

Lianhe Global has assigned ‘BBB+’ global scale Long-term Issuer Credit Rating with Stable Outlook to Fujian Zhanglong Group Co., Ltd.

HONG KONG, 29 June 2022 – Lianhe Ratings Global Limited (“Lianhe Global”), an international credit rating company, has assigned ‘BBB+’ global scale Long-term Issuer Credit Rating to Fujian Zhanglong Group Co., Ltd. (“Zhanglong Group” or “the company”). The Outlook is Stable.

The Issuer Credit Rating reflects a high possibility that the Zhangzhou Municipal People’s Government (“Zhangzhou government”) would provide strong support to Zhanglong Group if needed, in light of its 90% ownership of Zhanglong Group, Zhanglong Group’s strategic position as an important state-owned assets operation and development entity of Zhangzhou and the strong linkage between the Zhangzhou government and Zhanglong Group, including management supervision, strategic alignment, and ongoing operational and financial support. In addition, the Zhangzhou government may face significant negative impact on its reputation, business and financing activities should Zhanglong Group encounter any operational or financial difficulties.

The Stable Outlook reflects our expectation that Zhanglong Group’s strategic importance would remain intact while the Zhangzhou government will continue to ensure Zhanglong Group’s stable operation.

Key Rating Rationales

Zhangzhou Government’s Ownership and Strong Supervision: The Zhangzhou government has 90% ownership of Zhanglong Group via the State-owned Assets Supervision and Administration Commission of the Zhangzhou government (“Zhangzhou SASAC”). The other 10% stake is held by Fujian Provincial Department of Finance. The Zhangzhou government also has strong control and supervision over Zhanglong Group, including control of the board of directors, senior management appointments, major strategic, investment and financing planning.

Strategic Importance and Strategic Alignment: Zhanglong Group is an important state-owned entity that is mainly responsible for regional industrial development, infrastructure construction and operation of Zhangzhou, to support the local economic and industrial development, as well as urban infrastructure construction and development. Zhanglong Group’s water business has franchise advantage, in which it supplies water to more than 90% of the urban area of Zhangzhou. Zhanglong Group plans to expand the operating scale of water business and sustain the development of supply chain business. Additionally, Zhanglong Group has set up an urban development fund to promote the upgrading of urban infrastructure and improve the comprehensive financing capacity of Zhangzhou’s state-owned enterprises.

Ongoing Government Support: Zhanglong Group has received supports from the Zhangzhou government for its business operation, mainly including asset injections, government subsidies, financial support, and it also benefits from preferential tax and/or tax exemption policies in encouraged industrial and/or utilities business. Zhanglong Group had received total government support in the form of asset injections of approximately RMB4 billion between 2019 and end-March 2022, mainly including equity of farms, stocks of Zhangzhou Pien Tze Huang Pharmaceutical Co., Ltd (600436.SH) and other quality assets. Zhanglong Group has received financial subsidies from the local government mainly for supporting projects related to public infrastructure or special projects. We believe Zhanglong Group is likely going to receive timely government support in the form of operational and/or financial subsidies.

Moderately Weak Financials and Debt Burden: Zhanglong Group's financial leverage as measured by total liabilities/total assets has been at a relatively high level at c. 66%-69% in the past three years. We expect its financial leverage to remain below 70% considering the government's supervision. At end-March 2022, Zhanglong Group had unrestricted cash of approximately RMB3.4 billion, and yet the total debt of the company was approximately RMB37.3 billion, of which short-term debt accounted for the majority of c. RMB23.0 billion. Having said that, Zhanglong Group has wide access to financing channels and established relationships with banks, with available credit line of c. RMB19.1 billion at end-March 2022, and part of short-term debt can be issued on a rolling basis.

Moderate Economic and Fiscal Conditions of Zhangzhou: As a seaside city, Zhangzhou provides a network of roadways to access seaports for the central regions and benefits from the development of the West Coast Economic Zone. Zhangzhou's GDP reached RMB502.5 billion, representing a year-over-year growth rate of 7.7%, in 2021. The economic growth was mainly fueled from the secondary and tertiary industries.

Zhangzhou's aggregate fiscal revenues were mainly derived from budgetary revenue. The tax revenue accounted for approximately 65%-70% of its budgetary revenue in the past three years. Zhangzhou's fiscal deficit has been at a relatively high level. The fiscal self-sufficiency rate of Zhangzhou was relatively low, leading it to continue to receive subsidies from higher government authorities.

Rating Sensitivities

We would consider downgrading Zhanglong Group's rating if (1) there is a perceived weakening in support from the Zhangzhou government, particularly due to its reduced strategic importance with diminished government functions, or (2) there is a significant reduction of the Zhangzhou government's ownership of Zhanglong Group, or (3) there is a downgrade in our internal credit assessment on the Zhangzhou government.

We would consider upgrading Zhanglong Group's rating if (1) there is strengthened support from the Zhangzhou government, or (2) there is an upgrade in our internal credit assessment on the Zhangzhou government.

About Lianhe Global

Lianhe Global is an international credit rating company that provides credit ratings to corporations, banks, non-bank financial institutions, local government financing vehicles, and other asset classes around the globe. Lianhe Global also provides credit risk research and other services related to credit ratings.

Rating Methodology

The principal methodology used in this Zhanglong Group's rating is Lianhe Global's China Local Government Financing Vehicle Criteria published on 31 December 2021, which can be found at the website www.lhratingsglobal.com.

Note: The above Issuer/Issuance Credit Ratings are solicited at the request of the rated entity or a related third party.

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