Qingdao Haifa State-owned Capital Investment and Operation Group Co., Ltd.

Initial Issuer Report

Summary	
Issuer Rating	A
Outlook	Positive
Location	China
Industry	Local Investment and Development Companies
Date	17 January 2025

Key Figures of Qingdao and QHSCI (RMB billion)	2022	2023
Qingdao		
GDP	1,492.1	1,576.0
GDP growth rate (%)	3.9	5.9
Budgetary revenue	127.3	133.8
Government fund	89.6	50.3
Transfer payment	35.9	34.9
Budgetary expenditure	169.6	171.9
QHSCI	**2023**	**2024.9**
Assets	137.7	145.4
Equity	37.1	39.5
Revenue	113.8	55.9

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

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Applicable Criteria

China Local Investment and Development Companies Criteria (31 July 2024)

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'A' global scale Long-term Issuer Credit Rating to Qingdao Haifa State-owned Capital Investment and Operation Group Co., Ltd. ("QHSCI" or "the company"). The Outlook is Positive.

Summary

The Issuer Credit Rating reflects a high possibility that the People's Government of Qingdao City ("Qingdao government") would provide strong support to QHSCI if needed, in light of its direct full ownership of QHSCI, QHSCI's strategic importance as an important local investment and development company ("LIDC") responsible for infrastructure construction and state-owned asset operation in Qingdao, especially in the West Coast New Area ("WCN Area") and the linkage between the Qingdao government and QHSCI, including appointment of the senior management, strategic alignment, supervision of major investment and financing plans and ongoing operational and financial support. In addition, the Qingdao government may face significant negative impact on its reputation and financing activities if QHSCI encounters any operational and financial difficulties.

The Positive Outlook reflects our expectation that QHSCI's strategic importance would be strengthened given its increasing involvement in the infrastructure construction and land development in Qingdao Area of the China (Shandong) Pilot Free Trade Zone ("Qingdao FTZ"), while the Qingdao government will continue to ensure QHSCI's stable operation. In addition, we expect the company to play a more important role in promoting local industrial development, as it is proactively developing industrial parks and investing in leading industries, such as film and television culture, life and health and high-end manufacturing within the region.

Rating Rationale

Government's Ownership and Supervision: The Qingdao government holds 100% shares of QHSCI via the State-owned Assets Supervision and Administration Commission of Qingdao ("Qingdao SASAC"). The Qingdao government has strong control over the company, including appointment and supervision of the senior management, strategic alignment, major investment and financing planning decisions. In addition, the Qingdao government formulates a performance assessment policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

Strategic Importance and Strategic Alignment: QHSCI is an important LIDC that is responsible for infrastructure construction and stated-owned asset operation in Qingdao, especially in the WCN Area. The company focuses on three key areas: urban-rural integration development, modern industrial park operations, and equity investment and capital operations. It leads in five primary industries—industrial investment, urban development, film and culture, health and wellness, and high-end manufacturing—while also managing land consolidation and infrastructure development tasks. QHSCI plays an important role in the urban development and operation in Qingdao and WCN Area. Its business operation and strategic planning have been aligned with Qingdao government's development plans.

Ongoing Government Support: QHSCI receives support from the Qingdao government such as supportive policies, financial support, asset and equity injection, project assets and government subsidies. Between 2021 and the first nine months of 2024, QHSCI received financial subsidies of RMB864.9 million from the Qingdao government, mainly including operation subsidies and supporting funds. In 2021, the Qingdao SASAC transferred its 100% equity stake in Qingdao Aokema Holding Group Co., Ltd. ("Aokema") to the compamy. Given QHSCI's strategic importance in Qingdao, we believe QHSCI is likely going to receive ongoing government support in the future.

QHSCI's Financial and Liquidity Position: QHSCI's total assets increased to RMB145.4 billion at end-September 2024 from RMB120.6 billion at end-2021, owing to ongoing project constructions and equity and asset injections from Qingdao government. Its total debt was RMB86.1 billion at end-September 2024, increased from RMB62.6 billion at end-2021. The short-term debt and long-term debt accounted for 56.0% and 44.0% of the total debt, respectively. The company's financial leverage, as measured by total liability/total asset, remained relatively stable at around 73% in the past years.

QHSCI's liquidity was moderately weak. At end-September 2024, QHSCI had unrestricted cash balance of RMB6.4 billion, compared with its debt to be due within one year of RMB48.2 billion. Having said that, the company may use bank borrowings, bond issuance and non-traditional financing to support its debt repayments and business operations. It had unused credit facilities of RMB41.4 billion at end-September 2024.

Economy and Fiscal Condition of Qingdao: Qingdao is a municipality with an independent planning status enjoying provincial-level status in the economic planning and independent budgetary status directly linked to the central government. Qingdao realized a GDP of RMB1,576.0 billion in 2023, with its economic growth rate elevated to 5.9% in 2023 from 3.9% in 2022. The GDP scale of Qingdao was ranked 1st among all jurisdictions of Shandong in 2023.

The aggregate fiscal revenue of the Qingdao government was mainly derived from budgetary revenue and government fund income. The budgetary revenue increased mildly to RMB133.8 billion in 2023 from RMB127.3 billion in 2022, and the proportion of tax revenue over the budgetary revenue rose to 75.2% from 69.2% over the same period. The fiscal self-sufficiency of the Qingdao government slightly improved in 2023, with its budget deficit narrowing to 28.5% from 33.2% in 2022. The government fund income plunged to RMB50.3 billion in 2023 from RMB89.6 billion in 2022, which was mainly due to the downturn of the real estate industry. The government debt ratio (measured by total government debt/aggregate revenue) was also lifted to 163.8% from 120.7% over the same period, mainly due to the large increase in special purpose debt.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Qingdao

Qingdao is a municipality with an independent planning status enjoying provincial-level status in the economic planning and independent budgetary status directly linked to the central government. Qingdao realized a GDP amount of RMB1,576.0 billion in 2023, with its economic growth rate elevated to 5.9% in 2023 from 3.9% in 2022. The GDP scale of Qingdao was ranked 1st among all jurisdictions of Shandong in 2023. Qingdao's economy was mainly driven by the secondary and tertiary industries, which accounted for 33.4% and 63.4% of the aggregate GDP in 2023, respectively.

Qingdao's GDP and Fixed Asset Investment

(RMB billion)	2021	2022	2023
GDP	1,413.6	1,492.1	1,576.0
-Primary industry (%)	3.3	3.2	3.1
-Secondary industry (%)	35.9	34.8	33.4
-Tertiary industry (%)	60.8	62.0	63.4
GDP growth rate (%)	8.3	3.9	5.9
Fixed asset investment growth rate (%)	10.1	10.3	10.3
Population (million)	1,413.6	1,492.1	1,576.0

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Qingdao

The aggregate fiscal revenue of the Qingdao government was mainly derived from budgetary revenue and government fund income. The budgetary revenue increased mildly to RMB133.8 billion in 2023 from RMB127.3 billion in 2022, and the proportion of tax revenue over the budgetary revenue rose to 75.2% from 69.2% over the same period. The fiscal self-sufficiency of the Qingdao government slightly improved in 2023, with its budget deficit narrowing to 28.5% from 33.2% in 2022. The government fund income plunged to RMB50.3 billion in 2023 from RMB89.6 billion in 2022, which was mainly due to the downturn of the real estate industry.

The total outstanding debt of the Qingdao government surged to RMB362.0 billion at end-2023 from RMB308.0 billion at end-2022. The government debt ratio (measured by total government debt/aggregate revenue) was also lifted to 163.8% from 120.7% over the same period, mainly due to the large increase in special debt.

Qingdao's Fiscal Condition

(RMB billion)	2021	2022	2023
Budgetary revenue	136.8	127.3	133.8
Budgetary revenue growth rate (%)	9.1	5.5*	5.1
Tax revenue	101.7	88.1	100.6
Tax revenue (% of budgetary revenue)	74.3	69.2	75.2
Government fund income	119.3	89.6	50.3
Transfer payment	25.9	35.9	34.9
Aggregate revenue	**284.0**	**255.2**	**221.0**
Budgetary expenditure	170.6	169.6	171.9
Budget balance[1] (%)	-24.7	-33.2	-28.5

*[1] Budget balance = (1-budgetary expenditure / budgetary revenue) * 100%*
** Excluding the effect of value-added tax credit refund policy*
Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

QHSCI, originally known as Qingdao West Coast Development (Group) Co., Ltd., was established as a wholly state-owned company by the Qingdao Government in accordance with the notice on its formation (Qing Zheng Fa [2012] No. 12), with an initial registered capital of RMB10 billion. The company's registered capital remains at RMB10 billion, fully paid, with the Qingdao SASAC holding 100% ownership and serving as the actual controller.

Strategic Importance and Government Linkage

Strategic Importance of QHSCI to Qingdao

QHSCI is an important LIDC that is responsible for infrastructure construction and stated-owned asset operation in Qingdao, especially in the Qingdao West Coast New Area ("WCN Area"). The company focuses on three key areas: urban-rural integration development, modern industrial park operations, and equity investment and capital operations. It leads in five primary industries—industrial investment, urban development, film and culture, health and wellness, and high-end manufacturing—while also managing land consolidation and infrastructure development tasks. QHSCI plays an important role in the urban development and operation in Qingdao. Its business operation and strategic planning have been aligned with Qingdao government's development plans.

Strong Linkage with the Qingdao Government

QHSCI has a strong linkage with the Qingdao government, as the Qingdao government has the final decision-making authority and strong supervision over the company, including appointment and supervision of the senior management, strategic alignment and decision on its major investment and financing plan decisions. In addition, the Qingdao government has assessment mechanism over the company and regularly appoints auditors to review the company's operating performance and financial position.

Government Support

QHSCI receives support from the Qingdao government such as supportive policies, financial support, asset and equity injection, project assets and government subsidies. Between 2021 and the first nine months of 2024, QHSCI received financial subsidies of RMB864.9 million from the Qingdao government, mainly including operation subsidies and supporting funds. In 2021, the Qingdao SASAC transferred its 100% equity stake in Qingdao Aokema Holding Group Co., Ltd. to the compamy. Given QHSCI's strategic importance in Qingdao, we believe QHSCI is likely going to receive ongoing government support in the future.

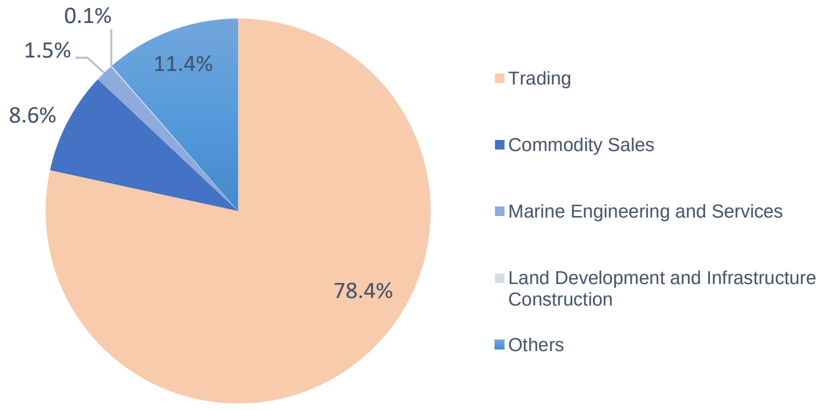
Business Profile

An Important LIDC Responsible for Infrastructure Construction and Stated-owned Asset Operation in Qingdao and WCN Area

QHSCI is an important LIDC that is responsible for infrastructure construction and stated-owned asset operation in Qingdao and WCN Area. It is responsible for land consolidation and infrastructure construction in key areas, including the Lingshan Bay Industrial Zone, the Lingshan Bay West Area, the Cangmashan Tourist Resort, and the Qingdao FTZ. The total revenue of QHSCI was RMB79.2 billion, 106.8 billion, 113.8 billion and 55.8 billion in 2021, 2022, 2023 and the first nine months of 2024, respectively. The significant revenue growth since 2022 was due to substantial changes in its consolidation scope, with Nanjing Sample Technology Group Co. Ltd. and Aokema being included. As a result, commodity sales, trading and equity investment had become the primary sources of revenue and profit for the company. The gross profit margin remained stable at around 4% in the past years.

Revenue Breakdown

(Total revenue: RMB55.9 billion in the first nine months of 2024)



Source: The company and Lianhe Global's calculation

Land Development and Infrastructure Construction

QHSCI is tasked by the Qingdao Government to carry out primary land development, resettlement housing construction and infrastructure construction in the WCN Area under the “closed operation” business model. It is currently engaged in primary land development in Lingshan Bay Film and Television Culture Industrial Zone, the Cangma Mountain Tourist Resort Zone, the Lingshan Bay West Zone and Qingdao FTZ. The company coordinates tasks such as relocation compensation, land leveling, planning and design, funding procurement, and the construction of resettlement housing. The settlement for development and consolidation projects is based on the actual costs of land development, plus a certain percentage markup. The projects have a long construction cycle, substantial funding requirements, and extended investment recovery periods. Besides, the company has led the construction of a large number of infrastructure projects of great significance to the area, including the development of transportation networks, pipelines, public facilities, roads and bridges.

Trading

QHSCI’s trading operations encompass two main segments: the copper industry and trading business by Qingdao Qingfa Holding Group Co., Ltd. (“QHG”). In the copper sector, the primary trading products are electrolytic copper and copper rods, with a high supplier concentration. The main operating entity is Yingtan Copper Industry Development Investment Co., Ltd., which profits by purchasing and selling copper products, earning trade margins.

In QHG's trading segment, the main operating entities include QHG, Qingdao Comprehensive Bonded Group Co., Ltd., and Sinogerman United Group Co., Ltd. This segment handles general trade, parallel imports of vehicles, and bulk commodity trading, with general trade focusing on food and beverages, cleaning products, and personal care items—all sourced independently. Parallel vehicle imports primarily involve customer procurement, while bulk commodities include steel, electrolytic copper, and frozen products. Financing for trade operations is achieved through working capital loans, leveraging bank credit, or utilizing a low percentage of deposit guarantees to issue bank acceptance bills.

Commodity Sales

QHSCI's commidity sales mainly consist of steel products from Xinyirun Supply Chain Management (Shanghai) Co., Ltd. ("Xinyi Run") and electrical appliances from Aokema. Xinyi Run's steel sales, which account for over 98% of its revenue in 2023, showed a decreasing trend in the past few years, with low profit margins and high reliance on a few clients. The company uses a "goods first, payment later" model, retaining ownership until full payment is received. Aokema, focused on refrigeration equipment and appliances, saw a slight revenue drop in 2023, mainly due to decreased income from refrigeration products. Its sales strategy combines agency and direct sales for domestic markets, while also developing its own brand customers for exports.

Maritime Engineering and Services

QHSCI's maritime engineering and services operate globally. The primary entity responsible for this business is Prosper Construction Holdings Limited ("Ruigang"), established in 2001 and listed on the Hong Kong Stock Exchange in 2016 (6816.HK). Ruigang specializes in maritime construction services, including dredging, land reclamation, and foundation work for marine facilities. The company has a fleet designed for these operations and participates in China's Belt and Road Initiative, with projects in Indonesia, Vietnam, Macau, Pakistan, Malaysia, and Hong Kong.

Ruigang typically acquires projects through bidding for various engineering contracts, with funding sourced from advance payments, contractual payments, and its own capital. Revenue comes from construction income, with a payment model that includes advance payments and monthly assessments of completed work. Project management and payment collection are influenced by local policies and exchange rates.

Others

QHSCI diversifies its revenue and profit through financial services, smart terminal sales, movies, real estate, cross-border trade and other businesses. The financial services are primarily focusing on factoring, microloans, leasing, and fund management. The smart terminal sales provide comprehensive solutions based on video and radio frequency identification technologies for sectors like smart transportation and customs logistics. The cross-border trade services include comprehensive foreign trade services for small to medium-sized manufacturers and primarily export electronic products and textiles.

Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality

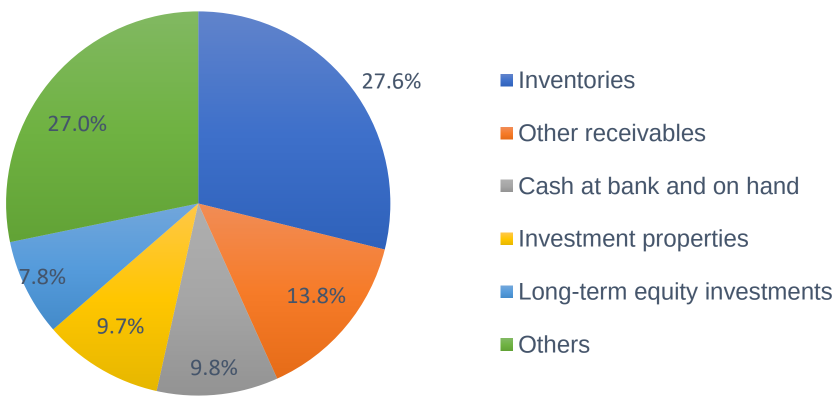
(RMB million)	2021	2022	2023	End-September 2024
Total Asset	120,593	131,615	137,661	145,373
Equity	31,854	34,890	37,085	39,548
Debt	62,570	73,871	81,874	86,090
Debt / (Debt + Equity) (%)	66.3	67.9	68.8	68.5
LT Debt	32,810	33,139	33,998	37,844
LT Debt / (LT Debt + Equity) (%)	50.7	48.7	47.8	48.9

Source: The company's financial reports and Lianhe Global's calculations

QHSCI's total assets increased to RMB145.4 billion at end-September 2024 from RMB120.6 billion at end-2021, owing to ongoing project constructions and equity and asset injections from Qingdao government. Its total debt was RMB86.1 billion at end-September 2024, increased from RMB62.6 billion at end-2021. The short-term debt and long-term debt accounted for 56.0% and 44.0% of the total debt, respectively. The company's financial leverage, as measured by total liability/total asset, remained relatively stable at around 73% in the past years.

Asset Breakdown

(Total assets: RMB145.4 billion at end-September 2024)



Source: The company and Lianhe Global's calculation

QHSCI's asset quality was moderately weak. The company's primary assets consisted of inventories, receivables, and investment properties at end-September 2024. Inventories, mainly development costs, accounted 28% of the total assets, typically requiring a long time to monetize. Receivables, including accounts receivable and other receivables, accounted for 19.3% of total assets, primarily arising from business clients and local government departments. It may affect the company's liquidity and restrict its business activities. Additionally, the company had restricted assets of RMB26.7 billion at end-September 2024, representing 18.4% of its total assets. The restrictions are mainly due to the company using land, real estate, and equity assets as collateral for financing through pledges, which may further limit the asset liquidity of the company.

Debt Servicing Capability

QHSCI's liquidity was moderately weak. At end-September 2024, QHSCI had unrestricted cash balance of RMB6.4 billion, compared with its debt to be due within one year of RMB48.2 billion. Having said that, the company may use bank borrowings, bond issuance and non-traditional financing to support its debt repayments and business operations. It had unused credit facilities of RMB41.4 billion at end-September 2024.

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