

## Laizhou Finance Investment Co., Ltd.

### Initial Issuer Report

#### Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	10 July 2023

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

#### Summary

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

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

#### Rating Rationale

**Government’s Ownership and Supervision:** The Laizhou government directly holds the full ownership of LFI through the Finance Bureau of Laizhou City (“Laizhou FB”), and is the actual controller of the company. The Laizhou 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 Laizhou 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 Laizhou and Strategic Alignment:** LFI, as the most important LIDC in Laizhou, is primarily responsible for infrastructure construction and operation of state-owned assets within the region with strong regional advantages. The company undertakes most of the important municipal infrastructure projects in the region, and is responsible for urban renewal, rural revitalization, sewage treatment, water supply and other industrial fields in the region under the planning of the Laizhou government. LFI 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:** LFI received operational and financial support from the Laizhou government. LFI received a total subsidy amount of c. RMB542.2 million from 2020 to the first three months of 2023, mainly including operating subsidies. The Laizhou government will repurchase some infrastructure construction projects and provide policy supports to LFI to ensure its business operation. Besides, LFI received multiple asset injections in the form of cash, equities, operating income rights of ore sources, real estates and other operating income rights from the Laizhou government to expand its asset size and diversify its business. Given the regional advantage in infrastructure construction in Laizhou, LFI has advantages to obtain land resources and major projects. We believe LFI

#### Key Figures of Laizhou and LFI

(RMB billion)	2021	2022
<b>Laizhou</b>		
GDP	70.1	77.1
GDP growth rate (%)	2.6	5.0
Budgetary revenue	4.2	4.2
Government fund	1.7	3.2
Transfer payment	1.5	1.8
Budgetary expenditure	4.9	5.8
<b>LFI</b>	<b>2022</b>	<b>2023.3</b>
Assets	28.0	30.2
Equity	18.3	18.3
Revenue	1.2	0.1

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

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#### Applicable Criteria

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

is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

**LFI's Financial Matrix and Liquidity Position:** LFI's total assets showed a continuous growth trend in the past years and reached RMB30.2 billion at end-March 2023, mainly due to the growth of intangible assets resulting from the injection from the Laizhou government. The current asset accounted for a large proportion in total asset. LFI's financial leverage (total liabilities to total assets) increased to 39.4% at end-March 2023, while its adjusted debt increased to c. RMB8.4 billion at end-March 2023 from c. RMB943.7 million at end-2020, where the short-term debt accounted for 55.3%. The liquidity of LFI was relatively tight, with unrestricted cash and unused credit facilities of c. RMB1.1 billion and RMB2.0 billion at end-March 2023, respectively, compared with its debt due within one year of c. RMB4.7 billion. Having said that, LFI has access to various financing channels, including bank loans and non-traditional financing (e.g., finance lease), to support its debt repayment and business operations.

**Economy and Fiscal Condition of Laizhou:** Laizhou is a county-level city under the administration of Yantai City, Shandong Province ("Yantai"), located in the west part of Yantai. Laizhou recorded stable economic growth in the past three years, achieving a GDP of c. RMB77.1 billion in 2022, with a year-on-year growth of 5.0%. Laizhou's economic growth was mainly fueled by the secondary and tertiary industries in the past few years, which accounted for 45.9% and 41.9% in 2022, respectively. The Laizhou government's aggregate fiscal revenues are mainly derived from budgetary revenue and government fund income, of which the budgetary revenue grew steadily and reached RMB4.2 billion in 2022. The tax revenue accounted for c. 62%-68% of its budgetary revenue between 2020 and 2022. The government fund income also increased to c. RMB3.2 billion in 2022. The budget deficit of the Laizhou government was c. 35.9% at end-2022, while the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Laizhou government decreased to 73.5% at end-2022. The special purpose debt constituted c. 60.2% of the total debt at end-2022.

## Rating Sensitivities

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

We would consider upgrading LFI's rating if there is an upgrade in our internal credit assessment on the Laizhou government.

## Operating Environment

### Economic Condition of Laizhou

Laizhou is a county-level city under the administration of Yantai in Shandong Province, and is located in the west of Yantai. Laizhou has jurisdiction over 6 streets and 11 towns with a total land area of c. 1,928 square kilometers. Laizhou had a residential population of c. 0.8 million with an urbanization rate of 47.3% at end-2022.

Laizhou realized a GDP of RMB77.1 billion in 2022, representing a growth rate of 5.0%. Its GDP scale was ranked 4<sup>th</sup> out of all counties and districts under the administration of Yantai in 2022. Laizhou's economic growth was mainly fueled by the secondary and tertiary industries, which accounted for 45.9% and 41.9% of Laizhou's GDP, respectively, in 2022.

The fixed asset investment also recorded steady growth in the past two years. Meanwhile, Laizhou's GDP per capita reached c. RMB94,000 in 2022.

<b>Laizhou's GDP and Fixed Asset Investment</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
GDP	67.4	70.1	77.1
-Primary industry (%)	12.9	13.3	12.1
-Secondary industry (%)	44.5	43.8	45.9
-Tertiary industry (%)	42.6	42.9	41.9
GDP growth rate (%)	2.3	2.6	5.0
Fixed asset investment	32.0	33.7	36.9
Fixed asset investment growth rate (%)	(16.8)	5.3	9.4
Population (million)	0.8	0.8	0.8

Source: Public information and Lianhe Global's calculations

## Fiscal Condition of Laizhou

The aggregate fiscal revenue of the Laizhou government was mainly derived from the budgetary revenue and government fund income. The budgetary revenue of the Laizhou government maintained a steady growth in the past three years, reaching c. RMB4.2 billion with a year-on-year increase of 10.2% in 2022, excluding the influence of value-added tax credit refund. The tax revenue accounted for c. 62-68% of the budgetary revenue in 2020-2022. Laizhou's government fund income, mainly generated by land sales, also increased to c. RMB3.2 billion in 2022 from c. RMB1.7 billion in 2021.

The budget deficit of the Laizhou government decreased to 18.1% in 2021, but rebounded to 35.9% in 2022 due to higher budgetary expenditure. The debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Laizhou government was stable at 70%-78% from 2020 to 2022. The local government's outstanding debt increased from c. RMB4.9 billion at end-2020 to c. RMB6.8 billion at end-2022, mainly due to the increase in special purpose debt.

<b>Laizhou's Fiscal Condition</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Budgetary revenue	4.1	4.2	4.2
Budgetary revenue growth rate (%)	3.0	0.8	10.2*
Tax revenue	2.6	2.8	2.9
Tax revenue (% of budgetary revenue)	61.9	66.5	67.7
Government fund income	1.1	1.7	3.2
Transfer payment	1.9	1.5	1.8
<b>Aggregate revenue</b>	<b>7.1</b>	<b>7.3</b>	<b>9.3</b>
Budgetary expenditure	5.2	4.9	5.8
<b>Budget deficit<sup>1</sup> (%)</b>	<b>26.9</b>	<b>18.1</b>	<b>35.9</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

LFI was established in 2015 with an initial registered capital of RMB20 million, funded by Laizhou FB. Its registered capital and paid-in capital increased to RMB3 billion and RMB461.9 million at end-March 2023 after several capital and equity transfers from the Laizhou government. At end-March 2023, LFI had a shareholding structure in which the Laizhou FB, as the controlling shareholder, held 100% of the company's equity.

## Strategic Importance and Government Linkage

### Strategic Importance of LFI to Laizhou

In 2022, following the guidance of the Laizhou government, Laizhou completed the reorganization and merger of state-owned enterprises. The Laizhou government transferred all shares of three LIDCs in Laizhou to LFI, resulting in LFI becoming the most important LIDC in Laizhou. LFI is primarily responsible for the infrastructure construction and operation of state-owned assets within the region with strong regional advantages. The company undertakes most of the important municipal infrastructure projects in the region, and is responsible for urban renewal, rural revitalization, sewage treatment, water supply and other industrial fields in the region under the planning of the Laizhou government. As the sole entity for state-owned asset management and operation in Laizhou, LFI 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.

### Linkage with the Local Government

LFI's linkage with the local government is strong, as the Laizhou FB directly holds the full ownership of the company. The Laizhou 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 Laizhou 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

LFI continued to receive financial subsidies, mainly including operating subsidies and tax breaks, from the local government to maintain its business operation. LFI received subsidies of c. RMB5.4 million, RMB91.2 million, RMB414.6 and RMB31.0 million in 2020, 2021, 2022 and the first three months of 2023, respectively. To expand the company's asset size and diversify its business, the Laizhou government made multiple asset injections to the company in 2022, including land tenure, operating income rights of ore sources, real estates and other operating income rights, totaling to c. RMB5.2 billion. Besides, the Laizhou government also injected all shares of three LIDCs in Laizhou to LFI in 2022, making it the largest and the most important LIDC in the region. The Laizhou government will repurchase some infrastructure construction projects and provide policy supports to LFI to ensure its business operation. Given the franchise advantage in infrastructure construction in Laizhou, LFI has advantages to obtain land resources and major projects. We believe LFI is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

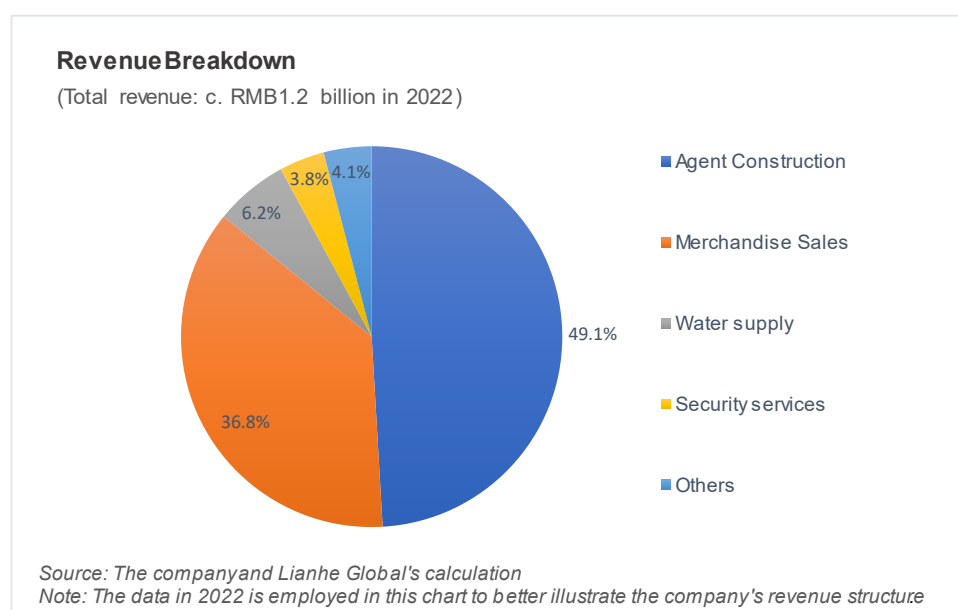
### Business Profile

#### The Sole Entity Responsible for Infrastructure Construction, and State-owned Asset Operation in Laizhou

LFI, as the most important LIDC in Laizhou, is mainly responsible for infrastructure construction such as road construction and renovation projects, under the coordination plan of the Laizhou government. Moreover, the Laizhou government also entrusts the company with functions related to water supply, sewage treatment and other industrial upgrading

projects. As the sole infrastructure construction body within the region, LFI plays a vital role in promoting economic and social development of Laizhou.

The primary sources of operating revenue for LFI included its agent construction, merchandise sales, water supply and security services. The company experienced steady revenue growth over the past three years, with revenue reaching of c. RMB152.6 million, RMB807.4 million and RMB1.2 billion for 2020, 2021 and 2022, respectively. In the first quarter of 2023, it recorded revenue of c. RMB105.4 million. The fast revenue growth in 2021 was primarily attributable to its expanding agent construction and merchandise sales businesses. The overall gross profit margin of LFI was 36.9%, 14.9%, 10.5% and 30.3% in 2020, 2021, 2022 and the first three months of 2023, respectively. In general, LFI's business was diversified, and it has regional advantages in its major businesses.



### Agent Construction

LFI is the sole entity responsible for infrastructure construction in Laizhou. The company carries out municipal and other infrastructure projects in the region through entrusted construction mode, where the Laizhou government is the main entrusting party. The Laizhou government settles with LFI by paying the actual costs plus an additional margin. The company's monopoly on infrastructure construction in Laizhou gives it a strong regional advantage. Its revenue in this segment was relatively stable over the past years, with RMB75.6 million, RMB382.8 million, RMB572.9 million generated in 2020, 2021 and 2022, respectively. The gross profit margin remained steady at 12%-14.5% as well. LFI did not generate any income in the first three months of 2023 due to the settlement practice, as most of the company's construction revenue are recognized towards the end of the year. LFI has completed various construction projects. Currently, the company is working on several large-scale projects, thus it incurs high capital expenditure pressure.

### Merchandise Sales

LFI diversified its business operations by adding the merchandise sales business to complement its main operations. While this segment generated revenues of RMB10.8 million, RMB 324.2 million, RMB429.3 million and RMB79.7 million in 2020, 2021, 2022 and

the first three months of 2023, respectively, its gross margin was fluctuated between 2%-36%.

## Other Businesses

Other businesses of LFI include water supply, security services, vehicle testing and driving license, 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. In addition, water supply business improves the efficiency of urban utility supply in Laizhou and enhance the level of basic public services.

## Financial Profile

### Balance Sheet Structure and Quality

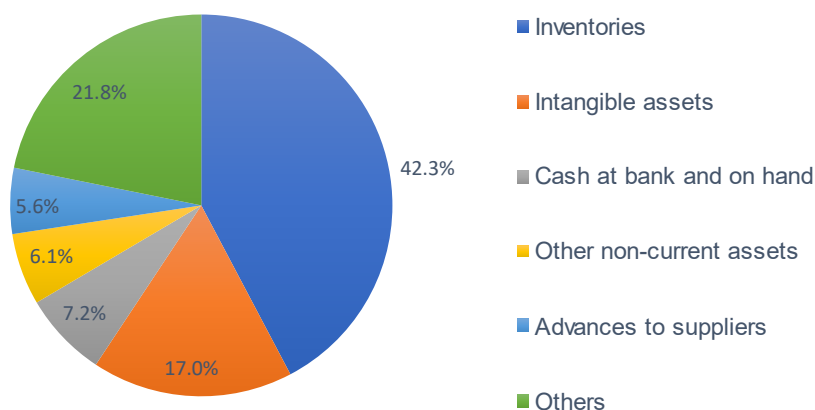
<b>Balance Sheet Structure and Quality</b>				
<b>(RMB million)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>March 2023</b>
Total Asset	14,365	17,052	28,036	30,181
Equity	11,626	11,932	18,257	18,294
Debt	944	3,001	6,539	8,414
Debt / (Debt + Equity) (%)	7.5	20.1	26.4	31.5
LT Debt	780	1,621	3,315	3,761
LT Debt / (LT Debt + Equity) (%)	6.3	12.0	15.4	17.1

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

LFI's total assets showed a continuous growth in the past few years, with a growth rate of 18.7%, 64.4% and 7.7% at end-2021, end-2022 and end-March 2023, respectively, and reached RMB30.2 billion at end-March 2023. The increase of LFI's total assets was largely due to its intangible assets, resulting from the large-scale asset injection from the Laizhou government. At end-March 2023, current assets constituted the major proportion of the company's asset structure, accounting for c. 62.5% of its total assets. LFI's assets mainly consisted of inventories, intangible assets, cash at bank and on hand, other non-current assets and advances to suppliers. Inventories included development costs associated with LFI's core business operations, such as agent construction costs, which increased in parallel with the growth of the relevant projects. Intangible assets mainly comprised land tenure and franchise injected from the Laizhou government. LFI's intangible assets may lack liquidity, though some of them could generate stable income for the company. Other non-current assets were mainly operating income rights of ore sources, which were also injected from the Laizhou government in 2022. Though LFI had considerable current assets, its assets were relatively illiquid, primarily due to the significant proportion of costs associated with construction projects and the intangible assets.

### Asset Breakdown

(Total assets: RMB30.2 billion at end-March 2023)



Source: The company and Lianhe Global's calculation

LFI's financial leverage (total liabilities to assets) reached 19.1%, 30.0%, 34.9% and 39.4% at end-2020, end-2021, end-2022, and end-March 2023, respectively, representing an upward trend. In view of the relevant guidelines of the Laizhou government, we expect the financial leverage of LFI to stabilize at this level. LFI's adjusted total debt increased significantly from c. RMB944 million at end-2020 to c. RMB8.4 billion at end-March 2023, with short-term debt accounting for c. 55.3% of the total debt. There was no significant change in the ownership equity structure of LFI at end-March 2023, compared with that at end-2021. The capital surplus increased to RMB17.3 billion at end-March 2023. LFI mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure and urban renewal related projects under construction and to be constructed in the future.

### Debt Servicing Capability

The liquidity of LFI was moderately tight. At end-March 2023, LFI had a cash balance and unused credit facilities of c. RMB2.2 billion and RMB2.0 billion, respectively, but a relatively high proportion of cash of RMB1.0 billion was restricted, compared with its debt due within one year of c. RMB4.7 billion at the same time. Having said that, LFI has access to various financing channels, including bank loans and non-traditional financing (e.g., finance lease), to support its debt repayment and business operations.

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