

Yantai Zhengyuan Investment Holding Group Co., Ltd

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	16 April 2024

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

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Laishan District (“Laishan government”) would provide very strong support to YZIHG if needed, in light of its full ownership of YZIHG, YZIHG’s strategic importance as the most important local investment and development company (“LIDC”) that is responsible for infrastructure construction and state-owned asset operation in Laishan, and the linkage between the Laishan government and YZIHG, including appointment of the senior management, strategic alignment, supervision of major investment and financing plan decisions and ongoing operational and financial support. In addition, the Laishan government may face significant negative impact on its reputation and financing activities if YZIHG encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Laishan government is the sole shareholder of the company via the Laishan District State-owned Assets Supervision and Administration Bureau (“Laishan SASAB”), and is the actual controller of the company. The Laishan government has the final decision-making authority and supervision over the company, including appointment and supervision of the senior management, strategy alignment and major investment and financing plan decisions, etc. In addition, the Laishan government has formulated a performance assessment mechanism for the company and appoints auditors to review the company’s operating performance and financial position.

Strategic Importance to Laishan and Strategic Alignment: YZIHG is the most important LIDC in Laishan that is responsible for infrastructure construction and state-owned asset operation within the region. YZIHG is engaged in the construction of a wide range of infrastructure projects in Laishan, including roads, industrial parks and other public facilities, etc. The company is also engaged in commodity sales, property sales, engineering construction, leasing, property services, senior care services and consulting services, etc. It 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: YZIHG continued to receive financial subsidies and asset/capital injections from the local government to support its business operations. We believe the government support will remain intact given the company’s strategic importance in Laishan. Between 2021 and 2023, the local government injected cash capital of RMB843.5 million into YZIHG, enlarging its paid-in capital to RMB1.0 billion at end-2023 from RMB0.2 billion at end-2021. During the same period, YZIHG received financial subsidies totaling around RMB137.3 million from the local government. Meanwhile, the

Key Figures of Laishan and YZIHG (RMB billion)

	2022	2023
Laishan		
GDP	46.4	51.4
GDP growth rate (%)	5.9	6.1
Budgetary revenue	4.3	5.0
Government fund	0.2	0.4
Transfer payment	2.1	2.4
Budgetary expenditure	3.7	3.9
YZIHG	2022	2023
Assets	21.5	23.6
Equity	15.8	16.0
Revenue	0.7	1.2

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

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Applicable Criteria

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

company received asset injections from the local government in the form of cash, buildings, lands, properties, equity transfers and other assets, which reached about RMB1.0 billion.

YZIHG's Financial and Liquidity Position: YZIHG's total asset size grew moderately to RMB23.6 billion at end-2023 from RMB20.2 billion at end-2021, which was largely attributed to the increase of inventory. The company's financial leverage, as measured by debt/capitalization, rose to 26.4% at end-2023, compared with 14.0% at end-2021. YZIHG's long-term debt represented 37.1% of its total debt at end-2023, compared with 46.9% at end-2021, which implied an increase of the proportion of the short-term debt to the total debt at end-2023.

YZIHG's short-term debt servicing pressure is manageable. At end-2023, YZIHG had a cash of RMB1.3 billion (including restricted cash of RMB0.3 billion), together with the unused credit facilities of RMB6.0 billion, compared with its debt due within one year of RMB3.6 billion. In addition, YZIHG has access to various financing channels to support its debt repayment and business operations.

Economy and Fiscal Condition of Laishan: Laishan is a district of Yantai City ("Yantai"), Shandong Province, and it is located in the main city center of Yantai. Laishan maintained steady economic growth in recent years, with the GDP growth of 5.9% and 6.1% in 2022 and 2023, respectively. Laishan's GDP amount was ranked 8th in Yantai in 2023 (out of a total 13 districts/counties). GDP per capita of Laishan was RMB131,240 in 2023, which was higher than the GDP per capita of China (RMB89,358) but lower than that of Yantai (RMB143,964).

The aggregate fiscal revenue of the Laishan government was mainly derived from the budgetary revenue and transfer payment. Laishan's budgetary revenue increased by 17.7% year-on-year to RMB5.0 billion in 2023. The contribution of the tax revenue declined to 65.2% in 2023 from 84.5% in 2021, mainly due to the tax benefit policies. The fiscal self-sufficiency rate of the Laishan government was high. It achieved budget surplus in recent years, which reached 21.4%, 11.9% and 21.1% in 2021, 2022 and 2023, respectively. Given the Laishan government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 145.9% at end-2023 from 115.5% at end-2021.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Laishan

Laishan is a district of Yantai, Shandong Province, and it is located in the main city center of Yantai, bordering the Yellow Sea in the northeast. Laishan is an important transportation hub of Yantai, connecting more than 100 ports with international and domestic cities. Laishan has jurisdiction over 6 streets, 1 provincial-level economic development zone, 1

provincial-level tourist resort and 1 provincial-level nature reserve, with a total land area of 285.4 square kilometers. Laishan had a residential population of 0.4 million with an urbanization rate of 85.9% at end-2022.

Laishan maintained steady economic growth in recent years. Its GDP reached RMB51.4 billion in 2023, representing a year-on-year growth rate of 6.1%, up from 5.9% in 2022. Laishan's GDP amount was ranked 8th in Yantai in 2023 (out of a total 13 districts/counties). The economic structure of Laishan was stable, and it was mainly fueled by the secondary and tertiary industries, which accounted for 35.5% and 63.7% of its GDP in 2023, respectively. GDP per capita of Laishan was RMB131,240 in 2023, which was higher than the GDP per capita of China (RMB89,358) but lower than that of Yantai (RMB143,964). In view of the decline in real estate investment, Laishan recorded a significant decline of 19.7% year-on-year in fixed asset investment in 2023.

Laishan's GDP and Fixed Asset Investment			
(RMB billion)	2021	2022	2023
GDP	42.1	46.4	51.4
-Primary industry (%)	0.9	0.9	0.8
-Secondary industry (%)	34.5	35.0	35.5
-Tertiary industry (%)	64.6	64.1	63.7
GDP growth rate (%)	9.0	5.9	6.1
Fixed asset investment	32.3	35.5	28.5
Fixed asset investment growth rate (%)	10.8	10.0	-19.7
Population (million)	0.4	0.4	*0.4
<i>*Estimated data</i>			
<i>Source: Public information and Lianhe Global's calculations</i>			

Fiscal Condition of Laishan

The aggregate fiscal revenue of the Laishan government was mainly derived from the budgetary revenue and transfer payment. Laishan's budgetary revenue increased by 17.7% year-on-year to RMB5.0 billion in 2023. The contribution of the tax revenue declined to 65.2% in 2023 from 84.5% in 2021, mainly due to the tax benefit policies. On the other hand, the budgetary expenditure remained stable and reached RMB3.9 billion in 2023. The fiscal self-sufficiency rate of the Laishan government was high. It achieved budget surplus in recent years, which reached 21.4%, 11.9% and 21.1% in 2021, 2022 and 2023, respectively.

The Laishan government received a certain number of subsidies from higher government continuously, thus the transfer payment reached RMB2.4 billion in 2023. In addition, Laishan's government fund income dropped significantly to RMB0.2 billion in 2022 from RMB0.7 billion in 2021, but rebounded to RMB0.4 billion in 2023. It was mainly due to the volatility of land use right transfer income amid challenging property market conditions.

The outstanding debt of the Laishan government continued to grow. At end-2023, the Laishan government's outstanding debt was RMB11.4 billion, including RMB5.8 billion of general obligations and RMB5.7 billion of special debt. Given the Laishan government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 145.9% at end-2023 from 115.5% at end-2021.

Laishan's Fiscal Condition			
(RMB billion)	2021	2022	2023
Budgetary revenue	4.2	4.3	5.0
Budgetary revenue growth rate (%)	12.0	0.7	17.7

Tax revenue	3.6	3.0	3.3
Tax revenue (% of budgetary revenue)	84.5	70.4	65.2
Government fund income	0.7	0.2	0.4
Transfer payment	2.9	2.1	2.4
Aggregate revenue	7.9	6.5	7.8
Budgetary expenditure	3.3	3.7	3.9
Budget balance ¹ (%)	21.4	11.9	21.1

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

YZIHG was established by the Laishan SASAB in September 2017, with a registered capital of RMB0.2 billion. After a series of capital injections, YZIHG's registered and paid-in capital reached RMB3.0 billion and RMB1.0 billion at end-2023, respectively. The Laishan SASAB is the sole shareholder and actual controller of the company.

Strategic Importance and Government Linkage

Strategic Importance of YZIHG to Laishan

YZIHG is the most important LIDC in Laishan that is responsible for infrastructure construction and state-owned asset operation within the region. YZIHG is engaged in the construction of a wide range of infrastructure projects in Laishan, including roads, industrial parks and other public facilities, etc. The company is also engaged in commodity sales, property sales, engineering construction, leasing, property services, senior care services and consulting services, etc. It 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

YZIHG's linkage with the local government is strong as the Laishan government is the sole shareholder of the company via the Laishan SASAB, and is the actual controller of the company. The Laishan government has the final decision-making authority and supervision over the company, including appointment and supervision of the senior management, strategy alignment and major investment and financing plan decisions, etc. In addition, the Laishan government has formulated a performance assessment mechanism for the company and appoints auditors to review the company's operating performance and financial position.

Government Support

YZIHG continued to receive financial subsidies and asset/capital injections from the local government to support its business operations. We believe the government support will remain intact given the company's strategic importance in Laishan. Between 2021 and 2023, the local government injected cash capital of RMB843.5 million into YZIHG, enlarging its paid-in capital to RMB1.0 billion at end-2023 from RMB0.2 billion at end-2021. During the same period, YZIHG received financial subsidies totaling around RMB137.3 million from the local government. Meanwhile, the company received asset injections from the local

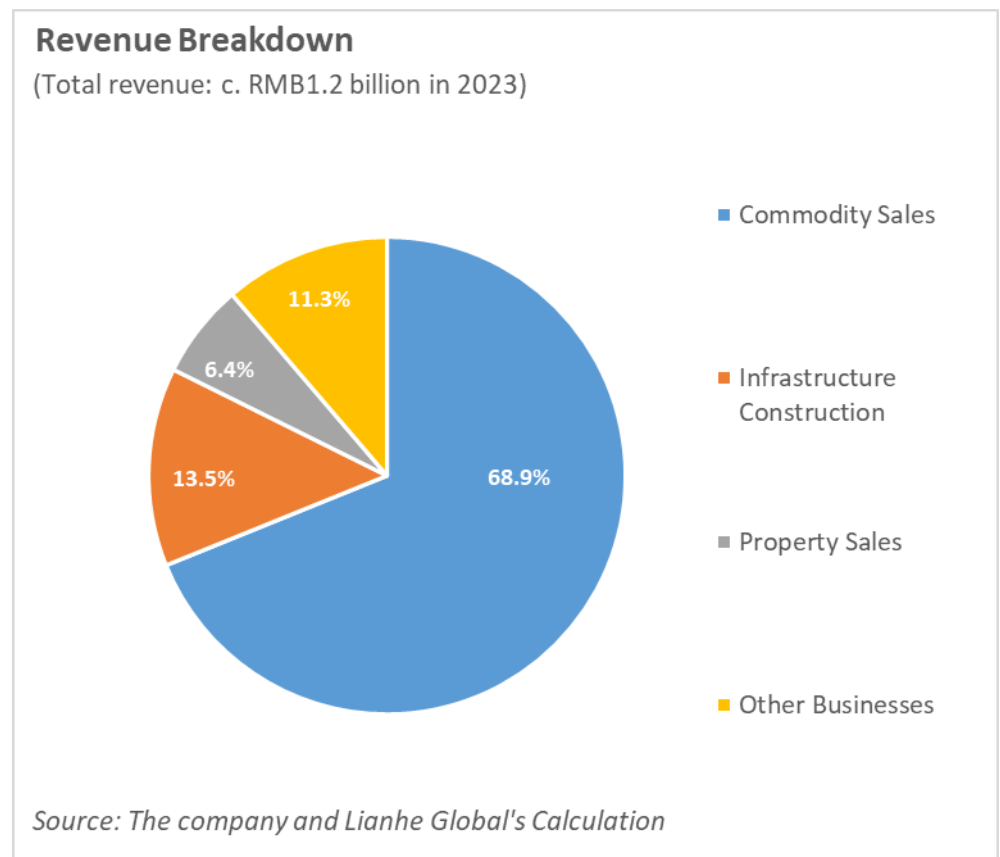
government in the form of cash, buildings, lands, properties, equity transfers and other assets, which reached about RMB1.0 billion.

Business Profile

The Most Important Entity Responsible for Infrastructure Construction and State-owned Asset Operation in Laishan

YZIHG is the most important LIDC in Laishan that is responsible for infrastructure construction and state-owned asset operation within the region. The primary sources of operating revenue for YZIHG are infrastructure construction, commodity sales and property sales. The company is also engaged in engineering construction, leasing, property services, senior care services and consulting services, etc.

The company's total revenue had an upward trend, which reached RMB0.7 billion, RMB0.7 billion and RMB1.2 billion in 2021, 2022 and 2023, respectively. The overall gross profit margin of YZIHG fluctuated between 9% and 20% over the same period.



Infrastructure Construction

YZIHG is engaged in the construction of a wide range of infrastructure projects in Laishan, including roads, industrial parks and other public facilities. The company signed agreements with entrusting parties and is responsible for fundraising and construction of the entrusted projects. The company used to settle construction costs plus management fees annually with the entrusting parties in accordance with the construction progress of the projects. As the company is participating in more self-operated projects by now, the segment revenue

decreased significantly in 2023. The segment gross profit margin was stable at c. 12% in recent years.

Commodity Sales

YZIHG takes part in more market-oriented activities by expanding its business to commodity sales. The company is involved in the trading of chemical materials and engineering materials. YZIHG is going to involve in the trading of timber as well in the future. The revenue generated from this segment increased significantly in 2023, but the segment gross profit margin was low compared with other segments.

Property Sales

YZIHG is mainly selling inventories of the 3 completed office building projects for this segment. Given the declining inventory volume, the recognized property sales value from office buildings may drop going forward. Nevertheless, the company is scheduled to sell affordable housing projects, which may boost the segment revenue.

Other Businesses

Other businesses of YZIHG include engineering construction, leasing, property services, senior care services and consulting services, etc., with each segment accounted for a small proportion of the company's total revenue. Other businesses mainly play the role of supplementing the revenue of the main business and further diversify YZIHG's revenue structure.

Financial Profile

Balance Sheet Structure and Quality

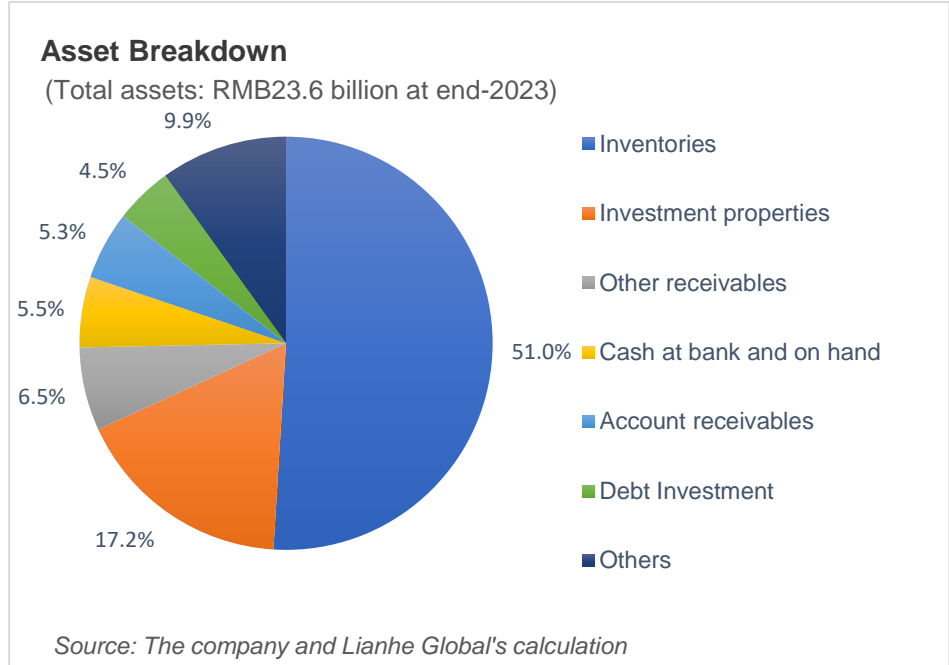
Balance Sheet Structure and Quality			
(RMB million)	2021	2022	2023
Total Asset	20,164	21,546	23,572
Equity	15,276	15,779	16,008
Debt	2,493	3,959	5,733
Debt / (Debt + Equity) (%)	14.0	20.1	26.4
LT Debts	1,169	1,351	2,127
LT Debt / (LT Debt + Equity) (%)	7.1	7.9	11.7

Source: Company information and Lianhe Global's calculations

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At end-2023, the company's assets were mainly comprised of inventories, investment properties and other account receivables, which added up to RMB17.6 billion and represented 75% of the company's total asset. The company's project construction activities accumulated sizeable inventories (mainly lands and construction costs), investment properties, fixed asset and construction in progress, with a total of RMB16.6 billion and represented 71% of total asset at end-2023. These assets usually take a long time to

monetize due to the protracted construction and payment collection period. In addition, the company had a large number of other account receivables, primarily due from government agencies, representing 6.5% of total asset at end-2023. Their repayment schedules are highly subject to the fiscal conditions of the local government.



Debt Servicing Capability

YZIHG's short-term debt servicing pressure is manageable. At end-2023, YZIHG had a cash of RMB1.3 billion (including restricted cash of RMB0.3 billion), together with the unused credit facilities of RMB6.0 billion, compared with its debt due within one year of RMB3.6 billion. In addition, YZIHG has access to various financing channels to support its debt repayment and business operations.



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