

Tengzhou Xinhua Investment 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 Tengzhou Xinhua Investment Group Co., Ltd. (“TZXH” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Tengzhou City (“Tengzhou government”) would provide strong support to TZXH if needed. This mainly considers the Tengzhou government’s majority ownership of TZXH, TZXH’s strategic importance as the most important local investment and development company (“LIDC”) responsible for affordable housing development and infrastructure construction in Tengzhou City (“Tengzhou”), and the strong linkage between the Tengzhou government and TZXH, including the appointment of senior management, strategic alignment, supervision of major investment and financing decisions and ongoing operational and financial support. In addition, the Tengzhou government may face significant negative impact on its reputation and financing activities if TZXH encounters any operational and financial difficulties.

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

Rating Rationale

Tengzhou Government’s Ownership and Supervision: The Tengzhou government holds 98.65% shares of TZXH via Tengzhou State-owned Assets Supervision and Administration Bureau (“Tengzhou SASAB”), and is the ultimate controller of TZXH. The Tengzhou 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 Tengzhou government formulates 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: As the most important LIDCs in Tengzhou, TZXH is mainly responsible for affordable housing development and infrastructure construction in Tengzhou. TZXH is mainly engaged in affordable housing construction, commodity property development and infrastructure construction services in Tengzhou. Its business operations and strategic planning have been aligned with the local government’s economic and social development policies.

Ongoing Government Support: The Tengzhou government provided strong ongoing support to TZXH. The Tengzhou government allocated equities of several LIDCs in the region to TZXH in the past few years. Between 2020 and the first half of 2023, the company received operational subsidies and funds amounting to RMB2.8 billion to support TZXH’s activities in relation to providing public goods. We expect TZXH to receive ongoing support from the Tengzhou government in the coming years considering its strategic importance in Tengzhou.

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	24 November 2023

Key Figures of Tengzhou and TZXH (RMB billion)

Tengzhou	2021	2022
GDP	85.8	90.1
GDP growth rate (%)	8.5	4.2
Budgetary revenue	6.1	6.4
Government fund	8.8	9.6
Transfer payment	3.3	3.9
Budgetary expenditure	8.0	10.4
TZXH	2021	2022
Asset	38.7	36.0
Equity	11.9	11.2
Revenue	5.7	4.9

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

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Applicable Criteria

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

TZXH's Financial and Liquidity Position: The total assets of TZXH increased moderately from RMB36,562 million at end-2020 to RMB37,524 million at end-June 2023, which was mainly due to the increase in inventory and cash. The total liabilities of TZXH increased to RMB26,138 million at end-June 2023 from RMB25,378 million at end-2020, and the financial leverage (total liabilities to assets) of TZXH stayed at c. 69.0% in the past few years. The total debts of the company increased to RMB10,194 million at end-June 2023 from RMB9,117 million at end-2020. The total debt capitalization ratio and long-term debt capitalization ratio increased slightly to 47.2% and 40.9% at end-June 2023, respectively.

The liquidity of TZXH was moderate. At end-June 2023, TZXH had cash on hand of RMB2.0 billion (including restricted cash of RMB652 million), compared to its non-current debts due within one year of RMB2,313 million. Moreover, the company also has sufficient access to financing channels, including bank borrowings, and bond issuances to satisfy its obligations. In addition, TZXH had unused bank credit line of RMB1.6 billion at end-June 2023.

Economy and Fiscal Condition of Tengzhou: Tengzhou is a county-level city directly under the jurisdiction of Shandong Province and managed by Zaozhuang City ("Zaozhuang") on behalf of Shandong Province. Tengzhou's GDP growth rate fluctuated in the past three years, which reached 1.0%, 8.5% and 4.2% in 2020, 2021 and 2022, respectively. The GDP of Tengzhou reached RMB90.1 billion in 2022, which was ranked 1st among all jurisdictions of Zaozhuang.

The aggregate fiscal revenue of the Tengzhou government is mainly derived from budgetary revenue and government fund income. The budgetary revenue increased modestly from RMB5.6 billion in 2020 to RMB6.4 billion in 2022. The fiscal self-sufficiency rate of the Tengzhou government was moderate but remained weak, and the budget deficit widened to 63.9% in 2022 from 39.4% in 2020. The Tengzhou government's total debts surged to RMB19.0 billion at end-2022 from RMB15.0 billion at end-2020. The fiscal debt ratio (total government debt outstanding/aggregate revenue) of the Tengzhou government increased from 84.3% to 95.3% over the same period.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Tengzhou

Tengzhou is a county-level city directly under the jurisdiction of Shandong Province and managed by Zaozhuang City ("Zaozhuang") on behalf of Shandong Province. Tengzhou lies in the northwest of Zaozhuang, with a total area of c. 1,495 square kilometers. Tengzhou is the hometown of the famous ancient Chinese philosopher, Mozi, and the originator of Chinese crafts, Luban. Moreover, Tengzhou is titled as one of the Top 100 National Counties (Cities), Top 100 Chinese Industrial Counties (Cities), etc. At end-2022, Tengzhou has

jurisdiction over 16 towns and 5 streets, and it has a residential population of c. 1.6 million, and an urbanization rate of 60.5%.

Tengzhou's GDP growth rate fluctuated in the past three years, which reached 1.0%, 8.5% and 4.2% in 2020, 2021 and 2022, respectively. The GDP of Tengzhou reached RMB90.1 billion in 2022, which was ranked 1st among all jurisdictions of Zaozhuang. The economy of Tengzhou was mainly supported by the secondary and tertiary industries in the past few years, which accounted for 43.6% and 46.2% in 2022, respectively. The GDP per capita of Tengzhou in 2022 was RMB57,652, which is higher than that of Zaozhuang (RMB53,243) but lower than that of China (RMB85,698).

Tengzhou's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	75.3	85.8	90.1
-Primary industry (%)	10.4	10.2	10.2
-Secondary industry (%)	45.0	45.5	43.6
-Tertiary industry (%)	44.6	44.3	46.2
GDP growth rate (%)	1.0	8.5	4.2
Fixed asset investment	61.8	69.4	76.4
Fixed asset investment growth rate (%)	5.2	12.2	10.1
Population (million)	1.6	1.6	1.6

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Tengzhou

The aggregate fiscal revenue of the Tengzhou government is mainly derived from budgetary revenue and government fund income. The budgetary revenue increased modestly from RMB5.6 billion in 2020 to RMB6.4 billion in 2022, and the tax revenue contributed about 76.0%-82.3% of the total budgetary revenue in 2020-2022. The fiscal self-sufficiency rate of the Tengzhou government was moderate but remained weak, and the budget deficit widened to 63.9% in 2022 from 39.4% in 2020. The government fund income, which is mainly derived from land use rights transfers, accounted for 47.9%-49.8% of the total fiscal revenue in 2020-2022, and recorded RMB9.6 billion in 2022.

The Tengzhou government's total debts surged to RMB19.0 billion at end-2022 from RMB15.0 billion at end-2020. The general obligation debt slightly declined to RMB5.6 billion at end-2022 from RMB5.7 billion at end-2020, while the special purpose debt increased to RMB13.4 billion at end-2022 from RMB9.2 billion at end-2020. The fiscal debt ratio (total government debt outstanding/aggregate revenue) of the Tengzhou government increased from 84.3% to 95.3% over the same period.

Tengzhou's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	5.6	6.1	6.4
Budgetary revenue growth rate (%)	-18.1	10.1	6.4
Tax revenue	4.3	5.0	4.8
Tax revenue (% of budgetary revenue)	77.7	82.3	76.0
Government fund income	8.8	8.8	9.6
Transfer payment	3.2	3.3	3.9
Aggregate revenue	17.7	18.3	20.0
Budgetary expenditure	7.8	8.0	10.4
Budget balance ¹ (%)	-39.4	-29.7	-63.9

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Full Government Ownership

TZXH was established in February 2019 with an initial registered capital of RMB50 million, funded by the Tengzhou SASAB. After an array of equity transfers, the company's paid-in capital reached RMB6.756 million at end-June 2023. Tengzhou SASAB is the controlling shareholder of the company with 98.65% of equity shares, and the remaining shares are controlled by Shandong Caixin Assets Operation Co., Ltd. at end-June 2023.

Strategic Importance and Government Linkage

Strategic Importance of TZXH to Tengzhou

As the most important LIDCs in Tengzhou, TZXH is mainly responsible for affordable housing development and infrastructure construction in Tengzhou. TZXH is mainly engaged in affordable housing construction, commodity property development and infrastructure construction services in Tengzhou. 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 Tengzhou government holds 98.65% shares of TZXH via Tengzhou SASAB and is the ultimate controller of TZXH. The Tengzhou 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 Tengzhou government has formulated a performance assessment policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

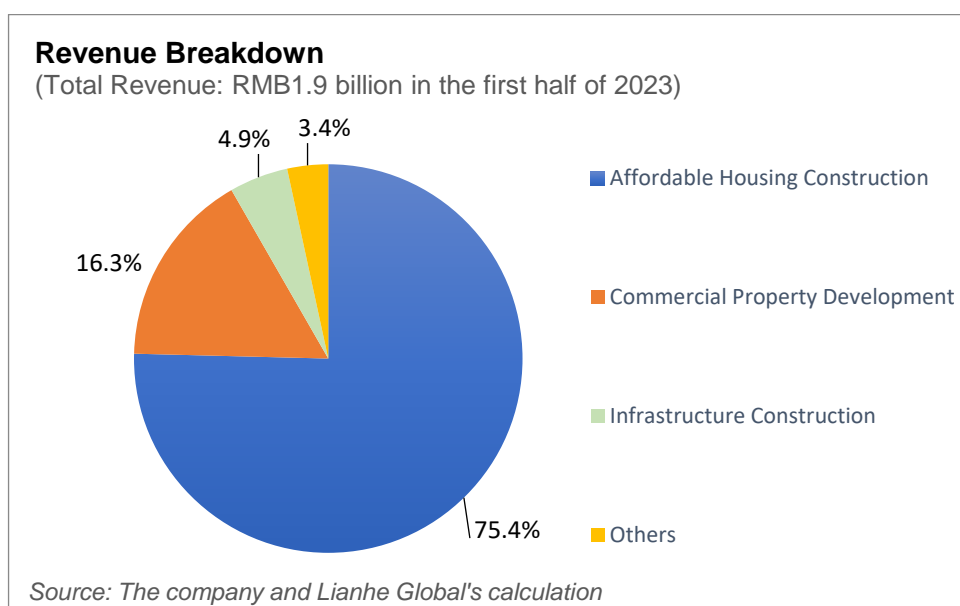
Ongoing Government Support

The Tengzhou government provided strong ongoing support to TZXH. The Tengzhou government allocated equities of several LIDCs in the region to TZXH in the past few years. Between 2020 and the first half of 2023, the company received operational subsidies and funds amounting to RMB2.8 billion to support TZXH's activities in relation to providing public goods. We expect TZXH to receive ongoing support from the local government in the coming years considering its strategic importance in Tengzhou.

Business Profile

The Key Entity Responsible for Affordable Housing Development and Infrastructure Construction in Tengzhou

TZXH is a key LIDC that operates in affordable housing construction, commercial property development, infrastructure construction and other businesses in Tengzhou. The total operating revenue of TZXH was RMB3,968.5 million, RMB5,734.7 million, RMB4,920.8 million and RMB1,944.3 million in 2020, 2021, 2022 and the first half of 2023, respectively.



Affordable Housing Construction

The affordable housing development business contributes the majority of the company's total revenue. The business is generally operated under two modes: self-operated and government repurchase. Under the self-operated mode, TZXH acquires land through a "tender, auction and listing" procedure and goes through the entire property development process. Under the government repurchase mode, TZXH signs contracts with the government, and is responsible for the land demolition, housing construction and supporting facilities building. The consideration will be paid to TZXH based on the cost plus a profit margin. The income derived from this segment was RMB2,826.5 million, RMB4,172.8 million, RMB3,189.2 million and RMB1,465.8 million in 2020, 2021, 2022 and the first half of 2023, respectively. The gross margin ranged between 6.3% and 14.3% over the same period.

Commercial Property Development

The commercial property development business acquires land through a "tender, auction and listing" procedure, formulates plans for real estate development, conducts land surveys, designs and carries out constructions, and finally sells commodity properties. The income derived from this segment was RMB906.6 million, RMB1,051.5 million, RMB1,136.0 million and RMB317.4 million in 2020, 2021, 2022 and the first half of 2023, respectively. The gross margin varied between 15.0% and 44.5% over the same period.

Infrastructure Construction

The infrastructure construction business is generally conducted under agent construction mode. The company signs contracts with the government and constructs projects. Following the delivery of projects, the revenue will be paid to TZXH annually based on the actual cost plus a profit margin. The income derived from this segment was RMB149.5 million, RMB336.8 million, RMB262.4 million and RMB95.4 million in 2020, 2021, 2022 and the first half of 2023, respectively. The gross margin changed between 10.1% and 15.1% over the same period.

Other Businesses

Apart from the businesses mentioned above, the company also participates in local finance services, state-owned assets operation and other businesses, whose revenue only accounts for a small part of the company's total revenue.

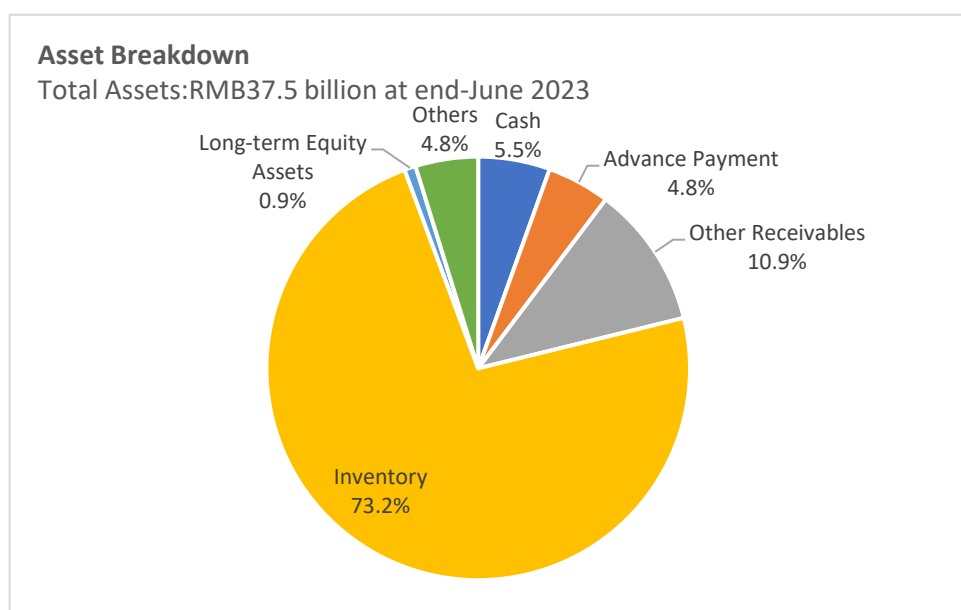
Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	June 2023
Total Asset	36,562	38,694	36,004	37,524
Equity	11,184	11,943	11,211	11,387
Debt	9,117	8,921	8,689	10,194
Debt / (Debt+Equity) (%)	44.9	42.8	43.7	47.2
LT Debt	7,048	6,194	5,353	7,881
LT Debt / (LT Debt+Equity) (%)	38.7	34.1	32.3	40.9

Source: TZXH's 2023 interim financial report, 2020-2022 audited annual reports and Lianhe Global's calculation

The total assets of TZXH increased moderately from RMB36,562 million at end-2020 to RMB37,524 million at end-June 2023, which was mainly due to the increase in inventory and cash. The total liabilities of TZXH increased to RMB26,138 million at end-June 2023 from RMB25,378 million at end-2020, and the financial leverage (total liabilities to assets) of TZXH stayed at c. 69.0% in the past few years. The total debts of the company increased to RMB10,194 million at end-June 2023 from RMB9,117 million at end-2020. The total debt capitalization ratio and long-term debt capitalization ratio increased slightly to 47.2% and 40.9% at end-June 2023, respectively.



Source: The company and Lianhe Global's calculation

The current assets accounted for c. 96.6% of the company's total assets at end-June 2023, which mainly consisted of cash, other receivables and inventories. The liquidity of the



company's assets was relatively weak, as over 75% of the current assets were inventories. The non-current assets of TZXH were RMB1,264 million at end-June 2023, which mainly consisted of long-term equity assets, debt investment and other non-current assets.

Debt Servicing Capability

The liquidity of TZXH was moderate. At end-June 2023, TZXH had cash on hand of RMB2.0 billion (including restricted cash of RMB652 million), compared to its non-current debts due within one year of RMB2,313 million. Moreover, the company also has sufficient access to financing channels, including bank borrowings, and bond issuances to satisfy its obligations. In addition, TZXH had unused bank credit line of RMB1.6 billion at end-June 2023.

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