

Credit Opinion

1 March 2024

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

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Shandong Quanhui Industrial Development Co., Ltd.

Initial credit rating report

CCXAP assigns first time long-term credit rating of BBB_g to Shandong Quanhui Industrial Development Co., Ltd., with stable outlook.

Summary

The BBB_g long-term credit rating of Shandong Quanhui Industrial Development Co., Ltd. (“QHID” or the “Company”) reflects Zhangqiu District Government’s (1) 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 Zhangqiu District Government’s capacity to provide support reflects Zhangqiu District’s gross regional production (“GRP”) ranking upper-middle among the counties or districts in Jinan City over the years, and its relatively strong economic and financial strength.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) important role in local economic and industrial development; and (2) good track record of receiving supports from its parent company and the local government.

However, the rating is constrained by the Company’s (1) medium exposure to commercial activities with relatively large capital expenditure pressure; (2) increasing debt burden driven by business expansion; and (3) medium contingent liability risk associated with guarantee business.

The stable outlook on QHID’s rating reflects our expectation that Zhangqiu District Government’s capacity to provide support will be stable, and the Company will maintain its important role in the economic and industrial development of Zhangqiu District over the next 12 to 18 months.

Rating Drivers

- Important role in local economic and industrial development
- Medium exposure to commercial activities with relatively large capital expenditure pressure
- Good track record of receiving supports from its parent company and the local government
- Increasing debt burden driven by business expansion
- Medium contingent liability risk associated with guarantee business

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Zhangqiu District Government's capacity to provide support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as reduced exposure to risk commercial activities or improved financing ability.

What could downgrade the rating?

The rating could be downgraded if (1) Zhangqiu District Government's capacity to provide 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 strategic significance, increased exposure to risk commercial activities, or weakened debt management.

Key Indicators

	2020FY	2021FY	2022FY	2023Q3
Total Asset (RMB billion)	11.3	15.0	17.6	17.7
Total Equity (RMB billion)	9.8	10.0	10.8	10.7
Total Revenue (RMB billion)	1.3	1.9	2.2	1.6
Total Debt/Total Capital (%)	2.2	12.4	17.8	18.0

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

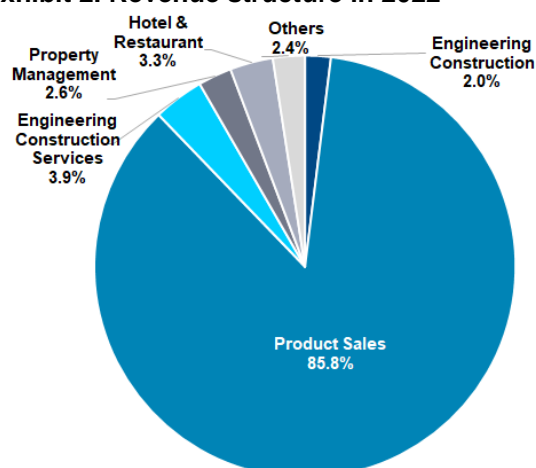
Source: Company data, CCXAP research

Corporate Profile

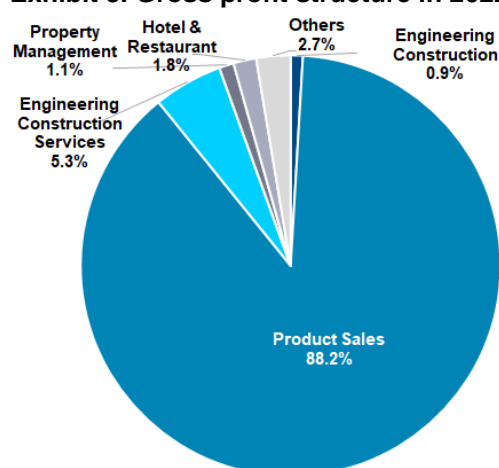
Founded in 2019, QHID became an important comprehensive state-owned enterprise in Zhangqiu District after the consolidation of some local state-owned enterprises in 2023, mainly engages in production and sales of blowers and urban renewal projects. It also developed diversified businesses, including industrial parks development and operation, engineering construction, equity investment, guarantee business, as well as hotel management in Zhangqiu District. QHID is a wholly-owned subsidiary of Jinan Zhangqiu Holding Group Co., Ltd. ("ZQHG"), who is the largest local infrastructure investment and financing company ("LIIFC") in Zhangqiu District and directly owned and controlled by the Finance Bureau of Zhangqiu District.

Exhibit 1. Shareholding chart as of 31 December 2023

Source: Company data, CCXAP research

Exhibit 2. Revenue structure in 2022

Source: Company data, CCXAP research

Exhibit 3. Gross profit structure in 2022**Rating Considerations****Government's Capacity to Provide Support**

We believe the local government of Zhangqiu District has a strong capacity to provide support given Zhangqiu District's GRP ranking upper-middle among the counties or districts in Jinan City over the years, and its relatively strong economic and financial strength.

Shandong Province is the third largest province in China by GRP, with a solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive and agri-food. Jinan City is a sub-provincial city, the capital city of Shandong Province, and the core city of the Jinan metropolitan area. Supported by the rapid development of core industries such as automobiles, pharmaceutical manufacturing, and information technology, the regional economy of Jinan City has demonstrated steady growth and its GRP had exceeded RMB1.0 trillion over the past three years. Over the same period, Jinan City has been ranking 9th by GRP among 15 sub-provincial cities in China and ranking 2nd among 16 prefecture-level cities in Shandong Province. Jinan City had a strong financial profile. From 2020 to 2022, its general budgetary revenue increased from RMB90.6 billion to RMB100.0 billion, with an average self-sufficiency rate (general budgetary revenue/general budgetary expenditure) of around 76.6%. As of 31 December 2022, the local government's outstanding debt amounted to RMB266.1 billion, accounting for 22.1% of its GRP. In 2023, Jinan City's GRP amounted to RMB1.3 trillion, representing a year-on-year("YoY") growth rate of 6.1%.

Exhibit 4. Key Economic and Fiscal Indicators of Jinan City

	2020FY	2021FY	2022FY
GRP (RMB billion)	1,014.1	1,143.2	1,202.8
GRP Growth (%)	4.9	7.2	3.1
General Budgetary Revenue (RMB billion)	90.6	100.8	100.0
General Budgetary Expenditure (RMB billion)	128.8	129.3	122.6
Local Government Debt (RMB billion)	168.3	211.9	266.1

Source: Jinan Municipal Government, CCXAP research

Zhangqiu District is in the east of Jinan City and is the sub-central city of Jinan. Zhangqiu District has a strong industrial foundation and a complete industrial system. Mingshui Economic and Technological Development Zone (“Mingshui ETDZ”), under the jurisdiction of Zhangqiu District, is the sole state-level ETDZ in Jinan City. Mingshui ETDZ has been recognized as a national new industrialization industry demonstration base, a national advanced machinery manufacturing industry base, a national characteristic industry base for heavy-duty vehicles, and a national organic polymer material base.

In recent years, the economic strength of Zhangqiu District has continued to increase, but has shown a slower growth. In 2022, the GRP of Zhangqiu District amounted to RMB129.8 billion, representing a YoY increase of 0.1%. In 2022, the local government’s general budgetary revenue decreased to RMB5.4 billion, due to the reduction in tax revenue resulted by the government tax refund policy. Moreover, its fiscal balance ratio (general budgetary revenue/general budgetary expenditure) significantly decreased in 2022, decreasing from 85.2% in 2020 to 65.0% in 2022. However, the average fiscal balance ratio over the past three years was still relatively high, valued at 81.4%. As of 31 December 2022, Zhangqiu District’s outstanding governmental debt amounted to RMB16.1 billion, accounting for 12.4% of its GRP. In 2023, Zhangqiu District’s GRP was RMB116.5 billion, ranking 5th among 12 districts and counties in Jinan City.

Exhibit 5. Key Economic and Fiscal Indicators of the Zhangqiu District

	2020FY	2021FY	2022FY
GRP (RMB billion)	100.2	112.0	129.8
GRP Growth (%)	7.2	4.6	0.1
General Budgetary Revenue (RMB billion)	7.0	7.7	5.4
General Budgetary Expenditure (RMB billion)	8.2	8.2	8.3
Local Government Debt (RMB billion)	11.0	14.2	16.1

Source: Zhangqiu District Government, CCXAP research

Government’s Willingness to Provide Support

Important role in local economic and industrial development

There are two most important LIIFCs in Zhangqiu District, which are ZQHG and Shandong Longshan Industrial Development Investment Group Co., Ltd. (“LSID”), respectively. LSID is a key urban construction and development entity, as well as the main driver of industrial development in Zhangqiu District. ZQHG is the largest LIIFC in Zhangqiu District in terms of the total assets, which is an important infrastructure investment, construction, and operation entity in Zhangqiu District and plays a significant role in local urban development and state-owned assets operation. QHID is one of the key subsidiaries of ZQHG, mainly engages in regional key project construction and industrial parks development and operation in Zhangqiu District.

QHID engages in the urban renewal projects in Zhangqiu District, including land acquisition and development, and operation. The Company is expected to achieve funding balance through future operating income, such as secondary land sales, and sales and leasing income. As of 30 September 2023, there was one urban renewal project under construction, with a total investment amount of RMB2.4 billion and uninvested amount of RMB902 million.

Moreover, QHID also engages in engineering construction business with relevant qualifications. The engineering construction work are mainly infrastructure constructions and the main clients are ZQHG and its subsidiaries. The Company has completed several projects, including land consolidation, road renovation, water supply renovation of old residential areas, as well as emergency repairment of pipeline networks. As of 30 September 2023, the Company had 8 contracts on hand, with a total contract amount of RMB11 million.

Medium exposure to commercial activities with relatively large capital expenditure pressure

Apart from public-related activities, QHID also engages in various kinds of commercial activities, mainly including production and sales of blowers, industrial parks development and operation, financial investment, guarantee business, as well as hotel management in Zhangqiu District. We consider QHID's commercial business exposure to be medium. However, the future investment needs in industrial park development would bring certain capital expenditure pressure to the Company.

QHID conducts production and sales of blowers through its subsidiary Shandong Zhangqiu Blower Co., Ltd. ("Zhangqiu Blower", Stock Code: 002598.SZ). After the consolidation of some local state-owned enterprises in Zhangqiu District, QHID indirectly holds 29.81% shares of Zhangqiu Blower. Zhangqiu Blower has a relatively strong industry position and technical strength in the field of roots blower. However, the Chinese roots blower market is relatively competitive, the products are mainly concentrated in low-end areas with low technical barriers and low profitability levels. The customer structure of Zhangqiu Blower is relatively scattered, mainly composed of private-owned enterprises national wide. Moreover, the production and sales of blowers has been increasing over the past three years. In 2022, Zhangqiu Blower recorded a total revenue of RMB1.9 billion, contributing around 85.8% to the total revenue of QHID. As of 30 September 2023, Zhangqiu Blower had 3 projects under construction, including production workshops and high-end energy-saving ventilator, with a total investment of RMB202 million and an outstanding investment of RMB157 million, which is expected to increase its future production capacity.

According to its strategic plan, QHID engages in industrial parks development and operation to promote the development of local industries. The Company undertakes the responsibilities of financing, construction, operation of industrial parks and is expected to achieve fund balance through leasing and sales. As of 30 September 2023, there were 4 industrial park projects under construction and planning, with a total investment of RMB1.8 billion and uninvested amount of RMB1.6 billion. Shandong Strategic Emerging Industry Park Project, the largest industrial park project of QHID with total investment of RMB1.3 billion, is positioned as a national-level innovation and entrepreneurship demonstration base. However, the Company's investment recovery cycle of industrial parks is long, making it more difficult to achieve fund balancing in short period of time and may expose the Company to larger investment and execution risks.

The Company shoulders the responsibilities of state-owned assets investment and operation, as well as the attraction of industrial investment in Zhangqiu District. QHID conducts financial investment business through equity investment and fund investment. According to the strategy plan of Zhangqiu District Government and the Company, the investment profile includes different industries such as high-tech, health medicine, high-end manufacture, as well as finance industries. As of 30 June 2023, the book value of the investment profile was

RMB553.3 million. The Company is expected to achieve investment return through dividends and disposal of the shares. However, the contribution of financial investment business to the Company's revenue is relatively low. The financial investment business is easily affected by the performance of invested companies and the changes in economic conditions.

Moreover, QHID also engages in hotel management business including accommodation, catering, as well as conferences. The Company has two hotels, which were acquired through local government transfer and outside purchase. However, the operation of hotels is vulnerable to the local economic environment and population mobility. The revenue of the Company's hotel management business decreased from RMB11.1 million in 2020 to RMB6.2 million in 2022.

Track record of receiving supports from its parent company and the local government

QHID has a good track record of receiving support from its parent company ZQHG and the local government, including equity transfer, financial subsidies, and loan guarantee. According to the latest plan of Zhangqiu District Government and ZQHG, the local government transferred 100% of shares of more than 20 state-owned companies held by ZQHG and 45.23% of shares of Zhangqiu Huinong New Rural Construction Investment and Development Co., Ltd. held by ZQHG to QHID at the end of 2023, enhancing its capital strength and enlarging its business scope. ZQHG also provides loan guarantees to QHID, with a total guaranteed amount of RMB1.5 billion, accounting for 65% of the Company's total debt. We believe that QHID will receive ongoing support from the local government and its parent company ZQHG, given its important position in local economic and industrial development.

Increasing debt burden driven by business expansion

Due to the business expansion, QHID's total debt has recorded an ongoing increase over the past years. As of 30 September 2023, the Company's total debt sharply increased to RMB2.4 billion from RMB215 million as of end-2020, while the total capitalization ratio increased from 2.2% to 18.0%. The Company also demonstrated a relatively large short-term debt pressure. As of 30 September 2023, the Company's short-term debt accounted for 65.7% of total debt. Meanwhile, the cash to short-term debt ratio was only 0.3x, which could not fully cover its short-term debt. Moreover, some assets of QHID are restricted for loans including land and fixed assets, which could reduce the Company's financial flexibility. As of 30 September 2023, the Company had restricted assets with a total amount of RMB4.4 billion, accounting for 25.0% of its total assets. As the Company may continue to rely on external financing for its investment in industrial park projects, it is expected that the Company's total debt burden would further increase in the next 12-18 months.

Access to diversified funding channels

QHID has a fair access to different funding channels such as bank loans, bond issuance, and non-standard financing. Bank loans and bond issuance contribute the majority of total debt. The Company maintains long-term and close relationships with state-owned commercial banks and joint-stock commercial banks, such as EverGrowing Bank Co., Limited, Industrial and Commercial Bank of China Limited, and China Citic Bank Corporation Limited. As of 30 September 2023, the Company had total bank facilities of RMB1.8 billion, with an unutilized portion of RMB663 million, indicating tight liquidity buffer. As the major shareholder of Zhangqiu Blower, the Company also pledged some shares of Zhangqiu Blower for loans. As of 6 February 2024, QHID pledged 46.5 million shares of Zhangqiu Blower, accounting for 50% of its total holdings. The Company also has access to onshore debt market. Zhangqiu Blower issued one tranche of convertible corporate bond, raising

RMB243 million in 2023. The Company's exposure to non-standard financing was manageable, accounting for less than 10% of its total debt.

Medium contingent liability risk associated with guarantee business

The credit profile of QHID is constrained by its guarantee business, which could potentially increase its repayment obligations. The Company conducts guarantee business through its subsidiary Shandong Tongsheng Financing Guarantee Co., Ltd. ("TSFG"), which was transferred by the local government in 2023. TSFG cooperates with 16 domestic banks to provide loan guarantees for micro and small scaled enterprises, agricultural entities, entities in rural areas, and farmers in Jinan City. As of 30 June 2023, TSFG's outstanding external guarantees amounted to RMB729 million. Given its business nature, the compensation rate of TSFG's guarantee business was relatively high, which was 8.23% as of 30 June 2023. TSFG also had compensation receivables of RMB167 million as of the same date. TSFG is expected to increase the recovery of compensation and reduce the compensation rate by strengthening counter-guarantee measures and due diligence procedures on the guaranteed companies.

ESG Considerations

QHID assumes environmental risks through its construction projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

QHID bears social risks as it implements public policy initiatives by undertaking infrastructure construction projects in Zhangqiu District. 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.

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

Structural Considerations

QHID's senior unsecured debt rating is in line with its long-term credit rating. We believe that government support will flow through the Company given its important role in the economic and industrial development of Zhangqiu District, thereby mitigating any differences in an expected loss that could result from structural subordination.

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 6. Peer comparison

	Shandong Quanhui Industrial Development Co., Ltd.	Jinan Zhangqiu Cultural Tourism Development Co., Ltd.
Long-Term Credit Rating	BBB _g	BBB _g
Shareholder	Jinan Zhangqiu Holding Group Co., Ltd. (100%)	Shandong Longshan Industrial Development Investment Group Co., Ltd. (100%)
Positioning	Important entity in construction of major projects and industrial development in Zhangqiu District	Important entity in investment, development, construction and operation of cultural tourism projects in Zhangqiu District
Total Asset (RMB billion)	17.7	13.1
Total Equity (RMB billion)	10.7	6.1
Total Revenue (RMB billion)	1.6	0.2

All ratios and figures are calculated using CCXAP's adjustments based on financial data as of 30 September 2023.

Source: Company data, CCXAP research

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