聯合評級國際 Lianhe Ratings Global

Feicheng City Urban Investment Holding Group Co., Ltd.

Initial Issuer Report

Summary	
Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	23 Novermber 2023

Key Figures of Feicheng and FCUI (RMB billion)

Feicheng	**2021**	**2022**
GDP	77.1	82.7
GDP growth rate (%)	4.7	5.3
Budgetary revenue	4.5	4.7
Government fund	2.1	1.6
Transfer payment	2.0	2.3
Budgetary expenditure	5.9	6.9
FCUI	**2022**	**2023.9**
Asset	33.3	38.3
Equity	26.8	31.3
Revenue	1.1	0.6

Source: Public information, FCUI 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 'BBB' global scale Long-term Issuer Credit Rating with Stable Outlook to Feicheng City Urban Investment Holding Group Co., Ltd. ("FCUI" or "the company")

Summary

The Issuer Credit Rating reflects a high possibility that the People's Government of Feicheng district ("the Feicheng government") would provide very strong support to FCUI if needed. This mainly considers the Feicheng government's full ownership of FCUI, FCUI's strategic importance as an important local investment and development company ("LIDC") responsible city development and operation in Feicheng, the strong linkage between the Feicheng government and FCUI. In addition, the Feicheng government may face significant negative impact on its reputation and financing activities if FCUI encounters any operational and financial difficulties.

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

Rating Rationale

Government's Ownership and Supervision: The Feicheng government holds 100% equity of FCUI through the Feicheng State-owned Assets Operation Center ("the Feicheng SAOC") and is the company's ultimate controller. 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: FCUI is the largest LIDC in terms of asset size in Feicheng. The company provides essential public service (heat supply) and undertakes key projects within the region. It has also diversified into coal trading and sales of sand, grain and oil as well as other bulk commodities. Its business operations and strategic planning have been aligned with the local government's economic and social development policies.

Ongoing Government Support: The Feicheng government provides ongoing support to FCUI. The local government injected RMB26.7 billion worth of capital and assets, including cash, mineral resources, properties and equity of local SOEs, into FCUI between 2020 and the first nine months of 2023. Over the same period, the company also received operational subsidies amounting to RMB281 million to support FCUI's operations. We expect FCUI to receive ongoing support from the local government in the coming years considering its strategic importance in Feicheng.

Economy and Fiscal Condition of Feicheng: Feicheng is a county-level city directly under the jurisdiction of Shandong Province and managed by Tai'an on behalf of Shandong

Province. It is located in the center of Shandong Province and west of Tai'an. Feicheng is a time-honored city with abundant tourism resources and cultural sites.

Feicheng was ranked 55th on the list of Top 100 Counties in China in 2022, with relatively strong economic and financial strength. Feicheng's economy has maintained steady growth in the past three years. Its GDP reached RMB82.7 billion in 2022, representing a year-over-year growth rate of 5.3%. Both was ranked 1st among the nine jurisdictions of Tai'an. Its economic development focused on special metal materials, new energy, high-end chemicals, construction and installation and modernize food industry in recent years.

The Feicheng government's budgetary revenue increased steadily in the past three years with growth rates of 1.1%, 9.4% and 14.9% in 2020, 2021 and 2022, respectively. The improvement of budgetary revenue has in turn helped to mitigate the budget deficit, which slightly improved to 47.6% in 2022 from 48.4% in 2020. However, as another important component of the aggregate revenue, the government-managed fund (mainly generated by the land concession revenue) decreased to RMB1.6 billion in 2022 from RMB3.3 billion in 2020, mainly due to the real estate market downturn.

The outstanding debt of the Feicheng government continued to grow, as it borrowed heavily in special debts to support its public projects. At end-2022, the Feicheng government's outstanding debt reached RMB8.1 billion, up from RMB5.3 billion at end-2020. Feicheng's government debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 88.1%from 56.0% over the same period.

FCUI's Financial and Liquidity Position: FCUI's asset size grew rapidly to RMB38.3 billion at end-September 2023 from RMB8.4 billion at end-2020, largely attributed to a series of asset allocations and capital injections from the local government. Correspondently, the company's financial leverage, as measured by debt/capitalization, has maintained at a low level of 10-15% since 2021. However, FCUI's asset quality was weak, as intangible assets, valued at RMB20.5 billion, accounted for more than 50% of the company's total asset at end-September 2023. The intangible assets mainly included income rights of river sand and rock resources allocated from the local government in 2021. Yet these assets only brought limited revenue and profit to the company in the past two years.

FCUI's liquidity was relatively tight. At end-September 2023, the company had cash of RMB517 million (including restricted cash of RMB181 million), compared to debt due within one year of RMB1.5 billion. Nevertheless, FCUI has access to various financing channels, including bank borrowings, bond issuances, and other non-traditional financings, to support its debt repayments and business operations. At end-September 2023, the company had unused credit lines of RMB1.8 billion.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Feicheng

Feicheng is a county-level city directly under the jurisdiction of Shandong Province and managed by Tai'an on behalf of Shandong Province. It is located in the center of Shandong Province and west of Tai'an. Feicheng is a time-honored city with abundant tourism resources and cultural sites. Feicheng has jurisdiction over 10 towns, 4 streets, 1 national high-tech development zone and 1 provincial-level economic development zone with a total land area of 1,277 square kilometers. By the end of 2022, Feicheng had a resident population of c. 0.88 million, with an urbanization rate of 68.5%.

Feicheng was ranked 55th on the list of Top 100 Counties in China in 2022, with relatively strong economic and financial strength. Feicheng's economy has maintained steady growth in the past three years. Its GDP reached RMB82.7 billion in 2022, representing a year-over-year growth rate of 5.3%. Both was ranked 1st among the nine jurisdictions of Tai'an. Feicheng's economic growth was mainly fueled by the tertiary and secondary industries in the past few years, which accounted for 40.5% and 51.5% in 2022, respectively. Its economic development focused on special metal materials, new energy, high-end chemicals, construction and installation and modernize food industry in recent years. The fixed asset investment growth rate of Feicheng fluctuated in the past three years, owing to Covid's disruption, which was -16.3%, -37.3% and 21.9% in 2020, 2021 and 2022, respectively.

Feicheng's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	72.2	77.1	82.7
-Primary industry (%)	7.8	8.1	8.0
-Secondary industry (%)	50.0	49.3	51.5
-Tertiary industry (%)	42.1	42.6	40.5
GDP growth rate (%)	3.5	4.7	5.3
Fixed asset investment	-	-	20.3
Fixed asset investment growth rate (%)	-16.3	-37.3	21.9
Population (million)	0.89	0.89	0.88

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Feicheng

The Feicheng government's budgetary revenue increased steadily in the past three years with growth rates of 1.1%, 9.4% and 14.9% in 2020, 2021 and 2022, respectively. The improvement of budgetary revenue has in turn helped to mitigate the budget deficit, which slightly improved to 47.6% in 2022 from 48.4% in 2020. Yet the Feicheng government's fiscal self-sufficiency was still insufficient. It continuously received subsidies from higher governments. As another important component of the aggregate revenue, the government-managed fund (mainly generated by the land concession revenue) decreased to RMB1.6 billion in 2022 from RMB3.3 billion in 2020, mainly due to the real estate market downturn.

The outstanding debt of the Feicheng government continued to grow, as it borrowed heavily in special debts to support its public projects. At end-2022, the Feicheng government's outstanding debt reached RMB8.1 billion, up from RMB5.3 billion at end-2020. Feicheng's government debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 88.1%from 56.0% over the same period.

Feicheng's Fiscal Condition (RMB billion)	2020	2021	2022
Budgetary revenue	4.1	4.5	4.7
Budgetary revenue growth rate (%)	1.1	9.4	14.9*
Tax revenue	3.5	3.8	3.8
Tax revenue (% of budgetary revenue)	86.1	85.7	81.8
Government fund income	3.3	2.1	1.6
Transfer payment	2.0	2.0	2.3
Aggregate revenue	**9.4**	**8.7**	**9.2**
Budgetary expenditure	6.1	5.9	6.9
Budget balance[1] (%)	**-48.4**	**-32.7**	**-47.6**

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

Ownership Structure

Full Government Ownership

FCUI was established in May 2013 with an initial registered capital of RMB1.0 million. After an array of equity transfers and capital injections, the Feicheng government has held 100% equity of FCUI through the Feicheng State-owned Assets Operation Center ("the Feicheng SAOC") since May 2023, and FCUI's registered and paid-in capital have been enlarged to RMB5.0 billion and RMB1.0 billion, respectively.

In May 2023, the Feicheng government transferred 100% shares of three LIDCs to FCUI, including Feicheng City Urban Construction Investment Group Co., Ltd. ("FCUC"), the largest urban construction entity in terms of asset size in Feicheng. Currently, FCUI and FCUC shares a same management team.

Strategic Importance and Government Linkage

Strategic Importance of FCUI to Feicheng

FCUI is the largest LIDC in terms of asset size in Feicheng. The company provides essential public service (heat supply) and undertakes key projects within the region. It has also diversified into coal trading and sales of sand, grain and oil as well as other bulk commodities. Its business operations and strategic planning have been aligned with the local government's economic and social development policies.

Strong Linkage with the Local Government

The Feicheng government holds 100% equity of FCUI through management committee holds 100% shares of FCUI through the Feicheng SAOC, and is the company's ultimate controller. 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

The Feicheng government provides ongoing support to FCUI. The local government injected RMB26.7 billion worth of capital and assets, including cash, mineral resources, properties and equity of local SOEs, into FCUI between 2020 and the first nine months of 2023. Over the same period, the company also received operational subsidies amounting to RMB281 million to support FCUI's activities in relation to providing public goods and services. We expect FCUI to receive ongoing support from the local government in the coming years considering its strategic importance in Feicheng.

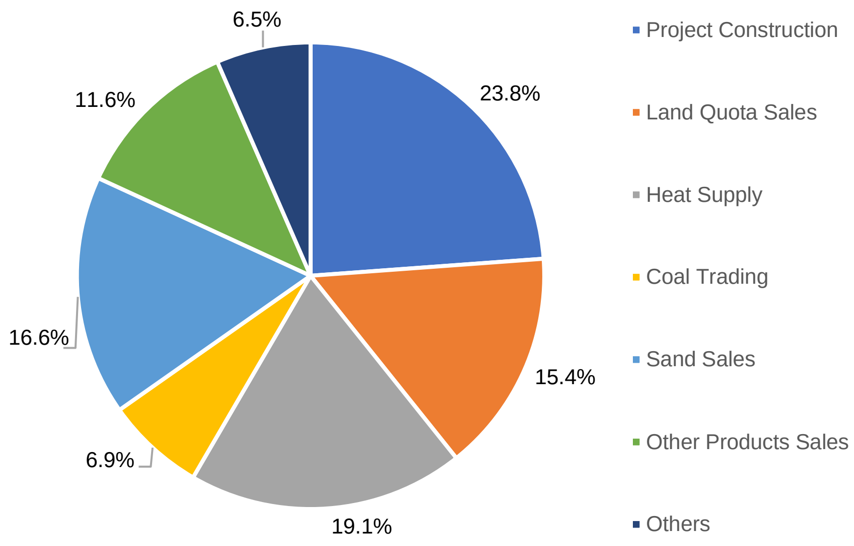
Business Profile

The Key Entity Responsible for City Development and Operation in Feicheng

FCUI, as an important LIDC in Feicheng, is mainly responsible for providing essential public service (heat supply) and undertaking key projects within the region. It has also diversified into coal trading and sales of sand, grain and other products.

Revenue Breakdown

(Total revenue: RMB616 million in the first nine months of 2023)



Source: The company and Lianhe Global's Calculation

Heat Supply

FCUI participates in heat supply business in Feicheng, which is an essential utility for cold region of the northern China. The company's heat supply service covers the urban areas of Feicheng, with a strong franchise advantage within the region. We believe the heat supply business enhances FCUI's importance in Feicheng. Yet given the public nature of this business, combined with high depreciation and maintenance costs of the pipeline network, the heat supply business continued to record negative gross margin, thus mainly relied on external support to back its operations.

Project Construction

In recent years, FCUI has been developing and operating rural revitalization and industrial parks projects in Feicheng. The company also undertakes key infrastructure projects including public transportation and facilities, as well as river improvement projects within the region. The company is usually responsible for the investment and development of projects then settles with project owners.

FCUI has a strong project pipeline with nine major projects under construction, which could support the segment's development in the coming years. Nevertheless, these projects require RMB1,570 million to be invested, incurring moderately high capital expenditure pressure in the coming years.

Land Quota Sales

FCUI creates land quotas for urban and rural developments by transforming wasteland into arable land, and sell them to users who need to occupy arable land at market prices. The land quota is a major source of profit for the company. It also has a sizeable inventory quota to be sold. Yet the segment's performance is highly subject to the local government's development plans and land market conditions. The revenue and gross profit margin of this segment have fluctuated greatly in recent years.

Coal Trading and Others

The coal trading business is mostly conducted in a "demand-driven" model, where it determines the amount of materials to be procured strictly based on the actual purchase orders placed by customers, mainly power plants. The company makes a profit from the spread between buying and selling prices (c. 1%-2%). FCUI's trading business has a high concentration of suppliers, mainly private-owned traders. Given that FCUI needs to prepay suppliers, the company faces a certain level of counterparty risk.

In addition, FCUI involves in sales of sand, grain and oil as well as other bulk commodities. 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**	**Sept. 2023**
Total Asset	8,443	31,527	33,261	38,331
Equity	5,756	26,869	26,812	31,327
Debt	2,627	3,216	4,075	5,505
Debt / (Debt + Equity) (%)	31.3	10.7	13.2	14.9
LT Debts	1,971	2,625	2,815	3,976
LT Debt / (LT Debt + Equity) (%)	25.5	8.9	9.5	11.3

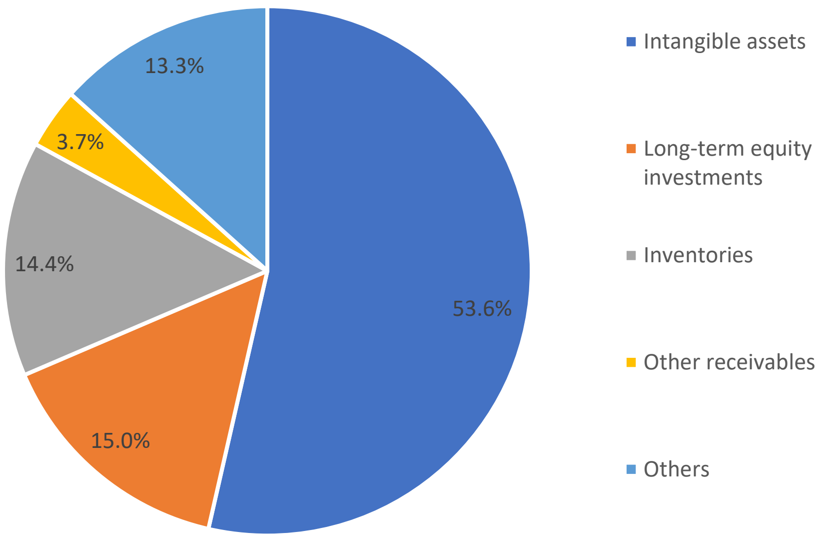
Source: The company's financial reports and Lianhe Global's calculations

FCUI's asset size grew rapidly to RMB38.3 billion at end-September 2023 from RMB8.4 billion at end-2020, largely attributed to a series of asset allocations and capital injections from the local government. Correspondently, the company's financial leverage, as measured by debt/capitalization, has maintained at a low level of 10-15% since 2021.

However, FCUI's asset quality was weak, as intangible assets, valued at RMB20.5 billion, accounted for more than 50% of the company's total asset at end-September 2023. The intangible assets mainly included income rights of river sand and rock resources allocated from the local government in 2021. Yet these assets only brought limited revenue and profit to the company in the past two years. In addition, long-term equity investment, amounting to RMB5.7 billion and representing 15.0% of the company's total asset, mainly consisted of the shares of Feicheng City Assets Management Group Co., Ltd., another major LIDC in Feicheng. Considering the business nature of LIDC, we believe these shares are lack of liquidity.

FCUI's active participation in Feicheng's project construction also accumulated sizeable inventories (mainly construction costs), which usually takes a long time to monetize due to the protracted construction and cash collection period. Moreover, the company had other receivables of RMB1.4 billion at end-September 2023, mainly due from government agencies in Feicheng. The collection schedule is subject to the local government's fiscal conditions.

Asset Breakdown
(Total assets: RMB38.3 billion at end-September 2023)



Source: The company and Lianhe Global's calculation

Debt Servicing Capability

FCUI's liquidity was relatively tight. At end-September 2023, the company had cash of RMB517 million (including restricted cash of RMB181 million), compared to debt due within one year of RMB1.5 billion. Nevertheless, FCUI has access to various financing channels, including bank borrowings, bond issuances, and other non-traditional financings, to support its debt repayments and business operations. At end-September 2023, the company had unused credit lines of RMB1.8 billion.

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