Zhejiang Changsanhe Holding Group Co., Ltd.
Initial Issuer Report

Summary	
Issuer Rating	A-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	30 June 2023

Key Figures of Huzhou and ZCHG (RMB billion)	2021	2022
Huzhou		
GDP	364.5	385.0
GDP growth rate (%)	9.5	3.3
Budgetary revenue	41.4	38.7
Government fund	64.6	54.6
Transfer payment	12.3	15.6
Budgetary expenditure	52.4	60.2
ZCHG		
Assets	14.5	19.6
Equity	14.4	16.8
Revenue	0.6	0.7

Source: Public information, ZCHG and Lianhe Global's calculations

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

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'A-' global scale Long-term Issuer Credit Rating with Stable Outlook to Zhejiang Changsanhe Holding Group Co., Ltd. ("ZCHG" or "the company")

Summary

The Issuer Credit Rating reflects a high possibility that the People's Government of Huzhou City, Zhejiang Province ("Huzhou government") would provide strong support to ZCHG if needed, in light of its indirect majority ownership of ZCHG, ZCHG's strategic importance as the key local investment and development company ("LIDC") that is responsible for infrastructure construction and industry cultivation in Huzhou City, Zhejiang Province ("Huzhou"), especially in Yangtze River Delta (Huzhou) Industrial Cooperation Zone ("Changhe Area"), and the linkage between the Huzhou government and ZCHG, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing operational and financial support. In addition, the Huzhou government may face significant negative impact on its reputation and financing activities if ZCHG encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that ZCHG's strategic importance would remain intact while the Huzhou government will continue to ensure ZCHG's stable operation.

Rating Rationale

Huzhou Government's Ownership and Supervision: The Huzhou government indirectly holds the majority ownership of ZCHG through State-owned Assets Supervision and Administration Commission of Huzhou City ("Huzhou SASAC") and other LIDCs in the region, and is the actual controller of the company. The Huzhou SASAC, as the largest shareholder, directly holds 47.22% of the company's shares and indirectly holds 28.37%, totaling to 75.59% of the company's shares. The remaining 23.09% and 1.32% of the company's shares are indirectly held by Tianzihu Office of Huzhou Inter-Provincial Undertaking Industrial Transfer Demonstration Zone Management Committee and Zhejiang Province Finance Development Co. Ltd., respectively. The Huzhou government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Huzhou government has assessment mechanism over the company and it appoints auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Huzhou and Strategic Alignment: ZCHG, as the sole implementation body for infrastructure investment, construction and operation in Changhe Area, is primarily responsible for the industrial land development, construction of roads and other projects, industry cultivation and investment promotion within the Changhe Area. Additionally, it also undertakes infrastructure projects in the neighboring areas. With the support of the local government, the company actively participates in and contributes to the integration of the Yangtze River Delta. The company plays an important role in promoting the economic and social development of the Changhe Area and Huzhou. Its business operation and development have been aligned with the government's development plans.

Ongoing Government Support: ZCHG received operational and financial support from the government. ZCHG received a total subsidy amount of c. RMB99.8 million from 2020 to 2022, mainly including operating subsidies. The Huzhou government also injected cash, land, mining right, properties and other assets into ZCHG to expand its asset size and diversify its business. Besides, the government will repurchase some infrastructure projects and provide policy supports to ZCHG to ensure its business operation. Given the regional advantages in infrastructure construction within the Changhe Area, ZCHG has advantage to obtain major projects and other resources. We believe ZCHG is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

ZCHG's Financial Matrix and Liquidity Position: ZCHG's total assets showed a continuous growth trend in the past years and reached RMB19.6 billion at end-2022, mainly due to the increase in inventories and intangible assets. The current assets of ZCHG accounted for c. 53.4% of the total assets at end-2022. However, the overall assets were less liquid, due to the large proportion of costs associated with construction projects and intangible assets. ZCHG's financial leverage (total liabilities to assets) was 14.3% at end-2022, representing a low level. Its adjusted total debt increased to c. RMB2.2 billion at end-2022, mainly due to the increase in long-term borrowings. The liquidity of ZCHG was sufficient. At end-2022, ZCHG had unrestricted cash balance and unused credit facilities of c. RMB726.3 million and RMB4.3 billion, respectively, compared with its debt due within one year of c. RMB209.2 million at the same time. Besides, ZCHG proactively plans to enhance its financing channels by exploring options such as bond issuance.

Economy and Fiscal Condition of Huzhou: Huzhou is a prefecture-level city directly under the jurisdiction of Zhejiang Province. It recorded an economic growth in 2022, achieving a GDP of c. RMB385 billion, with a year-on-year growth of 3.3%. Its total GDP ranks 8th among all cities in Zhejiang. The aggregate fiscal revenue of the Huzhou government was mainly derived from the budgetary revenue and government fund income. In 2022, the budgetary revenue of the Huzhou government decreased to c. RMB38.7 billion due to the large-scale value-added tax credit refunds to support the economy. At the same time, the government fund income decreased to RMB54.6 billion in 2022, owing to the weak property market. Huzhou's budget deficit increased to 55.4% in 2022. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 107.4% at end-2022 from 86.4% at end-2021.

Rating Sensitivities

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

We would consider upgrading ZCHG's rating if (1) there is an upgrade in our internal credit assessment on the Huzhou government. (2) there is an upgrade in our internal credit assessment on the Huzhou government.

Operating Environment

Economic Condition of Huzhou

Huzhou is a prefecture-level city of Zhejiang Province, and is located in the north of Zhejiang, bordering Jiangsu and Anhui provinces. Huzhou has jurisdiction over 2 districts and 3 counties, with a total area of 5,820 square kilometers. At end-2022, Huzhou had a resident population of c. 3.4 million, with an urbanization rate of 66.4%.

Huzhou's economic growth fluctuated in the past years, with GDP growth rate recording at 3.3%, 9.5% and 3.3% in 2020, 2021 and 2022, respectively. Huzhou's GDP reached c. RMB385.0 billion in 2022, and was ranked the 8th among 11 prefecture-level cities under the jurisdiction of Zhejiang. Huzhou's economic growth was mainly fueled by the secondary and tertiary industries, which accounted for 51.1% and 44.7% in 2022, respectively. GDP per capita of Huzhou reached c. RMB 112,900 in 2022, which was slightly lower than that of Zhejiang (c. RMB 118,500), but much higher than that of China (c. RMB85,700).

Located at the junction of Zhejiang, Anhui and Jiangsu provinces, Changhe Area was established in January 2022, with the authorization from the Zhejiang provincial government. With a total planned area of 86.9 square kilometers, Changhe Area focuses on the development of advanced equipment and new material industries.

Huzhou's GDP and Fixed Asset Investment (RMB billion)	**2020**	**2021**	**2022**
GDP	320.1	364.5	385.0
-Primary industry (%)	4.4	4.1	4.2
-Secondary industry (%)	49.6	51.2	51.1
-Tertiary industry (%)	46.0	44.7	44.7
GDP growth rate (%)	3.3	9.5	3.3
Fixed asset investment	218.3	249.3	272.0
Fixed asset investment growth rate (%)	6.6	14.2	9.1
Population (million)	3.4	3.4	3.4

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Huzhou

The Huzhou government's aggregate fiscal revenues are mainly derived from budgetary income and government fund income. The Huzhou government's budgetary revenue decreased to c. RMB38.7 billion in 2022 from c. RMB41.4 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. The financial self-sufficiency rate of Huzhou was insufficient and it recorded a budget deficit of 55.4% in 2022. Moreover, Huzhou's government fund income also decreased to c. RMB54.6 billion in 2022 from c. RMB64.6 billion in 2021, owing to weak property market.

The outstanding debt of the Huzhou government continue to grow in recent years and reached c. RMB118.9 billion at end-2022, which included RMB55.4 billion of general obligations and RMB63.5 billion of special purpose debt. The debt ratio, as measured by the total government debt/aggregate revenue, was lifted to 107.4% in 2022 from 86.4% in 2021, mainly due to the increase in special purpose debt.

Huzhou's Fiscal Condition (RMB billion)	**2020**	**2021**	**2022**
Budgetary revenue	33.7	41.4	38.7
Budgetary revenue growth rate (%)	6.5	22.9	1.4*
Tax revenue	31.3	38.0	34.3
Tax revenue (% of budgetary revenue)	93.0	91.8	88.7
Government fund income	52.9	64.6	54.6
Transfer payment	13.8	12.3	15.6
Aggregate revenue	**100.8**	**118.5**	**110.7**
Budgetary expenditure	48.4	52.4	60.2
Budget deficit[1] (%)	**-43.9**	**-26.8**	**-55.4**

[1] Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%
Note: Excluding the influence of value-added tax credit refund*
Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

ZCHG, formerly known as Huzhou Mount Renhuang Scenic Area Construction Investment Management Co., Ltd., was established in August 2011. In December 2021, the company was renamed as the present one and its 100% equity was transferred to Huzhou SASAC.

After an array of capital injection and equity transfer, the company's registered and paid-in capital reached RMB3.0 billion and RMB2.3 billion, respectively, by the end of November 2022. ZCHG had a shareholding structure in which the Huzhou SASAC, as the controlling shareholder, held 47.2% of the company's equity directly and 28.4% of it indirectly through other stated-owned enterprises.

Strategic Importance and Government Linkage

Strategic Importance of ZCHG to Huzhou

ZCHG, as the sole implementation body for infrastructure investment, construction and operation in Changhe Area, is primarily responsible for the industrial land development, construction of roads and other projects, industry cultivation and investment promotion within the Changhe Area. Additionally, it also undertakes infrastructure projects in the neighboring areas. With the support of the local government, the company actively participates in and contributes to the integration of the Yangtze River Delta. The company plays an important role in promoting the economic and social development of the Changhe Area and Huzhou. Its business operation and development have been aligned with the government's development plans.

Linkage with the Local Government

ZCHG's linkage with the local government is strong as the Huzhou government indirectly holds the majority ownership of ZCHG through the Huzhou SASAC and other LIDCs in the region. The Huzhou government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Huzhou government has assessment mechanism over the company and it appoints auditor to supervise the operating performance and financial position on a periodic basis.

Government Support

ZCHG continued to receive financial subsidies, mainly including operating subsidies from the local government to maintain its business operation. ZCHG received subsidies of c. RMB15.6 million, RMB14.2 million and RMB70 million in 2020, 2021 and 2022, respectively. The Huzhou government also injected cash, land, mining rights, properties and other assets into ZCHG to expand its asset size and diversify its business, amounted to RMB1.1 billion and RMB2.3 billion in 2021 and 2022, respectively. Besides, the government will repurchase some infrastructure projects and provide policy supports to ZCHG to ensure its business operation. Given the regional advantages in infrastructure construction within the Changhe Area, ZCHG has advantage to obtain major projects and other resources. We believe ZCHG is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

Business Profile

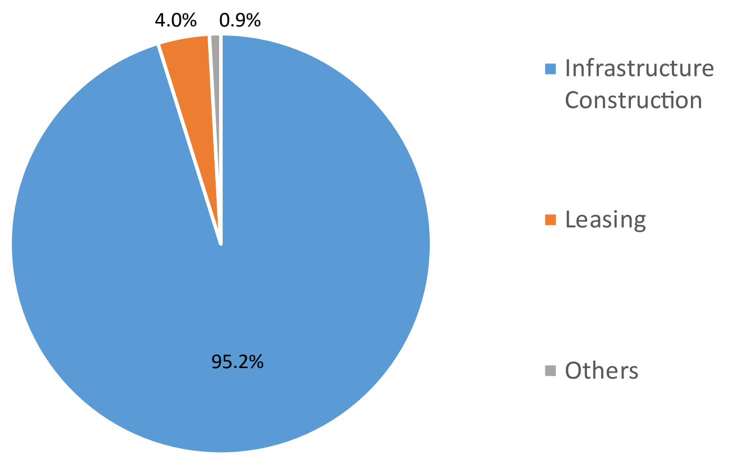
The Key Entity Responsible for Infrastructure Construction in Huzhou and Changhe Area

ZCHG, as an important LIDC in Huzhou and the sole LIDC in the Changhe Area, is mainly responsible for the development and construction, industry cultivation and investment promotion within the region as well as infrastructure construction in neighboring areas. The company’s strong franchise advantage enables it to undertake important infrastructure construction projects under the instruction of government agencies.

The primary source of operating revenue for the company is infrastructure construction, while it also engaged in leasing, property service, electricity charge, etc. The company’s total revenue reached c. RMB176.5 million, RMB615.9 million and RMB744.2 million in 2020, 2021 and 2022, respectively, representing an upward trend. The overall gross profit margin of ZCHG was on a slight downward trend in the past three years, recording at c. 12.9% in 2022. In general, the company's business was concentrated, and it has regional advantages in its major businesses.

Revenue Breakdown

(Total revenue:c. RMB744.2 million in 2022)



Source: The company and Lianhe Globals Calculation

Infrastructure Construction

The company's infrastructure construction business is divided into three models: agent construction model, BT model and self-built model. Projects under the agent construction model are financed by proceeds from government’s special purpose debt, while projects under the BT model are financed by the company’s own funds. The revenue recognition for both models includes construction costs incurred plus a certain percentage of profit. Self-built projects are financed by the company’s own funds and bank loans, and will be rented or sold after completion. The revenue in this segment reached RMB174.8 million, RMB614.8

million and RMB708.3 million in 2020, 2021 and 2022, respectively. The gross profit margin of this segment remained stable at c. 13% in past years. Currently, the company is working on several large-scale self-built projects, thus it incurs high pressure on capital expenditure.

Leasing

The company diversified its business operations in 2022 by adding the leasing business, which mainly includes pipeline leasing and property leasing. The revenue from this segment reached RMB29.4 million 2022, with a gross profit margin of -17.1%, which is mainly due to the large amount of depreciation in pipeline assets.

Other Businesses

Other businesses of ZCHG include property service, electricity charge, etc., with each segment accounting for a very small proportion of the company's total revenue. Other business mainly plays the role of supplementing the revenue of the main business and make the revenue structure more diversified.

Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality

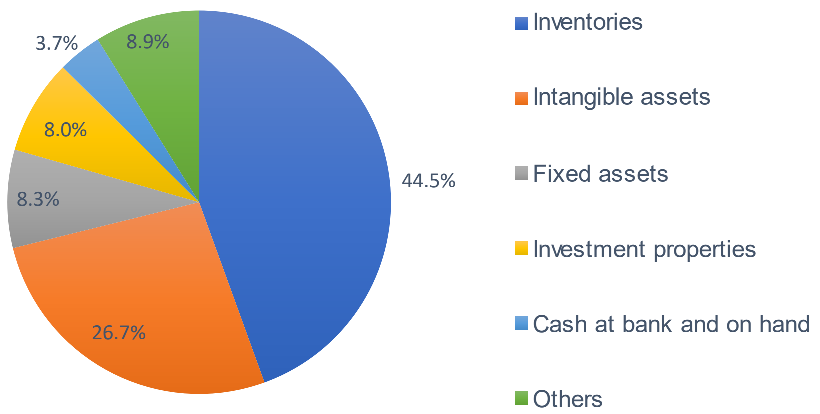
(RMB million)	**2020**	**2021**	**2022**
Total Asset	3,831	14,508	19,650
Equity	3,796	14,421	16,834
Debt	10	10	2,238
Debt / (Debt + Equity) (%)	0.3	0.1	11.7
LT Debt	-	-	2,029
LT Debt / (LT Debt + Equity) (%)	-	-	10.8

Source: Company information and Lianhe Global's calculations

ZCHG's total assets showed a continuous growth in the past few years, with a growth rate of 278.7% and 35.4%% at end-2021 and end-2022, respectively, and reached RMB19.6 billion at end-2022. The increase of ZCHG's total assets was primarily driven by the increase in inventories and intangible assets. At end-2022, ZCHG's assets mainly consisted of inventories, intangible assets, investment properties, fixed assets and cash at bank and on hand. Inventories mainly included land assets and project construction costs associated with ZCHG's agent construction and project construction business, which increased in parallel with the growth of the relevant projects. Intangible assets mainly comprised pipeline network assets using right and mining right injected from the Huzhou government. Investment properties included houses and buildings designated for public rental, also resulting from the Huzhou government's capital injection.

Although the cash at bank and on hand increased significantly to RMB727.3 million in 2022 from RMB1.4 million in 2021 as a result of the capital injection from the local government, the total assets of ZCHG were illiquid primarily due to the large proportion of costs associated with construction projects and intangible assets.

Asset Breakdown
(Total assets: RMB19.6 billion at end-2022)



Source: The company and Lianhe Global's calculation

ZCHG's financial leverage (total liabilities to assets) was 0.9%, 0.6% and 14.3% at end-2020, end-2021 and end-2022, respectively, representing a low level. We expect ZCHG's financial leverage would remain below 25% considering the government's supervision. Its adjusted total debt increased to c. RMB2.2 billion at end-2022, mainly due to the increase in long-term borrowings. The short-term debt and long-term debt accounted for c. 9.3% and 90.7% of the total debt at end-2022, respectively. The company did not engage in any non-traditional financing at end-2022. The paid in capital and capital surplus increased to RMB2.3 billion and RMB14.3 billion at end-2022 from RMB30 million and RMB3.8 billion at end-2020, respectively, due to large amount of government capital injections. ZCHG will increasingly relies on external financing to support its capital expenditures and debt repayments, which we expect to increase in the future given its projects under construction and to be constructed in the future.

Debt Servicing Capability

The liquidity of ZCHG was sufficient. At end-2022, ZCHG had unrestricted cash balance and unused credit facilities of c. RMB726.3 million and RMB4.3 billion, respectively, compared with its debt due within one year of c. RMB209.2 million at the same time. Besides, ZCHG proactively plans to enhance its financing channels by exploring options such as bond issuance.

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