

Credit Opinion

29 December 2023

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

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Weihai Huantong Industrial Investment Group Co., Ltd.

Surveillance credit rating report

CCXAP affirms first-time long-term credit rating of BBB_g- to Weihai Huantong Industrial Investment Group Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Weihai Huantong Industrial Investment Group Co., Ltd. (“HTII” or the “Company”) reflects Huancui District Government’s (1) relatively 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 Huancui District Government’s capacity to support reflects its status as the development center of Weihai City and the seat of Weihai Municipal Government. It has relatively strong economic conditions and good fiscal metrics.

The rating also reflects the local government’s extremely high willingness to support, which is based on the Company’s (1) full ownership and ultimate control by the Huancui District Government; (2) essential role in infrastructure construction and regional development in Huancui District; and (3) solid track record of receiving government supports.

However, the rating is constrained by the Company’s (1) moderate exposure to commercial activities with increasing business risk related to property development; (2) increasing debt level and moderate asset liquidity; and (3) medium exposure to contingent liabilities

The stable outlook on HTII’s rating reflects our expectation that the local government’s capacity to support will remain stable, and the Company’s characteristics, such as its essential role in infrastructure construction and regional development in Huancui District, will remain largely unchanged over the next 12-18 months.

Rating Drivers

- Essential role in infrastructure construction and regional development in Huancui District
- Solid track record of receiving government supports
- Moderate exposure to commercial activities with increasing business risk related to property development
- Increasing debt level and moderate asset liquidity
- Good access to funding from banks and domestic bond market
- Medium exposure to contingent liabilities

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Huancui District Government's capacity to support the Company strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as materially lowers the exposure to risky commercial activities and more diversified funding sources.

What could downgrade the rating?

The rating could be downgraded if (1) Huancui 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 support, such as reduced strategic significance or deteriorated debt management.

Key Indicators

	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	28.6	49.0	53.0	52.9
Total Equity (RMB billion)	10.8	26.0	27.1	27.2
Total Revenue (RMB billion)	1.1	1.1	1.7	0.2
Total Debt/Total Capital (%)	57.5	41.8	42.9	42.5

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

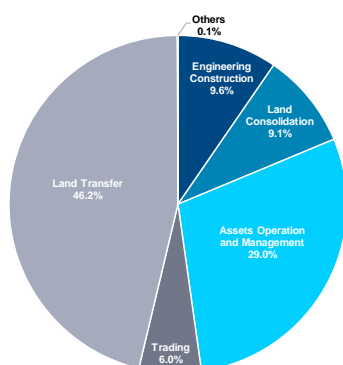
Source: Company data, CCXAP Research

Corporate Profile

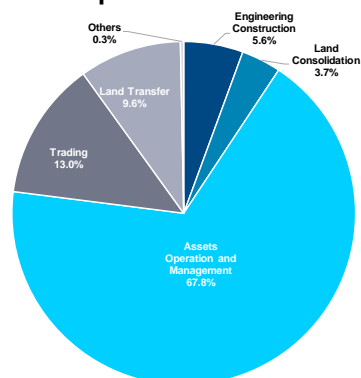
Founded in November 2021, HTII is the most important local infrastructure investment and financing company ("LIIFC") in Huancui District, Weihai City, Shandong Province. After consolidation of the local state-owned enterprises, HTII has become the largest state-owned enterprise by asset size and the dominant platform engaged in infrastructure construction, land consolidation, and operation of state-owned assets in Huancui District. The Company also undertakes diversified commercial businesses such as leasing of sea area use rights, property projects, and parking lots, as well as commodity trading business. As of 30 September 2023, the Company was directly and wholly owned by the State-owned Assets Service Center of Huancui District ("Huancui SASC") and the Huancui District Government was the ultimate controller.

Exhibit 1. Shareholding chart as of 30 September 2023

Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2022

Source: Company information, CCXAP research

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

We believe Huancui District Government has a relatively strong capacity to provide support given its relatively strong economic conditions and good fiscal metrics, but constrained by significant reduction on tax revenue in 2022.

Shandong is the third largest province in China by gross regional products ("GRP") in 2022, with a solid foundation in different industries such as logistics, shipbuilding, marine technology, chemical, automotive, and agri-food. Weihai City is located at the east of the Shandong Peninsula, which has formed three major industrial patterns, including traditional industries such as machinery manufacturing, food processing, transportation equipment, textile and clothing; emerging industries such as new medicine and medical equipment, new information and new materials; future industries such as marine life, the internet of things and intelligent equipment. In 2022, Weihai City reported a GRP of RMB340.8 billion, increased by 1.5% year-over-year ("YoY"), and ranked 11th among prefecture-level cities in Shandong Province. However, its tax revenue significantly decreased from RMB19.9 billion in 2021 to RMB15.8 billion in 2022 due to the tax rebate policy. Meanwhile, its general budgetary revenue decreased from RMB26.7 billion to RMB22.5 billion. Moreover, it recorded an increase in general budgetary expenditure, resulting a reduction in fiscal balance ratio (general budgetary revenue/ general budgetary expenditure). In 2022, Weihai City's fiscal balance decreased from 77.7% in 2021 to 54.0%. Weihai City relies on transferring income from higher level government and bond issuance to achieve fiscal balance. As of 31 December 2022, Weihai City reported a government debt of RMB89.5 billion and accounted for 22.9% of its GRP.

Exhibit 4. Key Economic and Fiscal Indicators of Weihai City

	2020FY	2021FY	2022FY
GRP (RMB billion)	301.8	346.4	340.8
GRP Growth (%)	3.0	7.5	1.5
General Budgetary Revenue (RMB billion)	25.2	26.7	22.5
General Budgetary Expenditure (RMB billion)	35.0	34.3	41.7
Local Government Debt (RMB billion)	73.5	79.5	89.5

Source: Weihai Municipal Government, CCXAP research

Huancui District is the political, economic, cultural, and technological center of Weihai City and seat of the Weihai Municipal Government. Supported by the pillar industries such as new materials, high-end equipment manufacturing, and biomedicine, Huancui District demonstrated ongoing economic growth for the past three years. In 2022, Huancui District's GRP rose by 1.6% YoY to RMB44.3 billion. Due to the tax rebate policy, its general budgetary revenue decreased from RMB4.4 billion in 2021 to RMB3.8 billion in 2022, and tax revenue contributed around 85% of its general budgetary revenue. Although Huancui District's fiscal balance ratio decreased in 2022, it has maintained a high fiscal balance ratio of over 110% over the past three years. Huancui District Government also has a moderate government debt/GRP ratio of 17.3% as of 31 December 2022.

Exhibit 5. Key Economic and Fiscal Indicators of Huancui District

	2020FY	2021FY	2022FY
GRP (RMB billion)	38.7	44.2	44.3
GRP Growth (%)	3.7	6.1	1.6
General Budgetary Revenue (RMB billion)	4.2	4.4	3.8
General Budgetary Expenditure (RMB billion)	3.2	3.1	3.4
Local Government Debt (RMB billion)	6.3	6.7	7.7

Source: Huancui District Government, CCXAP research

Government's Willingness to Provide Support**Essential role in infrastructure construction and regional development in Huancui District**

HTII is the most important LIIFC delegated by Huancui District Government to undertake local infrastructure construction, state-owned asset operations, and land consolidation. After the injection of Weihai Central City State-Owned Asset Management Co., Ltd. ("CCAM") in 2021, one of the important LIIFCs in Huancui District, and its subsidiary Weihai City Huancui Urban Development Investment Co., Ltd., HTII has become the essential entity in the economic and industrial development of the region, indicating an irreplaceable position.

HTII carries out key public policy projects through different construction models consisting of agency construction, government purchase, land balancing as well as self-operation. The Company plays a clear strategic role in regional and social development and engages in large amounts of projects such as town constructions, road renovations, shantytown renovations, industrial parks, hospitals, as well as innovation centers. HTII's public-policy role helps Weihai City and Huancui District attract enterprises and investments to strengthen regional economic growth, which has high importance to the local government.

Under the agency construction model, the Company signs entrusted construction agreements with the local government before entrusted construction projects are developed, and transfers the project ownership to the government after the project is completed. The government will pay the total costs plus certain percentage markups after examining the projects. Under the government purchase model, the Company constructs

shantytown renovation projects assigned by the local government according to the agreements and receives service fees annually. Under the land balancing model, after the Huancui District Government arranges and sells the land around the infrastructure projects year by year, it returns all the income to the Company after deducting relevant expenses. Under the self-operation model, the projects will be leased or sold to generate income when the Company completes construction. As of 31 December 2022, there were 6 projects under construction under agency construction, government purchase, and land balancing models, with a planned total investment of RMB7.3 billion and uninvested amount of RMB403 million. Meanwhile, the Company had 3 projects under construction and 3 projects under planning under self-operation model, such as hospital and parking lots construction, with a planned total investment of RMB10.1 billion and outstanding investment of RMB8.2 billion. The abundant projects under construction and planning can ensure the sustainability of its infrastructure construction, but also bring relatively large capital expenditure pressure.

Moreover, HTII has a strong role in local state-owned asset management, including roads, tunnels, and bridges transferred from the local government, with a long concession for more than 10 years, showing strong sustainability. Meanwhile, the Company is also entrusted by the government to engage in the maintenance of municipal facilities, sanitation, and garden maintenance. The Company also assumes the responsibility for the regional land consolidation, and receives government payment based on the total costs plus certain markups in return after the land consolidation is completed and transferred.

We believe the visibility and predictability of the Company's business position are high and its policy mandate is strong. We also expect the Company to undertake most of the public projects in the mandated areas and transfer-out of its public projects is unlikely.

Solid track record of receiving government supports

HTII and its subsidiaries have a solid track record of receiving recurring support from the Huancui District Government, including operating subsidies, and capital and asset injections, in order to help the Company to meet its policy objectives and financial obligations. In 2021, the local government transferred 100% equity of CCAM and the use right of 16 sea areas to HTII with a use period of ten years, which significantly enlarged its capital reserve by RMB14.5 billion. The local government further transferred assets to the Company in 2022, including buildings and land use right, with a total value of RMB183 million. Apart from that, the Company received capital injection in cash from Huancui SASC, increasing the paid-in capital by RMB400 million in 2022. From 2020 to 2022, the local government also provided operating subsidies of around RMB620 million to HTII. Considering the strategic role of HTII, we expect the Company will continue to receive support from the local government in the future, which will enhance its operating and capital strength accordingly, in our view.

Moderate exposure to commercial activities with increasing business risk related to property development

In addition to public activities, HTII is also involved in other commercial businesses such as leasing of sea area use rights, property projects, and parking lots, as well as commodity trading business. Although the commercial assets accounted for a relatively large proportion of total assets as of end-2022, we estimate the Company's risk exposure to commercial business is moderate as the majority of the assets are the sea area use rights transferred from the local government with low operational risk.

HTII conducts asset operation business through leasing of sea area use rights, properties, and parking lots, which contributes the largest part of its total revenue. Most of the Company's commercial businesses are policy-driven in line with the development policy of Huancui District, mainly to support the daily operation of local

government and enterprises. The Company owns 23 sea area use rights with a leasable area of 15,636.3 hectares, part of which are leased to a local state-owned enterprise engaging in aquaculture business, generally for 5 years. The Company plays a role as custodian to promote the development of the local aquaculture industry. Moreover, the Company's parking lots and the majority of the commercial properties such as office buildings, industrial parks, and service centers are leased to the government agencies and state-owned enterprises in Huancui District, generating annual revenue of around RMB90 million in 2022.

However, HTII engages in the development of commercial properties such as commercial complexes and residential projects that are purely market-oriented. Also, the Company's shantytown renovation projects contain part of houses that are sold at the market price after the resettlement ones are sold to resettled households. Moreover, the Company is entrusted by the local government to purchase the property projects from Hengda Real Estate Group Co., Ltd. including hotel office buildings, cinemas, residences, shops, parking spaces, and to engage in the development and sales of the project. These commercial projects are subject to changes in the property market, and the subsequent project development and income may experience higher volatility, particularly during the downturn in China's property market. In addition, the Company is planning to acquire the remaining equity of some joint venture projects from distressed property developers. The increasing investments in property-related commercial activities will inevitably expose the Company to higher business and financial risks. As of 31 December 2022, there were 2 projects under planning, with a total investment amount of RMB673 million.

Additionally, HTII's trading business generates supplementary income to the Company, including the main products of coke, coking coal, steel, and cement. The commodity prices were relatively volatile and the revenue from trading business has been decreasing over the past three years. However, the Company has maintained a sound gross profit margin of 40.9% in 2022 though trade hedging. The Company's trading business generates a large proportion of account receivables, and part of the uncollected amounts come from private-owned enterprises, exerting certain recovery risks. In addition, the concentration risk from upstream and downstream customers is relatively high, with the top five suppliers and customers accounting for more than 80% of total procurement and more than 50% of total sales by the end of 2022.

Increasing debt level and moderate asset liquidity

HTII's total debts demonstrated rapid growth along with the ongoing investment in construction projects. As of 31 March 2023, the Company reported total debt of RMB20.0 billion, increasing from RMB18.7 billion as of end-2021. HTII has a large investment plan in its diversified business including infrastructure construction, land consolidation, as well as commercial properties, which will exert certain capital pressure. Thanks to the government's continuous asset injections, the Company maintained moderate debt leverage, and its total capitalization ratio was 42.4% as of the same date. At the same time, the Company's short-term debt was RMB7.6 billion, accounting for 37.7% of total debt, and its cash to short-term debt ratio was 0.6x, indicating that its cash reserves could not fully cover its short-term debt. Considering the large capital expenditure needs of its construction projects, we expect the Company's debt level to continue to rise.

Additionally, HTII has moderate asset liquidity. The Company's total asset mainly consists of intangible assets, inventories and other receivables, which accounted for approximately 72% of its total asset as of 31 March 2023. Intangible assets are mainly using right of sea areas transferred by the local government. Inventories are mainly undeveloped lands and investment costs of infrastructure construction projects, while other receivables are mainly loans provided to the subordinate towns and streets for supporting infrastructure construction and

development of state-owned enterprises within the district, all of which are considered low liquidity. As of 31 December 2022, the Company had restricted assets of RMB8.6 billion, accounting for 31.6% of the net assets.

Good access to funding from banks and domestic bond market

The important strategic position of HTII and its subsidiaries in Huancui District is well-recognized by banks and domestic bond market. Most of the incremental debt consists of bank loan or domestic bond issuance proceeds. The Company has built borrowing relationships with policy banks and major state-owned banks in China, including Agricultural Development Bank of China, Bank of China Limited, and Industrial & Commercial Bank of China Ltd. As of 30 September 2023, it received total credit facilities of RMB12.6 billion, with the available portion being RMB2.7 billion. HTII's exposure to non-standard products such as financial leasing is moderate, accounting for around 15% to 20% of the total debt. Moreover, the Company's two major subsidiaries have participated in the domestic bond market. CCAM has issued one tranche of PPN and one tranche of corporate bond in 2023, raising RMB1.8 billion. The Company also tapped into offshore bond market. In November 2023 to December 2023, HTII issued 2 tranches of offshore bonds, raising RMB1.1 billion. We believe HTII's funding access will be stable, taking into account the Company's important status as the largest platform in infrastructure construction of Huancui District after successfully consolidating these subsidiaries.

Medium exposure to contingent liabilities

HTII's credit profile is constrained by its external guarantees, which could potentially increase its repayment obligations. As of 31 December 2022, the Company had outstanding external guarantees of RMB4.1 billion, representing 15.0% of its net assets. Most of them were provided to local state-owned enterprises. The contingent liabilities of the Company are subject to regional risks, as the majority of the guarantees have been provided to local state-owned enterprises. In addition, the Company provided a loan guarantee for one of its joint venture property development project companies, namely Weihai Fuhuan Real Estate Development Co., Ltd. ("Fuhuan Real Estate"), which is under the control of Guangzhou R&F Properties Co., Ltd. Fuhuan Real Estate has been in default from the loan payments and incurred lawsuits in 2022. Although HTII had not made any compensation for this external guarantee as of 30 June 2023, it still bears certain contingent liabilities risks.

ESG Considerations

HTII faces environmental risks because it has undertaken infrastructure construction projects. Such risks could be moderated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

HTII bears social risks as it implements public policy initiatives by building public infrastructure in Huancui 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.

HTII's governance considerations are also material as the Company is subject to oversight by the Huancui 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 \(July 2022\)](#).

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