CCXAP assigns first time long-term credit rating of BBB_g to Huizhou Zhongkai City Development Group Co., Ltd., with stable outlook.

Hong Kong, 16 May 2023 – China Chengxin (Asia Pacific) Credit Ratings Company Limited ("CCXAP") has assigned first time long-term credit rating of BBB_g to Huizhou Zhongkai City Development Group Co., Ltd. ("HZCD" or the "Company"), with stable outlook.

The BBB_g long-term credit rating of HZCD reflects (1) Huizhou Zhongkai High-tech Industrial Development Zone ("Zhongkai HTZ") Government's relatively strong capacity to provide support; and (2) the local government's extremely high willingness to provide support, based on our assessment of the Company's characteristics. Our assessment of Zhongkai HTZ Government's capacity to provide support reflects Zhongkai HTZ's continued growth in economic and fiscal strength, with good fiscal balance.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) strong market position as the sole investment and financing entity in Zhongkai HTZ, after consolidating local state-owned assets and resources; (2) dominant role in undertaking local public activities with high sustainability; and (3) track record of receiving government payments. However, the rating is constrained by the Company's (1) high exposure to commercial activities; (2) rapid debt growth with large capital expenditure needs; and (3) moderate asset quality.

Corporate Profile

Founded in 2003, and after consolidating 7 state-owned industrial park development enterprises, HZCD has become the sole local infrastructure investment and financing company ("LIIFC") in Zhongkai HTZ. It plays the most important role in the local public policy activities, such as infrastructure construction, industrial park development, and sewage treatment. Besides, the Company also engages in some commercial activities such as supply chain, property leasing, engineering construction and fund investment. As of 31 December 2022, the Company was directly and wholly owned by State-owned Assets Affairs Center of Huizhou Zhongkai HTZ.

Rating Rationale

Credit Strengths

Strong market position as the sole investment and financing entity in Zhongkai HTZ. After the consolidation of 7 state-owned industrial park development enterprises in September 2022, HZCD's market position has significantly enhanced, and it has become the sole investment and financing entity in Zhongkai HTZ. Considering its high strategic significance to the development of Zhongkai HTZ, we believe the Company is unlikely to be replaced by other local state-owned enterprises in the foreseeable future.

Dominant role in undertaking local public activities, with high sustainability. Mandated by the local government, HZCD plays a dominant role in undertaking local public activities that are vital to local economic and social development, such as urban infrastructure construction, industrial park development, and sewage treatment. Given sufficient projects under construction, we consider the sustainability of the public-related businesses to be high, but the Company may face large capital expenditure pressure.

Track record of receiving government payments. HZCD has a track record of receiving payments from the local government. These payments take various forms, such as government subsidies, capital injections, and asset transfers. The Company regularly receives government subsidies to support its business operation. Overall, given the Company's important position and its contribution to regional economic development, we believe that it will receive strong government support in times of need.

Diversified access to funding. HZCD has diversified access to funding as reflected by its good banking relationships and access to the onshore debt capital market. The Company has also diversified its financing channel to onshore debt capital market since 2021. As of end-2022, it had raised about RMB2.0 billion in onshore debt market, with a coupon range between 3.5% and 4.9%. Additionally, the Company has low reliance on non-standard financing.

Credit Challenges

High exposure to commercial activities, with manageable business risks. In addition to public activities, HZCD is also involved in various commercial activities such as supply chain, property leasing, fund investment, and construction engineering. We consider its commercial business exposure to be high, accounting for more than 30% of its total assets. However, the business risk for the commercial businesses is manageable as most of them show good development momentum and provide positive cash flows to the Company.

Rapid debt growth and moderate asset quality. With ongoing financing for its construction projects and the consolidation of regional resources in recent years, HZCD has a rapid debt growth. The Company's total debt increased from RMB2.2 billion at end-2020 to RMB11.5 billion at end-2022, with total capitalization of 54.3%. HZCD has moderate asset liquidity. The Company's total asset mainly consists of inventories and non-current assets, which accounted for 83.6% of its total asset as of 31 December 2022.

Rating Outlook

The stable outlook on HZCD's rating reflects our expectation that Zhongkai HTZ Government's capacity to provide support will remain stable, and the Company will maintain its dominant role in undertaking local public activities in Zhongkai HTZ over the next 12 to 18 months.

What could upgrade the rating?

The rating could be upgraded if (1) Zhongkai HTZ Government's capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as expansion of its policy role, material decrease in commercial activities exposure, or improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Zhongkai HTZ Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to support, such as decrease in importance of its policy role, material decrease in government payments, or deteriorated debt management.

Rating Methodology

The methodology used in this rating is the Rating Methodology for China's Local Infrastructure Investment and Financing Companies (July 2022).

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The first name below is the lead rating analyst for this rating and the last name below is the person primarily responsible for approving this rating.

Peter Chong
Senior Analyst

+852-2860 7124
peter_chong@ccxap.com

Elle Hu
Executive Director of Credit Ratings
+852-2860 7120
elle_hu@ccxap.com

Client Services: +852-2860 7111

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China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 1904-1909, 19/F, Jardine House,
1 Connaught Place, Central, Hong Kong

Website: www.ccxap.com

Email: info@ccxap.com

Tel: +852-2860 7111

Fax: +852-2868 0656