

Qingdao Oceantec Valley Investment and Development Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	21 February 2024

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

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Jimo District, Qingdao City (“the Jimo government”) would provide strong support to QDOV if needed, in light of its indirect full ownership of QDOV, QDOV’s strategic importance as an important local investment and development company (“LIDC”) that is responsible for infrastructure construction and maintenance in Jimo District (“Jimo”), especially in the core area of Qingdao Oceantec Silicon Valley (“Oceantec Valley”), and the linkage between the Jimo government and QDOV, including appointment of the senior management, strategic alignment, supervision of major investment and financing plans and ongoing operational and financial support. In addition, the Jimo government may face significant negative impact on its reputation and financing activities if QDOV encounters any operational and financial difficulties.

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

Rating Rationale

Jimo Government’s Ownership and Supervision: Qingdao Oceantec Valley Management Bureau (“Management Bureau”) holds 100% shares of QDOV on behalf of Qingdao Jimo District State-owned Asset Operation and Service Center (“Jimo SAOSC”), the company’s actual controller. The local 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 Jimo government has assessment mechanism over the company and appoints auditors to supervise the operating performance and financials on a periodic basis.

Strategic Importance to Jimo and Strategic Alignment: QDOV is an important LIDC responsible for infrastructure construction and maintenance in Jimo, especially in the core area of Oceantec Valley. The company’s business operation plays a significant role in urban development within the region. Its strategic planning has been aligned with the local government’s economic and social development plans.

Ongoing Government Support: QDOV receives ongoing support from the local government. The local government provided operational subsidies of RMB550 million between 2020 and 2022 to QDOV to support its operations. The local government also injected cash capital and project fund amounting to RMB100 million and RMB1,755 million, respective, into the company over the same period. In addition, QDOV received assets such as sea area use rights, franchise rights of tourism, parking lots and advertisement and trees, which could generate stable operational and rental incomes. We expect the support from the local government to remain intact given QDOV’s strategic importance.

Key Figures of QDOV and Jimo

(RMB billion)

Jimo	2021	2022
GDP	145.3	151.3
GDP growth rate (%)	6.9	2.6
Budgetary revenue	11.6	10.0
Government fund	12.2	5.8
Transfer payment	4.5	4.5
Budgetary expenditure	12.8	13.3
QDOV	2022	2023.9
Asset	37.2	41.6
Equity	34.3	36.5
Revenue	2.7	2.5

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

Analysts

Sigmund Jiang, CFA, CESGA
 (852) 3462 9587
sigmund.jiang@lhratingsglobal.com

Roy Luo, FRM, CESGA
 (852) 3462 9582
roy.luo@lhratingsglobal.com

Applicable Criteria

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

Economy and Fiscal Condition of Jimo and Ocean-tec Valley: Jimo is one of the seven urban districts of Qingdao City. Jimo recorded an economic growth in 2022, achieving a GDP of RMB151.3 billion, with a year-on-year growth of 2.6%. Its total GDP ranks third among 20 districts and counties in Qingdao. Ocean-tec Valley, formerly known as Jimo High-tech Zone, was established in January 2001 and renamed as the present one in November 2017. With a total planned land and sea area of 443 square kilometers, Ocean-tec Valley features marine high-tech R&D and industrial clusters.

The aggregate fiscal revenue of the Jimo government was mainly derived from the budgetary revenue and government fund income. In 2022, the budgetary revenue of the Jimo government decreased to RMB10 billion (2021: RMB11.6 billion) due to the large-scale value-added tax credit refunds to support the economy. At the same time, the government fund income dropped to RMB5.8 billion in 2022 from RMB12.2 billion in 2021. The budget deficit increased to 33.5% in 2022 from 10.2% in 2021, while the debt ratio (i.e., total government debt divided by aggregate revenue) of the Jimo government increased to 80.4% from 39.7% over the same period.

QDOV's Financial and Liquidity Position: QDOV's total asset surged to RMB41.6 billion at end-September 2023 from RMB21.7 billion at end-2020, mainly due to the local government's large-scale asset injections over the same period. The company also relied on borrowings to fund its project development within the core area of Ocean-tec Valley, lifting the total debt to RMB4.2 billion at end-September 2023, as compared with RMB720 million at end-2020. Yet the company's financial leverage, as measured by debt/capitalization stayed at a relatively low level of 10.4% at end-September 2023.

QDOV's asset liquidity was relatively weak, as the company had accumulated sizable inventories of RMB18.7 billion (mainly construction costs) and receivables (including other receivables) (mainly due from government agencies and other SOEs in Jimo) of RMB7.7 billion, from its project development activities, representing 45.0% and 18.5% of total asset end-September 2023, respectively. These assets usually take a long time to monetize due to the protracted construction and payment collection period.

QDOV's short-term debt serving pressure was moderately high. At end-September 2023, the company had cash balance of RMB555 million (including restricted cash of RMB486 million), while it had debt due within one year of RMB2.3 billion. Yet the company has access to various financing channels, including bank borrowings and bond issuances, to support its debt repayments and business operations. At end-September 2023, the company had unused bank facilities of RMB2.1 billion at end-2023.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Jimo

Jimo is a municipal district of Qingdao City, Shandong Province and is located in the north of the central urban areas of Qingdao City. Jimo has jurisdiction over 4 towns and 11 streets, with a total area of 1,793 square kilometers. Besides, it owns one provincial economic development zone, one provincial high-tech industrial zone, and one provincial tourism resort. At end-2021, Jimo had a resident population of c. 1.4 million, with an urbanization rate of 59.1%.

Jimo maintained steady economic growth in the past three years. Jimo's GDP reached RMB151.3 billion, representing a year-over-year growth rate of 2.6% in 2022, and its GDP ranked the 3rd among 20 districts and county-level cities under the administration of Qingdao. Featured with "marine economy", Jimo focused on the development of high-tech industries, equipment manufacturing, textile and clothing in recent years. Jimo's economic growth was mainly fueled by the secondary and tertiary industries in the past few years, which accounted for 50.3% and 43.9% in 2022, respectively.

Oceantec Valley, formerly known as Jimo Provincial High-tech Industrial Zone, was established in January 2001 and renamed as the present one in November 2017. With a total planned land and sea area of 443 square kilometers, Oceantec Valley features marine high-tech R&D and industrial clusters.

Jimo's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	127.8	145.3	151.3
-Primary industry (%)	6.0	5.8	5.9
-Secondary industry (%)	49.3	50.8	50.3
-Tertiary industry (%)	44.7	43.4	43.9
GDP growth rate (%)	5.8	6.9	2.6
Fixed asset investment	147.5	156.1	163.7
Fixed asset investment growth rate (%)	4.4	5.8	4.9
Population (million)	1.3	1.4	1.4

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Jimo

The Jimo government's aggregate fiscal revenues are mainly derived from budgetary income and government fund income. The Jimo government's budgetary revenue decreased to RMB9.96 billion in 2022 from RMB11.6 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. In addition, Jimo's government fund income, mainly generated by land sales, dropped sharply to RMB5.8 billion in 2022 from RMB12.2 billion, owing to the weak property market. As a result, the Jimo government recorded aggregate revenue of RMB20.3 billion in 2022, down from RMB28.3 billion in 2021.

In contrast, its budgetary expenditure increased to RMB13.3 billion from RMB12.8 billion. Therefore, the Jimo government's budget deficit was enlarged to 33.5% from 10.2% over the same period. Moreover, its government debt grew significantly in 2022, mainly due to the increase in special debts to support project development in Jimo, lifting the government debt ratio, as measured by total government debt/aggregate revenue, to 80.4% from 39.7% over the same period.

Jimo's Fiscal Condition			
(RMB billion)	2020	2021	2022

Budgetary revenue	11.2	11.6	10.0
Budgetary revenue growth rate (%)	0.1	3.6	1.0*
Tax revenue	8.0	9.1	6.4
Tax revenue (% of budgetary revenue)	71.3	78.6	64.4
Government fund income	16.5	12.2	5.8
Transfer payment	2.0	4.5	4.5
Aggregate revenue	29.7	28.3	20.3
Budgetary expenditure	12.8	12.8	13.3
Budget balance ¹ (%)	-14.5	-10.2	-33.5

¹ 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

QDOV was established in May 2016 funded by the Technological Innovation Service Center of Qingdao Oceanec Valley Core Area Management Committee. In 2020, the company's sole shareholder was changed to Management Bureau.

At end-August 2023, QDOV's registered capital and paid-in capital were RMB2 billion and RMB0.5 billion, respectively. Management Bureau holds 100% shares of QDOV on behalf of Jimo SAOSC, the company's actual controller.

Strategic Importance and Government Linkage

Strategic Importance of QDOV to Jimo

QDOV is an important LIDC responsible for infrastructure construction and maintenance in Jimo, especially in the core area of Oceanec Valley. The company's business operation plays a significant role in urban development within the region. Its strategic planning has been aligned with the local government's economic and social development plans.

Strong Linkage with the Local Government

QDOV's linkage with the local government is strong as Management Bureau holds 100% shares of the company on behalf of Jimo SAOSC. The local 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 local government has assessment mechanism over the company and appoints auditors to supervise the operating performance and financials on a periodic basis.

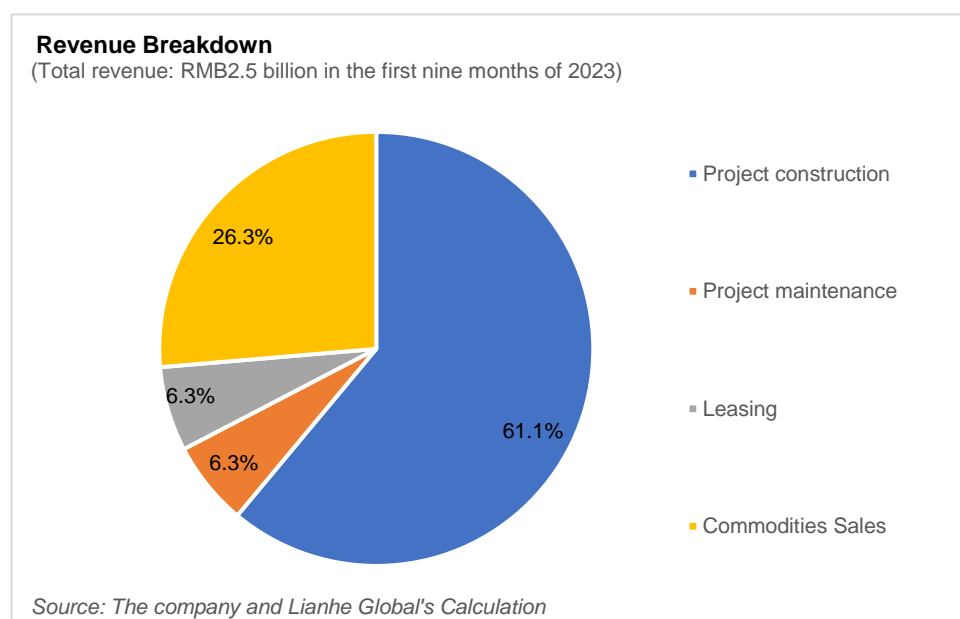
Ongoing Government Support

QDOV receives ongoing support from the local government. The local government provided operational subsidies of RMB550 million between 2020 and 2022 to QDOV to support its operations. The local government also injected cash capital and project fund amounting to RMB100 million and 1,755 million, respectively, into the company over the same period. In addition, QDOV received assets such as sea area use rights, franchise rights of tourism, parking lots and advertisement and trees, which could generate stable operational and rental incomes. We expect the support from the local government to remain intact given QDOV's strategic importance.

Business Profile

An Important LIDC Responsible for Infrastructure Construction in the Core Area of Oceantec Valley

QDOV, as an important LIDC in Jimo District, is mainly responsible for infrastructure construction within the core area of Qingdao Oceantec Valley, with a strong regional franchise advantage. The primary source of operating revenue for the company is project construction, while it also engages in project maintenance, leasing and commodities sales activities. The company's total revenue reached RMB0.84 billion, RMB2.05 billion, RMB2.72 billion and RMB2.51 billion in 2020, 2021, 2022 and the first nine months of 2023, respectively, representing an upward trend. The overall gross profit margin of QDOV stayed at 13%-15% over the same period.



Project Construction and Maintenance

QDOV undertakes infrastructure construction projects within the core area of Oceantec Valley, with a strong regional franchise advantage. The projects in this segment are usually conducted under agent construction model, where the company signs agent-construction agreements with local SOEs and is responsible for fundraising and construction of entrusted projects. Upon the completion of the entrusted projects, the company transfers these projects to the entrusting party and gets payments according to the agreements. Currently, the company is working on several large-scale projects and has a strong project pipeline with total planned investment amounting to RMB7.2 billion at end-2022, which may bring a high capital expenditure pressure on QDOV in the coming years.

QDOV is also responsible for the operation and maintenance of infrastructure facilities, including roads, parks and pipeline network, etc. within the core area of Oceantec Valley, and obtain asset management fees from Management Bureau annually.

Commodities Sales and Leasing

QDOV has diversified its business operations since 2022 by adding the commodities sales business to complement its main operations. The company undertakes the sales of zinc ingots, rubber and PTA by spot transaction and makes a profit from the spread between

buying and selling prices. The revenue generated from this segment reached RMB482 million and RMB662 million in 2022 and the first nine months of 2023, respectively. However, the gross margin was very low (2022: 0.09%).

QDOV also rents stated-owned properties, parking lots and sea area using rights (mainly injected by the local government), etc. to earn rental incomes.

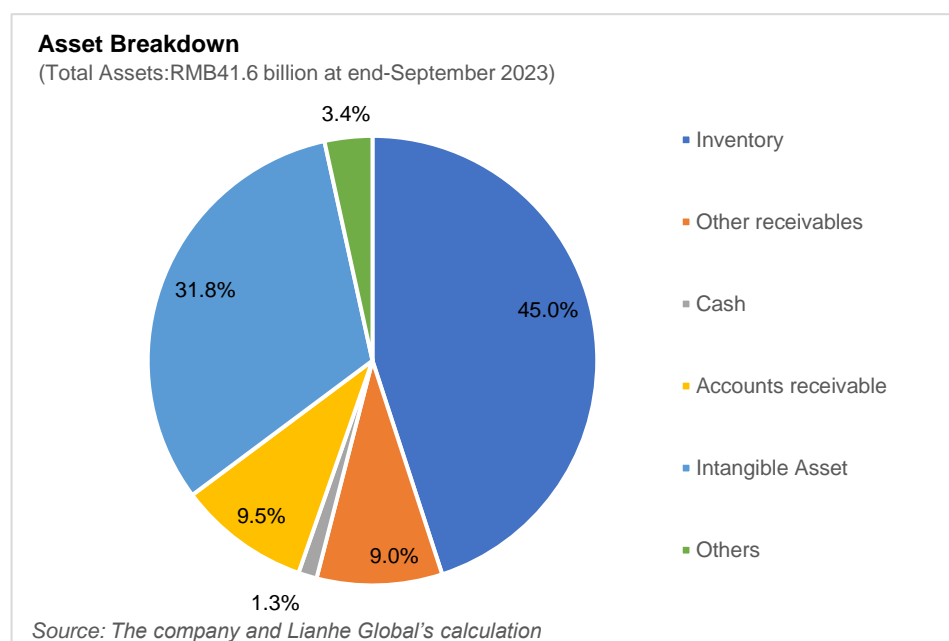
Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	September 2023
Total Asset	21,686	30,437	37,222	41,622
Equity	19,401	28,833	34,275	36,457
Debt	720	925	2,123	4,234
Debt / (Debt + Equity) (%)	3.6	3.1	5.8	10.4
LT Debts	475	540	560	1,900
LT Debt / (LT Debt + Equity) (%)	2.4	1.8	1.6	5.0

Source: Company information and Lianhe Global's calculations

QDOV's total asset surged to RMB41.6 billion at end-September 2023 from RMB21.7 billion at end-2020, mainly due to the local government's large-scale asset injections over the same period. The company also relied on borrowings to funds its project development within the core area of Oceantec Valley, lifting the total debt to RMB4.2 billion at end-September 2023, as compared with RMB720 million at end-2020. Yet the company's financial leverage, as measured by debt/capitalization stayed at a relatively low level of 10.4% at end-September 2023.



QDOV's asset liquidity was relatively weak, as the company had accumulated sizable inventories of RMB18.7 billion (mainly construction costs) and receivables (including other receivables) (mainly due from government agencies and other SOEs in Jimo) of RMB7.7 billion, from its project development activities, representing 45.0% and 18.5% of total asset

end-September 2023, respectively. These assets usually take a long time to monetize due to the protracted construction and payment collection period. In addition, the company had a large amount of intangible asset (mainly franchise rights, sea area using rights, sand excavation rights, etc.) injected by the local government, which accounted for 31.8% of total asset.

Debt Servicing Capability

QDOV's short-term debt serving pressure was moderately high. At end-September 2023, the company had cash balance of c. RMB555 million (including restricted cash of RMB486 million), while it had debt due within one year of RMB2.3 billion. Yet the company has access to various financing channels, including bank borrowings and bond issuances, to support its debt repayments and business operations. At end-September 2023, the company had unused bank facilities of RMB2.1 billion at end-2023.



Disclaimer

Credit rating and research reports published by Lianhe Ratings Global Limited (“Lianhe Global” or “the Company” or “us”) are subject to certain terms and conditions. Please read these terms and conditions at the Company’s website: www.lhratingsglobal.com

A credit rating is an opinion addresses the creditworthiness of an entity or security. Credit ratings are not a recommendation to buy, sell, or hold any security. Credit ratings do not address market price, marketability, and/or suitability of any security nor its tax implications or consequences. Credit ratings may be subject to upgrade or downgrade or withdrawal at any time for any reason at the sole discretion of Lianhe Global.

All credit ratings are the products of a collective effort by accredited analysts through rigorous rating processes. No individual is solely responsible for a credit rating. All credit ratings are derived by credit committee vesting processes. The individuals identified in the reports are solely for contact purpose only.

Lianhe Global conducts its credit rating services based on third-party information which we reasonably believe to be true. Lianhe Global relies on information including, but not limited to, audited financial statements, interviews, management discussion and analysis, relevant third-party reports, and publicly available data sources to conduct our analysis. Lianhe Global has not conducted any audit, investigation, verification or due diligence. Lianhe Global does not guarantee the accuracy, correctness, timeliness, and/or completeness of the information. Credit ratings may contain forward-looking opinions of Lianhe Global which may include forecasts about future events which by definition are subject to change and cannot be considered as facts.

Under no circumstance shall Lianhe Global, its directors, shareholders, employees, officers and/or representatives or any member of the group of which Lianhe Global forms part be held liable to any party for any damage, loss, liability, cost, expense or fee in connection with any use of the information published by the Company.

Lianhe Global receives compensation from issuers, underwriters, obligors, or investors for conducting credit rating services. None of the aforementioned entity nor its related party participate in the credit rating process aside from providing information requested by Lianhe Global.

Credit ratings included in any rating report are solicited and disclosed to the rated entity (and its agents) prior to publishing. Credit rating and research reports published by Lianhe Global are not intended for distribution to, or use by, any person in any jurisdiction where such use would infringe local laws and regulations. Any user relies on information available through credit rating and research reports is responsible for consulting the relevant agencies or professionals accordingly to comply with the applicable local laws and regulations.

All published credit rating and research reports are the intellectual property of Lianhe Global. Any reproduction, redistribution, or modification, in whole or parts, in any form by any means is prohibited unless such user has obtained prior written consent from us.

Lianhe Global is a subsidiary of China Lianhe Credit Rating Co., Ltd. The credit committee of Lianhe Global has the ultimate power of interpretation of any methodology or process used in the Company’s independent credit ratings and research.

Copyright © Lianhe Ratings Global Limited 2024.