.0 billion. QCP's account receivables reached c. RMB4.6 billion at end-2022, of which the top five debtors accounted for 46.3% of the ending balance. The fixed assets reached c. RMB3.8 billion at end-2022, which was mainly consisted of houses and buildings (81% of total assets) and machinery (17%).

#### Asset Breakdown

(Total assets: RMB51.9 billion at end-2022)



Source: The company and Lianhe Global's calculation

QCP's financial leverage (total liabilities to total assets) increased steadily from 53.7% at end-2020 to 59.1% at end-2022. We expect QCP's financial leverage would remain at this level considering the government's supervision. Compared with the figures at end-2021, QCP's total liabilities increased by 19.5% to c.



RMB30.7 billion at end-2022, while its total equities increased by 1.6% to c. RMB21.3 billion at end-2022 with unchanged equity structure. The total debt of the company was c. RMB20.8 billion, of which short-term debt accounted for c. RMB10.0 billion.

### **Debt Servicing Capability**

QCP's liquidity was moderate. At end-2022, QCP had a total cash balance of c. RMB2.3 billion, of which unrestricted cash was c. RMB1.8 billion, and a total bank credit line of c. RMB39.6 billion, of which c. RMB23.0 billion was available, compared with its debt to be due within one year of c. RMB10.0 billion. QCP has access to multiple financing channels including bank borrowings, corporate bonds and other financing channels. Bank loans, corporate bonds and other financing channels accounted for c. 46%, 48% and 6% of QCP's total debt, respectively.

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