

Henan Zhongyu Credit Promotion Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	A+
Outlook	Stable
Location	China
Industry	NBFI
Date	4 January 2024

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘A+’ global scale Long-term Issuer Credit Rating to Henan Zhongyu Credit Promotion Co., Ltd. (“HZCP”); Outlook is Stable

Summary

The Issuer Rating reflects HZCP’s strong franchise and market position as the sole credit enhancement company in Henan Province (“Henan”) as well as its strong capital base for future business growth. The rating also considers its concentrated business profile, diversified revenue resources, increasing profitability and low debt burden. Besides, the People’s Government of Henan Province (“Henan government”) would provide strong support to HZCP if needed, in light of its majority ownership of HZCP, HZCP’s strategic importance as the sole provincial credit enhancement company in Henan, the linkage between the Henan government and HZCP and ongoing financial and policy support. In addition, the Henan government may face significant negative impact on its reputation and financing activities if HZCP encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that HZCP will maintain its monopoly market position in Henan’s credit enhancement market and an adequate funding and liquidity position which is commensurate with its credit profile.

Rating Rationale

The Sole Credit Enhancement Company in Henan with Monopoly Market Position and Pivotal Strategic Role: HZCP, as the only provincial-level credit enhancement company in Henan, has its operations centered in Henan. It primarily focuses on credit enhancement and investment activities, holding a certain level of importance within the financial system of Henan Province. The company has a monopoly position in the credit enhancement field in Henan, providing it with significant advantages in business operations. Additionally, the company plays a crucial and irreplaceable role in expanding financing channels, facilitating the financing needs of local enterprises, and boosting the financing activities in the bond market in Henan.

Rapid Business Growth with Substantial Capacity and Minimal Claim History, but High Concentration: As of end-September 2023, the company’s credit enhancement business balance significantly increased to RMB13.7 billion from RMB1.7 billion at end-2022, most of which were provided to local investment and development companies (“LIDC”) in Henan. The outstanding guarantees to capital ratio remained low at 1.12x, indicating substantial potential for future business expansion. Having said that, HZCP currently operates with a relatively small scale, accompanied by a modest provision for credit enhancement reserves. It has not encountered any instances of compensation, likely attributed to its short operating history. All credit enhancement operations have been conducted exclusively within Henan, indicating a high regional concentration. As of end-September 2023, the combined credit enhancement balance of the top five customers was RMB3.1 billion, accounting for 22.6% of the total balance, demonstrating a moderate level of borrower concentration.

Prudent Risk Management: HZCP is enhancing its risk management framework, focusing on industry and client selection, diverse business channels, and personalized risk mitigation

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Applicable Criteria

Non-Bank Financial Institutions
Criteria (21 November 2023)



measures. It prioritizes municipal-level LIDCs in Henan, with additional attention to high-quality district-level LIDCs in industry and client selection. Tailored risk mitigation measures are implemented based on borrower types. For core municipal LIDCs, counter-guarantee measures may be relaxed, whereas district-level LIDCs might need to provide extra collateral, such as land, real estate, receivables, and stocks. The credit products are mainly comprised of corporate bonds (37.5%), medium-term notes (23.3%), and certificate of deposit secured loans (27.9%), with other products accounting for around 10%, as of end-September 2023.

Increasing Profitability on Expanding Business Scale: With significant growth in the credit enhancement business in the first nine months of 2023, HZCP achieved a total profit of RMB256.5 million, with annualized average return on asset (“ROA”) of 3.20% (2022: 2.23%). Given the moderately low guarantee exposures, the future holds substantial potential for business growth and an increase in profitability, especially considering the company's unique position as the exclusive credit enhancement entity in Henan. Besides, the company's venture into investment activities and entrusted loan business would further enhance profitability.

Strong Capital Base and Low Leverage: HZCP's equity capital rose to RMB12.1 billion (RMB4.1 billion at end-June 2023) and shareholders increased to 19 from 6 following the introduction of strategic investors in September 2023 (including 14 core LIDCs in Henan and provincial financial institutions) injecting RMB8 billion of new capital. As in the early development stage, HZCP had a relatively small debt scale of RMB573 million (all short-term) at end-September 2023.

Strong External Support from Henan Government: We expect HZCP is likely to receive strong support from the Henan government if needed. The Henan Provincial State-owned Assets Supervision and Administration Commission (“Henan SASAC”) holds the majority of HZCP's shares via Central Plains Yuzi Investment Holding Group Co., Ltd. (“Yuzi Group”), a local investment and development company acting as the sole provincial-level investment and financing entity for urbanization and affordable housing construction in Henan. Henan SASAC is the actual controller of the company and the Henan government has the final decision-making authority and supervises the company on a regular basis. As the sole credit enhancement entity in Henan, HZCP benefits from ongoing support in capital and business expansion from the Henan government. With its expanding operations, HZCP's significance in maintaining economic and financial stability in Henan is anticipated to grow. In addition, the Henan government may face significant negative impact on its reputation and financing activities if HZCP encounters any operational and financial difficulties.

Rating Sensitivities

We would consider downgrading HZCP's rating if there is 1) significant deterioration in its credit profile, such as notably weakened capital adequacy, significant increase in compensation rate, and weakened funding structure etc., or 2) there is perceived weakening in support from the Henan government, particularly due to its reduced strategic importance with diminished government functions, or (3) there is a downgrade in our internal credit assessment on the Henan government.

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

Company Profile

HZCP was established on February 8, 2022, with Henan Yuzi Urban and Rural Integration Construction and Development Group Co., Ltd. [河南省豫资城乡一体化建设发展集团有限公司] (“Yuzi Integration”) as the initiator and controlling shareholder. The initial registered capital was RMB4 billion. In July 2022, Yuzi Integration transferred its holdings in the company, amounting to RMB500 million, RMB500 million, RMB400 million, RMB200 million, and RMB300 million, respectively, to Henan Province Enterprise Credit Insurance Fund, Henan Zhongyu Asset Management Co., Ltd., China Pingmei Shenma Energy and Chemical Group Co., Ltd., Luoyang Heluo New Industry Investment Development Co., Ltd., and Henan Asset Management Co., respectively.

In September 2023, HZCP received a capital injection of RMB8 billion, increasing the paid-up capital to RMB12 billion. The number of shareholders increased from 6 to 19, with the new shareholders mainly consisting of 14 local LIDCs in various cities in Henan. Yuzi Integration, as a wholly-owned subsidiary of Yuzi Group, is the controlling shareholder of the company. Yuzi Group is a wholly state-owned enterprise under the Henan SASAC, making the Henan SASAC the actual controller of the company.

Exhibit 1: HZCP’s Shareholding Structure

Shareholder	Capital Contribution (RMB billion)	Stake
河南省豫资城乡一体化建设发展集团有限公司	2.1	17.5
河南省企信保基金（有限合伙）	1.5	12.5
中国平煤神马控股集团有限公司	0.996	8.3
商丘企信保信用管理有限公司	0.65	5.4167
开封市企信保投资合伙企业（有限合伙）	0.65	5.4167
河南中豫资产管理有限公司	0.5	4.1668
漯河投资控股集团有限公司	0.49	4.0833
周口市城建投资发展有限公司	0.49	4.0833
平顶山市融城发展投资集团有限公司	0.49	4.0833
信阳申信发展投资集团有限公司	0.49	4.0833
平顶山发展投资控股集团有限公司	0.49	4.0833
许昌市城投发展集团有限公司	0.49	4.0833
南阳投资集团有限公司	0.49	4.0833
焦作城市发展投资（控股）集团有限公司	0.49	4.0833
鹤壁投资集团有限公司	0.49	4.0833
濮阳投资集团有限公司	0.394	3.2834
安阳投资集团有限公司	0.3	2.5
济源投资集团有限公司	0.3	2.5
洛阳市河洛新业投资发展有限公司	0.2	1.6667
Total	12.0	100.0

Source: HZCP and Lianhe Global’s calculations

Business Profile

The Sole Credit Enhancement Company in Henan with a Monopoly Market Position and Pivotal Strategic Role

HZCP is the first credit enhancement institution guided by the People’s Bank of China, the China Foreign Exchange Trading System, and the local financial regulatory authority.



Established with a mission to implement major strategic initiatives of the provincial government. HZCP, as the only provincial-level credit enhancement company in Henan, has its operations centered in Henan. It primarily focuses on credit enhancement and investment activities, holding a certain level of importance within the financial system of Henan Province. The company holds a monopoly position in the credit enhancement field in Henan, providing it with significant advantages in business operations. Additionally, the company possesses strategic importance as it plays a crucial and irreplaceable role in optimizing the financial environment of Henan, expanding financing channels and enhancing the direct financing capabilities for local enterprises, and boosting the financing activities in the bond market.

The company operates in the field of credit enhancement, investment, and entrusted loans, focusing on Henan while planning to extend its services nationwide. Its target clients include municipal and national-level LIDCs, high-quality state-owned enterprises, and leading private enterprises. While currently focusing on traditional credit enhancement and lending activities, the company is exploring innovative credit enhancement services.

Rapid Business Growth with Substantial Capacity and Minimal Claim History, but High Concentration

In 2022, being a newly established entity, the company conducted only four credit enhancement transactions with a total transaction amount of RMB1.7 billion, mainly comprising medium-term notes. In the first nine months of 2023, the company expanded its credit enhancement business, adding 53 new transactions totalling RMB13.6 billion. With vigorous efforts in credit enhancement, the balance of credit enhancement business surged by 705.9% to RMB13.7 billion at end-September 2023 compared to that of end-2022.

HZCP's credit enhancement business primarily originates from recommendations by financial institutions such as banks and securities companies, along with its own initiatives. As of end-September 2023, the outstanding guarantees to capital ratio remained low at 1.12x, indicating significant potential for future expansion. The company has not experienced any compensation events, although its provisions to outstanding guarantees was low at less than 0.1% at end-September-2023.

Geographically, all credit enhancement operations have been concentrated in Henan since the inception. The largest single customer represented 4.7% of outstanding guarantees while the top five customers accounted for 22.6% at end-September 2023, reflecting moderate customer concentration. Regarding the industry distributions, civil engineering and construction had the highest share of 25.7%, with other industries not exceeding 20% each.

Prudent Risk Management

HZCP continues to enhance its risk management framework, focusing on industry and client selection, diverse business channels, and personalized risk mitigation measures. It prioritizes municipal-level LIDCs in Henan, with additional attention to high-quality district-level LIDCs in industry and client selection. Tailored risk mitigation measures are implemented based on client types. For core municipal LIDCs, counter-guarantee measures may be relaxed, whereas district-level LIDCs might need to provide extra collateral. The company accepts various collaterals, including land, real estate, liquid receivables, stocks, and high-quality equity.

In terms of business process control, the company's credit enhancement operations follow key procedures, including business acceptance, project investigation, project review and evaluation, long-term credit rating reports, project implementation, and project tracking management. The primary risk management stages include on-site investigations, scrutiny of enterprise and financial data, interviews, field inspections, and analysis. The project review process involves



initiation by the business manager, co-signing by relevant departments, risk assessment by the risk control department, and financial examination by the finance department if needed.

HZCP maintains solid asset quality, with a history of low claims, a streamlined product structure, and a high-caliber client base. As of end-September 2023, the company's credit enhancement business remains default-free, reflecting a zero-compensation rate and showcasing robust compensation capabilities. The credit products are mainly comprised of corporate bonds (37.5%), medium-term notes (23.3%), and certificate of deposit secured loans (27.9%), with other products accounting for around 10%, as of end-September 2023.

Entrusted Loan and Investment Activities Serve as Supplementary sources of Revenue to Complement the Core Business Income

HZCP also engages in entrusted loan business with the focus on alleviating short-term debt pressures for enterprises in Henan, addressing temporary financial difficulties, and providing short-term financial support by directing funds to repay their maturing bonds and settle interest-bearing liabilities.

The company's entrusted loan balances witnessed significant growth, increasing to RMB6.2 billion at end-September 2023. Entrusted loan transactions typically have short durations, mainly ranging from 3 to 6 months, with only a small portion extending beyond one year. Risk mitigation measures primarily involve guarantees and pledges.

HZCP is in the early development stage in its investment activities. The investment scale is modest, with a limited variety of investment instruments. The investment operations, funded with the company's own capital, support the continuous expansion of credit enhancement services. The investments are primarily bonds and stocks.

Financial Profile

Increasing Profitability on Expanding Business Scale

HZCP generated a profit of RMB133.0 million in 2022, with an ROA and ROE of 2.2% and 2.3%, respectively. It marked significant growth in the credit enhancement business balance in the first nine months of 2023, resulting in a total profit of RMB210.6 million. The annualized ROA and ROE improved to 3.2% and 3.4%, respectively.

The advantageous position of HZCP, stemmed from its strong market foothold in Henan, is anticipated to contribute to a favourable and stable profitability trajectory in the future. Besides, as the sole credit enhancement entity in Henan, the company enjoys a distinct advantage in securing key projects. The Henan government is also committed to consistently introducing relevant policies to ensure the stable operation and profitability of the company. Besides, the venture into investment activities and entrusted loan business is expected to further boost HZCP's profitability.

Strong Capital Base and Low Leverage

The company possesses ample capital, providing robust support for the development of its credit enhancement business and offering significant room for business expansion. The introduction of strategic investors, including 14 core LIDCs in Henan and provincial financial institutions, bolstered the company's core capital to RMB12.2 billion as of end-September 2023, facilitated by a RMB8 billion capital injection. Its shareholder base also increased from 6 to 19.

Besides, the undistributed profits of HZCP increased to RMB177.4 million at end-September 2023 from RMB73.8 million at the end-2022.

HZCP faces risks related to credit enhancement project defaults and potential investment losses. As of end-September 2023, the company's total assets amounted to RMB13.0 billion. Entrusted loans accounted for 48.0% of total assets, with cash holdings at 41.7%. Early in its establishment, HZCP had a relatively small debt scale. As of end-September 2023, the company's short-term debt was RMB573 million, indicating sufficient liquidity with no long-term debt. In addition, the company has established good relationships with major banks. As of the end-June 2023, the company had credit lines totalling RMB18.4 billion, with an unused credit limit of RMB18.1 billion.

Exhibit 2: HZCP's Key Financial Metrics

RMB million	2022	9M2023
Total Assets	4,135.2	12,975.6
Total Equity	4,092.3	12,249.3
Net Profit	92.3	210.6
Return on Average Assets (% , annualised)	2.2	3.2
Return on Average Equity (% , annualised)	2.3	3.4
Credit Guarantees Balance	1,700.0	13,706.0
Outstanding Guarantees to Capital (x)	0.4	1.1
Risk Reserves to Outstanding Guarantees (x)	0.6	0.3
Compensation rate on guarantees (%)	0	0
Loan Impairment Charges to Average Gross Loans (x)	0	0
Debt to Capitalization Ratio (%)	0	4.5
Short-term Debt to Total Debt (%)	0	100.0
Common equity to total assets (tangible) (%)	99.0	94.4

Source: HZCP and Lianhe Global's calculations

External Support

Strong External Support from the Henan Government

Government's Ownership and Support

The Henan government has the majority ownership of HZCP via the Henan SASAC's fully owned LIDC, Yuzi Integration, which is appointed by the local government to supervise state-owned enterprises. The Henan government is the actual controller of the company and supervises the company. In addition, the Henan SASAC supervises HZCP on a periodical basis and has an assessment mechanism over the performance and senior management of the company. The Henan government exhibits a strong capability and willingness to support the company when necessary. In addition, the Henan government may face significant negative impact on its reputation and financing activities if HZCP encounters any operational and financial difficulties.

Government Function



As the sole credit enhancement institution in Henan, HZCP serves as a crucial complement to the provincial state-owned capital operation companies, exhibiting strong quasi-financial attributes in its operations. HZCP plays a dual role in Henan, it provides credit enhancement services for the issuance of bonds by enterprises within the province. It also utilizes its own funds to engage in transactions in the secondary bond market, effectively maintaining the valuation of outstanding bonds in Henan and correcting any mispricing situations. Besides, HZCP innovates in bond market products and systems based on actual needs, fostering the construction of the province's credit risk dispersion and sharing mechanism while introducing innovative credit enhancement service products.

Economic and Fiscal Condition of Henan

Henan is a province located in central China and serves as a pivotal region for the sequential development of the Chinese economy from east to west. The Central Plains Economic Zone, with Henan as its core, plays a crucial role as a significant block for economic growth in China. The GDP of Henan grew by 3.1% year-on-year to RMB6,134.5 billion in 2022, which was ranked 5th among all provinces in China in terms of GDP. The Henan provincial government's budgetary revenue decreased to RMB426.2 billion in 2022 from RMB435.4 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. Henan provincial government's financial self-sufficiency rate was low, and its budget deficit widened to -149.8% in 2022 due to lower budgetary revenue and larger budgetary expenditure on supporting social initiatives. The outstanding amount of the Henan provincial government's debt surged to RMB1,510.4 billion at end-2022, representing a year-over-year growth rate of 21.9%. The debt ratio (total government debt/aggregate revenue) climbed to 122.9% in 2022 from 95.1% in 2021, mainly due to the increase in special debt to support project developments in Henan.



Appendix I: HZCP's Rating Factors

Key Factors	Weight	Initial Rating
I. Operating Environment	15.00%	bbb+
II. Business Analysis	25.0%	a-
III. Governance and Management	5.0%	a-
IV. Risk Management and Exposures	20.0%	bbb+
V. Financial Profile	35.0%	a-
Stand-Alone Creditworthiness	100.0%	a-
VI. External Support		Very Strong
Issuer Credit Rating		A+

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