

Shandong Yihe Holding Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	12 March 2024

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

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Linyi City (“Linyi government”) would provide moderately strong support to SYHG if needed, in light of its full ownership of SYHG through the Management Committee of Yihe New District (“Yihe ND MC”), the de facto local government of Yihe New District (“Yihe ND”), SYHG’s strategic importance as the most important local investment and development company (“LIDC”) that is responsible for development and operation in Yihe ND, and the linkage between the Yihe ND MC and SYHG, 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 Linyi government may face negative impact on its reputation and financing activities if SYHG encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Yihe ND MC, the sole shareholder and the actual controller of the company, directly holds the full ownership of SYHG. The local government has the final decision-making authority and supervision over the company, including appointment and supervision of the senior management, strategy alignment and major investment and financing plan decisions, etc. In addition, the local government has formulated a performance assessment mechanism for the company and regularly appoints auditors to review the company’s operating performance and financial position.

Strategic Importance to Yihe ND and Strategic Alignment: SYHG, as the most important LIDC in Yihe ND, is mainly responsible for construction and operation within the region, with a strong regional franchise advantage. SYHG also engages in commodities sales, property service, leasing, etc. It plays an important role in promoting the economic and social development of the region. Its business operation and strategic planning have been aligned with the government’s development plans.

Ongoing Government Support: SYHG continued to receive financial subsidies and asset/capital injections from the Linyi government and the Yihe ND MC to support its business operations. We believe the government support will remain intact given the company’s strategic importance in Yihe ND. With the development of oil and ore trade in Shandong, and the continuous acceleration of urban construction and urbanization, the government’s support for the company is expected to be further strengthened.

SYHG’s Financial and Liquidity Position: SYHG’s total asset increased steadily to RMB23.8 billion at end-September 2023 from RMB18.9 billion at end-2020, as the company actively participated in Yihe ND’s construction and development. Its total debt continued to grow in the past few years and reached RMB9.6 billion at end-September 2023. The

Key Figures of Linyi and SYHG

(RMB billion)	2022	2023
Linyi		
GDP	577.9	610.5
GDP growth rate (%)	4.2	6.3
Budgetary revenue	42.0	44.6
Government fund	33.4	24.5
Transfer payment	37.5	46.2
Budgetary expenditure	87.5	92.0
SYHG		
Assets	21.3	23.8
Equity	11.1	11.2
Revenue	1.9	1.2

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

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Applicable Criteria

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

company's financial leverage, as measured by debt/capitalization, remained stable and at a manageable level between 43% and 46% from end-2020 to end-September 2023.

The liquidity of SYHG was weak. At end-September 2023, SYHG had unrestricted cash balance and unused credit facilities of RMB781.2 million and RMB1,272.9 million, respectively, compared with its debt due within one year of RMB3,482.4 million. The company has available onshore bond issuance quota of RMB500 million. SYHG mainly relies on external financing and it has accessed to various financing channels, including bank loans, bond issuance and non-traditional financing (such as financial lease), to support its debt repayments and business operations. Therefore, obtaining additional financing channels or government support is important for the company to maintain its liquidity.

Economy and Fiscal Condition of Linyi: Linyi is a prefecture-level city under the jurisdiction of Shandong Province ("Shandong") and located in the southeastern part of Shandong. Linyi's economic growth fluctuated in the past few years, due to Covid's disruption and economic recovery, with GDP growth rate recording at 8.7%, 4.2% and 6.3% in 2021, 2022 and 2023, respectively. Established in November 2022, Yihe ND focuses on the development of several leading industries, including intelligent manufacturing, opto-electronics, biological medicine, etc. in recent years.

The Linyi government's budgetary revenue maintained a steady growth in the past few years and reached RMB44.6 billion in 2023, with tax revenue accounting for 73.78% of budgetary revenue. Linyi's government fund income slumped to RMB24.5 billion in 2023 from RMB59.2 billion in 2021, owing to the weak property market. The debt ratio, as measured by the total government debt/aggregate revenue, increased to 146.5% in 2023 from 92.5% in 2021, mainly due to the increase in special debt.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Linyi

Linyi is a prefecture-level city under the jurisdiction of Shandong and located in the southeastern part of Shandong. Linyi has jurisdiction over 3 districts and 9 counties, with a total area of 17,191 square kilometers, making it the largest prefecture-level city in Shandong. At end-2022, Linyi had a resident population of 12.0 million, with an urbanization rate of 55.9%.

Linyi's economic growth fluctuated in the past few years, due to Covid's disruption and economic recovery, with GDP growth rate recording at 8.7%, 4.2% and 6.3% in 2021, 2022 and 2023, respectively. Linyi's economic growth was mainly fueled by the secondary and tertiary industries, which accounted for 38.9% and 52.4% in 2023, respectively. GDP per capita of Linyi increased to RMB55,800 in 2023 from RMB52,502.

Established in November 2022, Yihe ND covers 8 towns in Hedong District and Lanshan District of Linyi, including Linyi Economic Development Area and Linyi Comprehensive Bonded Zone. Yihe ND focuses on the development of several leading industries, including intelligent manufacturing, opto-electronics, biological medicine, etc. in recent years.

Linyi's GDP and Fixed Asset Investment

(RMB billion)	2021	2022	2023
GDP	551.8	577.9	610.5
-Primary industry (%)	8.9	8.8	8.7
-Secondary industry (%)	38.7	39.7	38.9
-Tertiary industry (%)	52.4	51.5	52.4
GDP growth rate (%)	8.7	4.2	6.3
Fixed asset investment	359.8	404.0	430.3
Fixed asset investment growth rate (%)	11.4	12.3	6.5
Population (million)	12.0	12.0	12.0*

Source: Public information and Lianhe Global's calculations

*2022 data is used as 2023 data is not yet available.

Fiscal Condition of Linyi

The Linyi government's budgetary revenue maintained a steady growth in the past few years and reached RMB44.6 billion in 2023, with tax revenue accounting for 73.78% of budgetary revenue. The financial self-sufficiency of Linyi government was weak and its budget deficit fluctuated in the past few years, recording at 106.4% in 2023. Therefore, the Linyi government highly relied on transfer payments from higher government and government fund income. Linyi government's transfer payment continued to grow in the past few years and reached RMB46.2 billion in 2023. On the other hand, Linyi's government fund income slumped to RMB24.5 billion in 2023 from RMB59.2 billion in 2021, owing to the weak property market.

The debt of the Linyi government continued to grow in the past few years and reached RMB169.1 billion at end-2023, including RMB33.3 billion of general obligations and RMB135.8 billion of special debt. The debt ratio, as measured by the total government debt/aggregate revenue, increased to 146.5% in 2023 from 92.5% in 2021, mainly due to the increase in special debt.

Linyi's Fiscal Condition

(RMB billion)	2021	2022	2023
Budgetary revenue	40.9	42.0	44.6
Budgetary revenue growth rate (%)	17.0	9.6	6.1
Tax revenue	33.5	32.1	32.9
Tax revenue (% of budgetary revenue)	81.7	76.3	73.8
Government fund income	59.2	33.4	24.5
Transfer payment	35.6	37.5	46.2
Aggregate revenue	135.9	113.1	115.4
Budgetary expenditure	80.7	87.5	92.0
Budget balance ¹ (%)	-97.1	-108.2	-106.4

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

Source: Public information and Lianhe Global's calculations



Ownership Structure

Government's Ownership

SYHG was established by the Yihe ND MC in April 2011. After an array of capital injections, SYHG's registered capital and paid-in capital were both RMB2.0 billion at end-November 2023. The Yihe ND MC is the sole shareholder and actual controller of the company.

Strategic Importance and Government Linkage

Strategic Importance of SYHG to Yihe ND

SYHG, as the most important LIDC in Yihe ND, is mainly responsible for construction and operation within the region, with a strong regional franchise advantage. SYHG also engages in commodities sales, property service, leasing, etc. It plays an important role in promoting the economic and social development of the region. Its business operation and strategic planning have been aligned with the government's development plans.

Strong Linkage with the Local Government

SYHG's linkage with the local government is strong as the Yihe ND MC, the sole shareholder and the actual controller of the company, directly holds the full ownership of SYHG. The local government has the final decision-making authority and supervision over the company, including appointment and supervision of the senior management, strategy alignment and major investment and financing plan decisions, etc. In addition, the local government has formulated a performance assessment mechanism for the company and regularly appoints auditors to review the company's operating performance and financial position.

Government Support

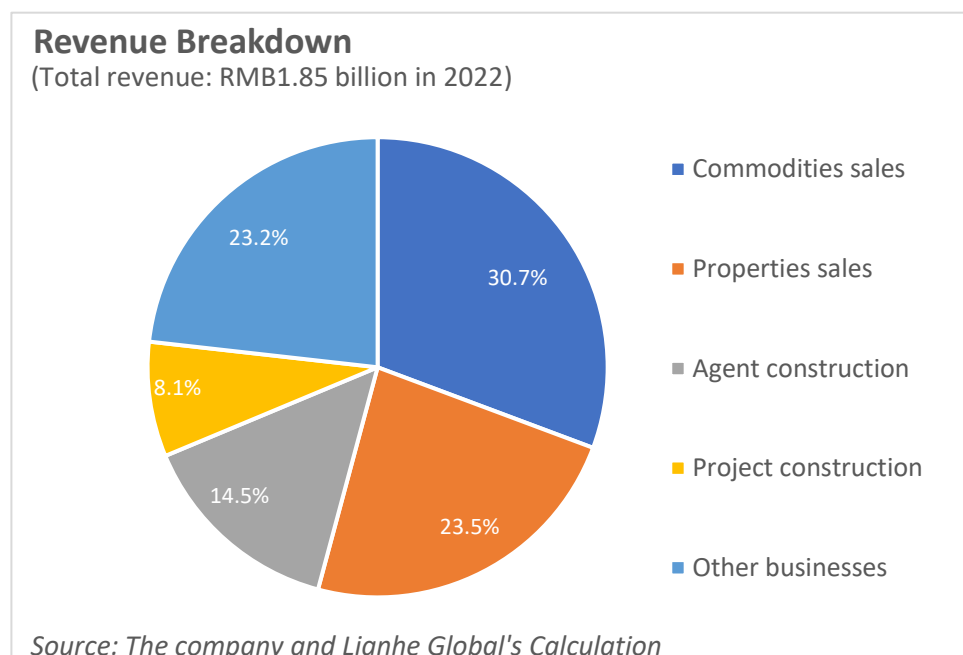
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Business Profile

The Most Important Entity Responsible for Construction and Operation in Yihe ND

SYHG, as the most important LIDC in Yihe ND, is mainly responsible for construction and operation within the region, with a strong regional franchise advantage. The primary sources of operating revenue for the company are commodities sales, properties sales and agent construction, while it also engages in project construction, property service, leasing, etc. The company's total revenue reached c. RMB2.18 billion and RMB1.85 billion in 2021 and 2022,

respectively. The overall gross profit margin of SYHG remained stable at around 19% over the same period.



Commodities Sales

As the major source of revenue for the company, commodities sales business mainly involves the sales of steel, electrolytic copper, etc. It is mostly conducted in a “demand-driven” model, where it determines the amount of materials to be procured strictly based on the actual purchase orders placed by customers. The revenue of this segment reached c. RMB791 million and RMB568 million in 2021 and 2022, respectively. The gross profit margin remained negative over the same period, mainly due to the fluctuation of commodities prices and exchange rates.

Properties Sales

Properties sales business mainly involves the sales of commodity housing projects. The company mainly adopts self-operating mode for this segment. Completed projects of the company had been almost sold out, but the company still had a strong project pipeline. The revenue of this segment reached c. RMB476 million and RMB435 million in 2021 and 2022, respectively. The gross profit margin of this segment remained relatively stable at 23%-24% over the same period.

Agent Construction

SYHG is designated by the Yihe ND MC to undertake infrastructure construction business within Yihe ND. The projects in this segment are generally conducted in the agent construction model, where the company signs the agent construction agreements with the entrusting party and settles construction costs plus a percentage of management fees with the entrusting party according to the project’s progress. The revenue of this segment reached c. RMB310 million and RMB269 million in 2021 and 2022, respectively. The gross profit margin of this segment remained stable at around 15% over the same period. Currently,

the company is working on several large-scale projects, thus it incurs high capital expenditure pressure.

Project Construction

Project construction business is mainly handled by two subsidiaries of the company, which acquire engineering projects like roads, buildings and water infrastructure through open biddings. The revenue generated from this segment reached RMB173 million and RMB150 million in 2021 and 2022, respectively, with the gross profit margin decreasing from 17.6% to 9.8% over the same period.

Other Businesses

Other businesses of SYHG mainly include property service, leasing, etc., which mainly play the role of supplementing the revenue of the main business and make the revenue structure more diversified.

Financial Profile

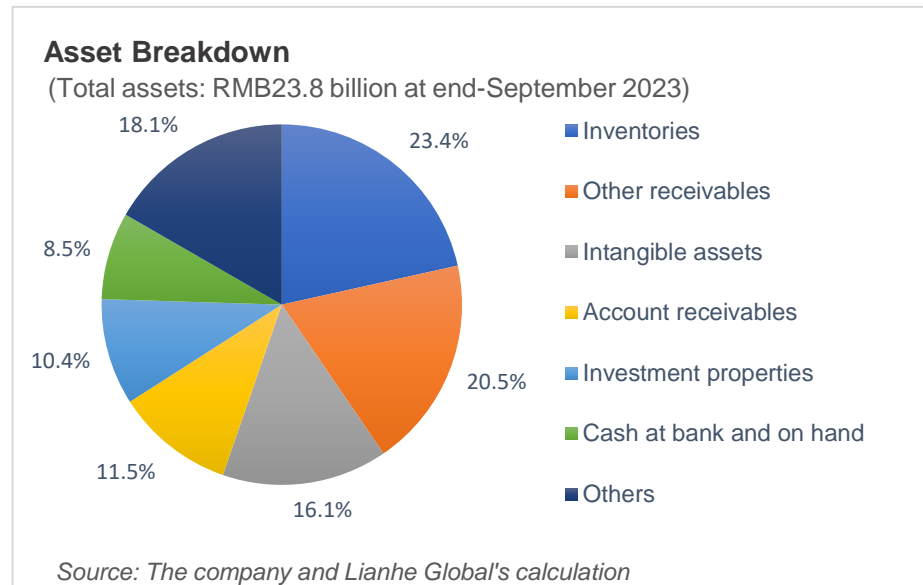
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	Sep 2023
Total Asset	18,864	19,293	21,278	23,777
Equity	9,090	9,256	11,135	11,190
Debt	7,240	7,516	8,288	9,612
Debt / (Debt + Equity) (%)	44.3	44.8	42.7	46.2
LT Debts	4,642	4,850	5,439	6,129
LT Debt / (LT Debt + Equity) (%)	33.8	34.4	32.8	35.4

Source: Company information and Lianhe Global's calculations

SYHG's total asset increased steadily to RMB23.8 billion at end-September 2023 from RMB18.9 billion at end-2020, as the company actively participated in Yihe ND's construction and development. Its total debt continued to grow in the past few years and reached RMB9.6 billion at end-September 2023 from RMB7.2 billion at end 2020. The short-term debt and long-term debt accounting for 36.2% and 63.8% of the total debt at end-September 2023, respectively. The company's financial leverage, as measured by debt/capitalization, remained stable and at a manageable level between 43% and 46% from end-2020 to end-September 2023.

SYHG's asset liquidity was relatively weak, as it has a large part of inventories, receivables and intangible asset. The company's agent construction and project construction activities had accumulated sizable inventories (mainly construction and development costs), representing 23.4% of total asset at end-September 2023. These assets usually take a long time to monetize due to the protracted construction and payment collection period. The company also had a large number of account receivables and other receivables (primarily due from government departments and local state-owned enterprises), representing 32.1% of total asset. In addition, intangible asset mainly comprised of land use right and franchise right.



Debt Servicing Capability

The liquidity of SYHG was weak. At end-September 2023, SYHG had unrestricted cash balance and unused credit facilities of RMB781.2 million and RMB1,272.9 million, respectively, compared with its debt due within one year of RMB3,482.4 million. The company has available onshore bond issuance quota of RMB500 million. SYHG mainly relies on external financing and it has accessed to various financing channels, including bank loans, bond issuance and non-traditional financing (such as financial lease), to support its debt repayments and business operations. Therefore, obtaining additional financing channels or government support is important for the company to maintain its liquidity.



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