

Pingtang Comprehensive Pilot Zone City Development Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	28 February 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB’ global scale Long-term Issuer Credit Rating with Stable Outlook to Pingtang Comprehensive Pilot Zone City Development Group Co., Ltd. (“Pingtang CDG” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the de facto local government of Pingtang Comprehensive Pilot Zone (“PCPZ”), the Management Committee of PCPZ (“PCPZ MC”) would provide strong support to Pingtang CDG if needed, in light of its full ownership of Pingtang CDG, Pingtang CDG’s strategic importance as the most important local investment and development company (“LIDC”) responsible for infrastructure construction and city operation in PCPZ, and the linkage between PCPZ MC and Pingtang CDG, including appointment and supervision of the senior management, strategic alignment, major investment and financing decisions and ongoing operational and financial support. In addition, PCPZ MC may face significant negative impact on its reputation and financing activities if Pingtang CDG encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that Pingtang CDG’s strategic importance would remain intact while PCPZ MC will continue to ensure Pingtang CDG’s stable operation.

Rating Rationale

Government’s Ownership and Supervision: PCPZ MC holds 100% stake in Pingtang CDG via the State-owned Assets Administration Bureau of Pingtang Comprehensive Pilot Zone (“PCPZ SAAB”). PCPZ MC has strong supervision over the company through PCPZ SAAB, including appointment and supervision of the senior management, decisions on development strategy, financial and investment planning. In addition, PCPZ SAAB has formulated a performance assessment policy for the company, and would regularly appoint auditors to review the company’s operating performance and financial position.

Strategic Importance and Strategic Alignment: Pingtang CDG’s business operations and strategic planning have been aligned with the local government’s economic and social development policies. PCPZ is an important area promoting cross-strait cooperation, while Pingtang CDG is the most important infrastructure construction and city operation entity in PCPZ. The company is responsible for developing and operating an array of projects, such as Pingtang-Taiwan Innovation Park, Taiwan Town and Sports Center. These projects provide spaces for business, living and cultural exchange in Pingtang.

Ongoing Government Support: PCPZ MC injected assets amounting to RMB9,434 million between 2019 and 2022 into the Pingtang CDG to enhance its equity base. Injected assets included cash, equities of LIDCs and SOEs in PCPZ, land use rights and properties, as well as agent construction projects (some are not-for-profit) completed by Pingtang CDG. Between 2019 and end-September 2022, Pingtang CDG also received financial subsidies of RMB170 million in relation to providing public services and goods from the local government. We expect the company to continue receiving capital injections and financial subsidies in the future.

Key Figures of PCPZ and Pingtang CDG

(RMB billion)	2020	2021
PCPZ		
GDP	30.1	33.9
GDP growth rate (%)	5.4	5.8
Budgetary revenue	5.5	5.5
Government fund	1.2	2.3
Transfer payment	2.9	3.9
Budgetary expenditure	9.6	8.5
Pingtang CDG		
Assets	66.8	70.3
Equity	34.2	34.4
Revenue	0.8	0.7

Source: Public information, Pingtang CDG and Lianhe Global’s calculations

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Applicable Criteria

China Local Investment and Development Companies Criteria (5 December 2022)

Economy and Fiscal Condition of PCPZ: PCPZ is a prefecture-level zone directly under the administration of Fujian Province and equipped with special and favorable supporting policies to promote cross-strait cooperation. PCPZ's GDP growth rate had moderated to 5.4% in 2020 and 5.8% in 2021 from 8.1% in 2019. PCPZ is developing its secondary sector by cultivating computer, communication and other electronics manufacturing industry.

PCPZ MC's budgetary revenue and fiscal self-sufficiency rate were relatively low. In addition, its government fund income dropped dramatically to RMB1.2 billion in 2020 from RMB7.6 billion in 2019, then rebounded to RMB2.3 billion in 2021 due to the volatile land use right transfer income amid challenging property market conditions. Nevertheless, as a Comprehensive Pilot Zone with strategic importance to Fujian Province and China, PCPZ receives stable transfer payments from higher-level governments.

Pingtang CDG's Financial Position: Pingtang CDG's total assets increased by 16.5% to RMB74.0 billion at end-September 2022 from RMB63.5 billion at end-2019, mainly due to the company's active participation in infrastructure projects in PCPZ. Over the same period, the company's total debt rose by 26.9% to RMB9.3 billion from RMB7.3 billion. Given the company relied on both project funds provided by the local government and borrowing to support the expansion of its assets, the company's financial leverage, as measured by total debt/capitalization, remained at a manageable level of 21.3% at end-September 2022.

At end-September 2022, the company's assets mainly comprised other non-current assets and inventory, representing 51.1% and 30.4% of the company's total assets, respectively. The former mainly composed of agent construction projects, self-management projects and PPP projects, etc. The growth of other non-current assets was consistent with the acceleration of the urban infrastructure development strategy in PCPZ. The latter mainly consists of land use rights injected by the local governments or acquired through open bidding. These lands were planned for developing commercial and residential properties, but their market value and actual development plan are subject to the property market conditions.

The liquidity of Pingtang CDG was moderately weak yet manageable. At end-September 2022, Pingtang CDG had a cash balance of c. RMB1.6 billion (including restricted cash of RMB33 million), compared with its debt due within one year of c. RMB1.8 billion. Pingtang CDG has access to various financing channels, including bank loans, onshore and offshore bond issuances and non-traditional financings to support its debt repayment and business operations.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of PCPZ

PCPZ is a prefecture-level zone directly under the administration of Fujian Province. In November 2011, the State Council formally approved the General Development Plan for the Pingtan Comprehensive Pilot Zone, equipping PCPZ with special and favorable supporting policies to promote cross-strait cooperation by facilitating investment, trading, as well as personnel and cultural exchange.

PCPZ's GDP growth rate had moderated to 5.4% in 2020 and 5.8% in 2021, compared with 8.0% of Fujian Province, from 8.1% in 2019. This was partially due to the decline in fixed asset investment, recording negative growth rates of 9.6% and 16.5% in 2020 and 2021, respectively. PCPZ recorded a GDP of RMB33.9 billion in 2021, of which 64.1% was contributed by the tertiary sector, such as the financial industry, trading and tourism, etc. Yet PCPZ's secondary industry was relatively weak, representing 24.0% of its aggregate GDP. The value-added of the secondary industry dropped by 9.3% year-on-year, dragging down the GDP growth rate by 2.5% in 2021. PCPZ is developing its secondary sector by cultivating computer, communication and other electronics manufacturing industry.

PCPZ's GDP and Fixed Asset Investment

(RMB billion)	2019	2020	2021
GDP	28.3	30.1	33.9
-Primary industry (%)	12.7	12.0	11.9
-Secondary industry (%)	28.5	28.0	24.0
-Tertiary industry (%)	58.8	60.0	64.1
GDP growth rate (%)	8.1	5.4	5.8
Fixed asset investment	28.0	25.3	21.1
Fixed asset investment growth rate (%)	0.8	-9.6	-16.5
Population (million)	0.5	0.4	0.4

Source: Public information and Lianhe Global's calculations

Fiscal Condition of PCPZ

PCPZ's budgetary revenue was relatively low, with a figure of RMB5.5 billion in 2021. The contribution of the tax revenue rose to 80.0% in 2021 from 60.9% in 2019. PCPZ's fiscal self-sufficiency rate was also relatively low, with a high-but-improving budget deficit, which improved to -55.3% in 2021 from -109.4% in 2019. Nevertheless, as a Comprehensive Pilot Zone with strategic importance to Fujian Province and China, PCPZ receives stable transfer payments from higher-level governments.

PCPZ's government fund income dropped dramatically to RMB1.2 billion in 2020 from RMB7.6 billion in 2019, then rebounded to RMB2.3 billion in 2021 due to the volatile land use right transfer income amid challenging property market conditions. Its government debt ratio, as measured by total government debt balance/aggregate revenue, remained at a high level of c. 336.6%, and the total government debt balance/GDP ratio stood at 119.0% in 2021.

PCPZ's Fiscal Condition			
(RMB billion)	2019	2020	2021
Budgetary revenue	4.6	5.5	5.5
Budgetary revenue growth rate (%)	18.4	20.0	0.6
Tax revenue	2.8	3.4	4.4
Tax revenue (% of budgetary revenue)	60.9	63.0	80.0
Government fund income	7.6	1.2	2.3
Transfer payment	2.8	2.9	3.9
Aggregate revenue	16.2	11.0	12.0
Budgetary expenditure	9.5	9.6	8.5
Budget deficit ¹ (%)	-109.4	-75.9	-55.3

¹ Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

Pingtang CDG, formerly known as Pingtan County State-Owned Assets Management Co., Ltd., was established by Pingtan County Bureau of Finance in December 1998, with the registered capital of RMB30 million. After a series of capital injections and equity transfers, PCPZ SAAB owns 100% shares of Pingtan CDG, and the company's registered capital was enlarged to RMB1,640 million.

In November 2021, the state-owned enterprises in PCPZ, including Pingtan CDG, implemented strategic restructuring, where 98.26% equity of Pingtan Comprehensive Pilot Zone Transportation Investment Group Co., Ltd. ("Pingtan TIG") and 99.41% equity of Pingtan Comprehensive Pilot Zone Land Development Group Co., Ltd. ("Pingtan LDG") held by PCPZ SAAB were transferred to Pingtan CDG free of charge. However, Pingtan CDG has no control over Pingtan LDG yet, and PCPZ SAAB remained the actual controller of Pingtan LDG; therefore, Pingtan CDG hadn't consolidated Pingtan LDG into its consolidated financial statements by end-September 2022.

Strategic Importance and Government Linkage

Strategic Importance of Pingtan CDG to PCPZ

Pingtang's business operations and strategic planning have been aligned with the local government's economic and social development policies. PCPZ is an important area promoting cross-strait cooperation, while Pingtan CDG is the most important infrastructure construction and city operation entity in PCPZ after receiving 98.26% shares of Pingtan TIG in 2021. The company is responsible for developing and operating an array of projects, such as Pingtan-Taiwan Innovation Park, Taiwan Town and Sports Center. These projects provide spaces for business, living and cultural exchange in Pingtan. Pingtan CDG also provides sanitation and maintenance services in the area.

Strong Linkage with the Local Government

Pingtang CDG has a strong linkage with the local government, as PCPZ MC holds 100% ownership of the company through the PCPZ SAAB. PCPZ MC also has strong supervision over the company through PCPZ SAAB, including appointment and supervision of the senior management, development strategy, major investment and financing decisions and other government support, etc. In addition, PCPZ SAAB has formulated a performance



assessment policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

Ongoing Government Support

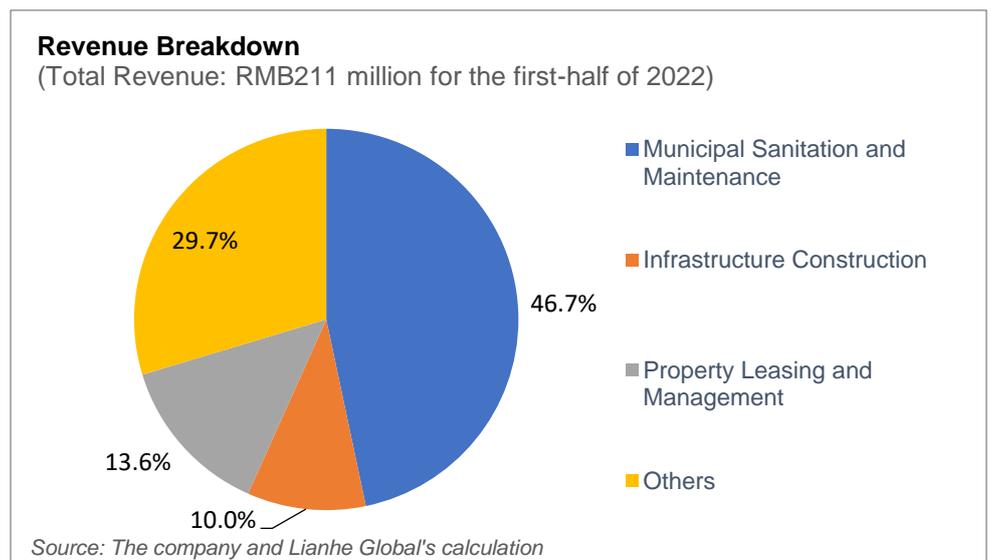
As the most important LIDC in the PCPZ, Pingtan CDG has been supported by the local government since its establishment. The company had initial paid-in capital of RMB30 million in 1998, which was increased to RMB1,640 million at end-September 2022 after several capital injections. In addition, PCPZ MC injected assets amounting to RMB700 million, 5,268 million and 3,466 million in 2019, 2021 and 2022, respectively. Injected assets included cash, equities of LIDCs and SOEs in PCPZ, land use rights and properties, as well as agent construction projects (some are not-for-profit) completed by Pingtan CDG. In particular, the company has received a large number of asset injections and equity allocations since PCPZ MC implemented local state-owned enterprises strategic restructuring plan in 2021.

Pingtan CDG also received ongoing financial subsidies in relation to providing public services and goods of RMB61 million, 80 million, 20 million and 9 million in 2019, 2020, 2021 and the first nine months of 2022, respectively, from the local government. We expect the company to continue receiving financial subsidies in relation to providing public services and goods in the future.

Business Profile

The Most Important LIDC Responsible for Infrastructure Construction and City Operation in PCPZ

Pingtan CDG is the most important LIDC in PCPZ that is responsible for infrastructure construction in PCPZ, carrying out major transportation and public facility development projects in the area. The company also provides city operation services, including municipal sanitation and maintenance, as well as leasing and management of the city's commercial complex, apartments, office buildings and industrial parks in PCPZ.



Infrastructure Construction

Pingtang CDG engages in constructing an array of infrastructure projects in PCPZ, including roads, underground integrated pipe corridors, resettlement housing, hospital and other public facilities. These projects are usually implemented according to the build-transfer or agent construction agreements signed with government agencies in PCPZ. Under the build-transfer model, the company needs to raise funds for the projects and recognize 106% of construction costs as revenue annually. In contrast, the entrusting parties usually provide initial capital and progress payments for agent construction projects. Pingtang CDG instead recognized management fees based on the project size as revenue.

By end-June 2022, Pingtang CDG had one build-transfer project and 26 major agent construction projects under construction, and these projects usually take three to ten years to complete. The total planned investment amounted to RMB5.6 billion, and there were RMB2.6 billion to be invested. Pingtang CDG also participates in small landscape improvement projects designated by the local government or acquired through opening bidding. These projects take a shorter term (usually within one year) to complete and have a good cash collection record. We expect the project pipeline to support the segment's development in the next two to three years. In addition, Pingtang CDG is developing self-management projects such as sports center and commercial properties for leasing.

Municipal Sanitation and Maintenance

The municipal sanitation and maintenance segment has become the largest revenue source of Pingtang CDG since 2021. The company provides sanitation services for municipal roads, public toilets, railway station and other public facilities in PCPZ. It is also responsible for maintaining landscapes, parks and squares, municipal roads, lighting distribution facilities and pipe corridors in the area.

Property Leasing and Management

Pingtang CDG leases self-management properties, including commercial complexes, apartments, parking spaces, office buildings and industrial parks for rental and management fee incomes. The segment's revenue demonstrated an upward trend in the past three years with increasing leasable areas. However, some properties' occupancy rate was low due to the impact of Covid-19 disruption and the relatively inactive business activities of PCPZ.

Others

Pingtang CDG's other business operations mainly include sales of sand and gravel materials, disposal of investment properties, as well as logistics and transportation. The company recorded revenue of RMB13 million from sales of sand and gravel materials in the first half of 2022. However, the subsidiary which holds the mining right was transferred to another LIDC in 2021. As a result, the company would not record sales of sand and gravel materials after selling out inventories.

Financial Profile

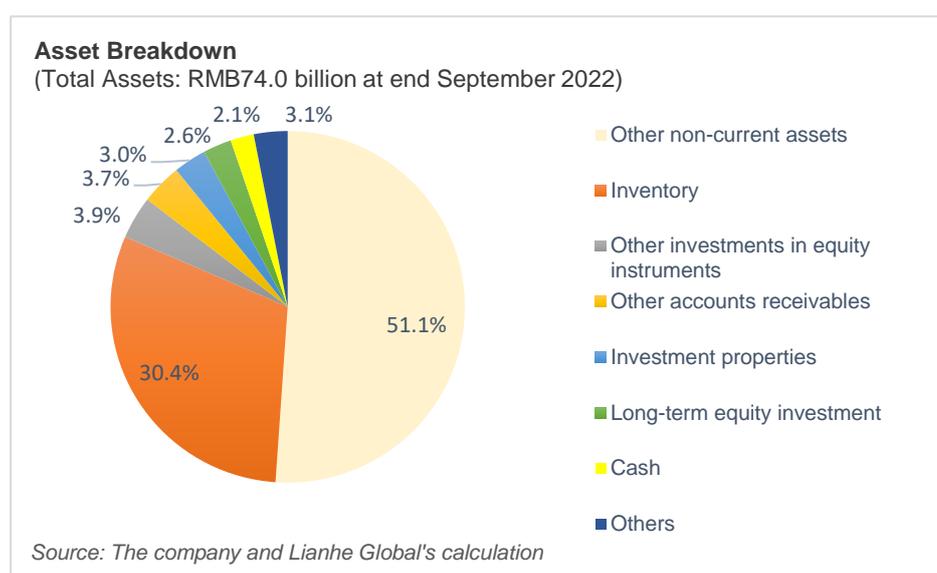
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Sept. 2022
Total Asset	63,469	66,840	70,297	73,952
Equity	29,075	29,206	34,243	34,392
Debt	7,334	7,115	6,516	9,310

Debt / (Debt + Equity) (%)	20.1	19.6	16.0	21.3
LT Debt	6,159	5,521	5,537	7,509
LT Debt / (LT Debt + Equity) (%)	17.5	15.9	13.9	17.9

Source: The company's financial reports and Lianhe Global's calculations

Pingtang CDG's total assets increased by 16.5% to RMB74.0 billion at end-September 2022 from RMB63.5 billion at end-2019, mainly due to the company's active participation in infrastructure projects in PCPZ, accumulating a large number of construction costs booked on the other non-current assets. Over the same period, the company's total debt rose by 26.9% to RM9.3 billion from RMB7.3 billion. Given the company relied on both project funds provided by the local government and borrowing to support the expansion of its assets, the company's financial leverage remained at a manageable level of 21.3% at end-September 2022.



Pingtang CDG's assets liquidity was moderately weak. At end-September 2022, the company's assets mainly comprised other non-current assets and inventory, representing 51.1% and 30.4% of the company's total assets, respectively.

The former amounted to RMB37.8 billion, up from RMB31.1 billion at end-September 2019, mainly composed of agent construction projects, self-management projects and PPP projects, etc. The growth of other non-current assets was consistent with the acceleration of the urban infrastructure development strategy in PCPZ. The local government had provided development funds for a part of projects and booked on long-term accounts payables, amounting to RMB31.4 billion at end-September 2022. Some projects would be held by Pingtang CDG for future operation and management upon their completion, and corresponding long-term accounts payables would be credited to its capital reserves. Yet some would be delivered to other government agencies or public institutions, and therefore might shrink Pingtang CDG's balance sheet simultaneously.

The latter amounted to RMB 22.5 billion, mainly consisting of land use rights injected by the local governments and acquired through open bidding. These lands were planned for developing commercial and residential properties, but their market value and actual development plan are subject to the property market conditions.

Pingtan CDG's other assets mainly included investments in properties as well as equity of SOEs and POEs in Pingtan. The company intends to hold these investments for the long run.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	9M2022
Cash Inflows from Operation	1,179	1,246	1,794	4,834
Cash Outflows from Operation	1,361	1,298	1,751	6,532
Net CF from Operation	-182	-52	44	-1,698
Cash Inflows from Investment	2,545	3,395	2,849	285
Cash Outflows from Investment	3,608	4,013	1,726	1,827
Net CF from Investment	-1,063	-618	1,123	-1,543
Cash Inflows from Financing	1,307	1,856	2,907	5,401
Cash Outflows from Financing	1,355	1,823	3,642	1,682
Net CF from Financing	-48	32	-735	3,719
Net Increase in Cash and cash equivalent	-1,293	-637	432	479

Source: The company's financial reports

Debt Servicing Capability

The liquidity of Pingtan CDG was moderately weak yet manageable. At end-September 2022, Pingtan CDG had a cash balance of c. RMB1.6 billion (including restricted cash of RMB33 million), compared with its debt due within one year of c. RMB1.8 billion. Pingtan CDG has access to various financing channels, including bank loans, onshore and offshore bond issuances and non-traditional financings (such as trust loans and financial leasing), to support its debt repayment and business operations. At end-June 2022, the company had unused bank facilities of RMB2,827 million.

Nevertheless, the company heavily relied on non-traditional financing channels, accounting for 42.6% of its total debt at end-September 2022. This could pose additional refinancing pressure on Pingtan CDG, especially amid heightened regulation over non-traditional financings.



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