

# Zhangzhou Yuanshan Development 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 Zhangzhou Yuanshan Development Co Ltd. (“ZZYD” or “the company”)

### Summary

The Issuer Credit Rating reflects a high possibility that the Zhangzhou Municipal People’s government (“Zhangzhou government”) would provide moderately strong support to ZZYD if needed. This mainly considers the Management Committee of Zhangzhou Hi-Tech District’s (“ZHTD MC”) (a local office of the Zhangzhou government and the de facto local government of Zhangzhou Hi-Tech District (“ZHTD”)) full ownership of ZZYD, ZZYD’s strategic importance as an important local investment and development company (“LIDC”) responsible for infrastructure construction in ZHTD, which is a national high-tech industrial development zone and one of the four key driver zones of Zhangzhou’s economic development., and the linkage between ZHTD MC and ZZYD, 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 Zhangzhou government may face negative impact on its reputation and financing activities if ZZYD encounters any operational and financial difficulties.

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

### Rating Rationale

**Government’s Ownership and Supervision:** ZHTD MC, as a local office of the Zhangzhou government, holds 100% shares of ZZYD through Finance Bureau of ZHTD. 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 regularly appoints auditors to review the company’s operating performance and financial position.

**Strategic Importance and Strategic Alignment:** ZZYD plays an important role in Zhangzhou’s economic development. ZZYD’s business operations and strategic planning have been aligned with the local government’s economic and social development policies. ZZYD is an important LIDC responsible for infrastructure construction and asset operation in ZHTD, which is a national high-tech industrial development zone and one of the four key driver zones of Zhangzhou’s economic development.

**Ongoing Government Support:** ZHTD MC injected leasable properties of RMB11,535 million and 155 million in 2019 and 2020, respectively, into ZZYD. ZHTD MC also transferred roads amounting to RMB1.4 billion to the company in 2020. However, we believe these roads are non-profitable assets. In addition, the company received ongoing operation subsidies of RMB125 million between 2020 and 2022. The Zhangzhou government has also guided the major state-owned entity in Zhangzhou to provide necessary support to ensure ZHTD’s development and relieve any liquidity stress of LIDCs in ZHTD. We expect ZZYD to receive ongoing support from the local government in the coming years considering its strategic importance in Zhangzhou.

### Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	19 July 2023

### Key Figures of Zhangzhou and ZZYD (RMB billion)

Zhangzhou	2021	2022
GDP	502.5	570.7
GDP growth rate (%)	7.7	6.9
Budgetary revenue	24.6	25.1
Government fund	22.1	22.7
Transfer payment	19.4	19.4
Budgetary expenditure	42.1	49.9
ZZYD	2021	2022
Asset	11.9	16.6
Equity	5.7	5.9
Revenue	4.3	8.6

Source: Public information, ZZYD and Lianhe Global’s calculations

### Analysts

Roy Luo, FRM  
 (852) 3462 9582  
[roy.luo@lhratingsglobal.com](mailto:roy.luo@lhratingsglobal.com)

Toni Ho, CFA, FRM  
 (852) 3462 9578  
[toni.ho@lhratingsglobal.com](mailto:toni.ho@lhratingsglobal.com)

### Applicable Criteria

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

**Economy and Fiscal Condition of Zhangzhou and ZHTD:** The GDP of Zhangzhou reached c. RMB570.7 billion, representing a year-over-year growth rate of 6.9% in 2022, which was ranked 4th out of all cities in Fujian Province in terms of GDP in 2022. Zhangzhou's GDP per capita was c. RMB112,578 and disposable income per capita c. RMB36,506, up 13.5% and 7.9% compared to 2021, respectively.

The Zhangzhou government's aggregate fiscal revenues are mainly derived from budgetary revenue. The budgetary revenue of the Zhangzhou government increased to RMB25.1 billion and represented an annual growth rate of 16.7% in 2022. The financial self-sufficiency rate of Zhangzhou remained low and recorded a budget deficit of 99.2% in 2022.

ZHTD was established in November 2012 and was upgraded to a national high-tech industrial development zone in December 2013 with the approval of the State Council. As a key driver of Zhangzhou's economic development, ZHTD is focusing on the development of equipment manufacturing, electronic information, food and health care and modern service industries. ZHTD maintained rapid economic growth in the past few years, with growth rates of 4.7%, 12.3% and 6.9% in 2020, 2021 and 2022, respectively. ZHTD's GDP reached RMB20.9 billion in 2022.

**ZZYD's Financial and Liquidity Position:** ZZYD's asset size grew significantly to RMB17.8 billion at end-March 2023 from RMB8.2 billion at end-2020. This was due to the company's active participation in ZHTD's project construction, as well as its investments in properties and equities in Zhangzhou. ZZYD primarily relied on borrowings to support the expansion of its asset. The company's total debt increased by 385.8% to RMB9.7 billion at end-March 2023 from RMB2.0 billion at end-2020. Therefore, the company's financial leverage, as measured by total debt/capitalization, increased significantly to 61.8% from 26.0% over the same period.

The liquidity of ZZYD was tight. At end-March 2023, the company had cash of RMB1.3 billion (including restricted cash of RMB717 million). At the same time, the company had debt due within one year of RMB4.0 billion. ZZYD has access to various financing channels, including bank borrowings and other non-traditional financings, to support its debt repayments and business operations. The company had unused credit lines of RMB604 million and an available bond issuance quota of RMB728 million at end-March 2023. Nevertheless, successfully rolling over its short-term bank borrowings (c. RMB1.2 billion at end-March 2023) and obtaining additional financing or government support are important for ZZYD to maintain its liquidity.

## Rating Sensitivities

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

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

## Operating Environment

### Economic Condition of Zhangzhou and ZHTD

Zhangzhou is a prefecture-level city in southern Fujian Province bordering Guangdong Province. Zhangzhou enjoys geographical advantages from the development of the West Coast Economic Zone, which is an economic development zone located in west of the Taiwan Straits. As one of the important road networks in Fujian, Zhangzhou plays a strategic role in the development of the West Coast Economic Zone that providing access to the seaports for central regions and strengthening economic cooperation between Central China, East and West China. Zhangzhou has jurisdiction over 4 districts and 7 county-level cities with a total land area of c.12,600 square kilometres and a residential population of c. 5 million.

The GDP of Zhangzhou reached c. RMB570.7 billion, representing a year-over-year growth rate of 6.9% in 2022, which was ranked 4<sup>th</sup> out of all cities in Fujian Province in terms of GDP in 2022. The economic growth was mainly fueled by the secondary and tertiary industries, accounting for 50.1% and 39.9% of GDP in 2022, respectively. Zhangzhou's GDP per capita was c. RMB112,578 and disposable income per capita c. RMB36,506, up 13.5% and 7.9% compared to 2021, respectively.

ZHTD was established in November 2012 and was upgraded to a national high-tech industrial development zone in December 2013 with the approval of the State Council. As a key driver of Zhangzhou's economic development, ZHTD is focusing on the development of equipment manufacturing, electronic information, food and health care and modern service industries. ZHTD maintained rapid economic growth in the past few years, with growth rates of 4.7%, 12.3% and 6.9% in 2020, 2021 and 2022, respectively. ZHTD's GDP reached RMB20.9 billion in 2022.

#### Zhangzhou's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	454.6	502.5	570.7
-Primary industry (%)	11.0	10.5	10.0
-Secondary industry (%)	45.2	49.0	50.1
-Tertiary industry (%)	43.8	40.5	39.9
GDP growth rate (%)	-3.9	7.7	6.9
Fixed asset investment	267.9	203.7	224.2
Fixed asset investment growth rate (%)	-27.8	8.2	10.1
Population (million)	5.1	5.1	5.1

Source: Public information and Lianhe Global's calculations

### Fiscal Condition of Zhangzhou

The Zhangzhou government's aggregate fiscal revenues are mainly derived from budgetary revenue. The budgetary revenue of the Zhangzhou government increased to RMB25.1 billion and represented an annual growth rate of 16.7% in 2022, while the proportion of tax revenue to the budgetary revenue fell sharply from 71.6% 2021 to 51.8% in 2022. The financial self-sufficiency rate of Zhangzhou remained low and recorded a budget deficit of 99.2% in 2022.

The outstanding debt of the Zhangzhou government continued to grow in 2022, mainly due to the rise in special purpose debt. The outstanding debt totaled RMB110.1 billion in 2022, including RMB40.9 billion of general obligations and RMB69.2 billion of special purpose debt.

The debt ratio (total outstanding debt/aggregate fiscal revenue) increased to 160.9% in 2022 from 140.2% in 2021.

<b>Zhangzhou's Fiscal Conditions</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Budgetary revenue	21.9	24.6	25.1
Budgetary revenue growth rate (%)	-0.4	12.6	16.7
Tax revenue	14.3	17.6	13.0
Tax revenue (% of budgetary revenue)	65.4	71.6	51.8
Government fund income	23.4	22.1	22.7
Transfer payment	20.4	19.4	<sup>2</sup> 19.4
<b>Aggregate revenue</b>	<b>66.4</b>	<b>67.2</b>	<b>68.4</b>
Budgetary expenditure	44.5	42.2	49.9
Budget deficit <sup>1</sup> (%)	-103.7	-71.2	-99.2

<sup>1</sup> Budget deficit = (1 - budgetary expenditure / budgetary revenue) \* 100%

<sup>2</sup> Transfer payment in 2022 is an estimated figure given the lack of information

Source: Public information and Lianhe Global's calculations

## Ownership Structure

### Government's Ownership

ZZYD was established in 2017 by Finance Bureau of ZHTD with a registered capital of c. RMB1.24 billion and a paid-in capital of RMB866.78 million. At end-2022, Finance Bureau of ZHTD held 100% shares of ZZYD.

## Strategic Importance and Government Linkage

### Strategic Importance of ZZYD to Zhangzhou

ZZYD's business operations and strategic planning have been aligned with the local government's economic and social development policies. As a national high-tech industrial development zone and one of the four key driver zones of Zhangzhou's economic development, ZHTD plays an important role in Zhangzhou's economic development. ZZYD is an important LIDC responsible for infrastructure construction and asset operation in ZHTD.

### Strong Linkage with the Local Government

ZHTD MC, as a local office of the Zhangzhou government, holds 100% shares of ZZYD through Finance Bureau of ZHTD. 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 regularly appoints auditors to review the company's operating performance and financial position.

### Ongoing Government Support

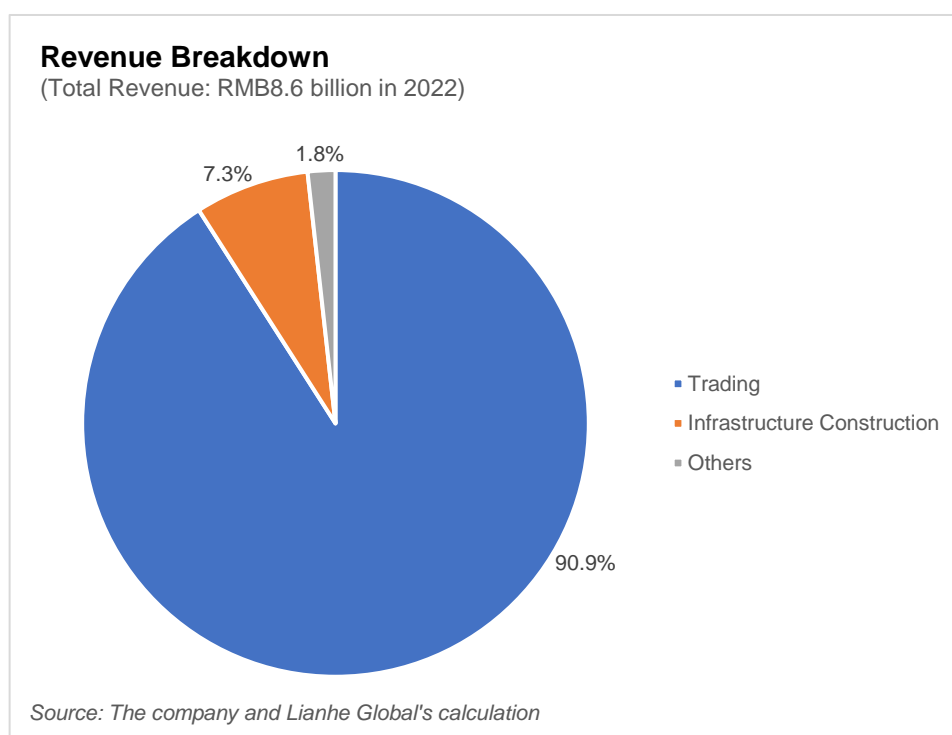
ZHTD MC injected leasable properties of RMB11,535 million and 155 million in 2019 and 2020, respectively, into ZZYD. ZHTD MC also transferred roads amounting to RMB1.4 billion to the company in 2020. However, we believe these roads are non-profitable assets. In addition, the company received ongoing operation subsidies of RMB45 million, 22 million and 58 million in 2020, 2021 and 2022, respectively, in relation to the company's activities of providing public goods and services.

The Zhangzhou government has also guided the major state-owned entity in Zhangzhou to provide necessary support to ensure ZHTD's development and relief any liquidity stress of LIDCs in ZHTD. We expect ZZYD to receive ongoing support from the local government in the coming years considering its strategic importance in Zhangzhou.

## Business Profile

### An Important LIDC Responsible for infrastructure construction in ZHTD

ZZYD is an important LIDC responsible for infrastructure construction in ZHTD. The company mainly participates in ZHTD's urban development projects, such as city infrastructures, public facilities and road constructions. It also engages in other businesses like trading, leasing of properties and parking lots, canteen catering, property management, daffodil sales, printing and human resources services in ZHTD. The company realized revenue of RMB2.9 billion, 4.3 billion and 8.6 billion in 2020, 2021 and 2022, respectively.



### Infrastructure Construction

ZZYD plays an important role in infrastructure construction in ZHTD. The project scope mainly includes city infrastructures, public facilities and roads. Under the agent construction model, ZZYD is responsible for bidding, fundraising and project management for major infrastructure construction in ZHTD. ZZYD receives the reimbursement plus a 25% margin as the project management fee from the local government based on the project progress. However, the company faces uncertainties in cash collection schedule. The company also engages in self-management projects such as industrial park and daffodil conservation area projects, which relies on rental income and commercial operations to cover construction costs and generate revenue.

ZZYD has a strong project pipeline at end-2022. The total planned investment for its major projects under construction amounted to RMB19.6 billion, of which RMB16.3 billion was

scheduled to be invested in the next three to five years. Nevertheless, this could also pose a high capital expenditure pressure on the company.

### Trading business and others

The trading business has become the largest revenue driver of ZZYD since 2020. The trading products mainly include building materials, electrolytic copper, aluminum ingot, titanium ore, steel, asphalt, zirconium ore, grain and oil. Despite the strong growth in revenue contribution, the trading business's gross margin stayed at a low 1.1-2.4% level in the past three years. Moreover, the company is exposed to high counterparty credit risk as it provides buyers with one to three months of credit terms.

ZZYD's other businesses mainly include leasing of properties and parking lots, canteen catering, property management, daffodil sales, printing and human resources services. These activities only generated a small fraction of revenue for ZZYD and had a limited impact on the company's overall financial condition and solvency.

## Financial Profile

### Balance Sheet Structure and Quality

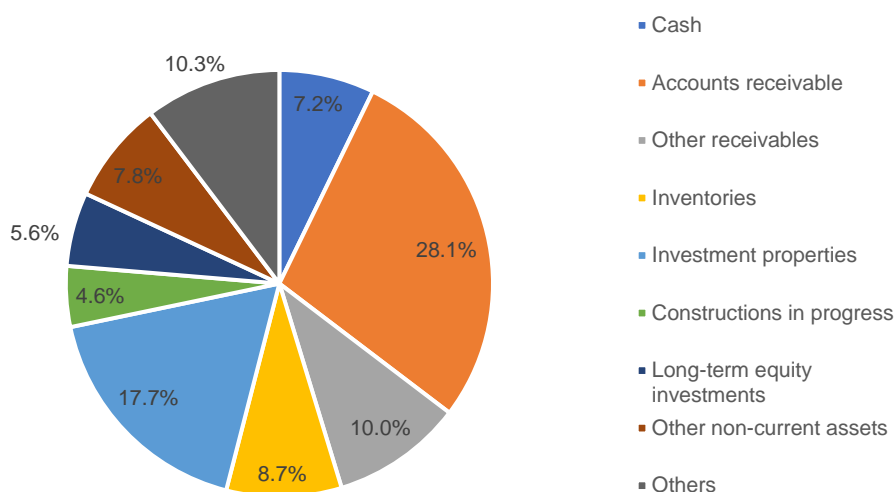
<b>Balance Sheet Structure and Quality</b>				
<b>(RMB million)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>March 2023</b>
Total Asset	8,241	11,879	16,582	17,825
Equity	5,688	5,686	5,937	5,982
Debt	1,996	5,484	9,067	9,697
Debt / (Debt + Equity) (%)	26.0	49.1	60.4	61.8
LT Debts	842	3,150	4,982	5,731
LT Debt / (LT Debt + Equity) (%)	12.9	35.7	45.6	48.9

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

ZZYD's asset size grew significantly to RMB17.8 billion at end-March 2023 from RMB8.2 billion at end-2020. This was due to the company's active participation in ZHTD's project construction, as well as its investments in properties and equities in Zhangzhou. ZZYD primarily relied on borrowings to support the expansion of its asset. The company's total debt increased by 385.8% to RMB9.7 billion at end-March 2023 from RMB2.0 billion at end-2020. Therefore, the company's financial leverage, as measured by total debt/capitalization, increased significantly to 61.8% from 26.0% over the same period.

### Asset Breakdown

(Total asset: RMB17.8 billion at end-March 2023)



Source: The company and Lianhe Global's calculation

ZZYD's asset liquidity was moderately weak. The company accumulated sizeable account receivables, other receivables, inventories (mainly comprised construction costs), construction in progress and other non-current assets (mainly comprised daffodil conservation area projects) from its project construction activities, amounting to RMB10.6 billion in aggregate and representing 59.2% of the company's total asset at end-March 2022. These assets usually take a long time to monetize due to the protracted construction, revenue recognition and receivable collection periods. ZZYD also had investment properties held for leasing of RMB3.2 billion and equity investment of RMB925 million, accounting for 17.7% and 4.6% of the company's total asset at end-2022, respectively. The company intends to hold these investments for the long term.

### Debt Servicing Capability

The liquidity of ZZYD was tight. At end-March 2023, the company had cash of RMB1.3 billion (including restricted cash of RMB717 million). At the same time, the company had debt due within one year of RMB4.0 billion. ZZYD has access to various financing channels, including bank borrowings and other non-traditional financings, to support its debt repayments and business operations. The company had unused credit lines of RMB604 million and an available bond issuance quota of RMB728 million at end-March. Nevertheless, successfully rolling over its short-term bank borrowings (c. RMB1.2 billion at end-March 2023) and obtaining additional financing or government support are important for ZZYD to maintain its liquidity.

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