

Shandong Zhonghai Investment Holding Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	28 March 2024

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

Summary

The Issuer Credit Rating reflects a high possibility that the de facto local government of Binzhou Economic and Technological Development Zone (“Binzhou EDZ”), namely the Management Committee of Binzhou EDZ (“Binzhou EDZ MC”), would provide very strong support to SZIHG if needed, in light of its direct full ownership of SZIHG, SZIHG’s strategic importance as the sole local investment and development company (“LIDC”) that is responsible for infrastructure construction in Binzhou EDZ, Binzhou City (“Binzhou”), and the linkage between the Binzhou EDZ MC and SZIHG, 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 local government may face significant negative impact on its reputation and financing activities if SZIHG encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Binzhou EDZ MC, the sole shareholder and the actual controller of the company, directly holds the full ownership of SZIHG. 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 appoints auditors to review the company’s operating performance and financial position.

Strategic Importance to Binzhou EDZ and Strategic Alignment: SZIHG, as the most important LIDC in Binzhou EDZ, is mainly responsible for the infrastructure construction within the region, with a strong regional franchise advantage. It is also engaged in leasing, commodity sales, apartment management service, 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: SZIHG continued to receive financial subsidies and asset/capital injections from the local government to support its business operations. We believe the government support will remain intact given the company’s strategic importance in Binzhou EDZ. Between 2021 and the first eight months of 2023, SZIHG received certain financial subsidies from the local government. Over the same period, the company received asset injections in the form of operation rights and equity transfers.

SZIHG’s Financial and Liquidity Position: SZIHG’s total asset grew to RMB20.4 billion at end-August 2023 from RMB14.9 billion at end-2021, as the company actively participated in Binzhou EDZ’s infrastructure development. Its total debt continued to grow in the past few years and reached RMB6.8 billion at end-August 2023 from RMB3.8 billion at end-2021.

Key Figures of Binzhou EDZ and SZIHG (RMB billion)

	2021	2022
Binzhou EDZ		
GDP	16.5	17.2
GDP growth rate (%)	6.8	4.1
Budgetary revenue	2.0	1.8
Government fund	0.01	0.01
Transfer payment	0.9	0.9
Budgetary expenditure	1.8	1.7
SZIHG	2022	2023.8
Assets	18.8	20.4
Equity	5.5	6.7
Revenue	0.5	0.6

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

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Applicable Criteria

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

The company's financial leverage, as measured by debt/capitalization, was at a manageable level of 44.4%-50.4% between end-2021 and end-August 2023.

The liquidity of SZIHG was weak. At end-August 2023, SZIHG had unrestricted cash balance of RMB134.2 million, compared with its debt due within one year of RMB878.6 million. In addition, SZIHG has accesses to bond issuance and non-traditional financing, to support its debt repayments and business operations. Still, successfully rolling over the short-term borrowing, obtaining additional financing channels or government support are important for the company to maintain its liquidity.

Economy and Fiscal Condition of Binzhou EDZ: Binzhou EDZ was established as a provincial-level economic and technological development zone in 2001 with the authorization of the Shandong government, and was upgraded into a national-level economic and technological development zone in 2013. Binzhou EDZ's economic growth rate fluctuated in the past few years, owing to Covid's disruption, which was 2.9%, 6.8% and 4.1% in 2020, 2021 and 2022, respectively. Its GDP amount reached RMB17.2 billion in 2022. Binzhou EDZ focused on the development of four major industries in recent years, namely high-end equipment, new energy and materials, IT and modern service industry.

The Binzhou EDZ government's aggregate fiscal revenue is mainly derived from budgetary revenue and transfer payment from higher government, while its government fund income is very limited. The Binzhou EDZ government's budgetary revenue decreased to RMB1.8 billion in 2022 from RMB2.0 billion in 2021, due to the large-scale value-added tax credit refund policies to support the economy. The transfer payment from higher government remained stable at RMB0.9 billion in the past few years. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, surged to 192.0% at end-2022 from 122.6% at end-2020, mainly due to the increase in special debt.

Rating Sensitivities

We would consider downgrading SZIHG'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 SZIHG, or (3) there is a downgrade in our internal credit assessment on the local government.

We would consider upgrading SZIHG's rating if there is an upgrade in our internal credit assessment on the local government.

Operating Environment

Economic Condition of Binzhou EDZ

Binzhou EDZ was established as a provincial-level economic and technological development zone in 2001 with the authorization of the Shandong government, and was upgraded into a national-level economic and technological development zone in 2013. Binzhou EDZ has jurisdiction over 3 streets and 188 villages, with a total land area of 189.2 square kilometers. At end-2022, Binzhou EDZ had a residential population of 163 thousand, with an urbanization rate of 71.9%.

Binzhou EDZ's economic growth rate fluctuated in the past few years, owing to Covid's disruption, which was 2.9%, 6.8% and 4.1% in 2020, 2021 and 2022, respectively. Its GDP amount reached RMB17.2 billion in 2022 and the economic growth was mainly fueled by the secondary and tertiary industries, accounting for 61.0% and 37.1% of its aggregate GDP,

respectively, in 2022. Binzhou EDZ focused on the development of four major industries in recent years, namely high-end equipment, new energy and materials, IT and modern service industry. Its fixed asset investment growth rate was on an upward trend in the past few years, recording at 8.3%, 17.7% and 23.1% in 2020, 2021 and 2022, respectively.

Binzhou EDZ's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	14.9	16.5	17.2
-Primary industry (%)	2.1	2.0	1.9
-Secondary industry (%)	59.3	61.7	61.0
-Tertiary industry (%)	38.6	36.3	37.1
GDP growth rate (%)	2.9	6.8	4.1
Fixed asset investment	6.2	8.7	10.1
Fixed asset investment growth rate (%)	8.3	17.7	23.1
Population (thousand)	161	162	163

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Binzhou EDZ

The Binzhou EDZ government's aggregate fiscal revenue is mainly derived from budgetary revenue and transfer payment from higher government, while its government fund income is very limited. The Binzhou EDZ government's budgetary revenue decreased to RMB1.8 billion in 2022 from RMB2.0 billion in 2021, due to the large-scale value-added tax credit refund policies to support the economy. The contribution of the tax revenue also slumped to 74.8% in 2022 from 90.5% in 2021. Its fiscal self-sufficiency rate was at a relatively high level and it recorded budget surpluses of 12.5%, 11.1% and 2.0% in 2020, 2021 and 2022, respectively. In addition, the transfer payment from higher government remained stable at RMB0.9 billion in the past few years.

The outstanding government debt of the Binzhou EDZ continued to grow. At end-2022, the Binzhou EDZ government's outstanding debt was RMB5.2 billion, including RMB1.6 billion of general obligations and RMB3.6 billion of special debt. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, surged to 192.0% at end-2022 from 122.6% at end-2020, mainly due to the increase in special debt.

Binzhou EDZ's Fiscal Condition

(RMB billion)	2020	2021	2022
Budgetary revenue	1.7	2.0	1.8
Budgetary revenue growth rate (%)	3.8	13.5	-10.0
Tax revenue	1.6	1.8	1.3
Tax revenue (% of budgetary revenue)	92.5	90.5	74.8
Government fund income	0.02	0.01	0.01
Transfer payment	0.9	0.9	0.9
Aggregate revenue	2.6	2.9	2.7
Budgetary expenditure	1.5	1.8	1.7
Budget balance ¹ (%)	12.5	11.1	2.0

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

Source: Public information and Lianhe Global's calculations



Ownership Structure

Government's Ownership

SZIHG was established in December 2005 with an initial registered capital of RMB500 thousand, co-funded by two local government agencies. In September 2023, the shareholder of SZIHG was changed into the Binzhou EDZ MC and its registered capital was increased to RMB1 billion. The Binzhou EDZ MC holds 100% shares of the company and is the company's sole shareholder and actual controller.

Strategic Importance and Government Linkage

Strategic Importance of SZIHG to Binzhou EDZ

SZIHG, as the most important LIDC in Binzhou EDZ, is mainly responsible for the infrastructure construction within the region, with a strong regional franchise advantage. It also engaged in leasing, commodity sales, apartment management service, 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

SZIHG's linkage with the local government is strong as the Binzhou EDZ MC, the sole shareholder and the actual controller of the company, directly holds the full ownership of SZIHG. 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 appoints auditors to review the company's operating performance and financial position.

Government Support

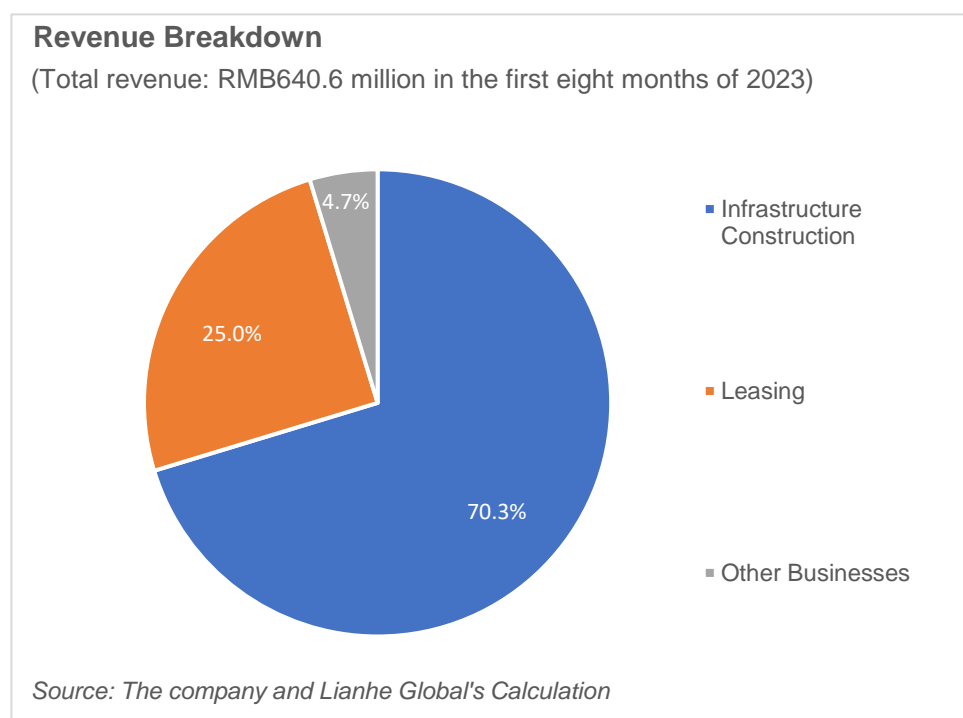
SZIHG continued to receive financial subsidies and asset/capital injections from the local government to support its business operations. We believe the government support will remain intact given the company's strategic importance in Binzhou EDZ. Between 2021 and the first eight months of 2023, SZIHG received certain financial subsidies from the local government. Over the same period, the company received asset injections in the form of operation rights and equity transfers.

Business Profile

The Sole Entity Responsible for Infrastructure Construction in Binzhou EDZ

SZIHG, as the most important LIDC in Binzhou EDZ, is mainly responsible for the infrastructure construction within the region, with a strong regional franchise advantage. The primary sources of operating revenue for SZIHG are infrastructure construction and leasing, while it is also engaged in commodity sales, apartment management service, etc. The company's total revenue grew in fluctuation in the past three years, recording at RMB505

million, RMB491 million and RMB641 million in 2021, 2022 and the first eight months of 2023, respectively.



Infrastructure Construction

SZIHG is the sole entity responsible for infrastructure construction within the Binzhou EDZ, enjoying a strong regional franchise advantage. By signing project construction agreement with the entrusting party, the company is responsible for the construction of the entrusted project and settles construction cost plus a certain percentage of profits with the entrusting party after the completion of the entrusted project. Currently, the company is working on several large-scale projects, thus it incurs high capital expenditure pressure.

Leasing and Other Businesses

As a supplementary source of revenue for the company, leasing business mainly involves the leasing of factories, office buildings, pipe corridors, etc.

Other businesses of SZIHG mainly include commodity sales, apartment management service, etc., which accounted for a relatively small proportion of the company's total revenue. They mainly play the role of supplementing the revenue of the main business and make the revenue structure more diversified.

Financial Profile

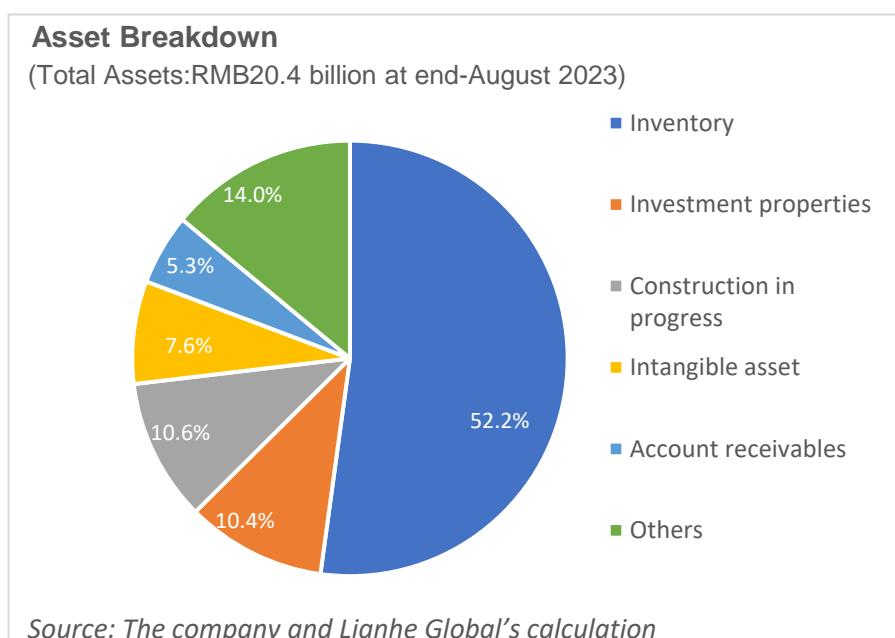
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality			
(RMB million)	2021	2022	August 2023
Total Asset	14,873	18,776	20,404
Equity	4,719	5,470	6,653

Debt	3,767	5,562	6,763
Debt / (Debt + Equity) (%)	44.4	50.4	50.4
LT Debts	3,026	4,772	5,884
LT Debt / (LT Debt + Equity) (%)	39.1	46.6	46.9

Source: Company information and Lianhe Global's calculations

SZIHG's total asset grew to RMB20.4 billion at end-August 2023 from RMB14.9 billion at end-2021, as the company actively participated in Binzhou EDZ's infrastructure development. Its total debt continued to grow in the past few years and reached RMB6.8 billion at end-August 2023 from RMB3.8 billion at end-2021. The short-term debt and long-term debt accounting for 13.0% and 87.0% of the total debt at end-August 2023, respectively. The company's financial leverage, as measured by debt/capitalization, was at a manageable level of 44.4%-50.4% between end-2021 and end-August 2023, mainly due to the continuous government support between 2021 and the first eight months of 2023, enhancing the company's equity base.



SZIHG's asset liquidity was moderately weak, as the company had a large size of inventory (mainly construction cost), investment properties and construction in progress, which added up to RMB14.9 billion at end-August 2023, representing 73% of total asset. In addition, the company had a large amount of intangible asset (mainly land use rights), which accounted for 7.6% of total asset.

Debt Servicing Capability

The liquidity of SZIHG was weak. At end-August 2023, SZIHG had unrestricted cash balance of RMB134.2 million, compared with its debt due within one year of RMB878.6 million. In addition, SZIHG has accesses to bond issuance and non-traditional financing, to support its debt repayments and business operations. Still, successfully rolling over the short-term borrowing, obtaining additional financing channels or government support are important for the company to maintain its liquidity.

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