

Weifang Urban Construction and Development Investment Group Co., Ltd.

Initial Issuer Report

Summary

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|----------------------|--|
| Issuer Rating | A- |
| Outlook | Stable |
| Location | China |
| Industry | Local Investment and Development Companies |
| Date | 16 June 2023 |

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘A-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Weifang Urban Construction and Development Investment Group Co., Ltd. (“WUCDI” or “the company”)

Summary

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

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

Rating Rationale

Weifang Government’s Ownership and Supervision: The Weifang government holds 90% ownership of WUCDI through the State-owned Assets Supervision and Administration Commission of Weifang City (“Weifang SASAC”). The remaining 10% stake is held by Shandong Caixin Asset Management Co., Ltd. (“SCAMC”), a LIDC which is fully owned by the Shandong Provincial Department of Finance. The Weifang government is the actual controller of the company. It 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 Weifang 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 Weifang and Strategic Alignment: WUCDI, as the key LIDC in Weifang, is primarily responsible for infrastructure construction and state-owned asset management and operation within the region. Serving as the key entity in charge of infrastructure projects throughout the entire city, WUCDI focuses on investing in and constructing urban infrastructure, transportation, and water conservancy facilities. In addition, the company is also responsible for the land development and transfer, heating supply, water supply, tourism development and other state-owned asset management and operation business within Weifang. WUCDI 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.

Key Figures of Weifang and WUCDI

| (RMB billion) | 2021 | 2022 |
|-----------------------|-------------|---------------|
| Weifang | | |
| GDP | 701.1 | 730.6 |
| GDP growth rate (%) | 9.7 | 3.7 |
| Budgetary revenue | 65.7 | 61.8 |
| Government fund | 82.5 | 70.9 |
| Transfer payment | 23.0 | 27.7 |
| Budgetary expenditure | 88.0 | 85.0 |
| WUCDI | 2022 | 2023.3 |
| Assets | 137.6 | 141.3 |
| Equity | 73.6 | 73.8 |
| Revenue | 16.8 | 4.2 |

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

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Applicable Criteria

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

Ongoing Government Support: WUCDI received operational and financial support from the government. WUCDI received a total subsidy amount of c. RMB2.2 billion from 2020 to the first three months of 2023, mainly including operating subsidies. The Weifang government continued to inject capitals, equities, special funds and other assets into WUCDI to expand its asset size. Besides, the Weifang government will repurchase some infrastructure projects and provide policy supports to WUCDI to ensure its business operation. Given it is the key entity for infrastructure construction and land development and transfer in Weifang, WUCDI has an advantage in acquiring land resources and major projects. We believe WUCDI is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

WUCDI's Financial Matrix and Liquidity Position: WUCDI's total assets showed a continuous growth trend in the past years and reached RMB141.3 billion at end-March 2023, mainly due to the increase of investments in other equity instruments. The non-current assets of WUCDI accounted for c. 75.3% of the total assets at end-March 2023, and the overall assets were less liquid. WUCDI's financial leverage (total liabilities to total assets) was 47.8% and its adjusted debt increased to c. RMB50.3 billion at end-March 2023. The liquidity of WUCDI was sufficient. WUCDI had an unrestricted cash balance and unused credit facilities of c. RMB5.4 billion and RMB10.9 billion at end-March 2023, respectively, compared with its debt due within one year of c. RMB11.0 billion. Besides, WUCDI 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 Weifang: Weifang is a prefecture-level city of Shandong Province, with a total land area of c. 16,167 square kilometers. Weifang recorded an economic growth in 2022, achieving a GDP of c. RMB730.6 billion, with a year-on-year growth of 3.7%. Its GDP scale was ranked 4th out of all prefecture-level cities under the administration of Shandong Province in 2022. The aggregate fiscal revenue of the Weifang government was mainly derived from the budgetary revenue and government fund income. The Weifang government's budgetary revenue decreased to c. RMB61.8 billion in 2022 from c. RMB65.7 billion in 2021, 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. RMB70.9 billion in 2022 from c. RMB82.5 billion in 2021, owing to the weak property market. The budget deficit of the Weifang government was c. 37.5% at end-2022, while the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Weifang government increased to 117.9% at end-2022. The special purpose debt constituted a high proportion of the total debt.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Weifang

Weifang is a prefecture-level city of Shandong Province, located in the western part of Shandong Peninsula and in the center of the peninsula city group. Weifang has jurisdiction over 6 county-level cities, 4 districts and 2 towns, with a total area of 16,167 square kilometers. At end-2022, Weifang had a resident population of c. 9.4 million, with an urbanization rate of 65.7%.

Weifang maintained steady economic growth in the past three years. Weifang's GDP reached c. RMB730.6 billion, representing a year-over-year growth rate of 3.7% in 2022. Its GDP was ranked 4th among all prefecture-level cities under the administration of Shandong Province in 2022. Weifang's economic growth was mainly fueled by the secondary and tertiary industries in the past few years, which accounted for 42.0% and 49.2% in 2022, respectively.

| Weifang's GDP and Fixed Asset Investment | | | |
|---|-------------|-------------|-------------|
| (RMB billion) | 2020 | 2021 | 2022 |
| GDP | 587.2 | 701.1 | 730.6 |
| -Primary industry (%) | 9.1 | 9.0 | 8.9 |
| -Secondary industry (%) | 39.3 | 40.4 | 42.0 |
| -Tertiary industry (%) | 51.6 | 50.6 | 49.2 |
| GDP growth rate (%) | 3.6 | 9.7 | 3.7 |
| Fixed asset investment | 406.8 | 471.9 | 531.9 |
| Fixed asset investment growth rate (%) | 4.5 | 16.0 | 12.7 |
| Population (million) | 9.4 | 9.4 | 9.4 |

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Weifang

The Weifang government's aggregate fiscal revenues are mainly derived from budgetary revenue and government fund income. The Weifang government's budgetary revenue decreased to c. RMB61.8 billion in 2022 from c. RMB65.7 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. Weifang recorded budget deficit of 37.5% in 2022. In addition, Weifang's government fund income, mainly generated by land sales, dropped to c. RMB70.9 billion in 2022 from c. RMB82.5 billion in 2021, owing to the weak property market.

The outstanding debt of the Weifang government continued to grow. At end-2022, the Weifang government's outstanding debt was c. RMB191.0 billion, including RMB70.4 billion of general obligations and RMB120.5 billion of special purpose debt. Given the Weifang government borrowed heavily in special purpose debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 117.9% at end-2022 from 90.6% at end-2020.

| Weifang's Fiscal Condition | | | |
|--------------------------------------|--------------|--------------|--------------|
| (RMB billion) | 2020 | 2021 | 2022 |
| Budgetary revenue | 57.4 | 65.7 | 61.8 |
| Budgetary revenue growth rate (%) | 0.5 | 14.5 | -1.7* |
| Tax revenue | 42.6 | 50.0 | 37.1 |
| Tax revenue (% of budgetary revenue) | 74.3 | 76.1 | 60.1 |
| Government fund income | 75.3 | 82.5 | 70.9 |
| Transfer payment | 23.8 | 23.0 | 27.7 |
| Aggregate revenue | 158.5 | 172.1 | 162.0 |

| | | | |
|---------------------------------|--------------|--------------|--------------|
| Budgetary expenditure | 79.6 | 88.0 | 85.0 |
| Budget deficit ¹ (%) | -38.7 | -33.9 | -37.5 |

¹ 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

WUCDI was established in September 2016, with an initial registered capital of RMB5.0 billion, funded by state-owned assets supervision and administration commission (SASAC) of Weifang. At end-March 2023, WUCDI's registered and paid-in capital was both RMB5.0 billion. WUCDI had a shareholding structure in which the Weifang SASAC, as the controlling shareholder, held 90% of the company's equity. The remaining 10% equity was held by SCAMC, a LIDC which is fully owned by Shandong Provincial Department of Finance.

Strategic Importance and Government Linkage

Strategic Importance of WUCDI to Weifang

WUCDI, as the largest and key LIDC in Weifang, is primarily responsible for infrastructure construction and state-owned asset management and operation within the region. Serving as the sole entity in charge of infrastructure projects throughout the entire city, WUCDI focuses on investing in and constructing urban infrastructure, transportation, and water conservancy facilities. In addition, the company is also responsible for the land development and transfer, heating supply, water supply, tourism development and other state-owned asset management and operation business within Weifang. WUCDI 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

WUCDI's linkage with the local government is strong as the Weifang government holds 90% ownership of WUCDI through Weifang SASAC. The Shandong Provincial Department of Finance holds the remaining 10% stake through SCAMC. The Weifang 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 Weifang 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

WUCDI continued to receive financial subsidies, mainly including operating subsidies (such as urban public facility usage fees, heating subsidies, land subsidies and tax breaks), from the local government to maintain its business operation. WUCDI received subsidies of c. RMB546 million, RMB1.3 billion, RMB326.6 million and RMB63.5 million in 2020, 2021, 2022 and the first three months of 2023, respectively. Besides, The Weifang government continued to inject capitals, equities, special funds and other assets into WUCDI to expand its asset size. The government will repurchase some water conservancy projects and other infrastructure projects constructed by WUCDI, purchase land resources developed by WUCDI, and provide policy supports to ensure its business operation. Given it is the key

entity for infrastructure construction and land development in Weifang, WUCDI has an advantage in acquiring land resources and major projects. We believe WUCDI is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

Business Profile

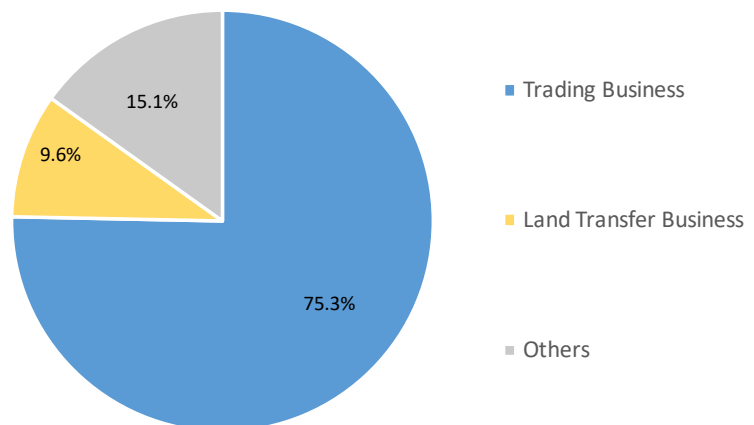
The Key Entity Responsible for Infrastructure Construction and State-owned Asset Operating in Weifang

WUCDI, as an important LIDC in Weifang, is mainly responsible for infrastructure construction, urban construction, land sales, water and heat supply within the region. The company's strong franchise advantage enables it to undertake important land consolidation and infrastructure construction projects under the instruction of the Weifang government. As the core platform designated by the Weifang to implement its infrastructure construction and state-owned asset management plans, WUCDI plays an important role in promoting economic and social development within the region.

The primary sources of operating revenue for WUCDI are trading business, land transfer, water and heat supply and chemical products sales, while it is also engaged in landscaping business and auto parts sales. The company's total revenue reached c. RMB9.5 billion, RMB17.4 billion, RMB16.8 billion and RMB4.2 billion in 2020, 2021, 2022 and the first three months of 2023, respectively, representing a steady trend. The overall gross profit margin of WUCDI remained stable at c. 5%-10% from 2020 to 2022. In general, WUCDI's business was well diversified, and it has regional advantages in its major businesses.

Revenue Breakdown

(Total revenue:c. RMB4.2 billion in the first three months of 2023)



Source: The company and Lianhe Global's Calculation

Land Transfer Business

The Weifang government entrusts WUCDI to undertake land consolidation, including land transfer, land acquisition and compensation, etc. The company acquires the land by "tender, auction and listing", and then pays the full amount of land premium and related taxes and

fees. WUCDI signs the land development agreement with the Weifang government and other government agencies. The entrusted party will repurchase the land parcel with investment cost plus a certain percentage of profit when the entrusted land parcels are sold. WUCDI realized land development income of c. RMB0.3 billion, RMB1.2 billion, RMB0.8 billion and RMB0.4 billion in 2020, 2021, 2022 and the first three months of 2023, respectively, with a high gross profit margin of c. 62%.

Trading Business

As an important source of revenue for WUCDI, the trading segment makes the company's business more diversified and plays a complementary role to its main business. WUCDI is mainly engaged in the sales of non-ferrous metals, like electrolytic copper. The revenue generated from this segment reached c. RMB5.0 billion, RMB12.9 billion, RMB12.4 billion and RMB3.2 billion in 2020, 2021, 2022 and the first three months of 2023, respectively, representing an upward trend. The gross profit margin of the segment was low, which was less than 1%. The suppliers and customers of the segment are concentrated, and most of them are private enterprises, indicating a high counterparty risk.

Other Businesses

Other businesses of WUCDI include water and heat supply, chemical products sales, landscaping business and auto parts sales, 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

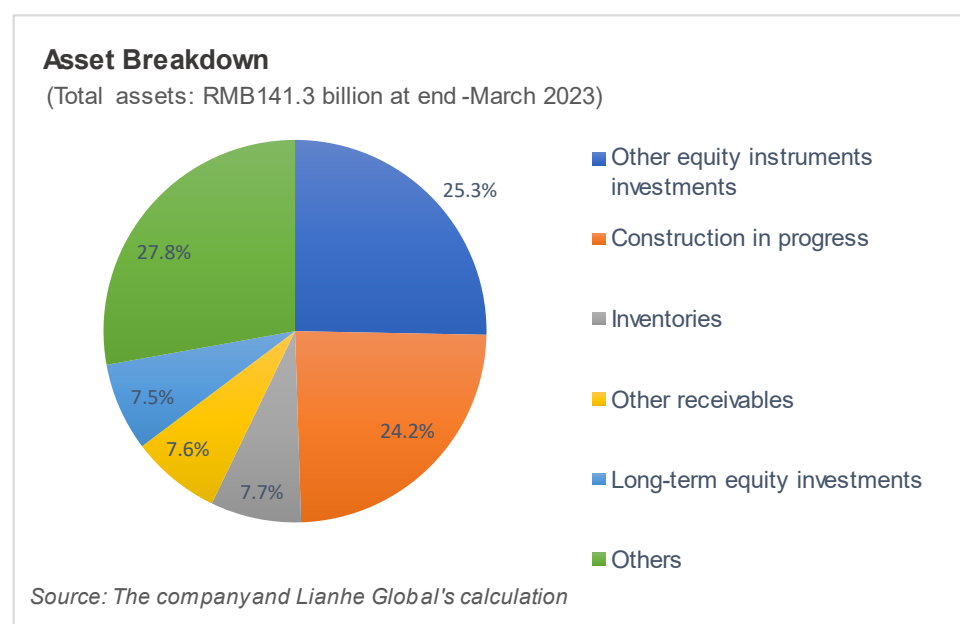
| Balance Sheet Structure and Quality | | | | |
|--|-------------|-------------|-------------|-------------------|
| (RMB million) | 2020 | 2021 | 2022 | March 2023 |
| Total Asset | 106,733 | 112,623 | 137,604 | 141,262 |
| Equity | 48,150 | 48,125 | 73,588 | 73,776 |
| Debt | 41,200 | 48,996 | 49,049 | 50,344 |
| Debt / (Debt + Equity) (%) | 46.1 | 50.4 | 40.0 | 40.6 |
| LT Debt | 31,441 | 29,855 | 32,723 | 37,746 |
| LT Debt / (LT Debt + Equity) (%) | 39.5 | 38.3 | 30.8 | 33.8 |

Source: Company information and Lianhe Global's calculations

WUCDI's total assets showed a continuous growth in the past few years, with a growth rate of 5.5%, 22.2% and 2.7% at end-2021, end-2022 and end-March 2023, respectively, and reached RMB141.3 billion at end-March 2023. The increase of WUCDI's total assets was largely due to the increase in investments in other equity instruments, resulting from the inclusion of its 30% stake in Weifang Ocean Investment Group Co., Ltd. ("WOIG"). WUCDI's assets mainly consisted of other equity instruments investments, construction in progress, inventories, other receivables and long-term equity investments. The majority of other equity instruments investments was attributed to its 30% ownership in WOIG, which is an important LIDC in Weifang. Additionally, WUCDI held ownership in private companies such as Shandong Meichen Ecological Environment Co., Ltd. Construction in progress primarily involved public welfare projects which were taken over from the Weifang State-owned Assets Operation and Investment Corporation. Once these projects are completed and

WUCDI's invested capital is recovered, they will gradually be transferred back to the Weifang government. Inventories mainly included land use rights that are acquired through auction, and project development costs associated with WUCDI's project construction business. Other receivables mainly pertained to interchanges of funds, project payments and deposits with government agencies and cooperative enterprises within Weifang, with moderate concentration of indebted party, controllable counterparty risk and low bad debt provision.

WUCDI witnessed growth in both its current assets and non-current assets in the past three years. The proportion of current assets and non-current assets in the total assets experienced slight fluctuations, but remains predominantly skewed towards non-current assets, indicating an illiquid asset structure.



WUCDI's financial leverage (total liabilities to assets) reached 54.9%, 57.3%, 46.5% and 47.8% at end-2020, end-2021, end-2022 and end-March 2023, respectively, representing a decreasing trend. Given the relevant guidelines of the Weifang government, we expect the leverage of WUCDI to maintain at this level in the future. WUCDI's total adjusted debt increased from c. RMB41.2 billion at end-2020 to c. RMB50.3 billion at end-March 2023, with short-term debt accounting for c. 25.0% of the total debt. There was no significant change in the ownership equity structure of WUCDI at end-March 2023, compared with that at end-2020. The capital surplus increased to c. RMB56.7 billion at end-March 2023 from c. RMB28.9 billion at end-2020. WUCDI mainly relies on external financing to support its capital expenditures, 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 WUCDI was sufficient. At end-March 2023, WUCDI had an unrestricted cash balance and unused credit facilities of c. RMB5.4 billion and RMB10.9 billion, respectively, compared with its debt due within one year of c. RMB11.0 billion at the same time. Besides, WUCDI 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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