

Shandong Yimeng Industrial Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	23 April 2024

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB’ global scale Long-term Issuer Credit Rating with Stable Outlook to Shandong Yimeng Industrial Group Co., Ltd. (“SYIG” 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 SYIG if needed, in light of its full ownership of SYIG through the Management Committee of Yihe New District (“Yihe ND MC”), the de facto local government of Yihe New District (“Yihe ND”), SYIG’s strategic importance as the important local investment and development company (“LIDC”) that is responsible for infrastructure construction, state-owned asset operation and industry development and investment in Yihe ND, and the linkage between the Yihe ND MC and SYIG, 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 SYIG encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Yihe ND MC (authorized by the Linyi government) holds the full ownership of SYIG through the Yihe New District Finance Bureau (“Yihe NDFB”). The Yihe NDFB is the sole shareholder and the actual controller of the company. 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: SYIG, as an important LIDC in the Yihe ND, is mainly responsible for infrastructure construction, state-owned asset operation and industry development and investment within the region. The company undertakes the construction and operation of industrial parks, urban renewal and other projects. The company is also engaged in land consolidation, commodity sales and cultural tourism, 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: SYIG continued to receive financial subsidies and asset/capital injections from the Linyi government, via the Yihe ND MC and the Yihe NDFB, to support its business operations. We believe the government support will remain intact given the company’s strategic importance in Yihe ND. Between 2021 and 2023, SYIG received financial subsidies amounting to RMB198.9 million from the local government to support SYIG’s business operation. Over the same period, the company received asset and

Key Figures of Linyi and SYIG

(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
SYIG		
Assets	19.3	18.9
Equity	12.2	12.5
Revenue	1.8	1.1

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

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Applicable Criteria

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

capital injections in the form of cash, lands, properties, equity transfers and other assets, which reached total about RMB4,851.3 million.

SYIG's Financial and Liquidity Position: SYIG's total asset size increased to RMB19.3 billion at end-2022 from RMB18.0 billion at end-2021, but dropped to RMB18.9 billion at end-2023, which was mainly due to the decrease in fixed asset. Although its total debt decreased to RMB2.8 billion at end-2023 from RMB3.3 billion at end-2021 (mainly due to the decrease in long-term debt), the short-term debt rose to 86.4% of the total debt at end-2023 from 75.9% at end-2021, which may indicate an increasing short-term debt service pressure. However, the company's financial leverage, as measured by debt/capitalization, remained low at the range of 18.5% and 22.4% from end-2021 to end-2023.

The liquidity of SYIG was weak. At end-2023, SYIG had unrestricted cash balance of RMB126.1 million, compared with its debt due within one year of RMB2,456.4 million. The company had unused credit facilities of RMB867 million at end-2023. Nevertheless, SYIG has accessed to various financing channels, including bank loans and non-traditional financing, to support its debt repayments and business operations. Moreover, we expect the company to roll over most of its short-term bank borrowings.

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, surged to 146.5% in 2023 from 92.5% in 2021, mainly due to the increase in special debt.

Rating Sensitivities

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

We would consider upgrading SYIG'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 (thousand)	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 outstanding 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, surged 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
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¹ Budget balance = (1-budgetary expenditure / budgetary revenue) * 100%

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

SYIG, formerly known as Shandong Guoying Real Estate Co., Ltd, was established in October 2020 with a registered capital of RMB3 million. In December 2023, the company name was changed to SYIG, and its equity was transferred to the Yihe NDFB, which became the sole shareholder of the company. At end-2023, SYIG's registered capital increased to RMB2 billion and its paid-in capital was RMB680 million. The company is wholly owned and actually controlled by the Yihe NDFB.

Strategic Importance and Government Linkage

Strategic Importance of SYIG to Yihe ND

SYIG, as an important LIDC in the Yihe ND, is mainly responsible for infrastructure construction, state-owned asset operation and industry development and investment within the region. The company undertakes the construction and operation of industrial parks, urban renewal and other projects. The company is also engaged in land consolidation, commodity sales and cultural tourism, 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

SYIG's linkage with the local government is strong as the Yihe ND MC (authorized by the Linyi government) holds the full ownership of SYIG through the Yihe NDFB. The Yihe NDFB is the sole shareholder and the actual controller of the company. 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.

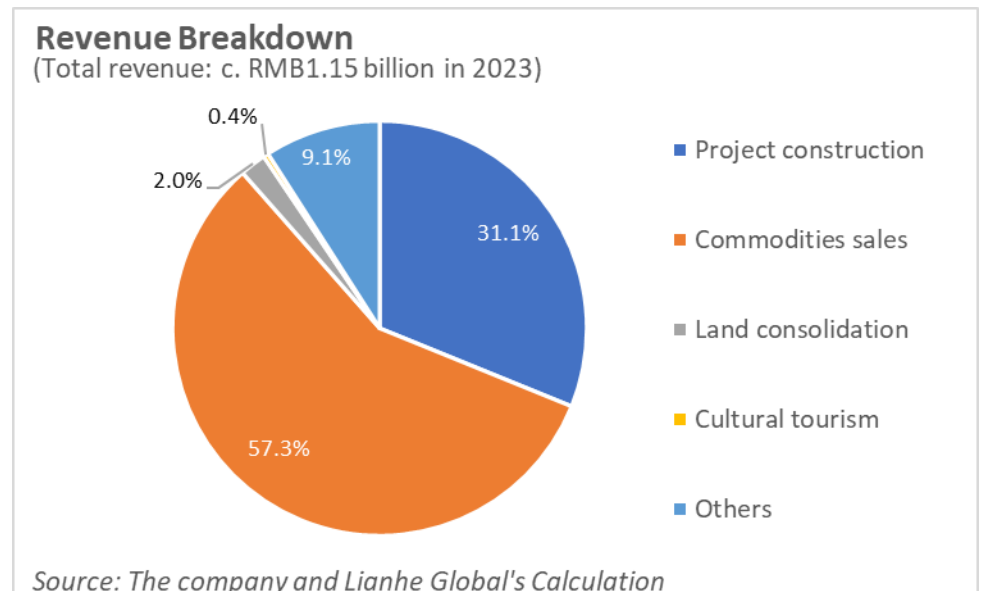
Government Support

SYIG continued to receive financial subsidies and asset/capital injections from the Linyi government, via the Yihe ND MC and the Yihe NDFB, to support its business operations. We believe the government support will remain intact given the company's strategic importance in Yihe ND. Between 2021 and 2023, SYIG received financial subsidies amounting to RMB198.9 million from the local government to support SYIG's business operation. Over the same period, the company received asset and capital injections in the form of cash, lands, properties, equity transfers and other assets, which reached total about RMB4,851.3 million.

Business Profile

The Important Entity Responsible for State-owned Asset Operation, Industry Development and Investment in Yihe ND

SYIG, as an important LIDC in the Yihe ND, is mainly responsible for infrastructure construction, state-owned asset operation and industry development and investment within the region. The company is also engaged in land consolidation, commodity sales and cultural tourism, etc. The primary sources of the company's operating revenue are project construction and commodities sales. The company's total revenue reached RMB1.11 billion, RMB1.78 billion and RMB1.15 billion in 2021, 2022 and 2023, respectively. The gross profit margin remained stable at c. 11%-14% over the same period.



Project Construction

The company's project construction business mainly includes the construction of industrial parks, urban renewal and other projects in Yihe ND. Most of the projects are operated under the agent construction model. The income derived from this segment was RMB594 million, RMB725 million and RMB341 million in 2021, 2022 and 2023, respectively. The gross profit margin of this segment stayed at c. 17.6% over the same period.

Commodities Sales

As an important source of revenue for the company, commodities sales business mainly involves the sales of petroleum products, steel products and ethylene glycol, etc. SYIG is also engaged in the trading between domestic and overseas markets. The income derived from these segments (including import and export trading, commodity sales and petroleum product sales) was RMB379 million, RMB875 million and RMB656 million in 2021, 2022 and 2023, respectively. Nevertheless, the segment gross profit margin was low compared with other segments.

Land Consolidation

SYIG is engaged in the integrated development and reserve of the land located in the major transportation facilities and prime area in Yihe ND. The company serves as the land reserve platform of a variety of land usage for the Yihe ND MC. It involves the purchase, management, development and utilization of the land resources in Yihe ND.

Other Businesses

Other businesses of SYIG mainly include leasing, cultural tourism, etc., which mainly play the role of supplementing the revenue of the main business and make the revenue structure more diversified.

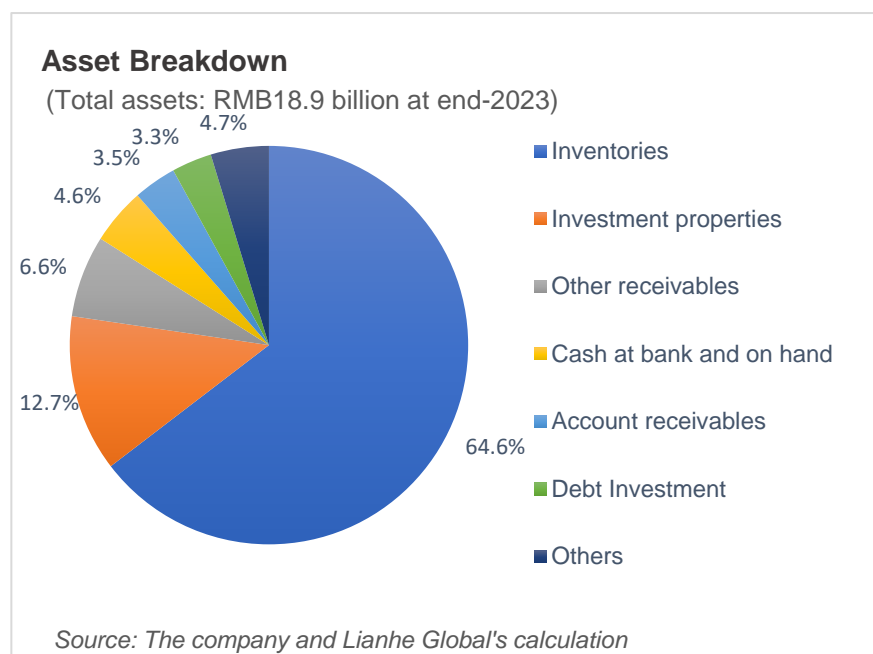
Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality			
(RMB million)	2021	2022	2023
Total Asset	18,046	19,266	18,881
Equity	11,990	12,208	12,522
Debt	3,276	3,516	2,843
Debt / (Debt + Equity) (%)	21.5	22.4	18.5
LT Debts	790	859	387
LT Debt / (LT Debt + Equity) (%)	6.2	6.6	3.0

Source: Company information and Lianhe Global's calculations

SYIG's total asset size increased to RMB19.3 billion at end-2022 from RMB18.0 billion at end-2021, but dropped to RMB18.9 billion at end-2023, which was mainly due to the decrease in fixed asset. Although its total debt decreased to RMB2.8 billion at end-2023 from RMB3.3 billion at end-2021 (mainly due to the decrease in long-term debt), the short-term debt rose to 86.4% of the total debt at end-2023 from 75.9% at end-2021, which may indicate an increasing short-term debt servicing pressure. However, the company's financial leverage, as measured by debt/capitalization, remained low at the range of 18.5% and 22.4% from end-2021 to end-2023.



SYIG's assets liquidity was moderately weak. The company's project construction activities accumulated sizeable inventories (mainly development costs), representing 64.6% of the company's total asset at end-2023. 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 investment properties (mainly land use rights), representing 12.7% of total asset at end-2023. Other receivables and account receivables, representing 10.1% of total

asset at end-2023, were mainly transactions with government agencies and state-owned enterprises in Yihe ND. These receivables had an aging period of mostly 1-3 years, with controllable counterparty risk and low bad debt provision.

Debt Servicing Capability

The liquidity of SYIG was weak. At end-2023, SYIG had unrestricted cash balance of RMB126.1 million, compared with its debt due within one year of RMB2,456.4 million. The company had unused credit facilities of RMB867 million at end-2023. Nevertheless, SYIG has accessed to various financing channels, including bank loans and non-traditional financing, to support its debt repayments and business operations. Moreover, we expect the company to roll over most of its short-term bank borrowings.

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