

Shandong Mingshui Guokai Development Group Co., Ltd.

Initial Issuer Report

Summary

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

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Shandong Mingshui Guokai Development Group Co., Ltd. (“SMGD” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Zhangqiu district (“the Zhangqiu government”) would provide strong support to SMGD if needed. This mainly considers the management committee of Mingshui Economic and Technological Development Zone’s (“the management committee”) (the de facto local government of Mingshui Economic and Technological Development Zone (“Mingshui EDZ”)) majority ownership of SMGD, SMGD’s strategic importance as an important local investment and development company (“LIDC”) responsible for the development and operation of Mingshui EDZ in Jinan’s Zhangqiu District (“Zhangqiu”), and the linkage between the local government and SMGD, including the appointment of senior management, strategic alignment, supervision of major investment and financing decisions and ongoing operational and financial support. In addition, the Zhangqiu government may face significant negative impact on its reputation and financing activities if SMGD encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The management committee indirectly holds 76% shares of SMGD and is the company’s ultimate controller. The Zhangqiu State-Owned Assets Operation Co., Ltd. (“ZSAO”), another LIDC in Zhangqiu, holds the rest of 24%. The local government has strong control over the company, including the appointment of senior management and supervision of SMGD’s development strategy, major financing plan and investment decisions. In addition, the local 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: SMGD is an important LIDC in Zhangqiu that is responsible for the development and operation of Mingshui EDZ. The company undertakes infrastructure and resettlement house project and operates industrials parks in Mingshui EDZ. Its business operations and strategic planning have been aligned with the local government’s economic and social development policies.

Ongoing Government Support: The local government provided ongoing support to SMGD. The local government injected assets, including industrial parks, coal mine and resettlement house projects, valued at c. RMB2.4 billion between 2020 and the first half of 2023. Over the same period, the company received operational subsidies amounting to RMB435 million to support SMGD’s activities in relation to providing public goods. We expect SMGD to

Key Figures of Mingshui and SMGD (RMB billion)

Zhangqiu	2021	2022
GDP	112.0	112.1
GDP growth rate (%)	4.6	0.1
Budgetary revenue	7.7	5.4
Government fund*	10.9	1.5
Transfer payment	6.7	4.8
Budgetary expenditure	8.2	8.3
SMGD	2021	2022
Asset	14.9	17.2
Equity	6.3	7.8
Revenue	0.5	1.1

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

* Adjusting land-transferring return to government fund income from transfer payment

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Applicable Criteria

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

receive ongoing support from the local government in the coming years considering its strategic importance in Zhangqiu.

Economy and Fiscal Condition of Zhangqiu: Zhangqiu is a municipal district under the jurisdiction of Jinan, the provincial capital of Shandong Province. Zhangqiu's GDP growth rate showed a downward trend in the past three years, recording at 7.2%, 4.6% and 0.1% in 2020, 2021 and 2022, respectively. Zhangqiu realized a GDP of RMB112.1 billion in 2022, which was ranked 4th among twelve jurisdictions of Jinan. Zhangqiu's GDP per capita was c. RMB102,300 in 2022, which was lower than the GDP per capita of Jinan (c. RMB127,700) but higher than that of Shandong (c. RMB86,000).

Mingshui EDZ was established as a provincial development zone approved by the Shandong provincial government in December 1992. In October 2012, it was upgraded to a national economic and technological development zone approved by the State Council. Mingshui EDZ has nurtured four leading industries of high-end equipment, new materials, new medicine and new information.

The Zhangqiu government's budgetary revenue decreased substantially to RMB5.4 billion in 2022 from RMB7.7 billion in 2021, due to the large-scale value-added tax refund policy as well as the economic slowdown. Its fiscal self-sufficiency rate lowered substantially, and its budget deficit widened to 53.8% in 2022 from 6.4% in 2021. In addition, Zhangqiu's government fund income (including the return of land-transferring incomes from the higher government) decreased to RMB1.4 billion in 2022 from RMB10.9 billion in 2021, owing to the weak property market.

Zhangqiu's government debt continued to grow in the past three years as the local government issued large amount of special debts to support projects' development in Zhangqiu. At end-2022, Zhangqiu's government debt reached RMB16.9 billion, up from RMB12.0 billion at end-2020. Its government debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased sharply to 157.2% from 47.0% over the same period, due to the increase in special debt as well as the decrease in aggregate revenue.

SMGD's Financial and Liquidity Position: SMGD's asset size grew rapidly to RMB18.2 billion at end-June 2023 from RMB10.4 billion at end-2020, largely attributed to the company's active participation in Mingshui EDZ's project development. As the company heavily relied on borrowings to fund its asset expansion its financial leverage, as measured by debt/capitalization increased significantly to 48.5% from 29.4% over the same period. At end-June 2023, SMGD's total debt reached RMB7.3 billion, up from RMB2.2 billion at end-2020.

In addition, SMGD's asset liquidity was weak, as it held a lot of investment properties (mainly industrial parks for leasing) and inventories (mainly lands and construction costs), which reached RMB7.1 billion and RMB5.7 billion at end-June 2023, representing 39.3% and 31.1% of the company's total asset, respectively. These assets usually take a long time to monetize due to the protracted construction and payment collection period.

SMGD's short-term debt pressure was high. At end-June 2023, the company had cash of RMB1.0 billion (including restricted cash of RMB287 million). At the same time, the company had debt due within one year of RMB2.2 billion. Nevertheless, SMGD has access to various financing channels, including bank borrowings, onshore and offshore bond issuances, and

other non-traditional financings, to support its debt repayments and business operations. At end-June 2023, the company had unused credit lines of RMB3.8 billion.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Zhangqiu

Zhangqiu is a municipal district under the jurisdiction of Jinan, the provincial capital of Shandong Province, and is located in the eastern part of Jinan. Zhangqiu has a total land area of 1,719 square kilometers and residential population of c. 1.1 million at end-2022, with an urbanization rate of 62.6%.

Zhangqiu's GDP growth rate showed a downward trend in the past three years, recording at 7.2%, 4.6% and 0.1% in 2020, 2021 and 2022, respectively. Zhangqiu realized a GDP of RMB112.1 billion in 2022, which was ranked 4th among twelve jurisdictions of Jinan. The economic growth was mainly fueled by the secondary and tertiary industries, accounting for 49.9% and 41.4% of Zhangqiu's aggregate GDP, respectively, in 2022. Zhangqiu's GDP per capita was c. RMB102,300 in 2022, which was lower than the GDP per capita of Jinan c. RMB127,700 thousand, but higher than that of Shandong (c. RMB86,000 thousand).

Mingshui EDZ was established as a provincial development zone approved by the Shandong provincial government in December 1992. In October 2012, it was upgraded to a national economic and technological development zone approved by the State Council. With a planned area of 154 square kilometers, Mingshui EDZ has nurtured four leading industries of high-end equipment, new materials, new medicine and new information.

Zhangqiu's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	100.2	112.0	112.1
-Primary industry (%)	8.2	8.4	8.7
-Secondary industry (%)	52.3	51.8	49.9
-Tertiary industry (%)	39.5	39.8	41.4
GDP growth rate (%)	7.2	4.6	0.1
Fixed asset investment growth rate (%)	0.7	9.8	-4.0
Population (million)	1.1	1.1	1.1

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Zhangqiu

The Zhangqiu government's budgetary revenue decreased substantially to RMB5.4 billion in 2022 from RMB7.7 billion in 2021, due to the large-scale value-added tax refund policy as well as the economic slowdown. Moreover, the contribution of the tax revenue decreased

to 75.9% from 79.2% over the same period. The fiscal self-sufficiency rate of the Zhangqiu government was relatively high in 2020 and 2021. However, due to the large drop in budgetary revenue in 2022, its fiscal self-sufficiency rate lowered substantially, and its budget deficit widened to 53.8% in 2022 from 6.4% in 2021. In addition, Zhangqiu's government fund income (including the return of land-transferring incomes from the higher government) decreased to RMB1.4 billion in 2022 from RMB10.9 billion in 2021, owing to the weak property market.

Zhangqiu's government debt continued to grow in the past three years as the local government issued large amount of special debts to support projects' development in Zhangqiu. At end-2022, Zhangqiu's government debt reached RMB16.9 billion, including RMB1.9 billion of general obligations and RMB15.0 billion of special debt, up from RMB12.0 billion at end-2020. Its government debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased sharply to 157.2% from 47.0% over the same period, due to the increase in special debt as well as the decrease in aggregate revenue.

Zhangqiu's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	7.0	7.7	5.4
Budgetary revenue growth rate (%)	9.1	10.0	-20.4*
Tax revenue	5.7	6.1	4.1
Tax revenue (% of budgetary revenue)	81.0	79.2	75.3
Government fund income**	14.8	10.9	1.5
Transfer payment**	3.6	6.7	4.8
Aggregate revenue	25.4	21.2	10.8
Budgetary expenditure	8.2	8.2	8.3
Budget balance¹ (%)	-16.6	-6.4	-53.8

¹ Budget balance = (1-budgetary expenditure / budgetary revenue) * 100%

* Excluding the influence of value-added tax credit refund

** Adjusting land-transferring return to government fund income from transfer payment

Source: Public information and Lianhe Global's calculations

Ownership Structure

Full Government Ownership

SMGD was established in April 2016 with an initial registered capital of RMB200 million. After an array of capital injection, SMGD's registered and paid-in capital were enlarged to RMB5.0 billion and RMB1,473 million, respectively, at end-June 2023. Zhangqiu government authorizes the Management Committee of Mingshui EDZ to perform the duties of shareholder, acting as the ultimate controller of SMGD by holding 76% shares of the company through the Development Service Center of Mingshui EDZ. ZSAO., another LIDC in Zhangqiu, holds the rest of 24% shares.

Strategic Importance and Government Linkage

Strategic Importance of SMGD to Zhangqiu

SMGD is an important LIDC in Zhangqiu that is responsible for the development and operation of Mingshui EDZ. The company undertakes infrastructure and resettlement house project and operates industrials parks in Mingshui EDZ. Its business operations and

strategic planning have been aligned with the local government’s economic and social development policies.

Strong Linkage with the Local Government

The management committee indirectly holds 76% shares of SMGD and is the ultimate controller of SMGD. The local government has strong control over the company through, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government has formulated a performance assessment policy for the company, and regularly appoints auditors to review the company’s operating performance and financial position.

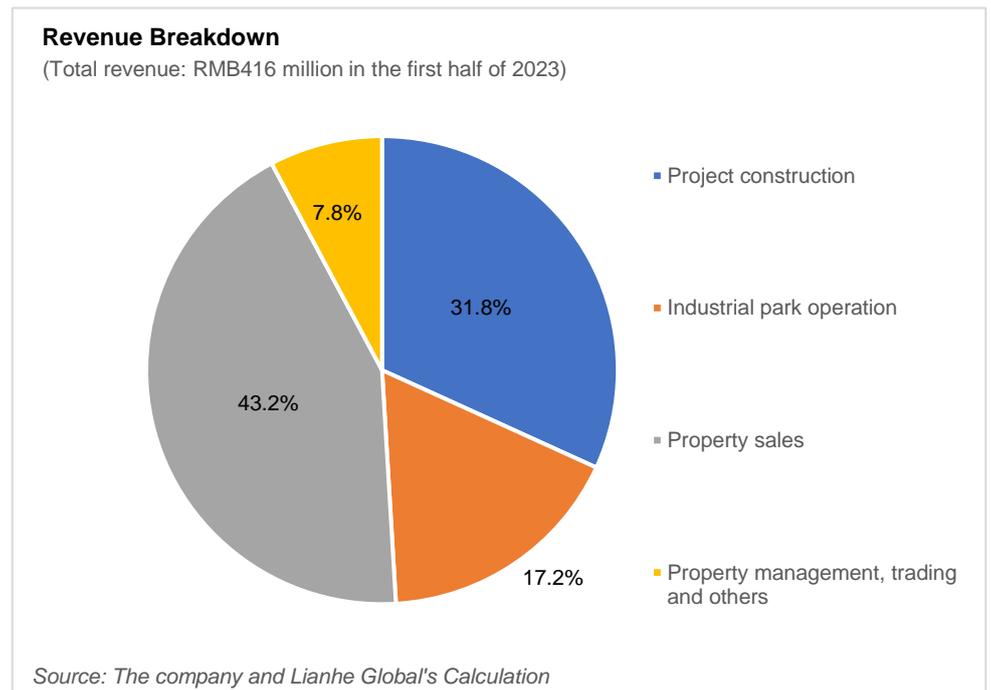
Ongoing Government Support

The local government provided ongoing support to SMGD. The local government injected assets, including industrial parks, coal mine and resettlement house projects, valued at c. RMB2.4 billion between 2020 and the first half of 2023. Over the same period, the company received operational subsidies amounting to RMB435 million to support SMGD’s activities in relation to providing public goods. We expect SMGD to receive ongoing support from the local government in the coming years considering its strategic importance in Zhangqiu.

Business Profile

An Important LIDC Responsible for Development and Operation of Mingshui EDZ

SMGD, as an important LIDC in Mingshui EDZ, is mainly responsible for the infrastructure construction and industrial park development and operation within the region, with a strong regional franchise. The company also engaged in property sales, property management, trading and other businesses. SMGD realized total revenue of RMB756 million, 531 million and 1,080 million and 416 million in 2020, 2021, 2022 and the first half of 2023, respectively.



The overall gross profit margin of SMGD was relatively high, staying above 20% over the same period.

Project Construction

SMGD engages project development activities in Mingshui EDZ through signing agent construction agreements with the management committee and the Zhangqiu government. According to the agreements, SMGD usually uses funds injected by shareholders and raised from external financing to conduct infrastructure projects, including municipal road and bridge construction, drainage, sewerage treatment, and resettlement house projects in Mingshui EDZ. The company recognizes construction costs incurred plus a certain percentage (15%-20%) of margin as revenue upon the completion of projects. The payment period is three to five years. At end-March 2023, SMGD had three resettlement house projects under construction with total planned investments of RMB6.5 billion, of which RMB2.0 billion were scheduled to be invested in the next one to two years.

Industrial Park Operation

In addition to agent construction, SMGD also develops self-operated industrial park projects in Mingshui EDZ to cooperate with the local government's efforts of inviting investments. SMGD leases completed factory and office buildings to companies settling in, which are jointly selected and approved by the local government and SMGD. The local government usually provides rental subsidies to settled companies up to five years. By end-March 2023, SMGD operated ten industrial parks in Mingshui EDZ, covering health, automobile manufacturing and technology industries, etc. We believe this segment promotes the local industrial development. However, some parks' occupancy rate stays low.

Property Sales, Property Management, Trading and others

SMGD has completed and largely sold off a residential property project, generating revenue of RMB103 million, 265 million and 180 million in 2021, 2022 and the first half of 2023, respectively. The property sales were a major revenue source for the company over the same period. However, the company had no other subsequent proposed property development project, land bank for real estate development and land planned for real estate development. SMGD also provides property management services for industrial parks and participates in the trading of metal and chemical medicine. These businesses supplement the revenue of the main business and diversified the revenue structure.

Financial Profile

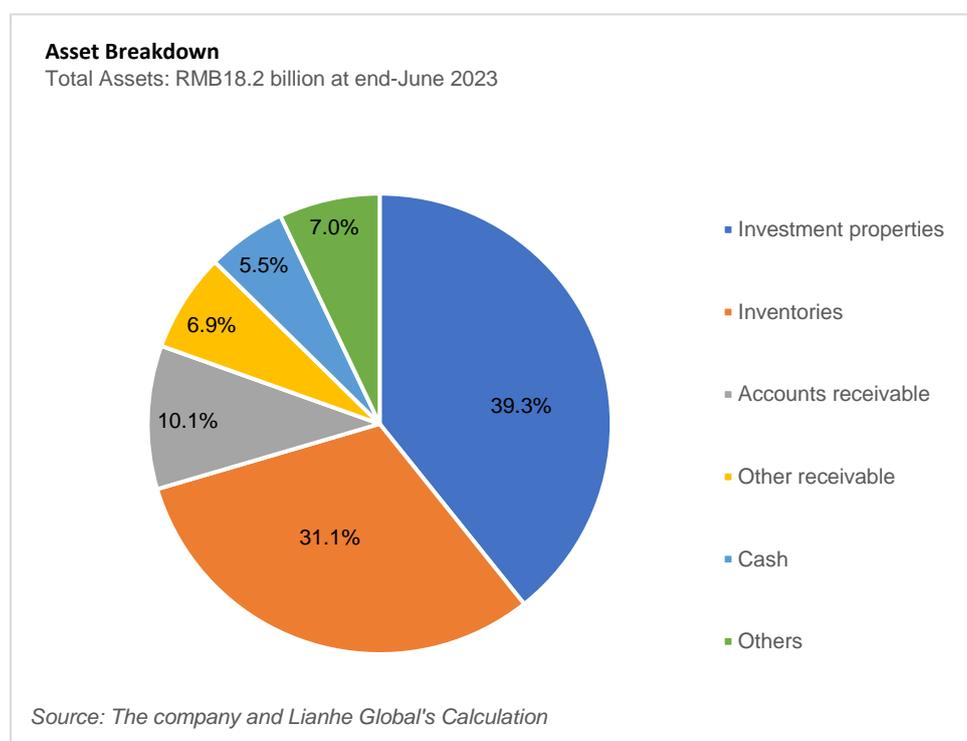
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	June-2023
Total Asset	10,420	14,860	17,168	18,174
Equity	5,339	6,265	7,776	7,792
Debt	2,219	3,813	5,729	7,342
Debt / (Debt + Equity) (%)	29.4	37.8	42.4	48.5
LT Debts	1,617	2,562	3,778	5,143
LT Debt / (LT Debt + Equity) (%)	23.2	29.0	32.7	39.8

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

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In addition, SMGD's asset liquidity was weak, as it held a lot of investment properties (mainly industrial parks for leasing) and inventories (mainly lands and construction costs), which reached RMB7.1 billion and RMB5.7 billion at end-June 2023, representing 39.3% and 31.1% of the company's total asset, respectively. These assets usually take a long time to monetize due to the protracted construction and payment collection period. Moreover, the company had a large number of accounts receivable and other receivables, primarily due from government agencies in Mingshui EDZ. Their repayment schedules are highly subject to the fiscal conditions of the local government.



Debt Servicing Capability

Although its debt structure was improving, with long-term debt's proportion slightly increased to 70.0% at end-June 2023 from 65.9% at end-2022, the company's short-term debt pressure remained high. At end-June 2023, the company had cash of RMB1.0 billion (including restricted cash of RMB287 million). At the same time, the company had debt due within one year of RMB2.2 billion.

Nevertheless, SMGD has access to various financing channels, including bank borrowings, onshore and offshore bond issuances, and other non-traditional financings, to support its debt repayments and business operations. At end-June 2023, the company had unused credit lines of RMB3.8 billion.

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