

Credit Opinion

19 September 2024

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB _g +
Outlook	Stable

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Shandong Hesheng Investment Co., Ltd.

Surveillance credit rating report

CCXAP affirms the long-term credit rating of Shandong Hesheng Investment Co., Ltd. at BBB_g+, with stable outlook.

Summary

The BBB_g long-term credit rating of Shandong Hesheng Investment Co., Ltd. ("SHIC" or the "Company") reflects Jimo District Government's (1) very strong capacity to provide support, and (2) very high willingness to provide support based on our assessment of the Company's characteristics.

Our assessment of Jimo District Government's capacity to support reflects Jimo District's status as one of the top three largest districts by gross regional product ("GRP") in Qingdao City, with growing economic and fiscal strengths.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) full ownership by the Jimo District Government; (2) strategic important role for the infrastructure construction and economic development in Jimo District, especially in the Economic Development Zone of Jimo District ("Jimo EDZ"); and (3) solid track record of receiving government support.

However, the rating is constrained by the Company's (1) increasing exposure to commercial activities; (2) higher investment needs which lead to increasing debt level; and (3) relatively high funding cost.

The stable outlook on SHIC's rating reflects our expectation that the Jimo District Government's capacity to provide support will be stable, and the Company will maintain its importance in the development of Jimo EDZ over the next 12 to 18 months.

Rating Drivers

- Strategic important role for the infrastructure construction and economic development in Jimo EDZ
- Solid track record of receiving government support including a large scale of asset injections
- Increasing exposure to commercial activities
- Higher investment needs lead to increasing debt level
- Access to different fundings with relatively high funding cost

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Jimo District Government's capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support such as materially reduced exposure to risky commercial activities and improved access to fundings.

What could downgrade the rating?

The rating could be downgraded if (1) Jimo District Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to provide support, such as reduced regional significance, deteriorated debt management, or deteriorated access to fundings.

Key Indicators

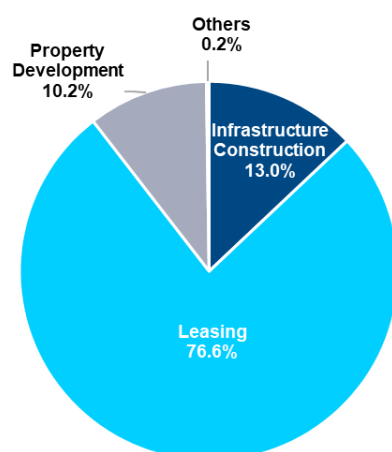
	2021FY	2022FY	2023FY	2024H1
Total Asset (RMB billion)	40.1	48.3	40.9	41.8
Total Equity (RMB billion)	34.5	39.8	31.8	31.7
Total Revenue (RMB billion)	1.4	2.2	2.2	1.0
Total Debt/Total Capital (%)	6.6	9.0	12.3	13.0

All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

Corporate Profile

Established in January 2020, SHIC is one of the major local infrastructure investment and financing companies ("LIIFCs") in Jimo District, Qingdao City. It is positioned as the key entity for infrastructure construction and state-owned assets operation in Jimo District, and is mainly responsible for infrastructure construction and leasing in Jimo EDZ. The Company is also diversified into other businesses, including self-operated construction and property development. As of 30 June 2024, the Company was wholly owned by the State-owned Assets Operation Service Centre of Jimo District of Qingdao City, which is under the direct administration of the Jimo District Government.

Exhibit 1. Revenue structure in 2023

Source: Company information, CCXAP research

Exhibit 2. Shareholding chart as of 30 June 2024

Source: Company information, CCXAP research

Rating Considerations**Government's Capacity to Provide Support**

We believe that the Jimo District Government has very strong capacity to provide support, which reflects Jimo District's status as one of the top three largest districts by GRP in Qingdao City, with growing economic and fiscal strengths.

Shandong Province is the third largest province in China by gross regional products, with a solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive and agri-food. Qingdao City is one of the five cities in China that are under separate state planning and is the strongest city in Shandong in terms of economic size and average income level. It reported GRP of RMB1,576.0 billion in 2023, ranking first in Shandong Province and 13th among China's municipalities. Qingdao City also has strong fiscal strength and good fiscal metrics. In the past three years, its general budgetary revenue covered over 70% of its general budgetary expenditure, and tax incomes accounted for more than 70% of its general budgetary revenue on average. As of end-2023, the local government's debt/GRP ratio was 23.0%.

Exhibit 3. Key economic and fiscal indicators of Qingdao City

	2021FY	2022FY	2023FY
GRP (RMB billion)	1,413.6	1,492.1	1,576.0
GRP Growth (%)	8.3	3.9	5.9
General Budgetary Revenue (RMB billion)	136.8	127.3	133.8
General Budgetary Expenditure (RMB billion)	170.7	169.6	171.9
Local Government Debt (RMB billion)	255.9	308.0	362.0

Source: Qingdao Municipal Government, CCXAP research

Jimo District is located in the southwest region of the Shandong peninsula, on the west coast of the Yellow Sea and the north of the Lao Mountain, with abundant supply of natural resources, such as land, sea and mineral resources. Jimo District comprises seven towns, one provincial-level economic development zone, one high-tech industrial development zone and one provincial-level tourism and resorts zone. It has formed six pillar industries, including traditional industries such as automobiles, textiles and clothing, as well as trade and logistic; emerging industries such as marine, new-generation information technology, as well as biomedicine.

Jimo District is a developing district and has shown continuous economic growth over the past three years. It recorded GRP of RMB145.3 billion, RMB151.3 billion, and RMB159.5 billion in 2021, 2022, and 2023, with growth rates of 6.9%, 2.6%, and 6.6% respectively. Jimo District's GRP ranked third among all the districts or counties in Qingdao City for years. Also, Jimo District had a relatively strong fiscal balance as its general budgetary revenue covered around 80% of its general budgetary expenditure on average over the past three years. It also has good fiscal stability with tax income contributing around 70% of the general budgetary revenue over the past three years. As of 31 December 2023, the outstanding amount of local government debt amounted to RMB20.9 billion, increasing from RMB16.3 billion at end-2022 and accounting for 13.1% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Jimo District

	2021FY	2022FY	2023FY
GRP (RMB billion)	145.3	151.3	159.5
GRP Growth (%)	6.9	2.6	6.6
General Budgetary Revenue (RMB billion)	11.6	10.0	10.6
General Budgetary Expenditure (RMB billion)	12.8	13.3	13.3
Local Government Debt (RMB billion)	12.8	16.3	20.9

Source: Jimo District Government, CCXAP research

Jimo EDZ is located in the east of Jimo District, and is a provincial-level economic development zone established with the approval of the Shandong Provincial Government in May 1992. It is aiming to develop core industries such as new generation of information technology industry and modern service industry. The local government has implemented investment promotion policies to attract more companies to settle in Jimo EDZ, and thereby promote the development of strategic emerging industries and high-tech industries in Jimo District as a whole.

Government's Willingness to Provide Support**Strategic important role for the infrastructure construction and economic development, especially in the Jimo EDZ**

SHIC is one of the key LIIFCs in Jimo District. It plays an essential role in urban construction and operation in Jimo District, mainly responsible for infrastructure construction in Jimo EDZ. The Company is expected to undertake more public-policy roles and projects in Jimo EDZ in the future according to the government planning,

which could ensure the sustainability of Company's development. We believe the Company is expected to maintain its high importance for Jimo District Government.

SHIC undertakes infrastructure construction business mainly by signing construction agreements with local government and carrying out the construction work accordingly. The local government would make payments to the Company based on the actual cost plus a markup in return upon completion. As of 30 June 2024, the Company had completed some key infrastructure construction projects including construction of road and public supporting facilities, river reconstruction and renovation of old residential areas, with a total investment of RMB2.3 billion. From the perspective of project reserves, the Company has one major project under construction and 2 major projects under planning as of 30 June 2024, with an estimated outstanding investment amount of RMB7.4 billion. Meanwhile, the Company also had one self-constructed urban renewal project under planning, with a total investment amount of around RMB3.5 billion. Such projects are beneficial for the improvement of local living conditions and ensure the sustainability of the company's business. However, the large future investment may bring certain capital expenditure pressure to the Company.

Increasing exposure to commercial activities

SHIC engaged in leasing, property development, and self-operated construction such as industrial parks and medical service center. While the commercial activities generate supplemental income, they may also pose higher operational and business risks than its infrastructure construction businesses. The Company's exposure to commercial businesses has been increasing in recent years, accounting for more than 30% of total assets as of 30 June 2024.

As the main state-owned assets operator in Jimo EDZ, SHIC possesses relatively large amount of leasing assets transferred by the local government, including aquaculture right of tidal flats, sea area using right, parking lots, pipelines and schools to the Company, which have generated additional recurring income to the Company. However, the rent payment collection is relatively weak. The schools were leased out to the Education and Sports Bureau of Jimo District for 10 years, and the rent is included in the annual fiscal budget of the local government. Most of other leasing assets were leased out to private-owned enterprises at relatively high prices, such as parking lots, with high concentration risk. With the completion of some constructed leasing projects, the rent out of more leasing assets, and the end of rent exemption period of some leased assets, the Company's rental income increased from RMB748.3 million in 2022 to RMB1.7 billion in 2023. However, the slowdown of the economic activities in recent years and the over-pricing of leased assets have led to the creation of large accounts receivable with a high degree of uncertainty in the collection period.

Meanwhile, the Company is undertaking some self-operated construction projects, including kindergarten, sports center, and medical service center. As of 30 June 2024, the Company had 2 self-operated projects under construction, including rural revitalization project and photovoltaic power generation project, with a total investment of RMB2.0 billion and uninvested amount of RMB1.5 billion. These 2 projects are expected to generate income through grain sales and power supply. The Company also had 2 self-constructed and self-operated projects under planning as of the same date, with a total estimate investment of RMB490.6 million. With the completion and operation of newly developed projects in the future, the Company's total revenue is expected to increase. However, there is uncertainty on the future returns of these self-operated projects.

SHIC also engages in property development business. As of 30 June 2024, the Company had completed one major project, with a total saleable area of 82.7 thousand square meters and around half of the area had been sold. Meanwhile, there was one key property project under planning, with an estimated investment amount of around RMB2.4 billion. Considering the Company mainly relies on external financing for its property

development business, it may face more pressure on capital expenditure in the future. Moreover, increasing investment in property development may bring more operating uncertainties and financial risks to the Company as the property sales are easily affected by the market conditions, especially during the downturn of the China's real estate market.

Good track record of receiving government support

In recognition of the importance of SHIC's businesses to the development of Jimo EDZ, the Company has constantly received comprehensive support from the local government, in terms of asset injections, project repayments, and operating subsidies. From January 2023 to June 2024, the Company received operating subsidies of RMB3.1 million from the local government. In addition, SHIC had received project repayments of RMB528.0 million from infrastructure construction projects as of 30 June 2024. The Company also received government special-purpose bonds for its infrastructure construction projects. Considering the important position of SHIC, we expect the Company to receive ongoing government support from the local government when necessary.

Higher investment needs lead to increasing debt level

SHIC shows rising debt burden owing to its debt-driven business expansion in the construction of public-policy projects over the past few years. As of 30 June 2024, the Company's total debt increased to RMB4.7 billion from RMB4.0 billion at end-2022. Its total capitalization ratio, as measured by total debt to total capital, was relatively low at 13.0%. However, the Company had a moderate debt maturity structure, with short-term debts accounted for around 50.6% of the total debts, indicating relatively high refinancing need as of 30 June 2024. In addition, the Company is planning further investment to support the construction of key projects in the region over the next few years. As the Company's operating cash flow and projects repayments are insufficient to fully support the future capital expenditure plan, the continuous investments in these projects will rely on external financing, we expect the Company's debt burden and leverage will continue to increase in the next 12 to 18 months.

Access to different fundings with relatively high funding cost

SHIC mainly relies on bank borrowing to finance its infrastructure construction and self-operated projects. The Company has maintained good relationships with large domestic banks, such as large state-owned banks and joint-stock commercial banks. As of 30 June 2024, the Company has obtained total credit facilities of RMB7.7 billion, with an unutilized amount of RMB2.7 billion. The Company has also recently entered the offshore bond capital market. The Company issued 3 tranches of offshore bonds from June to August 2024, raising around RMB1.2 billion. It also tapped into nonstandard financing channels such as debt financing scheme and trust companies to meet its funding needs. The exposure to non-standard financing is manageable, representing approximately 10% of total debt as of 30 June 2024. However, the cost of both offshore bonds and non-standard financing is relatively high.

ESG Considerations

SHIC bears environmental risks through its infrastructure construction projects. Such risks could be mitigated by conducting environmental studies and detailed planning before the commencement of the projects and close supervision during construction.

SHIC bears social risks as it implements public policy initiatives by building public infrastructure in Jimo EDZ. Demographic changes, public awareness and social priorities shape the Company's development targets and ultimately affect the local government's propensity to support the Company.

SHIC's governance considerations are also material as the Company is subject to oversight by Jimo District Government and has to meet several reporting requirements, reflecting its public-policy role and status as a government-owned entity.

Rating Methodology

The methodology used in this rating is the Rating Methodology for [China's Local Infrastructure Investment and Financing Companies \(July 2022\)](#).

Appendix

Exhibit 5. Peer comparison

	Shandong Hesheng Investment Co., Ltd.	Qingdao Jimo District Urban Development Investment Co., Ltd.	Qingdao Jimo District Urban Tourism Development and Investment Co., Ltd.
Long-Term Credit Rating	BBB _g +	BBB _g +	BBB _g +
Shareholder	Qingdao Jimo State-owned Assets Operation Service Centre (100%)	Qingdao Jimo State-owned Assets Operation Service Centre (100%)	Qingdao Jimo State-owned Assets Operation Service Centre (100%)
Positioning	Key entity in infrastructure construction and state-owned assets operation in Jimo EDZ	Key entity to carry out affordable housing and infrastructure construction projects within Jimo District	Key entity to focus on the provision of public utility services and infrastructure construction in Jimo District
Total Asset (RMB billion)	40.9	62.3	46.2
Total Equity (RMB billion)	31.8	19.6	18.0
Total Revenue (RMB billion)	2.2	2.3	0.7
Total Debt/Total Capital (%)	12.3	65.7	57.2

All ratios and figures are calculated using CCXAP's adjustments based on financial data as of 31 December 2023.

Source: Company information, CCXAP research

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