

Credit Opinion

30 November 2023

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

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Linyi Lanshan District Finance Investment Group Co., Ltd.

Surveillance credit rating report

CCXAP affirms Linyi Lanshan District Finance Investment Group Co., Ltd.'s long-term credit rating at BBB_g-, with stable outlook.

Summary

The BBB_g- long-term credit rating of Linyi Lanshan District Finance Investment Group Co., Ltd. (“LSFI” or the “Company”) reflects Lanshan District Government’s strong capacity and high willingness to provide support to the Company, based on our assessment of the Company’s characteristics.

Our assessment of Lanshan District Government’s capacity to support reflects Lanshan District’s status as the largest county-level district in Linyi City in terms of gross regional products (“GRP”), with strong economic conditions, good fiscal metrics and debt profile.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) ultimate control by the Lanshan District Government; (2) strong strategic role in the economic and industrial development in Lanshan District; and (3) track record of receiving government supports.

However, the Company’s rating is constrained by its (1) high business risk related to property and financial service segments; (2) moderate exposure to commercial activities exerts pressure on capital expenditure; and (3) increasing debt burden.

The stable outlook on LSFI’s rating reflects our expectation that the local government’s capacity to support will remain stable, and the Company will maintain its strategic importance in the economic and industrial development in Lanshan District over the next 12-18 months.

Rating Drivers

- Strong strategic role in the economic and industrial development in Lanshan District
- Track record of receiving government supports
- Higher business risk related to property and financial service segments
- Moderate exposure to commercial activities which exerts pressure on capital expenditures
- Increasing debt burden with expanded financing channels

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Lanshan District Government's capacity to provide support strengthens; or (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as lower exposure to risky commercial activities or improved public policy status.

What could downgrade the rating?

The rating could be downgraded if (1) Lanshan 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 or weakened funding ability.

Key Indicators

	2020FY	2021FY	2022FY	2023Q3
Total Asset (RMB billion)	9.2	12.3	14.5	18.3
Total Equity (RMB billion)	4.7	4.8	5.0	5.7
Total Revenue (RMB billion)	0.7	1.1	1.4	1.2
Total Debt/Total Capital (%)	44.6	57.5	56.1	65.6

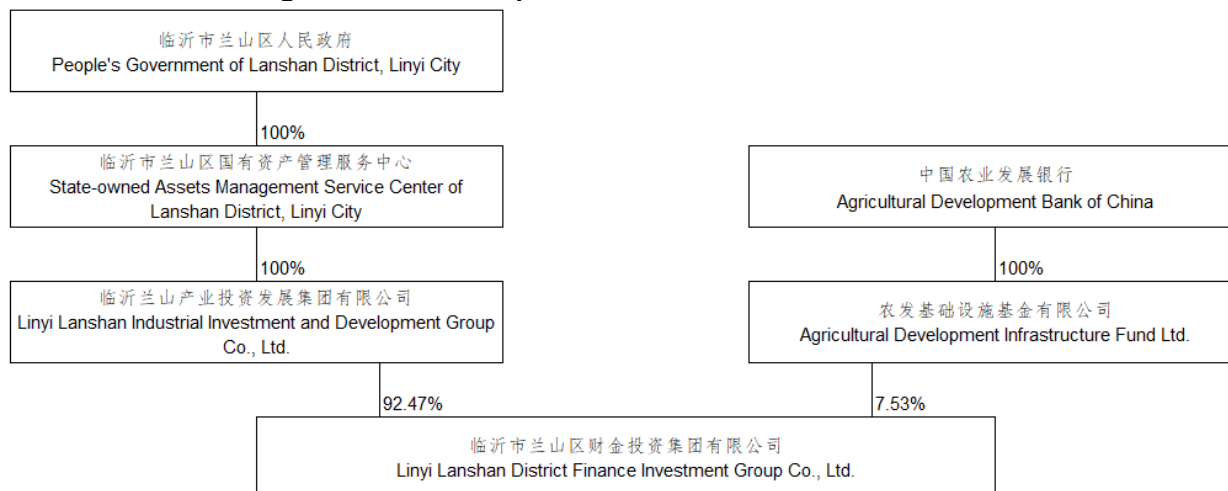
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company information, CCXAP research

Corporate Profile

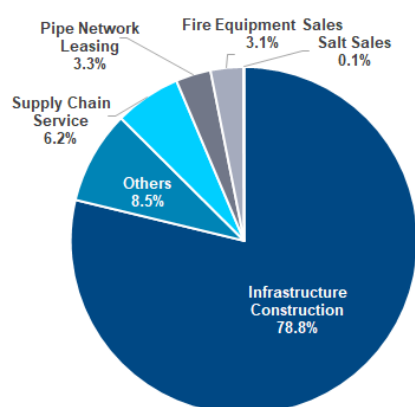
Founded in April 2018, LSFI is one of the key local infrastructure investment and financing companies ("LIIFCs") in Lanshan District, Linyi City, Shandong Province. It is also the key local state-owned enterprise that undertakes the role of infrastructure construction and operation of state-owned assets in Lanshan District. In addition, the Company is engaged in commercial activities including the development and operation of industrial parks, fire equipment and salt sales, fund investments, supply chain service, and provision of financial services such as on-lending and guaranteed businesses. The Lanshan District Government is the ultimate owner of LSFI. As of 30 September 2023, the State-owned Assets Management Service Center of Lanshan District held 92.47% of the Company's shares through Linyi Lanshan Industrial Development Group Co., Ltd.; the remaining shares were held by Agricultural Development Infrastructure Fund Ltd.

Exhibit 1. Shareholding chart as of 30 September 2023



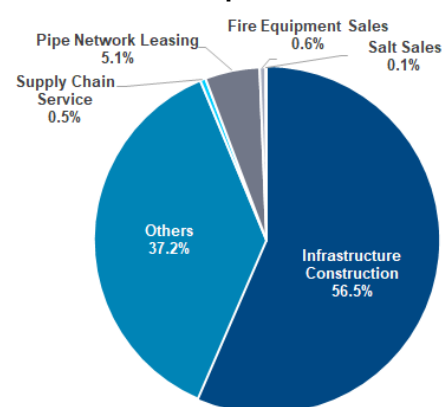
Source: Company information, CCXAP research

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 Lanshan District Government has a strong capacity to provide support given its sound economic fundamentals and fiscal strength, with a relatively large operating fiscal surplus and manageable debt burden.

Shandong Province is the third largest province in terms of gross regional product ("GRP") in China over the past three years, with a solid industrial foundation in logistics, shipbuilding and marine technology, chemical, automotive and agri-food. Linyi City is the largest city by population and area in Shandong Province, with rich water and land resources. Key industries that drive Linyi City's economic growth including agriculture and food processing, manufacturing, logistics, and high-end chemicals. In 2022, Linyi City recorded a GRP of RMB577.9 billion, a year-over-year ("YoY") increase of 4.2%, ranking 5th among prefecture-level cities in Shandong Province. However, Linyi City's fiscal balance was relatively weak as its general budgetary revenue could only cover around half of general budgetary expenses over the past three years. As of 31 December 2022, Linyi City reported a government debt of RMB146.3 billion, accounting for 25.3% of its GRP.

Exhibit 4. Key Economic and Fiscal Indicators of Linyi City

	2020FY	2021FY	2022FY
GRP (RMB billion)	480.5	546.6	577.9
GRP Growth (%)	3.9	8.7	4.2
General Budgetary Revenue (RMB billion)	35.0	40.9	42.0
General Budgetary Expenditure (RMB billion)	79.3	80.7	87.5
Local Government Debt (RMB billion)	112.1	125.7	146.3

Source: Statistics Bureau of Linyi City, CCXAP research

Lanshan District is located in the center of Linyi City and in the southeast of Shandong Province. It is the largest county-level district in Linyi City in terms of GRP. It has a GRP of RMB135.8 billion, which accounted for 23.5% of Linyi's GRP in 2022. It also ranked first in GRP per capita and general budgetary revenue among other administrative districts of Linyi City. Lanshan District implements the "5+5" industrial cultivation plan, accelerating the transformation and upgrading of the five leading industries namely food, wood, medicine, machinery manufacturing, and non-ferrous metals; and cultivates five emerging industries including commerce and logistics, modern finance, medical care and health, cultural creativity, and global tourism. Lanshan District has a very good fiscal profile. It has a high fiscal balance ratio (general budgetary revenue/general budgetary expenses) of over 150% and tax contributed over 85% of its general budgetary revenue over the past three years. Lanshan District Government also has a manageable debt profile, with a government debt/GRP ratio of 6.0% as of 31 December 2022.

Exhibit 5. Key Economic and Fiscal Indicators of Lanshan District

	2020FY	2021FY	2022FY
GRP (RMB billion)	118.8	133.4	135.8
GRP Growth (%)	3.6	8.3	4.2
General Budgetary Revenue (RMB billion)	10.0	11.6	11.8
General Budgetary Expenditure (RMB billion)	6.7	7.4	7.6
Local Government Debt (RMB billion)	5.5	6.2	8.1

Source: Statistics Bureau of Lanshan District, CCXAP research

Government's Willingness to Provide Support**Strong strategic role in the economic and industrial development in Lanshan District**

LSFI is the second largest LIIFC in Lanshan District by total assets, undertaking local infrastructure construction, state-owned asset operations and local industrial investments. LSFI engages in the infrastructure construction business through the entrusted construction model. The Company is entrusted mainly by the local government or a company owned by local residential and village committees, namely Shandong Donghe Real Estate Development Co., Ltd. ("Shandong Donghe"). Projects include the construction of road, bridge, school, and other facilities. The local government or Shandong Donghe will recognise the project settlement price after LSFI has completed the construction and development of such infrastructure projects, normally at a price that covers the construction costs incurred plus a 20% investment return. As of end-2022, the Company has completed 33 infrastructure projects, with a total investment of RMB2.6 billion. In terms of projects under construction, as of end-2022, the Company has 19 major construction projects under construction, with a total planned investment of RMB2.5 billion and uninvested amount of RMB773 million.

In addition, LSF1 is the most essential entity in local state-owned asset management and industrial investments in Lanshan District. The Company manages rainwater and sewage pipe networks in 4 subdistricts of Lanshan District. It is also in charge of the investment and construction of major industrial parks in Lanshan District such as the Wood Industry Technology Innovation Park and China Linyi International Grain and Oil Technology Logistics Park, which largely support local economic and industrial development.

We believe that the importance of LSF1 to the Lanshan District Government will remain high because the cost of replacing its functional role is high and it still has strong political and financial implications for the region.

Track record of receiving government payments

LSF1 has a good record of receiving recurring support from the Lanshan District Government, including operating subsidies, capital and asset injections, and payments for infrastructure construction projects, which could help the Company meet its policy objectives and financial obligations. Since its establishment, the local government has injected operational assets and several land resources into the Company. In 2022, the Company received a capital injection of RMB18 million from the Lanshan District Government. Moreover, the local government has provided different types of operating subsidies for more than RMB2.3 billion over the past three years.

However, the government repayments for the Company's infrastructure construction business are prolonged. As of end-2022, the total investment of the Company's main completed projects was RMB2.6 billion, while the cumulative project repayments received was RMB674 million. We expect that, as one of the key local state-owned enterprises in Lanshan District, the Company plays an irreplaceable role in the development and operation of the region, and the local government has a high willingness to provide support to the Company.

Higher business risk related to property and financial service segments

The Company's commercial business includes the development and operation of industrial parks, fund investments, sales of fire equipment and salts, supply chain service, and the provision of financial services such as on-lending and guaranteed businesses. Most of the Company's commercial businesses are policy-driven which align with the local development policy of Lanshan District and facilities companies to settle in. Nevertheless, the increasing investments in commercial activities will inevitably expose the Company to higher business and financial risks.

LSF1 develops industrial parks mainly in the West New Town of Lanshan District. It undertakes projects solely or establishes joint ventures with private enterprises to invest in local properties such as warehouses, factories, and commercial buildings for leasing or sales. LSF1 mostly undertakes the construction part in joint venture projects and its partners will shoulder the duty of property sales and leasing. The West New Town is a key industrial area in Lanshan District's future development, which is planned to build up its core industries including building materials, food, machinery, and new technology. However, the sales and leasing of projects are subject to the volatility of local investment progress and the property market, particularly during the economic downturn in China. Meanwhile, as the Company has jointly invested in cultural tourism and real estate projects with some private enterprises, it has generated a relatively large amount of other receivables from the joint venture companies, indicating certain recovery risks.

Moreover, LSF1 engages in industrial fund investment, on-lending, and guaranteed businesses through its subsidiaries but they are mostly in early stages of development. The main purpose of these businesses is to assist the development of local small and medium-sized enterprises in the region by providing financial support.

However, the policy-driven business model may make the Company suffer from higher asset risk, owing to its asset concentration in financially weaker entities. As of end-2022, LSFI conducted 21 financial guarantee businesses, with a total guaranteed amount of RMB74.6 million. The Company also conducted 16 emergency on-lending businesses, with a total amount of RMB157 million.

Additionally, LSFI's trading business is relatively volatile, including the main products of fire equipment and salt, although it provides supplementary income. The Company participates in the production and sales of fire equipment through its subsidiary acquired in 2019. It has five streamlined production lines for fire truck manufacturing, pre-painting treatment, cab modification, final assembly, and decoration. However, in 2022, the revenue of the fire equipment decreased to RMB43 million from RMB97 million last year, and the profit margin is relatively low. Meanwhile, the Company's salt sales were also affected by China's reform of the salt industry system, causing the revenue to decline in recent years. In 2022, the Company's annual salt sales volume was 795.9 tons, a significant decrease from the previous year.

The Company started its supply chain service business in 2022. The products of the Company's supply chain service business mainly include electrolytic copper and pet food. The Company signs procurement and sales contracts with upstream suppliers and downstream customers only when the procurement costs and selling prices are confirmed with them. In 2022, the company achieved supply chain service revenue of RMB85.4 million, accounting for 7.6% of the total operating revenue of the Company.

Moderate exposure to commercial activities which exerts pressure on capital expenditures

LSFI has a large investment plan in its commercial activities, especially in the investment of local industrial parks, which will exert certain capital pressure. As of end-2022, it had 3 property projects under construction or planning, with a total investment amount of RMB4.8 billion and an uninvested amount of RMB3.1 billion. We believe that the Company's expansion will be mainly funded by external debts as it is more difficult to obtain the government's direct financial support for its commercial activities. In addition, the expansion in the financial service business also imposes risk to the Company in relation to capital outflow from its contingent liabilities.

In addition, as of end-2022, the Company's main self-operated projects are the photovoltaic technology application and energy storage facility construction project of the Caijin Industrial Park, the thermal pipe network project of the western urban area of Lanshan District, and the Linyi Digital Logistics Demonstration Park, with a total investment of RMB3.1 billion. Considering the large capital expenditure needs of its commercial projects, we expect the Company's debt level to continue to grow over the next 12-18 months.

Increasing debt burden with expanded financing channels

LSFI has an increasing debt burden from continuous business expansion. The Company's total debt increased to RMB11.0 billion, as of 30 September 2023, from RMB6.4 billion at end-2022, making the total capitalization ratio that increased to 65.9% from 56.1% over the same period. As of 30 September 2023, the Company's short-term debts accounted for more than 60% of the total debts, mainly concentrated in the borrowings from the Liuqing Sub-District Office of Lanshan District. This type of borrowing is expected to renew annually when due according to the management. The remaining debts mainly come from bank loans and bonds. The Company has built a close relationship with large domestic banks, such as the Agricultural Development Bank of China, Bank of Communications, and China Construction Bank Corporation, with total bank credit facilities of RMB6.3 billion and an unutilized amount of RMB3.5 billion as of 31 October 2023.

The Company's financing channels have improved compared to previous year with new onshore and offshore bonds financing launched in 2023. The Company has issued 4 branches of offshore bonds in 2023, raising RMB309.0 million, JPY3.9 billion, and USD38.5 million. From January to October 2023, the Company also issued two tranches of corporate bonds, raising RMB1.0 billion. LSFI's exposure to non-standard financing is manageable, including financial leasing, accounting for around 5% of the total debts.

Overall, taking into account the Company's important status as the key role in local development of Lanshan District, we expect the Company to maintain access to stable funding from banks, and retain good refinancing capabilities if its financial channels were successfully expanded continuously.

Medium exposure to contingent liabilities

LSFI's exposure to contingent liabilities is increasing, and the credit profile is constrained by substantial external guarantees. As of 30 June 2023, the Company's external guarantee increased to RMB2.2 billion from RMB1.6 billion as of end-2021, accounting for 42.2% of its net assets. Most external guarantees were provided to local state-owned companies, and we believe the risks of providing guarantees to local SOEs is still manageable, given the local government's tight control over these companies. However, to ensure the sales of factory buildings in the Wood Technology Innovation Park, the Company provided external guarantees for mortgage loans of customers, most of which were private-owned enterprises in Lanshan District. The total amount of these external guarantees was around RMB288.0 million, accounting for 13% of the total external guarantees. The related contingent risk exposure became negative to LSFI's credit profile.

ESG Considerations

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

In terms of social concerns, the Company plays a crucial role in public policy in Lanshan District by conducting public infrastructure construction projects. It bears social risks as it plays as it implements public policy initiatives by building public infrastructure in Lanshan District. In addition, as one of the vital state-owned entities in Lanshan District, the Company has taken a number of measures to ensure the provision of utility and the daily needs of the residents.

In terms of corporate governance, the Company has established a sound and effective corporate governance structure consisting of shareholders, directors, supervisors, senior management team, and internal departments collectively and efficiently perform their duties. In addition, the Company is subject to oversight and reporting requirements of the Lanshan District Government, which has full control and supervision over the Company's operations.

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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