

Heze City Investment Holdings Group Co., Ltd.

Initial Issuer Report

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB’ global scale Long-term Issuer Credit Rating with Stable Outlook to Heze City Investment Holdings Group Co., Ltd. (“HZCI” or “the company”)

Summary

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.

Rating Rationale

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.

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	9 May 2023

Key Figures of Heze and HZCI (RMB billion)

Heze	2021	2022
GDP	397.7	420.5
GDP growth rate (%)	8.8	4.2
Budgetary revenue	28.4	29.0
Government fund	47.2	36.5
Transfer payment	36.8	40.3
Budgetary expenditure	63.3	65.4
HZCI	2021	2022.9
Asset	30.1	36.8
Equity	14.9	15.5
Revenue	1.3	1.9

Source: Public information, HZCI 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 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, 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 debt 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.

Operating Environment

Economic Condition of Heze

Heze is located in the southwest of Shandong Province, bordering Jiangsu, Henan, and Anhui provinces. It administrates two districts (Mudan District and Dingtao District), seven counties, one provincial-level economic development zone and one provincial-level high-tech zone, with a population of 8.6 million at end-2022. Heze's main industries include food, textiles, forestry products processing, chemicals, pharmaceuticals, electricity and machinery.

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%). Heze's economic growth was mainly fueled by the secondary and tertiary industries, accounting for 41.3% and 48.9% of its total GDP, respectively, in 2022.

Heze's absolute amount of GDP was still low. It was ranked 8th in Shandong Province at end-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 GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	348.3	397.7	420.5
-Primary industry (%)	9.9	9.8	9.8
-Secondary industry (%)	40.2	41.6	41.3
-Tertiary industry (%)	49.9	48.6	48.9
GDP growth rate (%)	3.9	8.8	4.2
Fixed asset investment	166.1	192.4	227.6
Fixed asset investment growth rate (%)	7.5	15.8	18.3
Population (million)	8.8	8.7	8.7

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Heze

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.

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.

Heze's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	23.8	28.4	29.0
Budgetary revenue growth rate (%)	7.2	19.3	7.0*
Tax revenue	17.9	21.9	19.3
Tax revenue (% of budgetary revenue)	75.2	77.0	66.7
Government fund income	44.8	47.2	36.5
Transfer payment	40.7	36.8	40.3
Aggregate revenue	109.5	112.9	106.0
Budgetary expenditure	63.0	63.3	65.4
Budget deficit ¹ (%)	-165.0	-122.9	-125.9

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

Source: Public information and Lianhe Global's calculations

Note*: Excluding the influence of value-added tax credit refund

Ownership Structure

Full Government Ownership

HZCI was established in 2009 with initial registered capital of RMB40 million. After an array of capital injections and equity transfers, the company's registered and paid-in capital both enlarged to RMB1 billion, and its shares were 100% held by Finance Bureau of Heze at end-2022.

Strategic Importance and Government Linkage

Strategic Importance of HZCI to Heze

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 District. 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.

Strong Linkage with the Local Government

HZCI has a strong linkage with the local government. 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.

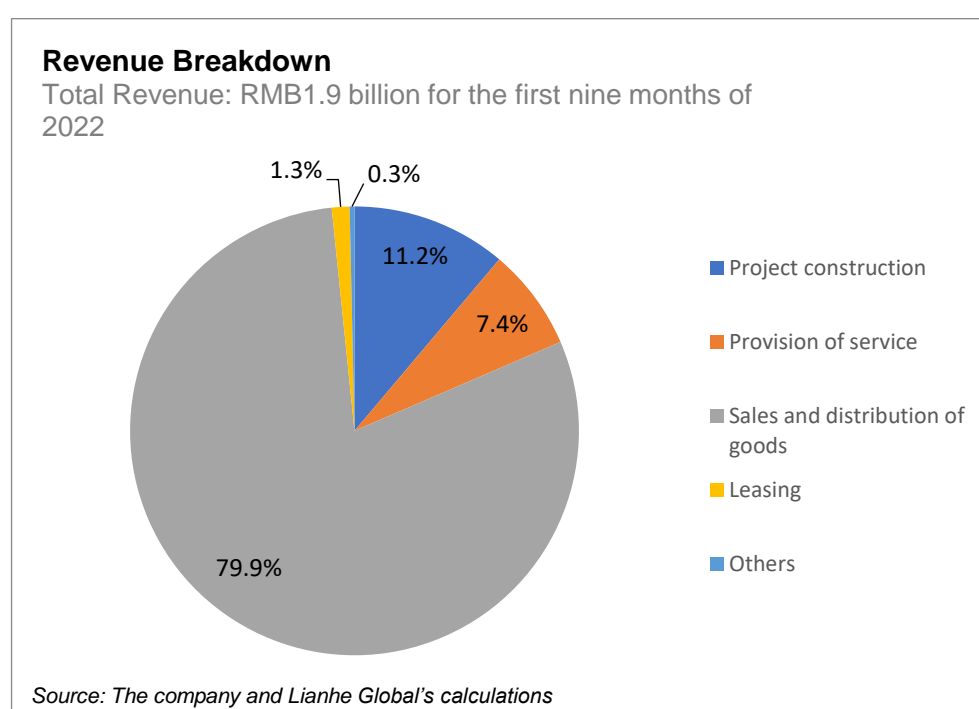
Ongoing Government Support

The Heze government provided project funds of RMB4.3 billion, 1.4 billion, 1.3 billion and 430 million in 2019, 2020, 2021 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 RMB2 million, 40 million and 40 million in 2019, 202 and 2021, respectively.

Business Profile

A major LIDC responsible infrastructure investment and construction and provision of public services in Heze

HZCI is a major infrastructure investment and construction entity in Heze. The company undertakes a series of urban and industrial development projects in Heze, including schools, industrial parks and a financial center. HZCI also operates Heze's public bus services and participates in property development, leasing, as well as sales and distribution of goods activities. The company realized revenue of RMB1.1 billion, 1.2 billion, 1.3 billion and 1.9 billion in 2019, 2020, 2021 and the first nine months of 2022, respectively.



Project Construction

HZCI is one of the major investment and construction entities in Heze. The company adopts both agent construction and self-operated models. Under the agent construction model, HZCI signs the agent construction agreements with the entrusting party (e.g., Finance Bureau of Heze) and is responsible for fundraising and construction of entrusted projects. The company settles construction costs plus 5% to 18% management fees annually with Finance Bureau of Heze according to the project's progress. Generally, the cash collection period is three to five years. Under the self-operated model, the HZCI acquires lands for planned projects through public bidding and operates them for rental income upon completion.

HZCI had completed most of its agent construction project by end-September 2022. The company is focusing on developing self-operated projects, including a biology industrial park in Juancheng, a county under Heze's administration, a financial center and a residential property project in Wanfu, and parking lots in Heze urban area. At end-September 2022, the total planned investment of self-operated

projects amounted to RMB5.2 billion, of which RMB2.6 billion was scheduled to be invested between 2023 and 2025.

Provision of Services

HZCI involves various public services in Heze, including operating urban and rural public transportation and taxi, platform service for property right transaction and education. The company also provides auctioneering, equipment installation, catering and accommodation services.

Sales and Distribution of Goods

The sales and distribution of goods have become the HZCI's revenue source since 2019. The company mainly sells and distributes foodstuffs, electrical appliances, building materials, electricity, chemical products and agricultural products.

Leasing and Others

HZCI's other businesses mainly include leasing of equipment facilities to hotels and vehicles to individuals. They only generated a small fraction of revenue for HZCI and had a limited impact on the company's overall financial profile and creditworthiness.

Financial Profile

Balance Sheet Structure and Quality

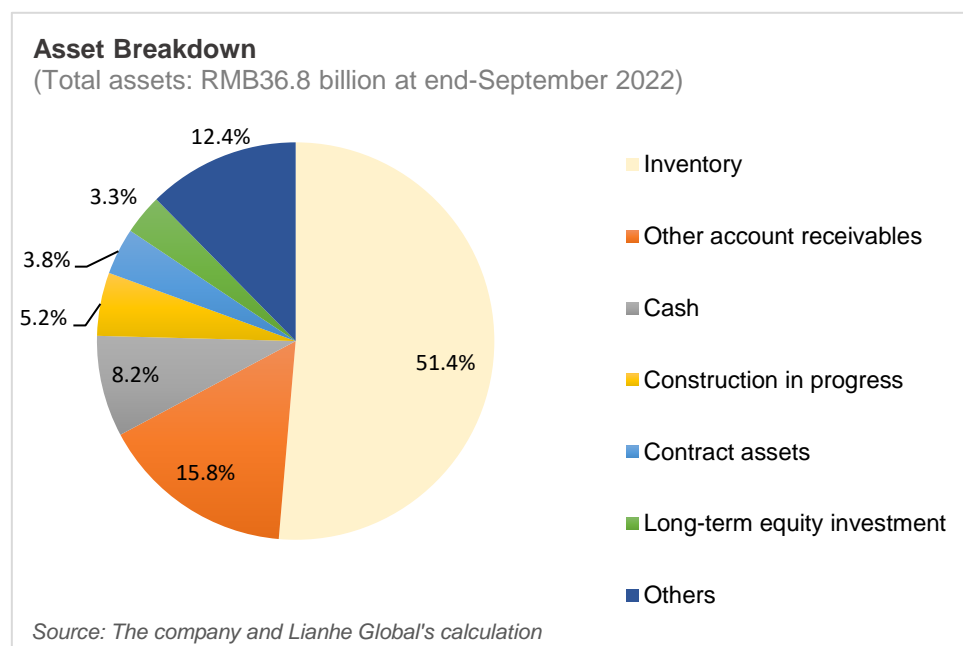
Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Sep 2022
Total Asset	20,638	24,701	30,129	36,754
Equity	11,728	13,474	14,890	15,454
Debts	5,978	4,418	8,860	14,758
Debt / (Debt + Equity) (%)	33.8	24.7	37.3	48.8
LT Debts	4,543	1,335	5,617	9,250
LT Debt / (LT Debt + Equity) (%)	27.9	9.0	27.4	37.4

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

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 48.3% 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. At end-September 2022, the company had inventory lands of RMB17.4 billion, of which RMB10.3 billion had not obtained ownership certificates. Most of HZCI's land reserve was located in Wanfu New District, and 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.



HZCI's asset liquidity was moderately weak. In addition to lands, the company also had construction costs of RMB1.3 billion booked on inventory and construction in the process (mainly self-operated projects) of RMB1.9 billion at end-September 2023. These assets usually take a long time to monetize due to the long construction, recognition and cash collection period. Moreover, HZCI had other receivables of RMB5.8 billion (some were technically loans), mainly due from other LIDCs and government agencies in Heze without a specified collection schedule.

Debt Servicing Capability

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.

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