

Qingdao Economic and Technological Development Zone Investment Holding Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB+
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	9 October 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB+’ global scale Long-term Issuer Credit Rating with Stable Outlook to Qingdao Economic and Technological Development Zone Investment Holding Group Co., Ltd. (“QEDIH” 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 QEDIH if needed, in light of its indirect full ownership of QEDIH, QEDIH’s strategic importance as the key local investment and development company (“LIDC”) responsible for infrastructure construction and innovative industries integration in the West Coast New Area, Qingdao City (“West Coast New Area”) (“Qingdao”), and the linkage between the West Coast New Area government and QEDIH, including management appointments, strategic alignment, supervision of major investment and financing plans 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 QEDIH encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that QEDIH’s strategic importance would remain intact while the West Coast New Area government will continue to ensure QEDIH’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 QEDIH through the Qingdao West Coast New Area State-owned Assets Administration (“West Coast New Area SAA”). The West Coast New Area government has the final decision-making authority and supervision over the company, including management appointments, strategic development and investment planning, and major funding decisions. In addition, the West Coast New Area government has assessment mechanism over the company and appoints auditors to supervise the operating performance and financials on a periodic basis.

Strategic Importance to West Coast New Area and Strategic Alignment: QEDIH, as the main implementation entity for infrastructure construction and integration of innovative industries in the West Coast New Area, plays an important role in promoting the economic development and innovation integration of the region. The company is primarily responsible for the infrastructure constructions in the core area of Guzhenkou (“Guzhenkou”) and Qingdao Economic and Technological Development Zone (“Qingdao ETDZ”) among the ten functional areas of the West Coast New Area, and the construction of industrial parks, office buildings, R&D centers, security centers and other projects related to innovation integration, as well as equity investment in related projects. QEDIH’s business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: QEDIH continued to receive financial subsidies, funding and asset/capital injections from the local government to support its business operations. We believe that the government support will remain intact given the company’s strategic role

Key Figures of West Coast New Area and QEDIH

(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
QEDIH		
Assets	94.6	110.4
Equity	30.2	33.3
Revenue	27.7	17.7

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

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Applicable Criteria

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

in the economic development of the West Coast New Area. In 2020-1H2023, QEDIH received subsidies totaling around RMB201 million. QEDIH received about RMB9.5 billion of project-specific funds (mainly for infrastructure constructions conducted by its subsidiaries), 100% equity of Qingdao Civil-Military Integration Development Group Co., Ltd. (“QMIDG”), and 100% equity of Qingdao UPC Holding Co., Ltd. (“QUH”) (青島中石大控股有限公司) during the period. Besides, the West Coast New Area government provides policy supports to QEDIH in land acquisitions and tax deductions.

QEDIH’s Financial and Liquidity Position: QEDIH’s total assets more than doubled to RMB110.4 billion at end-1H2023 from RMB45.9 billion at end-2020. The increase in QEDIH’s total assets was primarily due to continuous investment in projects under construction and changes in consolidated entities. Although QEDIH’s current assets accounted for a significant portion of total assets (about 67.0% at end-1H2023), overall asset liquidity was weak due to its high development costs and significant restricted assets for debt borrowings. QEDIH’s adjusted total debt increased significantly to RMB62.7 billion at end-1H2023 from RMB26.0 billion at end-2020. QEDIH mainly relies on external financing to support its capital expenditures and debt repayments, which we expect to continue.

The liquidity of QEDIH was moderately weak. At end-June 2023, QEDIH had unrestricted cash balance and unused credit facilities of RMB11.7 billion and RMB43.3 billion, respectively, compared with its debt due within one year of RMB22.5 billion. Besides, QEDIH has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayments 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. It is one of the seven urban districts of Qingdao. West Coast New Area recorded an economic growth in 2022, achieving a GDP of 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 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 RMB19.5 billion in 2022 from 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 that 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 from 19.6% at end-2018.

Rating Sensitivities

We would consider downgrading QEDIH’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 QEDIH, or (3) there is a downgrade in our internal credit assessment on the West Coast New Area government.

We would consider upgrading QEDIH’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, 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, 14 streets, and a residential population of 1.96 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 RMB469.2 billion, representing a year-over-year (y-o-y) growth rate of 4.8% in 2022, and its GDP ranked the first among all districts and counties under the administration of Qingdao. West Coast New Area'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 RMB238,900 in 2022, which was higher than the GDP per capita of China (RMB85,700) as well as that of Qingdao (RMB145,400).

West Coast New Area's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
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 RMB53.3 billion, including RMB4.3 billion of general obligations and RMB49.0 billion of special debt. Given that 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.

West Coast New Area's Fiscal Condition			
(RMB billion)	2020	2021	2022
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
Aggregate revenue	54.6	58.3	49.4
Budgetary expenditure	22.2	25.5	24.2
Budget deficit ¹ (%)	13.5	2.1	-8.0

¹ 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

QEDIH was established in November 2019 with an initial registered capital of RMB5.0 billion, funded by West Coast New Area SAA. In May 2020, QEDIH's 51% equity was transferred to the Qingdao West Coast New Area Ronghe Holdings Group Co., Ltd. (青岛西海岸新区融合控股集团有限公司) ("QWRH") (fully owned by the West Coast New Area SAA) without compensation, and QWRH injected its 97.62% equity in QMIDG to the company.

At end-June 2023, QEDIH's registered and paid-in capital were RMB5.0 billion and RMB3.7 billion, respectively; 51% of the company's equity was held by QWRH and the remaining 49% was held by the West Coast New Area SAA. The actual controller of the company is the West Coast New Area SAA and the ultimate controller is the West Coast New Area government.

Strategic Importance and Government Linkage

Strategic Importance of QEDIH to West Coast New Area

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

Strong Linkage with the Local Government

QEDIH's linkage with the local government is strong as the West Coast New Area government indirectly holds 100% ownership of QEDIH through the West Coast New Area SAA. The West Coast New Area government has the final decision-making authority and supervision over the company, including management appointments, strategic development and investment planning, and major funding decisions. In addition, the West Coast New Area government has assessment mechanism over the company and appoints auditors to supervise the operating performance and financials on a periodic basis.

Government Support

QEDIH continued to receive financial subsidies, funding and asset/capital injections from the local government to support its business operations. We believe that the government

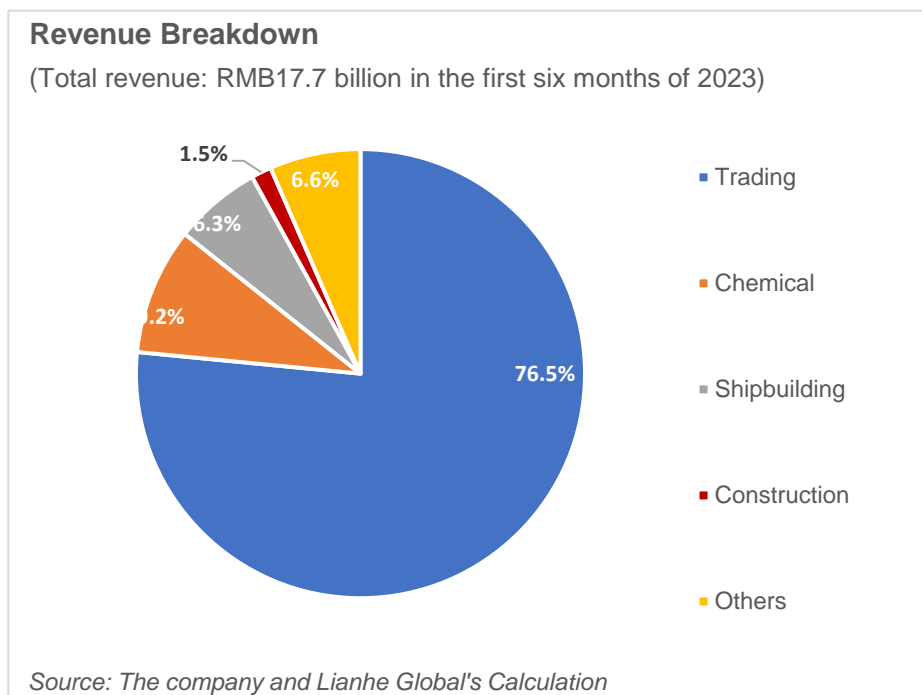
support will remain intact given the company's strategic role in the economic development of the West Coast New Area. In 2020-1H2023, QEDIH received subsidies totaling around RMB201 million. Meanwhile, the West Coast New Area government continued to provide project-specific funds and transferred equity shares and other assets to QEDIH. QEDIH received about RMB9.5 billion of project-specific funds (mainly for infrastructure constructions conducted by its subsidiaries), 100% equity of QMIDG, and 100% equity of QUH during the period. Besides, the West Coast New Area government provides policy supports to QEDIH in land acquisitions and tax deductions.

Business Profile

The Key Entity Responsible for Infrastructure Construction and Innovative Industries Integration in West Coast New Area

QEDIH, 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. Meanwhile, the company is also the key entity responsible for the implementation of the innovation integration strategy in the West Coast New Area, undertaking the construction of industrial parks related to innovation integration and equity investment in related projects. The company has received strong support from the local government and established good cooperative relations with government departments in various fields. Therefore, QEDIH has strong franchised advantages in infrastructure construction and innovation integration industries, and good development prospects within the region.

Trading business was the primary source of QEDIH's operating revenue while it also engaged in construction, chemical, shipbuilding, etc. The company's total revenue reached RMB15.9 billion, RMB20.2 billion, RMB27.7 billion and RMB17.7 billion in 2020, 2021, 2022 and the first six months of 2023, respectively, representing an upward trend. The overall gross profit margin of QEDIH from 2020 to 2022 was stable at around 4.5%.



Construction

The construction business is mainly undertaken by QMIDG and QMIDG's subsidiaries. QMIDG focuses on the infrastructure construction in 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 construction projects, roads construction, surrounding environment construction projects and some area renovations. This segment adopts an agent construction mode, where QMIDG 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. QMIDG settles the construction costs with a profit margin of approximately 8% with the entrusted party based on the completion time of projects. In addition, QMIDG also undertakes highway construction projects. Currently, the company has 4 projects under construction and requires about RMB4.0 billion of investment. Thus, it incurs certain pressure on capital expenditure.

Trading

QEDIH is mainly engaged in the sales of coal, steel, cement, timber, copper and non-ferrous metals. Expansion of the trading scale led to the continuous growth of the company's trading revenue, but the profit margin was relatively low (less than 2% in 2020-1H2023). The suppliers and customers of the segment are concentrated, and most of them are private enterprises, indicating potential counterparty risk.

Chemical

The chemical business was conducted by QEDIH's partially owned listed subsidiary Shinghwa Advanced Material Group Co., Ltd. QEDIH started to consolidated the company's financials in 2023. The main chemical products are lithium-ion battery electrolyte solvent, solute and additive products. The company arranges productions at the beginning of each year and adjusts the productions according to market demands. Customers include end customers and traders.

Shipbuilding

The shipbuilding business is mainly handled by Penglai Zhongbai Jinglu Ship Industry Co., Ltd. (蓬萊中柏京魯船業有限公司), whose customers are mainly from Greece, Germany, Brazil, South Korea, Sri Lanka, Japan, Singapore, mainland China, Taiwan, etc. The revenue from the ship sales is recognized based on the increase in the output value of products. With the growth of ship orders and selling prices, the revenue from shipbuilding business continued to grow.

Others

QEDIH's other businesses include real estate development, concrete production and sales, casting production and sales, construction and installation, switchgear sales and installation, property leasing, etc. These segments account for a relatively small portion of the company's total revenue and mainly serve to supplement the main businesses for revenue diversification.

Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality					
(RMB million)	2020	2021	2022	June 2023	June-2023(Adjusted*)
Total Asset	45,888	72,754	94,625	110,378	110,378
Equity	13,801	23,095	30,182	33,337	33,039
Debt	26,028	38,416	51,040	62,747	63,046
Debt / (Debt + Equity) (%)	65.3	62.5	62.8	65.3	65.6
LT Debts	16,012	23,955	31,998	40,227	40,525
LT Debt / (LT Debt + Equity) (%)	53.7	50.9	51.5	54.7	55.1

*Note: * Adjusted numbers and ratios reflect the perpetual debts reallocating to long-term debts and total debts from equity*

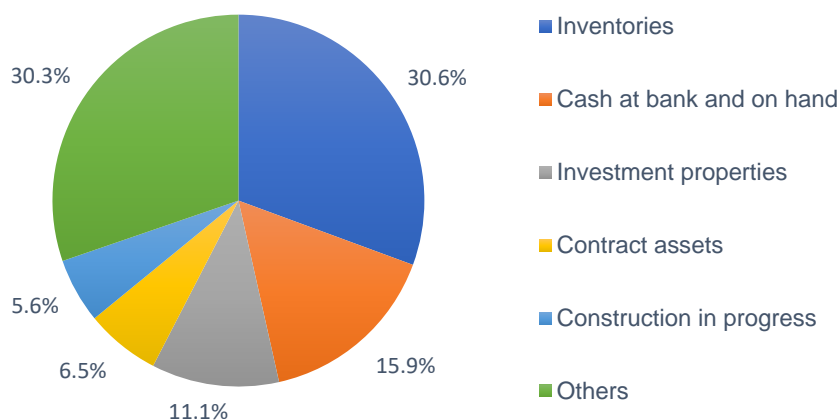
Source: Company information and Lianhe Global's calculations

QEDIH's total assets more than doubled to RMB110.4 billion at end-1H2023 from RMB45.9 billion at end-2020. The increase in QEDIH's total assets was primarily due to continuous investment in projects under construction. The asset growth was also affected by changes in consolidated entities.

QEDIH's assets consisted of inventories, cash at bank and on hand, investment properties, contract assets, construction in progress, etc. The inventories mainly included development costs associated with QEDIH's entrusted construction projects, old village renovation projects, and real estate projects. Investment properties included buildings and land use rights, and contract assets were project receivables. Although QEDIH's current assets accounted for a significant portion of total assets (about 67.0% at end-1H2023), overall asset liquidity was weak due to its high development costs and significant restricted assets for debt borrowings.

Asset Breakdown

(Total assets: RMB110.4 billion at end-June 2023)



Source: The company and Lianhe Global's calculation

QEDIH's financial leverage (total liabilities to assets) remained stable in 2020-1H2023, and was 69.8% at end-1H2023. QEDIH's adjusted total debt increased significantly to RMB62.7 billion at end-1H2023 from RMB26.0 billion at end-2020, mainly due to the increase in long-term borrowings and bonds, with short-term debt and long-term debt accounting for 35.9% and 64.1% of the total debt at end-1H2023, respectively. QEDIH mainly relies on external financing to support its capital expenditures and debt repayments, which we expect to continue.

Debt Servicing Capability

The liquidity of QEDIH was moderately weak. At end-June 2023, QEDIH had unrestricted cash balance and unused credit facilities of RMB11.7 billion and RMB43.3 billion, respectively, compared with its debt due within one year of RMB22.5 billion. Besides, QEDIH has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayments and business operations.

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