

Lianhe Global has assigned ‘BBB’ global scale Long-term Issuer Credit Rating with Stable Outlook to Heze City Investment Holdings Group Co., Ltd.

HONG KONG, 9 May 2023 – Lianhe Ratings Global Limited (“Lianhe Global”), an international credit rating company, has assigned ‘BBB’ global scale Long-term Issuer Credit Rating to Heze City Investment Holdings Group Co., Ltd. (“HZCI” or “the company”). The Outlook is Stable.

The Issuer Credit Rating reflects a high possibility that the Heze Municipal People’s Government (“the Heze government”) would provide strong support to HZCI if needed, in light of its full ownership of HZCI, HZCI’s strategic importance as a major local investment and development company (“LIDC”) responsible for infrastructure investment and construction in Heze and the linkage between the Heze government and HZCI, including the appointment of the senior management, strategic alignment, supervision of major financing plan and investment decisions and ongoing operational and financial support. In addition, the Heze government may face significant negative impact on its reputation and financing activities if HZCI encounters any operational and financial difficulties.

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

Key Rating Rationales

Government’s Ownership and Supervision: The Heze government holds 100% shares of HZCI through Finance Bureau of Heze. The local government has strong control over the company, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government has formulated a performance assessment policy for the company, and irregularly appoints auditors to review the company’s operating performance and financial position.

Strategic Importance and Strategic Alignment: HZCI is a major infrastructure investment and construction entity in Heze. Its strategic development plan has been aligned with the local government’s economic and social policies. The company has participated in the development of Wanfu New District since 2017, a key project aiming to expand urban space and promote the integrated development of Heze and Dingtao, a district under Heze’s administration. HZCI is also constructing industrial parks to support Heze’s economic and industrial development. In addition, the company is responsible for providing public services, such as public transportation, in Heze.

Ongoing Government Support: The Heze government provided project funds of RMB7.4 billion between 2020 and the first nine months of 2022 to support HZCI’s project construction activities. The company also received ongoing operational subsidies from the local government in relation to providing public services, amounting to RMB82 million over the same

period. We expect HZCI to receive ongoing support from the local government in the coming years considering its strategic importance in Heze.

Economy and Fiscal Condition of Heze: Heze realized a GDP of RMB420.5 billion in 2022, representing a year-on-year growth of 4.2%, which was higher than the growth rate of the GDP of China (3.0%) and that of Shandong Province (3.9%). Yet its absolute amount of GDP was still low. It was ranked 8th in Shandong Province in 2022 (out of the 16 prefecture-level cities). At the same time, Heze's GDP per capita was RMB48,431, which was ranked 15th in Shandong Province and it was below the province's average of RMB85,973.

Heze's budgetary revenue growth bounced back in 2021 but slowed in 2022, with a growth rate of 19.3% and 7.0%, respectively. Affected by the value-added tax credit refund policy, the tax revenue as a percentage of its budgetary revenue decreased from 77.0% in 2021 to 66.7% in 2022, a record low in recent years. On the other hand, the government fund income of Heze decreased by 22.7% to RMB36.5 billion in 2022, which is mainly due to the decline in land-transferring fees. In addition, Heze's government debt and budget deficit were high. Its government debt increased to RMB131.2 billion at end-2022 from RMB110.8 billion at end-2021, representing year-on-year growth of 18.4%, and the budget deficit increased to 125.9% in 2022. It is noteworthy to mention that the Heze government's fiscal debt ratio (total government debt outstanding/aggregate revenue) exceeded 100% in 2022, which was mainly due to the significant increase in its special purpose debt.

HZCI's Financial and Liquidity Position: HZCI's asset size grew significantly by 78.1% to RMB36.8 billion at end-September 2022 from RMB20.6 billion at end-2019. HZCI mainly relied on debts to finance its asset expansion. The company's total debts grew by 146.9% to RMB14.8 billion from RMB6.0 billion over the same period, pushing its financial leverage, as measured by debt/capitalization, to 48.8% from 33.8%. HZCI's asset expansion mainly resulted from actively participating in Heze's urban development. The company has participated in the development of Wanfu New District since 2017, accumulating a sizeable land reserve in the district. The company intends to use them to develop residential, commercial and industrial properties. Considering the project scale of Wanfu New District, we expect HZCI's capital expenditure to be high in the next two to three years.

The liquidity of HZCI was tight. At end-September 2022, HZCI had a cash balance of RMB3.0 billion (including restricted cash of RMB1.8 billion) compared with its debts due within one year of RMB5.2 billion. HZCI has access to various financing channels, including bank borrowings, bond issuances and other non-traditional financings, to support its debt repayments and business operations. Nevertheless, the company only had unused bank credit lines of RMB823 million at end-September 2022. Therefore, the company needs to successfully roll over its short-term bank borrowings (end-September 2022: RMB1.9 billion) and obtain additional financing sources or government support to maintain its liquidity.

Rating Sensitivities

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

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

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 HZCI's rating is Lianhe Global's China Local Investment and Development Companies Criteria published on 5 December 2022, 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.

Contact Information

Primary Analyst
Roy Luo
Senior Associate
(852) 3462 9582
roy.luo@lhratingsglobal.com

Committee Chairperson
Ben Yau
Senior Director
(852) 3462 9586
ben.yau@lhratingsglobal.com

Business Development Contact
Joyce Chi
Managing Director
(852) 3462 9569
joyce.chi@lhratingsglobal.com

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