

## Credit Opinion

28 September 2023

Ratings	
Senior Unsecured Debt Rating	BBB <sub>g</sub> +
Long-Term Credit Rating	BBB <sub>g</sub> +
Outlook	Stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

### Analyst Contacts

Christy Liu +852-2860 7130

Credit Analyst

[christy\\_liu@ccxap.com](mailto:christy_liu@ccxap.com)

Jessica Cao +852-2860 7139

Credit Analyst

[jessica\\_cao@ccxap.com](mailto:jessica_cao@ccxap.com)

Elle Hu +852-2860 7120

Executive Director of Credit Ratings

[elle\\_hu@ccxap.com](mailto:elle_hu@ccxap.com)

*\*The first name above is the lead analyst for this rating and the last name above is the person primarily responsible for approving this rating.*

### Client Services

Hong Kong +852-2860 7111

## Shandong Hesheng Investment Co., Ltd.

### Initial credit rating report

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub>+** to Shandong Hesheng Investment Co., Ltd., with stable outlook.

### Summary

The BBB<sub>g</sub> long-term credit rating of Shandong Hesheng Investment Co., Ltd. (“SHIC” or the “Company”) reflects Jimo District Government’s (1) strong capacity to provide support, and (2) extremely 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 for years, 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; and (2) strategic important role for the urban construction and economic development in Jimo District, especially in the Economic Development Zone of Jimo District (“Jimo EDZ”).

However, the Company’s rating is constrained by its (1) medium exposure to commercial activities; (2) increasing debt level because of higher investment needs; and (3) higher funding cost driven by moderating financing environment of the district.

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 District over the next 12 to 18 months.

## Rating Drivers

- Strategic important role for the urban construction and economic development, especially in the Jimo EDZ
- Medium exposure to commercial activities
- Increasing debt level because of higher investment needs
- Higher funding cost driven by moderating financing environment of the district

## 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 materially increased exposure to risky commercial activities.

## Key Indicators

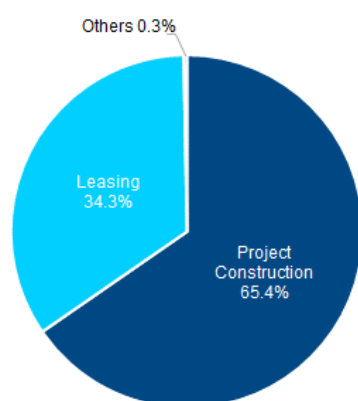
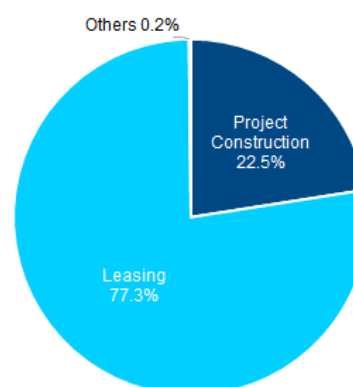
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	26.3	40.1	48.3	49.2
Total Equity (RMB billion)	24.2	34.5	39.8	39.8
Total Revenue (RMB billion)	0.3	1.4	2.2	0.8
Total Debt/Total Capital (%)	3.3	6.5	8.2	9.0

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

Source: CCXAP research

## Corporate Profile

Established in January 2020, SHIC is one of the major local state-owned entities in Jimo District, Qingdao City. It is positioned as the key entity for urban construction and assets operation in Jimo District, and is mainly responsible for projects 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 2023, 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 2022****Exhibit 2. Gross Profit Structure in 2022**

Source: Company information, CCXAP research

**Exhibit 3. Shareholding chart as of 30 June 2023**

Source: Company information, CCXAP research

## Rating Considerations

### Government's Capacity to Provide Support

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

Shandong Province is the third largest province in China by gross regional products ("GRP"), 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 a GRP of RMB1,492.1 billion in 2022, ranking first in Shandong Province and 13<sup>th</sup> among China's municipalities. Qingdao City also has strong fiscal strength and manageable debt profile. In the past five years, its general budgetary revenue covered around 80% of its general budgetary expenditure and tax incomes accounted for around 70% of its general budgetary revenue. Its government's debt/GRP was as low as 20.6% as of 31 December 2022.

**Exhibit 4. Key economic and fiscal indicators of Qingdao City**

	2020FY	2021FY	2022FY
GRP (RMB billion)	1,240.1	1,413.6	1,492.1
GRP Growth (%)	3.7	8.3	3.9
General Budgetary Revenue (RMB billion)	125.4	136.8	127.3
General Budgetary Expenditure (RMB billion)	158.5	170.7	169.6
Local Government Debt (RMB billion)	205.8	255.9	308.0

Source: Statistic Bureau of Qingdao City, 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 supplies 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 it has demonstrated fast economic growth over the past three years. It recorded GRP of RMB127.8 billion, RMB145.3 billion, and RMB151.3 billion in 2020, 2021, and 2022, with growth rates of 5.8%, 6.9%, and 2.6%, respectively. Jimo District's GRP ranked third among all the districts or counties in Qingdao City for years. Jimo District had a relatively strong fiscal balance as its general budgetary revenue covered around 80% of its general budgetary expenditure. 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 2022, the outstanding amount of local government debt amounted to RMB16.3 billion, increasing from RMB12.8 billion at end-2021 and accounting for 10.8% of its GRP.

**Exhibit 5. Key economic and fiscal indicators of Jimo District**

	2020FY	2021FY	2022FY
GRP (RMB billion)	127.8	145.3	151.3
GRP Growth (%)	5.8	6.9	2.6
General Budgetary Revenue (RMB billion)	11.2	11.6	10.0
General Budgetary Expenditure (RMB billion)	12.8	12.8	13.3
Local Government Debt (RMB billion)	11.8	12.8	16.3

Source: Statistic Bureau of Jimo District, 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 urban construction and economic development, especially in the Jimo EDZ**

SHIC is one of the key state-owned entities in Jimo District. It plays an essential role in urban construction and operation in Jimo EDZ, and is mainly responsible for major projects construction in Jimo EDZ. The Company is expected to undertake more 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 in Jimo District.

SHIC undertakes project construction business and receives projects payments based on the actual cost plus a markup in return upon completion. As of 30 June 2023, the Company had undertaken some key construction projects, with a total investment of RMB2.2 billion. From the perspective of project reserves, the Company has 2 key projects under construction as of 30 June 2023, with a total investment of RMB731 million. The Company also had 3 projects under planning under self-construction mode, with a total investment of RMB10.9 billion. Such projects are beneficial for local development and ensure the sustainability of the company's business.

The Company has received comprehensive support from the local government, in terms of asset injections and operating subsidies. From 2020 to June 2023, the local government has continuously injected assets to SHIC, such as sea area using right, parking lots, and sewage and heating pipelines, increasing capital reserve by approximately RMB39.2 billion. The Company also received operating subsidies of RMB60 million from the local government over the same period. Considering the important position of SHIC, we expect the Company to receive ongoing support from the local government when necessary.

### **Medium exposure to commercial activities**

SHIC's commercial activities are considered at a medium level. The Company engaged in leasing, property development, and project 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 project construction businesses. The Company's exposure to commercial businesses is considered to be medium.

As the main state-owned entity in Jimo EDZ, SHIC possesses relatively large amount of leasing assets, including aquaculture right of tidal flats, sea area using right, parking lots and schools to the Company, which have generated additional recurring income to the Company. However, the rent payment collection is relatively weak. Most of leasing assets were leased out to private-owned enterprises at relatively high prices, such as parking lots, with high concentration risk. Due to the impact of the epidemic over the past few years and the overpricing of leasing assets, large scale of receivables have been formed with large uncertainty in the collection period.

On the back of the local industry upgrade and development, the Company is undertaking more commercial projects, including industrial parks, kindergarten, sports center, and medical service center, and is expected to generate income through leasing. As of 30 June 2023, the Company had one completed industrial park and rent out for 10 years with a rent exemption period of more than one year to support the development of local industries. The Company also had 3 self-constructed and self-operated projects under construction as of 30 June 2023, with a total investment of RMB797 million and an outstanding amount of RMB485 million. With the completion and operation of newly developed investment properties in the future, the income from this business sector is expected to increase.

SHIC also engages in property development business. As of end-2022, the Company had one project under construction, including commercial housing and supporting facilities, with a total investment of RMB1.5 billion and an outstanding investment of RMB635 million. As of 30 June 2023, majority of the saleable area had been sold. Considering the Company mainly relies on external financing for its property development business, it may face more pressure on capital expenditure in the future.

### **Increasing debt level because of higher investment needs**

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 2023, the Company's total debt increased to RMB3.9 billion from RMB830.5 million at end-2020. Its total capitalization ratio, as measured by total debt to total capital, was relatively low at 9.0%. However, the Company had a moderate debt maturity structure, with short-term debts accounted for around 41.9% of the total debts. The Company is planning to invest more than RMB1.2 billion to support the construction of key projects in the region in 2023. 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.

### **Higher funding cost driven by the moderating financing environment of the district**

SHIC mainly relies on bank borrowing to finance its project 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. However, the Company demonstrated limited outstanding credit facilities which may constrain its liquidity position over the short to medium term. As of 31 March 2023, the Company has obtained total credit facilities of RMB5.1 billion, with an unutilized amount of RMB819 million only, indicating a limited liquidity buffer. It also tapped into high-cost nonstandard financing channels such as financial leasing and trust companies to meet its funding needs. The exposure to non-standard financing is moderate, which accounted for around 10%-15% of total debt as of 30 June 2023. However, the cost of non-standard financing is relatively high.

## **ESG Considerations**

SHIC bears environmental risks through its 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 undertaking construction projects 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 role and status as a government-owned entity.

## **Structural Considerations**

SHIC'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 strategic important role in the urban construction and economic development of Jimo 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 \(July 2022\)](#).

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**China Chengxin (Asia Pacific) Credit Ratings Company Limited**

Address: Suites 1904-1909, 19/F, Jardine House,  
1 Connaught Place, Central, Hong Kong

Website: [www.ccxap.com](http://www.ccxap.com)

Email: [info@ccxap.com](mailto:info@ccxap.com)

Tel: +852-2860 7111

Fax: +852-2868 0656