

# Linqu Economic Development Investment Group Co., Ltd.

## Initial Issuer Report

### Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	5 February 2024

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

### Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Linqu County (“Linqu government”) would provide strong support to LQED if needed, in light of its full ownership of LQED, LQED’s strategic importance as an important LIDC responsible project development and state-owned assets operation in Linqu County (“Linqu”), and the linkage between the Linqu government and LQED, including appointment of the senior management, strategic alignment, supervision of major investment and financing plan decisions and ongoing operational and financial support. In addition, the Linqu government may face significant negative impact on its reputation and financing activities if LQED encounters any operational and financial difficulties.

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

### Rating Rationale

**Linqu Government’s Ownership and Supervision:** The Linqu government holds 100% ownership of LQED through Linqu State-owned Asset Service Center (“Linqu SASC”). As the ultimate controller of LQED, Linqu government has strong control and supervision over the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Linqu government has assessment mechanism over the company through Linqu SASC and appoints auditors to supervise the operating performance and financials on a periodic basis.

**Strategic Importance to Linqu and Strategic Alignment:** LQED is an important LIDC responsible project development and state-owned assets operation in Linqu. The company develops industrial parks as well as servicing and supporting facilities to promote the development of aluminum industry, the pillar industry of Linqu. The company also operate important utilities (steam and heat supply) within the region. Its business operation and strategic planning have been aligned with the local government’s development plans, playing a significant role in promoting the economic and social development in Linqu.

**Ongoing Government Support:** LQED receive ongoing government support in forms of capital/asset injections and operational subsidies to support its business operations. The Linqu government transferred equity of several state-owned enterprises valued at RMB156 million in 2020 and lands valued at RMB3.3 billion in the first half of 2023 to LQED. In addition, LQED received operational subsidies amounting to RMB31 million between 2020 and the first half of 2023 from the local government. We believe that the government support will remain intact given the company’s strategic importance in Linqu.

**Economy and Fiscal Condition of Linqu:** Linqu is a county under the jurisdiction of Weifang City, Shandong Province (“Weifang”). Linqu is known as “Aluminum Capital of China”. It has a well-developed aluminum industry claiming approximately a quarter production capacity of aluminium products of Shandong Province. However, its GDP scale

### Key Figures of Linqu and LQED

#### (RMB billion)

	2021	2022
Linqu		
GDP	38.9	40.9
GDP growth rate (%)	11.0	4.4
Budgetary revenue	2.5	2.5
Government fund	6.2	5.7
Transfer payment	2.7	3.4
Budgetary expenditure	4.6	4.8
LQED	2022	2023.6
Asset	6.8	10.2
Equity	2.7	6.1
Revenue	0.92	0.35

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

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### Applicable Criteria

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

relatively small, amounting to RMB40.9 billion and ranked 10<sup>th</sup> out of twelve jurisdictions of Weifang in 2022. Linqu's economic growth rate fluctuated in the past few years, owing to Covid's disruption, while its fixed asset investment growth rate was on an upward trend.

The Linqu government's budgetary revenue decreased by 2.9% year-over-year to c. RMB2.5 billion in 2022, due to the large-scale value-added tax credit refund policies to support the economy. The Linqu government's fiscal self-sufficiency rate was low, and it recorded a budget deficit of 94.5% in 2022.

The outstanding government debt of the Linqu increased to RMB11.4 billion at end-2022 from RMB8.2 billion at end-2020, mainly due to the increase in special debt to support local project development. As a result, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 98.1% from 82.8% over the same period.

**LQED's Financial and Liquidity Position:** As LQED actively participated in the project development in Linqu, its total asset surged to RMB10.2 billion at end-June 2023 from RMB2.9 billion at end-2020. Its total debt reached RMB1.6 billion at end-June 2023 (end-2020: RMB180 million). LQED's financial leverage, as measured by debt/capitalization, was at a manageable level. LQED's financial leverage, as measured by debt/capitalization, was at a manageable level, staying at 20.7% at end-June 2023.

LQED's asset quality was moderately weak, as the company's project development activities accumulated sizeable inventories (mainly lands to be developed) and construction in progress, representing 56.4% and 11.7% of the company's total asset at end-June 2023, respectively. These project related assets usually take a long time to monetize due to protracted construction and payback periods.

LQED's short-term debt servicing pressure is manageable. At end-June 2023, LQED had unrestricted cash balance of RMB509 million, compared with its debt due within one year of RMB271 million. However, LQED's financing channel was limited, as the company mostly relied on bank borrowings and some non-traditional financing. The company only had unused credit facilities amounting to RMB142 million at end-June 2023 to support its debt repayments and business operations.

## Rating Sensitivities

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

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

## Operating Environment

### Economic Condition of Linqu

Linqu is a county under the jurisdiction of Weifang, Shandong Province and located in the southwestern part of Weifang. Linqu has jurisdiction over four streets and six towns, with a total area of 1,831 square kilometers. At end-2022, Linqu had a residential population of 0.8

million, with an urbanization rate of 56.3%. Linqu is known as “Aluminum Capital of China”. It has a well-developed aluminum industry claiming approximately a quarter production capacity of aluminium products of Shandong Province. Linqu also has abundant tourism resources with fourteen A-level Scenic Areas.

However, Linqu’s GDP scale relatively small, amounting to RMB40.9 billion and ranked 10<sup>th</sup> out of twelve jurisdictions of Weifang in 2022. Linqu’s GDP per capita was moderately low, recording RMB49,800 in 2022, which was well below than Weifang’s RMB77,700, and of that of China (c. RMB85,700).

Linqu’s economic growth rate fluctuated in the past three years, owing to Covid’s disruption, which was 4.2%, 11.0% and 4.4% in 2020, 2021 and 2022, respectively. Yet its fixed asset investment growth rate was on an upward trend, recording at 5.2%, 17.4% and 22.5% in 2020, 2021 and 2022, respectively.

<b>Linqu’s GDP and Fixed Asset Investment</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
GDP	32.2	38.9	40.9
-Primary industry (%)	12.1	11.6	11.2
-Secondary industry (%)	39.4	40.7	41.3
-Tertiary industry (%)	48.5	47.7	47.4
GDP growth rate (%)	4.2	11.0	4.4
Fixed asset investment growth rate (%)	5.2	17.4	22.5
Population (million)	0.8	0.8	0.8

*Source: Public information and Lianhe Global’s calculations*

## Fiscal Condition of Linqu

The Linqu government’s budgetary revenue decreased by 2.9% year-over-year to c. RMB2.5 billion in 2022, due to the large-scale value-added tax credit refund policies to support the economy. The contribution of the tax revenue also slumped to 76.9% in 2022 from 92.6% in 2021. The Linqu government’s fiscal self-sufficiency rate was low, and it recorded a budget deficit of 94.5% in 2022.

Therefore, Linqu government highly relies on government fund income and transfer payment from higher government. Linqu’s government fund income, mainly generated by land sales, maintained a rapid growth in 2020 and 2021, but decreased by 7.9% year-over-year to RMB5.7 billion in 2022, owing to the weak property market. On the other hand, the transfer payment from higher government was on an upward trend in the past few years and reached RMB3.4 billion in 2022, up from RMB2.8 billion in 2020.

The outstanding government debt of the Linqu increased to RMB11.4 billion at end-2022 from RMB8.2 billion at end-2022, mainly due to the increase in special debt to support local project development. As a result, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 98.1% from 82.8% over the same period.

<b>Linqu’s Fiscal Condition</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Budgetary revenue	2.1	2.5	2.5
Budgetary revenue growth rate (%)	5.0	20.9	2.6*
Tax revenue	1.9	2.4	1.9
Tax revenue (% of budgetary revenue)	88.6	92.6	76.9
Government fund income	4.9	6.2	5.7
Transfer payment	2.8	2.7	3.4

<b>Aggregate revenue</b>	<b>9.9</b>	<b>11.5</b>	<b>11.6</b>
Budgetary expenditure	4.2	4.6	4.8
Budget balance <sup>1</sup> (%)	-100.0	-79.5	-94.5

<sup>1</sup> Budget balance = (1-budgetary expenditure / budgetary revenue) \* 100%

Note\*: Excluding the influence of value-added tax credit refund

Source: Public information and Lianhe Global's calculations

## Ownership Structure

### Government's Ownership

LQED, formerly known as Linqu Financial Holding Co., Ltd., was established in October 2017, funded by Linqu State-owned Asset Management Office. In January 2020, LQED changed its name into the current one, while its shareholder changed its name into Linqu SASC. At end-June 2023, LQED's registered capital and paid-in capital were both RMB300 million. Linqu SASC, as the sole shareholder of the company, holds 100% shares of LQED.

## Strategic Importance and Government Linkage

### Strategic Importance of LQED to Linqu

LQED is an important LIDC responsible project development and state-owned assets operation in Linqu. Its business operation and strategic planning have been aligned with the local government's development plans, playing a significant role in promoting the economic and social development in Linqu.

The company develops industrial parks as well as servicing and supporting facilities (i.e. profile quality inspection center and convention and exhibition center) to promote the development of aluminum industry, the pillar industry of Linqu. In addition, company provides scrap materials recycling and centralized procurement services for aluminum producers in Linqu to improve their overall competitiveness. The company also operate important utilities (steam and heat supply) within the region.

### Strong Linkage with the Local Government

LQED's linkage with the local government is strong as the Linqu government holds 100% ownership of LQED through the Linqu SASC. The Linqu government has strong control and supervision over the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Linqu government has assessment mechanism over the company through Linqu SAOSC and appoints auditors to supervise the operating performance and financials on a periodic basis.

### Ongoing Government Support

LQED receive ongoing government support in forms of capital/asset injections and operational subsidies to support its business operations. The Linqu government transferred equity of several state-owned enterprises to LQED, including 100% shares of Linqu High Tech Industrial Investment Co., Ltd. ("LQHT"), Linqu Sharing Aluminum Technology Co., Ltd. ("Sharing Aluminum") and Linqu Salt Industry Co., Ltd. ("LQSI"), valued at RMB156 million in 2020. Yet the procedures for changes on industrial and commercial registration haven't completed.

The Linqu government also injected lands valued at RMB3.3 billion into LQED in the first half of 2023. In addition, LQED received operational subsidies amounting to RMB31 million between 2020 and the first half of 2023 from the local government. We believe that the government support will remain intact given the company's strategic importance in Linqu.

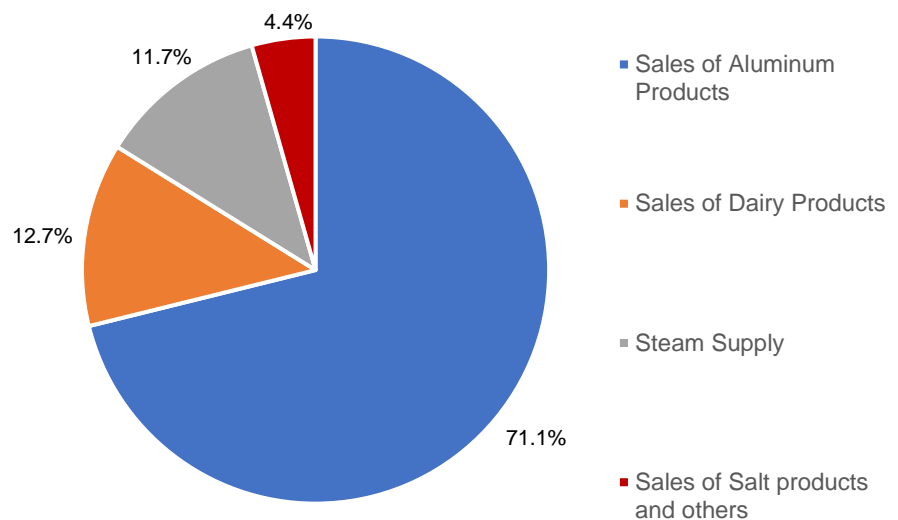
## Business Profile

### An important LIDC responsible for project development and promoting aluminum industry in Linqu

LQED is an important LIDC responsible for project development in Linqu. The company also engages in sales of aluminum, dairy, salt, steam and other products. It recorded revenue of RMB111 million, 413 million, 925 million and 354 million in 2020, 2021, 2022 and the first half of 2023, respectively, representing an upward trend. This was mainly driven by the increasing revenue from sales of aluminum products. However, the aluminum segment generated a low gross margin, and thus dragged down the company's overall gross margin to 4.6% from 49.7% over the same period.

#### Revenue Breakdown

(Total revenue: RMB354 million in the first half of 2023)



Source: The company and Lianhe Global's Calculation

## Project Development

LQED has developed four industrial parks focusing on aluminum and related industries. The company usually adopts self-management model, holding and operating industrial parks upon completion to obtain operational and rental incomes. These industrial parks provide convenient production and business environment for enterprises and promote the aluminum industry cluster in Linqu. LQED also participated the development of service and supporting facilities for aluminium industry, including The National Aluminium Profile Quality Inspection Center and Linqu (International) Convention and Exhibition Center. By end-June 2023, LQED had one industrial park project under construction, with total planned investment amounting to RMB1,550 million, of which RMB730 million scheduled to be invested in the coming years.

### Sales of Aluminum Products

Sharing Aluminum was established in 2020 by the Linqu government along with several aluminum producers in Linqu. Sharing Aluminum mainly engages in recycling scrap materials from these aluminum producers. LQED also provides centralized procurement services for aluminum producers in Linqu to achieve costs saving. We believe these activities could further improve the overall competitiveness of Linqu's aluminium industry, and the sales of aluminum products have become the most important source of revenue for LQED. However, given the nature of this segment, its gross margin was low (1H2023: 1.56%).

### Steam Supply and Sales of Dairy Products

LQED received 100% shares of LQHT transferred from the Linqu government in 2020. LQHT owns 51% stake in Linqu County Dongcheng Thermal Power Co., Ltd., which supplies steam and heat for enterprises and residents in Linqu. It is upgrading its deliverability by building new heating stations and expanding its pipe network. LQHT also owns two subsidiaries operating dairy farms, which produce and sales dairy products such as milk and dairy cattle. One of farm is the core supplier of Yili Group (600887.SH) in Weifang, a China's leading dairy producer.

### Sales of Salt Products and Others

In addition to LQHT, the Linqu government also transferred 100% shares of Linqu Salt Industry Co., Ltd. to LQED in 2020. It is local salt producer supplying table salt and industrial salt for Linqu. LQED also involves in property management and financial guarantee businesses in Linqu. Yet they only account small part of LQED's revenue.

## 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>June 2023</b>
Total Asset	2,941	5,356	6,840	10,196
Equity	1,710	2,313	2,740	6,073
Debt	177	808	1,186	1,582
Debt / (Debt + Equity) (%)	9.4	25.9	30.2	20.7
LT Debts	108	641	1,021	1,311
LT Debt / (LT Debt + Equity) (%)	5.9	21.7	27.2	17.8

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

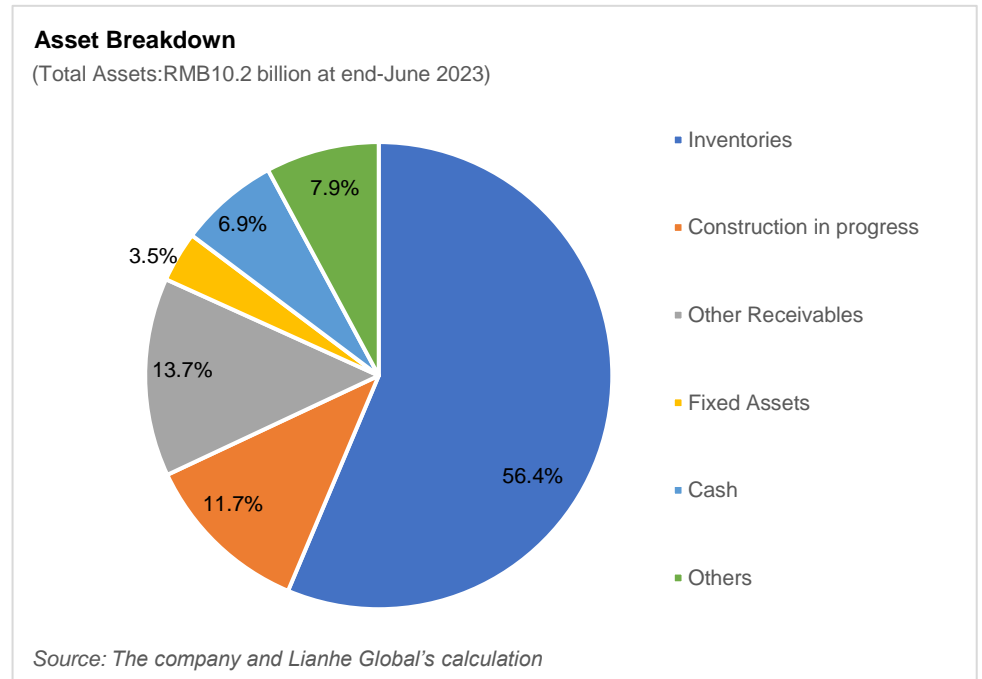
As LQED actively participated in the project development in Linqu, its total asset surged to RMB10.2 billion at end-June 2023 from RMB2.9 billion at end-2020. Its total debt reached RMB1.6 billion at end-June 2023, almost ninefold compared with RMB177 million at end-2020. The short-term debt and long-term debt accounting for 17.1% and 82.9% of the total debt at end-June 2023, respectively.

LQED's financial leverage, as measured by debt/capitalization, was at a manageable level. It increased to 30.2% at end-2022 from 9.4% at end-2020, but dropped to 20.7% at end-June 2023, owing to the land injection from the local government, enhancing its equity base.

LQED's asset quality was moderately weak, as the company's project development activities accumulated sizeable inventories (mainly lands to be developed) and construction in

progress, representing 56.4% and 11.7% of the company's total asset at end-June 2023, respectively. These project related assets usually take a long time to monetize due to protracted construction and payback periods. The local government injected lands to LQED for industrial park construction in the first half of 2023, further increasing its inventories.

In addition, LQED had a large number of other receivables, which accounted for 13.7% of total asset at end-June 2023, and a significant part of them were due from local SMEs, indicating a relatively high counterparty credit risk.



### Debt Servicing Capability

LQED's short-term debt servicing pressure is manageable. At end-June 2023, LQED had unrestricted cash balance of RMB509 million, compared with its debt due within one year of RMB271 million.

However, LQED's financing channel was limited, as the company mostly relied on bank borrowings and some non-traditional financing. At end-June 2023, LQED had total bank facilities of RMB2.9 billion, of which only RMB142 million were unused.



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