

Credit Opinion

15 November 2024

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

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Qingdao Hainuo Investment Development Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Qingdao Hainuo Investment Development Co., Ltd., with stable outlook.

Summary

The BBB_g long-term credit rating of Qingdao Hainuo Investment Development Co., Ltd. (“QDHN” or the “Company”) reflects Shinan 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 Shinan District Government’s capacity to support reflects Shinan District’s status as one of the top five largest districts by gross regional product (“GRP”) in Qingdao City for years, with good economic fundamentals and fiscal profile.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) important position in infrastructure construction and urban operations in Shinan District; (2) solid record of receiving government support; and (3) good access to multiple funding channels.

However, the Company’s rating is constrained by its (1) high exposure to commercial activities with large future investment needs and limited operating profits; (2) high debt leverage with relatively weak asset liquidity; and (3) medium exposure to contingent liabilities.

The stable outlook on QDHN’s rating reflects our expectation that the Shinan District Government’s capacity to provide support will be stable, and the Company will maintain its important role in local infrastructure construction and urban operations in Shinan District over the next 12 to 18 months.

Rating Drivers

- Important position in infrastructure construction and urban operations in Shinan District
- Solid record of receiving government support
- High exposure to commercial activities with large future investment needs and limited operating profits
- High debt leverage with relatively weak asset liquidity
- Good access to multiple funding channels
- Medium exposure to contingent liabilities

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Shinan 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 debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Shinan 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, or deteriorated refinancing ability.

Key Indicators

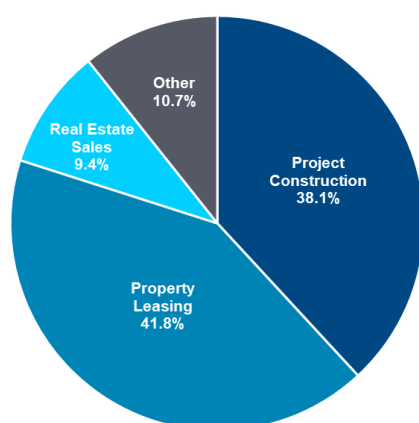
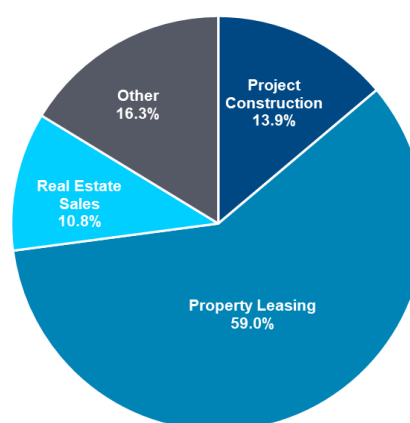
	2021FY	2022FY	2023FY	2024H1
Total Asset (RMB billion)	21.8	25.5	28.5	29.9
Total Equity (RMB billion)	7.0	7.6	7.9	7.8
Total Revenue (RMB billion)	0.3	0.5	0.6	0.4
Total Debt/Total Capital (%)	65.6	67.3	70.1	72.1

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

Source: Company data, CCXAP research

Corporate Profile

Established in March 2012, QBHN is one of the most important local infrastructure investment and financing company ("LIIFC") in Shinan District. The Company primarily undertakes infrastructure construction projects including schools, affordable housing, and housing renovation in Shinan District. It also undertakes diversified commercial activities, including real estate sales, construction of self-operated projects, property leasing, financial investment, as well as commercial trading. As of 30 June 2024, the Company was directly and wholly-owned by the Finance Bureau of Qingdao Shinan District.

Exhibit 1. Revenue structure in 2023**Exhibit 2. Gross profit structure in 2023**

Source: Company information, CCXAP research

Exhibit 3. Shareholding chart as of 30 June 2024

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe that the Shinan District Government has very strong capacity to provide support, reflects Shinan District's status as one of the top five largest districts by gross regional product ("GRP") in Qingdao City for years, with good economic fundamentals and fiscal profile.

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 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, its government's debt/GRP was 23.0%. In the first half of 2024, Qingdao City reported a GRP of RMB797.9 billion, representing 5.8% YoY growth.

Exhibit 4. 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

Located in the south of Qingdao on the coast of Jiaozhou Bay, Shinan District is the political, cultural, and financial center of Qingdao City and the seat of the Qingdao Municipal Government. It focuses on developing 6 pillar industries including wealth and innovation finance, digital economy, high-end business, fashion consumption, shipping logistics, as well as cultural tourism. Shinan District's GRP has been ranking top 5 among all the districts or counties in Qingdao City over the past few years. The GRP of Shinan District increased by 5.5% YoY to RMB157.8 billion in 2023. Moreover, Shinan District Government has good fiscal metrics. The average fiscal balance ratio (general budgetary revenue/general budgetary expenditure) over past three years was around 166%. It's average fiscal stability ratio (tax revenue/general budgetary revenue) was above 85% over the same period. As of end-2023, the outstanding amount of local government debt amounted to RMB5.1 billion, accounting for 3.2% of the GRP. In the first half of 2024, Shinan District achieved a GRP of RMB82.1 billion, with a YoY growth of 5.1% and ranking second in the Qingdao City.

Exhibit 5. Key economic and fiscal indicators of Shinan District

	2021FY	2022FY	2023FY
GRP (RMB billion)	140.1	149.6	157.8
GRP Growth (%)	6.2	4.7	5.5
General Budgetary Revenue (RMB billion)	9.3	9.2	8.8
General Budgetary Expenditure (RMB billion)	5.4	5.7	5.4
Local Government Debt (RMB billion)	3.8	4.4	5.1

Source: Shinan District Government, CCXAP research

Government's Willingness to Provide Support**Important position in infrastructure construction and urban operations in Shinan District**

QDHN is one of the most important LIIFCs in Shinan District. It is the main entity authorized by the Urban Construction Bureau of Shinan District to carry out infrastructure construction projects, with high strategic importance. The Company is mainly responsible for infrastructure construction, urban renewal operation and industrial park operation in Shinan District.

QDHN is involved in the construction of infrastructure projects in Shinan District, including school construction, road rehabilitation, affordable housing and dilapidated housing renovation projects, which can help improve the lives of the local residents in line with Shinan District's urban planning. The Company takes part in infrastructure construction mainly through agency construction model. Under the agency construction model, the Company is entrusted to be responsible for financing and constructing the projects. The Company receives project repayments from the entrusting parties based on the total cost plus 15% markups after examination. As of 30 June 2024, the Company had completed 8 main projects, with total investment of RMB1.2 billion and government repayments of RMB868.6 million. Meanwhile, the Company had 13 infrastructure construction

projects under construction with a total invested amount of approximately RMB5.3 billion and uninvested amount of RMB563 million. Most of these projects under construction have been completed but not settled yet. As of 30 June 2024, the Company cumulatively recognized revenue of RMB291 million from infrastructure construction projects under construction. However, the Company currently has no projects under planning. The stability and sustainability of the infrastructure construction projects will need to be monitored in the future. In addition, the payment of the infrastructure construction projects is prolonged, which may cause relatively high financial burden to QDHN.

Solid track record of receiving government support

As a key entity undertaking public activities in Shinan District, QDHN has a solid track record of receiving government support in various forms such as capital injection, financial subsidies, and government payment for construction projects. From 2021 to 2024H1, the Company received cash injection and asset injection from the local government, which increased its paid-in capital from approximately RMB1.9 billion to RMB2.1 billion. The Company's capital reserve increased from RMB2.6 billion to RMB3.0 billion during the same period, mainly due to the property assets injected by the local government. Meanwhile, the Company received government subsidies with a total amount of around RMB52.7 million. In addition, the Company also received special bond from local government to support its infrastructure construction business, with total amount of around RMB230.0 million in 2023. QDHN also received ongoing project repayments from local government for a total amount of RMB447.6 million from 2021 to 2024 H1. We expect the Company will continue to receive government support over the next 12 to 18 months, given its important policy role in Shinan District.

High exposure to commercial activities with relatively large future investment needs and limited operating profits

The Company is involved in various commercial activities, including the real estate sales, construction of self-operated projects, property leasing, financial investment, as well as commercial trading. We consider QBNH's exposure to the commercial business to be high, accounting for more than 30% of total assets in our estimation. These commercial activities may contribute part of the Company's income, but also involve higher operational and business risks than its public activities. At the same time, the Company's large scale of property development projects and self-construct projects would cause higher capital expenditure pressure on the Company. 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.

The Company's property sales business is mainly focused on the construction and sale of residential property projects and surrounding commercial buildings. As of 30 June 2024, the Company had two major completed property projects with a total investment of RMB1.2 billion and approximately 70% of the properties had been sold. Meanwhile, the Company had one large property project of commercial and residential under construction with total investment of RMB3.2 billion and uninvested amount of RMB1.8 billion. The Company also has one property project under planning with an estimated investment of around RMB370 million. However, during the slowdown of the Chinese property market, the fund's balance may suffer from high volatility due to the uncertainty of sales progress.

The Company also undertakes the construction of self-operated projects. Under the self-construction model, the Company assumes the responsibilities of financing, constructing and operating the projects and would achieve fund balancing through sales, leasing and operation revenue. As of 30 June 2024, the Company had 2 car parking projects under construction, with an estimated total investment of around RMB204.0 million and an uninvested amount of RMB119.0 million. Meanwhile, there are 5 large projects including Fushan Bay

Headquarters Business Building Project, Digital New Energy Vehicle Industrial Park Project, and Smart Computing Center under planning, with an estimated total investment of approximately RMB12.2 billion. The large amount of uninvested capital in self-operated projects would involve high capital expenditure for the Company. Moreover, the investment cycle of self-operated projects is long, and the fund balance bears more uncertainties. All the self-operated projects under planning are reserve projects and there is no specific construction plan yet.

QDHN also engaged in leasing business mainly through 3 industrial parks. These leasable industrial parks are mainly transferred by the government or purchased by the Company. As of 31 December 2023, the Company's 3 industrial parks had total available area for rent of 276.1 thousand square meters and comprehensive occupancy rate of 83%. The leasing revenue of 3 industrial parks was RMB141.3 million, RMB146.3 million and RMB131.3 million in 2021, 2022 and 2023, respectively. The operation of industrial parks is closely linked to local economic development. Moreover, the Company has invested more than RMB4.4 billion to purchase and furnish residential properties as leasable affordable housing and talent apartment for rent. However, most of the residential housing purchased by the Company is vacant and the rent generated from these purchased residential housing is limited.

QDHN is also involved in commercial trading, including meat and meat products, grain oil, chemicals, electronics and aquatic products. In 2023, the commercial trading business expanded rapidly as the increased diversity of trading products. Commercial trading generates a minor profit and is subject to certain repayment risks. The Company is also exposed to customer and supplier concentration risks, which may weaken the Company's bargaining power. In 2023, the top five suppliers and customers accounted for 73.1% and 87.2% of total procurement and total sales, respectively.

QDHN has engaged in financial investment to promote industrial development in Shinan District through equity investment, fund investment and debt investment. The Company's investments mainly focus on intelligent manufacturing, science and technology innovation, ocean economy and biomedical industries and other sectors, which are consistent with the main industries in Shinan District. The Company expects to achieve investment return through IPO, merger and acquisition, transfer of investment shares and liquidation at maturity. However, the investment return is relatively low. Moreover, the main invested enterprises are private-owned enterprises, which have higher operation risks during a market downturn. The financial investment business has significant volatility due to the performance of invested companies and change of economic situation.

High debt leverage with relatively weak asset liquidity

Due to the ongoing financing for its infrastructure construction and self-construction projects in recent years, QBHN demonstrates a rapid debt growth. As of 30 June 2024, the Company's total debt increased to RMB20.3 billion from RMB13.7 billion as of end-2021. The Company has a high debt leverage and its total capitalization ratio increased to 72.1% as of 30 June 2024 from 66.0% as of 31 December 2021. The Company's short-term debt accounted for 33.6% of total debt as of 30 June 2024, indicating certain short-term debt pressure. Meanwhile, the cash to short-term debt ratio was 0.2x, which could not fully cover its short-term debt. We estimate that the Company would continue to rely on external financing such as bank loans to support its further development, while its total capitalization ratio would remain relatively high over the next 12-18 months.

Moreover, the liquidity of the Company's assets was relatively weak. As of 30 June 2024, inventories, investment property, and construction in progress accounted for approximately 68% of total assets. The inventories and construction in progress are mainly cost of infrastructure construction, property development, and self-construction projects. The Company's investment properties are mainly industrial parks and other rental housing.

All of these assets were considered low liquidity. The low asset liquidity may undermine the Company's financial flexibility. Meanwhile, the total restricted assets were RMB5.1 billion which accounted for 17.2% of total assets, and investment property was the largest component of it. In 2023, the Company provided a lending of RMB270 million to private enterprise Luoke Intelligent Technology (Qingdao) Company as debt investment. We should pay attention to the progress of subsequent fund recovery

Good access to multiple funding channels

QDHN has good access to multiple funding channels such as bank loans, domestic bond financing, and non-standard financing. The Company maintains long-term close relationships with domestic banks, such as Industrial and Commercial Bank of China Limited, China Citic Bank Corporation Limited and Bank of Qingdao Co., Ltd. As of 30 June 2024, the Company had total bank facilities of RMB14.8 billion, with the available portion being around RMB3.2 billion. However, the Company's bank loans had certain concentration on regional banks in Qingdao City. As of 30 June 2024, the banks facilities of Bank of Qingdao Co., Ltd and Qingdao Rural Commercial Bank Corporation was RMB4.3 billion, accounting for around 29% of total bank facilities. The bank loans from regional banks generally have higher financing cost, which may increase the Company's financial burden.

The Company also actively participates in the domestic debt capital markets. From January 2021 to October 2024, the Company issued 9 tranches of domestic bonds, raising around RMB6.6 billion, with coupon rates ranging from 2.05% to 5.1%. However, the Company has a certain exposure to non-standard financing, which accounts for around 10%-15% of its total debt. Non-standard financing products generally have higher financing costs and shorter maturities, which could increase the Company's refinancing pressure.

Medium exposure to contingent liabilities

QDHN's credit profile is constrained by its external guarantees, which could potentially increase its repayment obligations. As of 30 June 2024, the Company had outstanding external guarantees of RMB4.4 billion, representing 56.2% of its net assets. All of them were provided to local state-owned enterprises, mainly were mutual guarantees between local state-owned enterprises in Shinan District. In case a credit event occurs, the Company may face certain contingent liability risks, which could negatively impact its credit quality.

ESG Considerations

QDHN 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.

QDHN bears social risks as it implements public policy initiatives by building public infrastructure in Shinan 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.

QDHN's governance considerations are also material as the Company is subject to oversight by Shinan District Government and must 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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