

Lianhe Global has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Zhuhai Rural Commercial Bank Co., Ltd.

HONG KONG, 27 March 2023 – Lianhe Ratings Global Limited (“Lianhe Global”), an international credit rating company, has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating to Zhuhai Rural Commercial Bank Co., Ltd. (“ZRCB”). The Outlook is Stable.

The Issuer Rating reflects ZRCB’s established strong network in Zhuhai, strong capitalization after the private placement and adequate liquidity. In addition, we expect that there is a high possibility that the Zhuhai Municipal People’s Government (“the Zhuhai government”) would provide strong support to ZRCB if needed, considering their strong linkage. The rating also considers ZRCB’s limited operating scale, high concentration risks and narrowing net interest margin.

The Stable Outlook reflects our expectation that ZRCB will maintain its established market position in Zhuhai and its linkage with the Zhuhai government while maintaining the capital adequacy ratio and liquidity ratio at the level commensurate with its credit profile.

Key Rating Rationales

Established Strong Network in Zhuhai: ZRCB, formerly known as Zhuhai Rural Credit Union, is a local bank in Zhuhai with a long operating history and the largest number of business sites covering whole Zhuhai, including its rural areas and three islands. It was ranked 8th in total deposit scale and top 3 in personal deposit scale consistently among banks operating in Zhuhai. The total deposit scale was behind stated-owned giants but ahead of an array of national players. The strong network provides stable funding to ZRCB. Customer deposits contributed over 80% to the bank’s total liabilities, of which c. 70% were personal deposits.

Strong Capitalization and Adequate Liquidity: ZRCB completed a sizeable private placement of RMB3.7 billion in 2022, lifting its capital adequacy ratio significantly to 22.44% at completion, a well above average level, from 13.95% at end-June 2022. This could greatly enhance the bank’s loss absorption capacity and viability and support its business growth. Yet we believe this high capital adequacy ratio was an exceptional case (let alone any further large-scale capital injection). We expect it to decrease gradually as the bank expands its assets in the next two to three years while staying at a healthy level.

ZRCB’s liquidity was adequate, given that the bank maintained a sizeable amount of highly liquid assets such as government and financial bonds. Its liquidity matching ratio also stayed at a relatively high level.

Linkage with the Zhuhai government: The Zhuhai government holds 43.22% shares of ZRCB through six SOEs in Zhuhai, and the Guangdong Rural Credit Union has turned over

the management control of ZRCB to the Zhuhai government since 2021. Moreover, ZRCB is a major financial institution in Zhuhai, which is important in promoting local economic growth, especially in supporting micro, small and medium enterprises (“MSMEs”) and rural development and maintaining regional financial stability. Therefore, we expect that there is a high possibility that the Zhuhai government would provide strong support to ZRCB if needed.

Limited Operating Scale; High Concentration Risks: ZRCB’s operating scale is small given its nature as a rural commercial bank, putting it at a disadvantaged position in respect to its pricing power, product sophistication and economies of scale.

ZRCB adopts a credit policy supporting agriculture and MSMEs, which is in accordance with the regulatory requirements and the bank’s own endowment. However, these borrowers are usually riskier than large corporates as they typically lack financial, management and other necessary resources to withstand adverse economic conditions. The asset quality of ZRCB’s loans was under pressure as economy was weak amid the covid pandemic and property market downturn, which has impaired borrowers, especially MSMEs’ loan repayment ability.

ZRCB diversifies its loan portfolio by limiting large exposures to a single borrower. However, the sector concentration of its loans was moderately high. At end-2022, retail and wholesale sector contributed a moderately high proportion in ZRCB’s loan portfolio, and this sector had a relatively high non-performing loan ratio. Also, ZRCB can only operate its lending business in Zhuhai due to the regulatory requirement. Zhuhai is an important city in Guangdong-Hong Kong-Macao Greater Bay Area, yet the bank is more susceptible to changes in regional economic conditions in Zhuhai.

Narrowing Net Interest Margin: ZRCB’s operating revenue was mainly driven by interest income arising from loans and bond investments. The fee and commission incomes were increasing but only contributed a small fraction of the bank’s total revenue. ZRCB’s net interest margin, however, demonstrated a downward trend between 2020 and 2022, which undermined the bank’s profitability. This was mainly because the lending rate was lowered by the charge and rate cut policy to support the real economy. In addition, ZRCB faces intensive competition among banks in Zhuhai, and its funding costs are higher than its larger competitors.

Rating Sensitivities

We would consider downgrading ZRCB’s rating if there is 1) a significant decrease in its capital adequacy, or 2) a notable deterioration in its asset quality, or 3) a weakened funding structure, or 4) a perceived weakening linkage between the Zhuhai government and ZRCB.

We would consider upgrading ZRCB’s rating if it were to 1) improve its operating scale without significantly compromising its capital adequacy and asset quality, and 2) lower the concentration of its loans portfolio, and 3) improve its profitability.

About Lianhe Global

Lianhe Global is an international credit rating company that provides credit ratings to corporations, banks, non-bank financial institutions, local investment and development companies, 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 ZRCB's rating is Lianhe Global's Banking Rating Criteria published on 20 March 2023 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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