

Bazhou Development Holding Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	18 August 2023

Key Figures of Bazhou and BDHG (RMB billion)

	2021	2022
Bazhou		
GDP	43.6	45.0
GDP growth rate (%)	4.1	2.7
Budgetary revenue	2.9	2.9
Government fund	0.6	1.0
Transfer payment	1.6	1.9
Budgetary expenditure	5.0	5.4
BDHG	2021	2022
Assets	5.2	13.0
Equity	4.5	11.1
Revenue	0.2	0.4

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

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Bazhou Development Holding Group Co., Ltd. (“BDHG” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Bazhou City, Langfang City (“Bazhou government”) would provide very strong support to BDHG if needed, in light of its full ownership of BDHG, BDHG’s strategic importance as the flagship local investment and development company (“LIDC”) that is responsible for infrastructure construction and operation of state-owned assets in Bazhou City, Langfang City (“Bazhou”), and the linkage between the Bazhou government and BDHG, 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 Bazhou government may face significant negative impact on its reputation and financing activities if BDHG encounters any operational and financial difficulties.

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

Rating Rationale

Bazhou Government’s Ownership and Supervision: The Bazhou government holds the full ownership of BDHG through Bazhou Finance Bureau (“Bazhou FB”), and it is the ultimate controlling shareholder of the company. The Bazhou 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 Bazhou government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Bazhou and Strategic Alignment: BDHG, as the most important LIDC in Bazhou, is primarily responsible for the infrastructure construction and operation of state-owned assets within the region with strong franchised advantages. The company undertakes most of Bazhou’s infrastructure projects in the region, and is responsible for water supply and sewage treatment, bail-out, trading and leasing business within the region. BDHG plays an important role in promoting the economic and social development of the region. Its business operation and strategic planning have been aligned with the government’s development plans.

Ongoing Government Support: BDHG continued to receive financial subsidies, mainly including operating subsidies and tax breaks, from the local government to maintain its business operation. BDHG received a total of c. RMB233.0 million in subsidies between 2020 and 2022. In addition, BDHG received asset and capital injections in the form of equity, operating real estates, agent construction projects, lands, and other assets, which reached a total of c. RMB9.1 billion between 2020 and 2022 from the Bazhou government, to expand its asset size and diversify its business. We believe BDHG is likely to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

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Applicable Criteria

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

BDHG's Financial Matrix and Liquidity Position: BDHG's total assets showed a rapid growth in the past few years, with a growth rate of 39.3% and 150.5% in 2021 and 2022, respectively, and reached RMB13.0 billion at end-2022. The increase of BDHG's total assets in 2022 was largely due to its increase in inventories, intangible assets and investment properties. BDHG had large proportion of non-current assets (73.9% at end-2022) and the overall asset liquidity was weak. BDHG's financial leverage (total liabilities to assets) was 12.5%, 13.0% and 15.0% at end-2020, end-2021 and end-2022, respectively, representing an upward trend but remained at a relatively low level. BDHG's total adjusted debt increased by 265.4% to c. RMB1.5 billion at end-2022. The liquidity of BDHG was moderately weak. At end-2022, BDHG had unrestricted cash balance and unused credit facilities of c. RMB0.2 billion and RMB0.9 billion, respectively, compared with its debt due within one year of c. RMB0.4 billion. However, BDHG has access to various financing channels, such as bank loans and non-traditional financing, to support its debt repayment and business operations.

Economy and Fiscal Condition of Bazhou: Bazhou, a county-level city of Langfang City, Hebei Province, and is located in The Beijing-Tianjin-Xiongan Central Core Area. Bazhou is well served for transport links and enjoys unique location advantages. The economic growth of Bazhou fluctuated in the past three years. The GDP growth was 1.8%, 4.1% and 2.7% in 2020, 2021 and 2022, respectively. The GDP amount was c. RMB45.0 billion in 2022, ranking 3rd among all districts and counties under the jurisdiction of Langfang. The aggregate fiscal revenue of the Bazhou government mainly originated from the budgetary revenue and transfer payment from the higher government. The Bazhou government's budgetary revenue maintained a relatively stable trend in the past three years, and reached c. RMB2.9 billion in 2022. The tax revenue was relatively volatile, accounting for 43.7%-64.9% of the budgetary revenue from 2020 to 2022. The debt ratio, which is measured as total government debt/aggregate revenue, continued to increase over the past three years, from 25.9% at end-2020 to 83.3% at end-2022, mainly due to the significant increase in special debt.

Rating Sensitivities

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

We would consider upgrading BDHG's rating if there is an upgrade in our internal credit assessment on the Bazhou government.

Operating Environment

Economic Condition of Bazhou

Bazhou, a county-level city of Langfang City, Hebei Province, is located in The Beijing-Tianjin-Xiongan Central Core Area. Bazhou is well served for transport links and enjoys unique location advantages. Besides, Bazhou is also famous for its folk arts and cultural relics. Bazhou has jurisdiction of over nine towns, three villages, one provincial development zone and an office. The total land area of Bazhou is c. 801 square kilometers, with a residential population of around 0.7 million at end-2022.

The economic growth of Bazhou fluctuated in the past three years. The GDP growth was 1.8%, 4.1% and 2.7% in 2020, 2021 and 2022, respectively. The GDP amount was c.

RMB45.0 billion in 2022, ranking 3rd among all districts and counties under the jurisdiction of Langfang. Considering Bazhou's economic structure, the economy was primarily driven by the secondary and tertiary industries, which accounted for 52.4% and 44.9% of GDP in 2022, respectively. Affected by the downturn of the real estate industry, fixed asset investment of Bazhou fell sharply in 2021 and 2022, with growth rate recording at -28.4% and -13.0%, respectively.

Bazhou's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	40.9	43.6	45.0
-Primary industry (%)	2.8	2.6	2.7
-Secondary industry (%)	51.9	48.7	52.4
-Tertiary industry (%)	45.3	44.0	44.9
GDP growth rate (%)	1.8	4.1	2.7
Fixed asset investment	24.0	17.2	14.9
Fixed asset investment growth rate (%)	5.3	-28.4	-13.0
Population (million)	0.7	0.8	0.7

Source: Public information, the company and Lianhe Global's calculations

Fiscal Condition of Bazhou

The aggregate fiscal revenue of the Bazhou government mainly originated from the budgetary revenue and transfer payment from the higher government. The Bazhou government's budgetary revenue maintained a relatively stable trend in the past three years, and reached c. RMB2.9 billion in 2022. The tax revenue was relatively volatile, accounting for 43.7%-64.9% of the budgetary revenue from 2020 to 2022. The financial self-sufficiency rate of the Bazhou government was low, and it recorded a budget deficit of -87.5% in 2022.

The outstanding debt of the Bazhou government increased from c. RMB2.3 billion as of end-2020 to c. RMB4.8 billion as of end-2022, representing a compound annual growth rate of 28.70%. The increase in government debt was mainly due to the surge in special debt, which climbed from c. RMB0.6 billion as of end-2020 to c. RMB2.8 billion as of end-2022. The debt ratio, which is measured as total government debt/aggregate revenue, continued to increase over the past three years, from 25.9% at end-2020 to 83.3% at end-2022.

Bazhou's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	2.7	2.9	2.9
Budgetary revenue growth rate (%)	-3.9	5.3	1.0
Tax revenue	1.6	1.9	1.3
Tax revenue (% of budgetary revenue)	58.7	64.9	43.7
Government fund income	3.0	0.6	1.0
Transfer payment	3.0	1.6	1.9
Aggregate revenue	8.8	5.2	5.8
Budgetary expenditure	7.0	5.0	5.4
Budget deficit ¹ (%)	-157.4	-72.6	-87.5

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

Source: Public information, the company and Lianhe Global's calculations

Ownership Structure

Government's Ownership

BDHG, formerly known as Bazhou Caixin City Construction Investment and Development Operation Co., Ltd., was established in June 2002 by Bazhou Bureau of Culture and Sports, Bazhou Bureau of Education and Bazhou Bureau of Construction, with an initial registered capital of RMB30.57 million. The company changed its name to the current one in February 2023.

After an array of capital replenishment and equity transfers, the company's registered capital and paid-in capital reached RMB5.0 billion and RMB1.8 billion, respectively, at end-2022. The sole shareholder of the company is the Bazhou FB, and the actual controller is the Bazhou government.

Strategic Importance and Government Linkage

Strategic Importance of BDHG to Bazhou

BDHG, as the most important LIDC in Bazhou, is primarily responsible for the infrastructure construction and operation of state-owned assets within the region with strong franchised advantages. The company undertakes most of Bazhou's infrastructure projects in the region, and is responsible for water supply and sewage treatment, bail-out, trading and leasing business within the region. BDHG plays an important role in promoting the economic and social development of the region. Its business operation and strategic planning have been aligned with the government's development plans.

Strong Linkage with the Local Government

BDHG's linkage with the local government is strong as the Bazhou government holds the full ownership of BDHG through the Bazhou FB, and it is the ultimate controlling shareholder of the company. The Bazhou 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 Bazhou government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

Government Support

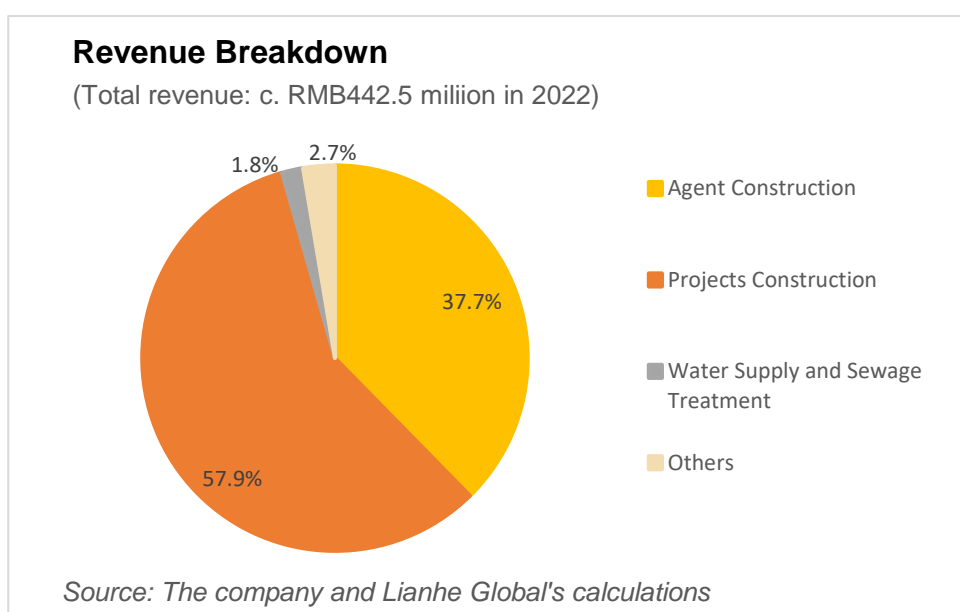
BDHG continued to receive financial subsidies, mainly including operating subsidies and tax breaks, from the local government to maintain its business operation. BDHG received subsidies of c. RMB68.5 million, RMB96.0 million and RMB68.5 million in 2020, 2021 and 2022, respectively.

In addition, BDHG received asset and capital injections in the form of equity, operating real estates, agent construction projects, lands, and other assets, which reached RMB1.8 billion, RMB1.1 billion and RMB6.1 billion in 2020, 2021 and 2022, respectively, from the Bazhou government, to expand its asset size and diversify its business. We believe BDHG is likely to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

Business Profile

The Flagship Entity Responsible for Infrastructure Construction and State-owned Assets Operation in Bazhou

BDHG, the flagship LIDC in Bazhou, is mainly responsible for the municipal infrastructure construction and state-owned assets operation within the region. The company and its subsidiaries undertake most of Bazhou's construction projects and enjoy a franchise in water supply and urban-rural sanitation, indicating a strong regional competitiveness. BDHG's total revenue was RMB49.2 million, RMB167.8 million and RMB442.5 million in 2020, 2021 and 2022, respectively. The gross profit margin of BDHG fluctuated in the past three years, recording at 12.2%, 70.5% and 40.8% in 2020, 2021 and 2022, respectively, mainly affected by the company's signing of a commissioned construction agreement with the Bazhou Government in 2021, and starting recognizing the commissioned construction revenue, as well as the fluctuation of project construction revenue.



Agent Construction

One of BDHG's core businesses is agent construction. Entrusted by the Bazhou government, the company operates Bazhou's infrastructure construction and management, and carries out the feasibility research, environment evaluation, exploitation, design and pitch of projects, according to the approved construction plans. Regarding the funding source, the Bazhou government will pay a specific percentage of the real investment to BDHG (15% in principal) as the construction management fee. The company calculates the actual investment amount in stages based on the construction progress, and confirms the construction management fee based on the calculated amount. The agent construction business income was RMB110.2 million and RMB166.6 million in 2021 and 2022, respectively. As there's no cost for the agent construction, the gross margin was both 100.0% in 2021 and 2022.

Project Construction

Except for the agent construction business, the company also undertakes projects construction business, which is managed by its subsidiary Hebei Daili Lujiao Project Co., Ltd. ("HDLP"). With Grade 2 qualification of general contracting on highways construction and Grade 3 qualification of general contracting on municipal public utility construction

engineering, HDLP obtains business mainly from public tender, and most of HDLP's contracting projects are government investment projects. Currently, HDLP holds several projects under construction, and the revenue will be confirmed according to a certain proportion of the construction progress. The operating revenue from the projects construction business was RMB43.4 million, RMB36.5 million and RMB256.3 million in 2020, 2021 and 2022, respectively. The gross profit margin of this segment was relatively low, at 8.5%, -1.7% and 0.5% in 2020, 2021 and 2022, separately.

Water Supply and Sewage Treatment

The company also engages in water business such as water supply and sewage treatment. The water supply business is managed by the subsidiary Bazhou Xinsheng Water Supply Co., Ltd. The cost of water is borne by the Bazhou Government, and the company is mainly responsible for the cost of raw materials, labour, energy, power, and depreciation costs. BDHG has gained a franchise of the whole area water supply business, and the water supply area is expected to expand with the completion and implementation of Bazhou's water supply pipeline improvement. The scale of the sewage treatment business was relatively small. The operating revenue from the water business reached RMB2.0 million, RMB6.9 million and RMB7.9 million in 2020, 2021 and 2022, respectively. The gross margin was -75.5%, 29.7% and 17.6% in 2020, 2021 and 2022, respectively.

Other Businesses

Other businesses of BDHG include bail-out, trading, leasing, etc. The company's subsidiary Bazhou Caixin Bail-out Fund Co., Ltd. is responsible for funding property development companies operating shantytowns renovation and corporations which are in demand for repaying loans and are qualified for banks' credit loan standards. The trading business focuses on cotton and water meters. These segments accounted for a relatively small proportion of the company's total revenue. Other businesses mainly play the role of supplementing the revenue of the main business and make the revenue structure more diversified.

Financial Profile

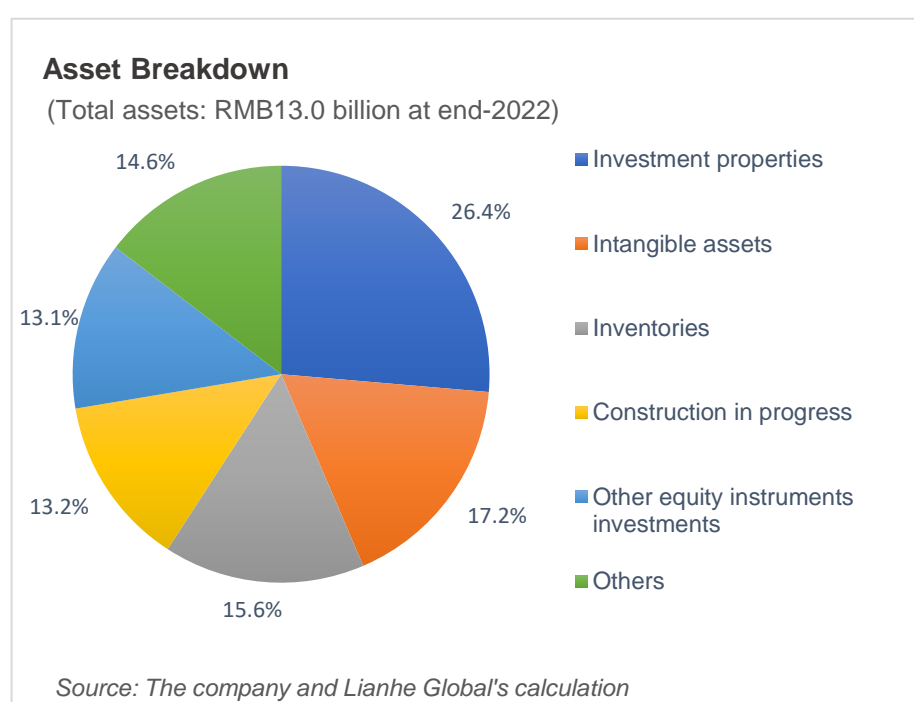
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality			
(RMB million)	2020	2021	2022
Total Asset	3,731	5,196	13,016
Equity	3,263	4,519	11,063
Debt	412	531	1,505
Debt / (Debt + Equity) (%)	11.2	10.5	12.0
LT Debt	107	189	981
LT Debt / (LT Debt + Equity) (%)	3.2	4.0	8.1

Source: Company information and Lianhe Global's calculations

BDHG's total assets showed a rapid growth in the past few years, with a growth rate of 39.3% and 150.5% in 2021 and 2022, respectively, and reached RMB13.0 billion at end-2022. The increase of BDHG's total assets in 2022 was largely due to its increase in inventories, intangible assets and investment properties. BDHG had large proportion of non-current assets (73.9% at end-2022) and the overall asset liquidity was weak.

BDHG's assets mainly consisted of investment properties, intangible assets, inventories, construction in progress and other equity instruments investments at end-2022. Investment properties primarily comprised of houses and buildings, as well as land use rights, most of which are obtained through government transfer. Intangible assets consisted of parking space operating rights, billboard charging rights and land use rights. The scale of inventories was large that mainly included inventory goods and a large amount of development costs. The scale of inventories increased significantly from RMB5.36 million in 2021 to RMB2.03 billion in 2022, mainly due to the government's free transfer of RMB2.01 billion worth of agent construction projects. The construction in progress primarily comprised of the cost of the whole area water supply renovation project, municipal projects and Mangniu River project. Other equity instruments investments included the cost of investment in Hebei Construction Transportation Investment Co., LTD., Jinbao Railway Co., LTD., and Hebei Xiongan Rail Express Co., LTD.



BDHG's financial leverage (total liabilities to assets) was 12.5 %, 13.0% and 15.0% at end-2020, end-2021 and end-2022, respectively, representing an upward trend but remained at a relatively low level. BDHG's total adjusted debt increased by 265.4% from c. RMB0.4 billion at end-2020 to c. RMB1.5 billion at end-2022, mainly due to the increase of long-term borrowings for operational needs, and other payables due to the increase in principal and interest payable on borrowings. The short-term debt and long-term debt accounting for c. 34.8% and c. 65.2% of the total debt at end-2022. There was no significant change in the ownership equity structure of BDHG at end-2022, compared with that at end-2021. The capital surplus increased to c. RMB8.7 billion at end-2022 from c. RMB2.3 billion at end-2020. BDHG mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its agent construction related projects under construction and to be constructed in the future.

Debt Servicing Capability

The liquidity of BDHG was moderately weak. At end-2022, BDHG had unrestricted cash balance and unused credit facilities of c. RMB0.2 billion and RMB0.9 billion, respectively,



compared with its debt due within one year of c. RMB0.4 billion. However, BDHG has access to various financing channels, such as bank loans and non-traditional financing, to support its debt repayment and business operations.

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