Shandong Gaochuang Holding Group Co., Ltd.

Initial Issuer Report

Summary	
Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	24 May 2024

Key Figures of SDGC and Weifang HIDZ (RMB billion)

Weifang HIDZ	**2021**	**2022**
GDP	61.6	64.6
GDP growth rate (%)	4.2	3.8
Budgetary revenue	7.1	6.3
Government fund	6.4	3.3
Transfer payment	0.5	1.1
Budgetary expenditure	4.1	3.5
SDGC	**2022**	**2023**
Asset	54.4	53.7
Equity	16.7	16.8
Revenue	3.7	3.9

Source: Public information, SDGC and Lianhe Global's calculations

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Applicable Criteria

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

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'BBB' global scale Long-term Issuer Credit Rating with Stable Outlook to Shandong Gaochuang Holding Group Co., Ltd. ("SDGC" or "the company")

Summary

The Issuer Credit Rating reflects a high possibility that the management committee of Weifang Hi-Tech Industrial Development Zone ("Management Committee") (the de facto local government of Weifang Hi-Tech Industrial Development Zone ("Weifang HIDZ") would provide strong support to SDGC if needed, in light of its indirectly majority ownership of SDGC, SDGC's strategic importance as a key local investment and development company ("LIDC") responsible for project development and city operation in Weifang HIDZ, and the linkage between the local government and SDGC. In addition, the local government may face significant negative impact on its reputation and financing activities if SDGC encounters any operational and financial difficulties.

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

Rating Rationale

Government's Ownership and Supervision: Fiscal and Finance Bureau of Weifang HIDZ ("Fiscal and Finance Bureau") indirectly holds 90% shares of SDGC and is the company's ultimate controller. The local government has strong control and supervision over the company. 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.

Strategic Importance to Weifang HIDZ and Strategic Alignment: SDGC is a key LIDC responsible for shantytown renovation, industrial park development and heat supply in Weifang HIDZ. The company's business operation plays a significant role in promoting local industrial development and city's operation in Weifang HIDZ. Its strategic planning has been aligned with the local government's economic and social development plans.

Ongoing Government Support: The local government provides ongoing support to SDGC and its subsidiaries, including cash capital injections and allocations of shares of other local SOEs and other assets between 2020 and 2023. The company also received operational subsidizes over the same period. We expect the support from the local government to remain intact given SDGC's strategic importance in Weifang HIDZ.

Economy and Fiscal Condition of Weifang HIDZ: Located in East of Weifang City, Weifang HIDZ, was established in 1991 and upgraded into a national-level development zone in 1992 with the authorization of the State Council. It focused on the development of four leading industries, namely power equipment, IT, medical and health care, new material. Weifang HIDZ realized GDP of RMB64.6 billion in 2022. Yet its GDP growth rate decelerated in the past few years.

Weifang HIDZ's budgetary revenue decreased to RMB6.3 billion in 2022 from RMB7.1 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. Its government fund income also slumped to RMB3.3 billion from RMB6.7 billion, owing to the weak property market. However, the outstanding debt of the Weifang HIDZ continued to grow in the past few years and reached RMB5.4 billion at end-2022, mainly due to the considerable new issuance of special debts to support project development. The government debt ratio, as measured by the total government debt/aggregate revenue, was lifted to 49.8% in 2022 from 25.4% in 2021.

SDGC's Financial and Liquidity Position: SDGC's total asset increased steadily between 2020 and 2023, which was mainly due to the company's active participation in project development in Weifang HIDZ. The company mainly relied on local government's capital injections and equity allocation to fund its asset expansion. Therefore, SDGC's financial leverage, as measured by debt/capitalization was on a downward trend in the past three years, decreasing to 53.2% at end-2023 from 62.3% at end-2020.

However, SDGC's asset liquidity was relatively weak, as the company had accumulated sizable inventories (mainly construction costs) and investment properties (mainly industrial parks) from its project development activities, respectively representing 57.5% and 12.4% of SDGC's total asset end-2023. These assets usually take a long time to monetize due to the protracted construction and payback period.

SDGC's short-term debt servicing pressure was moderate high. At end-2023, the company had cash balance of RMB2.5 billion, while it had debt due within one year of RMB7.5 billion. Yet we expect the company to rollover most of its short-term bank borrowings (end-2023: RMB1.4 billion). In addition, the company has access to various financing channels, including bank borrowings and bond issuances to satisfy its obligations. At end-2023, SDGC had unused facility lines of RMB8.2 billion.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Weifang HIDZ

Located in East of Weifang City, Weifang HIDZ was established in 1991 and upgraded into a national-level development zone in 1992 with the authorization of the State Council. Weifang HIDZ has a total area of 123 square kilometers, with a resident population of c. 0.4 million at end-2022. Its GDP per capita reached c. RMB158,500, which was much higher than that of Weifang (c. RMB77,700) and that of China (c. RMB85,700).

Weifang HIDZ realized GDP of RMB64.6 billion in 2022. However, the GDP growth rate decelerated in the past few years, recording at 7.7%, 4.2% and 3.8%, respectively, in 2020, 2021 and 2022. Weifang HIDZ's economic growth was mainly fueled by the secondary industry, which accounted for 66.8% in 2022. It focused on the development of four leading industries, namely power equipment, IT, medical and health care, new material.

Weifang HIDZ's GDP and Fixed Asset Investment (RMB billion)	**2020**	**2021**	**2022**
GDP	54.4	61.6	64.6
-Primary industry (%)	0.0	0.0	0.0
-Secondary industry (%)	66.2	66.2	66.8
-Tertiary industry (%)	33.8	33.8	33.3
GDP growth rate (%)	7.7	4.2	3.8
Fixed asset investment growth rate (%)	7.1	17.5	20.6
Population (million)	0.4	0.4	0.4

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Weifang HIDZ

Weifang HIDZ's aggregate fiscal revenues are mainly derived from budgetary revenue, which decreased to RMB6.3 billion in 2022 from RMB7.1 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. On the other hand, Weifang HIDZ's government fund income slumped to RMB3.3 billion in 2022 from RMB6.7 billion in 2021, owing to the weak property market. Yet the fiscal self-sufficiency rate of Weifang HIDZ was high, and it recorded a budget surplus of 45.0% in 2022.

The outstanding debt of the Weifang HIDZ continued to grow in the past few years, mainly due to the considerable new issuance of special debts to support project development in Weifang HIDZ. It reached RMB5.4 billion at end-2022, including RMB1.2 billion of general obligations and RMB4.2 billion of special debt. The government debt ratio, as measured by the total government debt/aggregate revenue, was lifted to 49.8% in 2022 from 25.4% in 2021.

Weifang HIDZ's Fiscal Condition (RMB billion)	**2020**	**2021**	**2022**
Budgetary revenue	6.0	7.1	6.3
Budgetary revenue growth rate (%)	2.2	18.0	-11.8
Tax revenue	5.5	6.4	4.8
Tax revenue (% of budgetary revenue)	91.3	90.0	76.0
Government fund income	7.2	6.7	3.3
Transfer payment	0.35	0.52	1.14
Aggregate revenue	13.6	14.4	10.8
Budgetary expenditure	3.1	4.1	3.5
Budget balance[1] (%)	49.4	42.1	45.0

*[1] Budget balance = (1-budgetary expenditure / budgetary revenue) * 100%*
Source: Public information and Lianhe Global's calculations

Ownership Structure

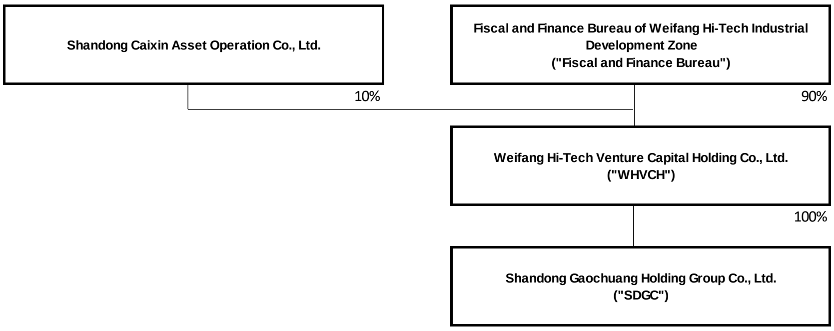
Government's Ownership

SDGC was established in February 2020 with an initial registered capital of RMB100 million, 100% funded by Weifang Hi-Tech Venture Capital Holding Co., Ltd. ("WHVCH")., an LIDC controlled by Fiscal and Finance Bureau. In January 2024, SDGC's registered capital increased to RMB16.7 billion, of which RMB16.1 billion was paid in.

At end-2023, Fiscal and Finance Bureau, as the actual controller, owned 90% shares of SDGC through WHVCH; the rest of 10% was indirectly owned by Shandong Caixin Asset

Operation Co., Ltd., a SOE wholly owned by Finance Department of Shandong Province, to subsidize Provincial Social Security Fund.

SDGC's shareholding structure



Source: SGDC

Strategic Importance and Government Linkage

Strategic Importance of SDGC to Weifang HIDZ

SDGC is a key LIDC responsible for shantytown renovation, industrial park development and heat supply in Weifang HIDZ. The company's business operation plays a significant role in promoting local industrial development and city's operation in Weifang HIDZ. Its strategic planning has been aligned with the local government's economic and social development plans.

Strong Linkage with the Local Government

SDGC's linkage with the local government is strong as Fiscal and Finance Bureau indirectly holds 90% shares of the company. The local government has strong control and supervision over the company. In addition, the local government has assessment mechanism over the company and appoints auditors to supervise its operating performance and financials on a periodic basis.

Ongoing Government Support

The local government provides ongoing support to SDGC and its subsidiaries, including cash capital injections and allocations of shares of other local SOEs and other assets between 2020 and 2023. The company also received operational subsidizes over the same period. We expect the support from the local government to remain intact given SDGC's strategic importance in Weifang HIDZ.

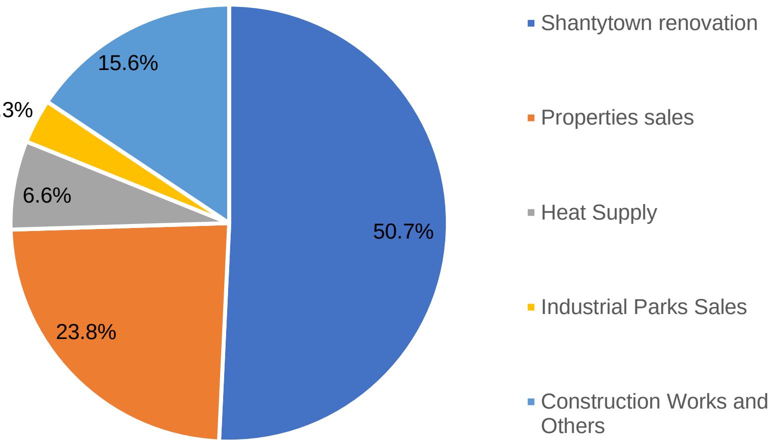
Business Profile

The Key Entity Responsible for Project Development in Weifang HIDZ

SDGC, as an important LIDC in Weifang HIDZ, is mainly responsible for shantytown renovation, industrial park development and heat supply within the region, with a strong regional franchise advantage. It also engaged in construction works, property management and logistics businesses, etc.

SDGC realized total revenue of RMB3.7 billion, 4.5 billion, 3.7 billion and 3.9 billion in 2020, 2021, 2022 and 2023, respectively. The overall gross margin of SDGC stayed between c. 15.0%-20.0% over the same period.

Revenue Breakdown
(Total revenue: RMB3.9 billion in 2023)



Source: The company and Lianhe Global's Calculation

Shantytown Renovation

SDGC participates in shantytown renovation within the region. SDGC is responsible for fundraising and construction of projects, and sells to targeted buyers at agreed upon prices. At end-June 2023, SDGC had 15 shantytown renovation projects under construction with total planned investment amounting to RMB16.5 billion, of which RMB3.4 billion was scheduled to be invested in coming years.

Properties and Industrial Parks Sales

SDGC develops and operates industrial parks within Weifang HIDZ aiming to attract investments in equipment manufacturing, new material, information, biological medicine, photoelectricity industries, etc. to promote local industrial development. After acquiring lands through auction, the company constructs the industrial parks with its own funds and sells or leases them to target enterprises upon completion. In addition, SDGC also develops and sells residential and commercial properties to improve the living and business environment around industrial parks.

By end-June 2023, SDGC had a large number of industrial parks projects under construction or scheduled to be developed, with total planned investment amounting to RMB14.6 billion. The company also planned to invest RMB7.2 billion in residential and commercial properties in the coming years. The strong project pipeline supports the development of this segment, yet also bring high capital expenditure pressure on SDGC.

Heating, Construction Works and Others

SDGC supplies heat for residents, enterprises and institutions in Weifang HIDZ, with a strong franchise advantage. The company also undertakes construction works within the region. These businesses accounted for a relatively small percentage of SDGC revenue, yet they enhance the company importance in Weifang HIDZ by providing essential public services within the region.

Financial Profile

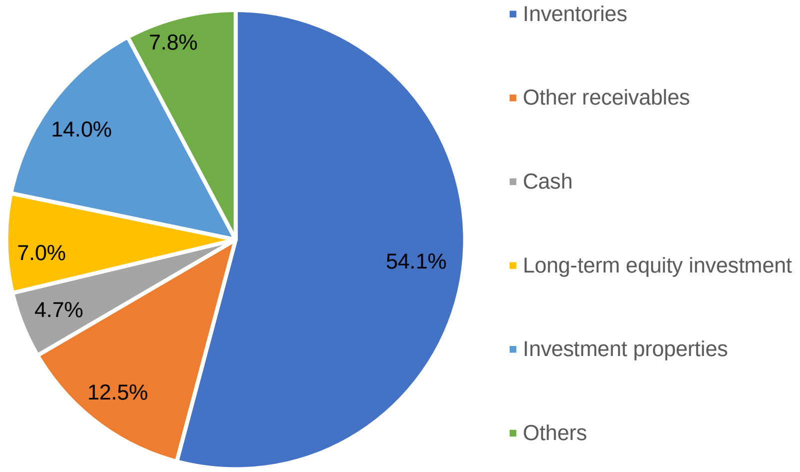
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality (RMB million)	2020	2021	2022	2023
Total Asset	44,574	51,768	54,372	53,682
Equity	11,885	15,789	16,692	16,821
Debt	19,648	22,920	22,806	19,147
Debt / (Debt + Equity) (%)	62.3	59.2	57.7	53.2
LT Debts	14,342	13,922	14,163	11,693
LT Debt / (LT Debt + Equity) (%)	54.7	46.9	45.9	41.0

Source: SDGC and Lianhe Global's calculations

SDGC's total asset increased steadily to RMB53.7 billion at end-2023 from RMB44.6 billion at end-2020, which was mainly due to the company's active participation in project development in Weifang HIDZ. The company mainly relied on local government's capital injections and equity allocation to fund its asset expansion. Its equity base enhanced to RMB19.1 billion from RMB11.9 billion over the same period, while the total debt stayed at RMB19-22 billion level. Therefore, SDGC's financial leverage, as measured by debt/capitalization was on a downward trend in the past three years, decreasing to 53.2% at end-2023 from 62.3% at end-2020.

Asset Breakdown
(Total Asset:RMB53.7 billion at end-2023)



Source: The company and Lianhe Global's calculation

However, SDGC's asset liquidity was relatively weak, as the company had accumulated sizable inventories (mainly construction costs) of RMB29.1 billion and investment properties (mainly industrial parks) of RMB7.5 billion from its project development activities, respectively representing 54.1% and 14.0% of SDGC's total asset end-2023. These assets usually take a long time to monetize due to the protracted construction and payback period. At the same time, the company had considerable other receivables (primarily due from government agencies and local SOEs), which amounted to RMB6.7 billion and accounted for 12.5% of its total asset. These receivables usually have no specified collection schedule.

Debt Servicing Capability

SDGC's short-term debt servicing pressure was moderate high. At end-2023, the company had cash balance of RMB2.5 billion, while it had debt due within one year of RMB7.5 billion. Yet we expect the company to rollover most of its short-term bank borrowings (end-2023: RMB1.4 billion). In addition, the company has access to various financing channels, including bank borrowings and bond issuances to satisfy its obligations. At end-2023, SDGC had facility lines of RMB8.2 billion.

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