

Credit Opinion

28 March 2025

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB _g -
Outlook	Stable

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Shandong Honghe Holding Group Co., Ltd.

Surveillance credit rating report

CCXAP affirms Shandong Honghe Holding Group Co., Ltd.'s long-term credit rating at BBB_g-, with stable outlook.

Summary

The BBB_g- long-term credit rating of Shandong Honghe Holding Group Co., Ltd ("SHHG" or the "Company") is underpinned by the Company's (1) status as a major coal mining company in Zoucheng City; (2) stable coal mining and trading business supported by solid and diversified demands; and (3) relatively high profitability level.

However, the rating is also constrained by the Company's (1) earnings vulnerable to energy prices and industry policy adjustments; (2) small scale of coal mining production and reserves; (3) relatively high debt leverage with certain debt repayment pressure; and (4) a moderate liquidity profile with limited credit facilities.

The rating also reflects SHHG's high likelihood of receiving strong support from its parent, Zoucheng Urban Assets Holding Group Co. Ltd ("ZCUA"), the largest local infrastructure investment and financing company ("LIIFC"), which mainly engages in the infrastructure construction in Zoucheng City. The high likelihood of parent support based on the Company's (1) unique position as the sole coal mining subsidiary of ZCUA; (2) status as a key revenue and profit contributor of ZCUA; (3) cross-default clauses associated with the offshore bond issuances of ZCUA.

The stable outlook on SHHG's rating reflects our expectation that the Company will maintain its good regional competitiveness in the coal mining business in Zoucheng City over the next 12-18 months.

Rating Drivers

- Major coal mining company in Zoucheng City
- Earnings vulnerable to energy prices and industry policy adjustments
- Stable coal mining and trading business supported by solid and diversified demands
- Small-scale coal mining production and reserves
- Relatively high debt leverages due to business expansion
- Moderate liquidity profile with limited credit facilities
- Strategic importance to its parent and local government

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) commodity prices rise substantially, further boosting the Company's profits; (2) the Company's market position strengthens with a material increase in product output; (3) the Company demonstrates lower debt leverage and improved liquidity position and (4) strong parent-subsidiary linkage with ZCUA.

What could downgrade the rating?

The rating could be downgraded if (1) commodity prices fell sharply, adversely affecting the Company's earnings; (2) the Company's total debt level rose sharply; (3) the Company demonstrates deteriorated credit metrics and weakened liquidity profile and (4) less parent-subsidiary linkage with ZCUA.

Key Indicators

	2021FY	2022FY	2023FY	2024Q3
Total Assets (RMB billion)	13.7	14.3	14.7	16.3
Total Equity (RMB billion)	6.4	6.9	7.1	6.7
Total Revenue (RMB billion)	4.6	5.4	5.1	3.9
Net Profits (RMB billion)	0.4	0.4	0.3	0.3
EBIT/Revenue (%)	12.6	14.3	15.1	-
EBIT/Average Assets (%)	4.4	5.6	5.4	-
Total Debt/Total Capital (%)	42.6	45.8	47.8	56.7
Total Debt/EBITDA (x)	6.4	5.9	6.4	-
EBIT/Interest (x)	2.2	1.9	2.0	-
(CFO-Dividend)/Total Debt (%)	4.0	2.7	2.1	-

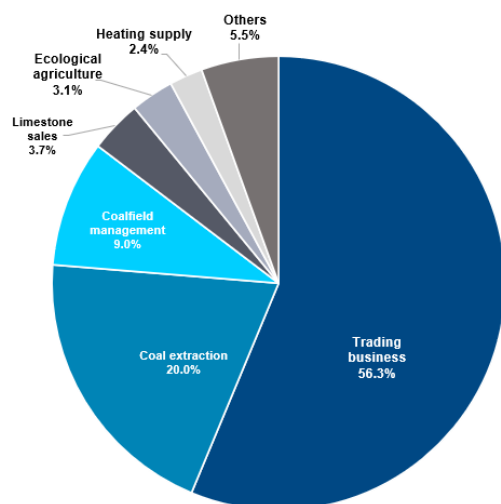
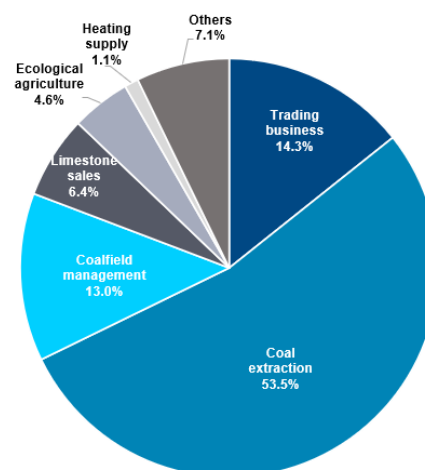
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

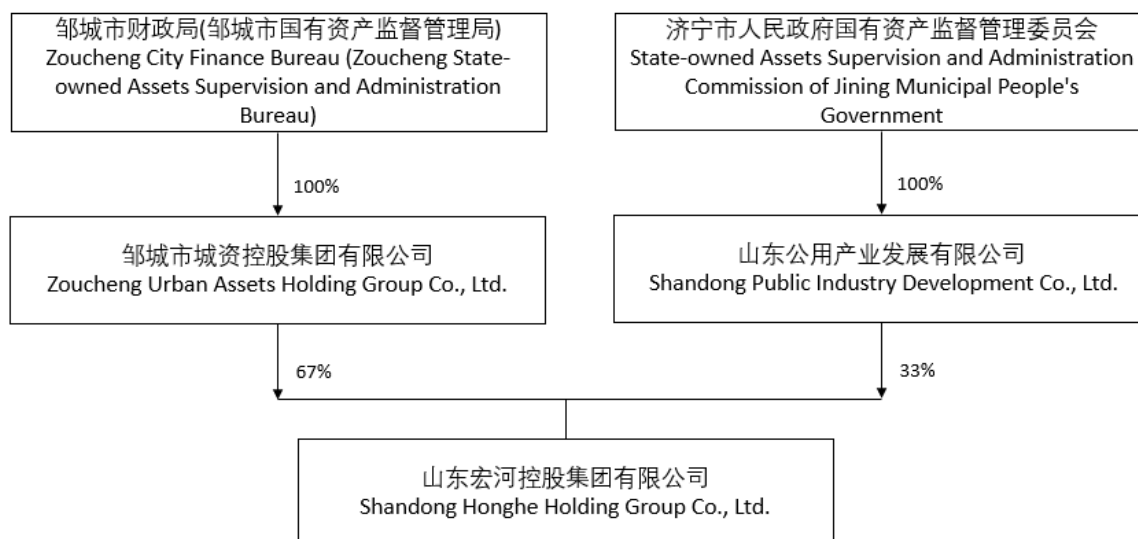
Corporate Profile

Founded in 1998, SHHG is a major coal mining and trading company in Zoucheng City of Shandong Province. In addition to coal-related business, the Company also engages in heating supply, limestone sales, and ecological agriculture business. In December 2024, Shandong Public Industry Development Co., Ltd. acquired 33% of the Company's shares by injecting 43.31% stake in Shandong Zhicheng Agricultural Development Group Co., Ltd., another LIIFC focusing on agricultural development in Zoucheng City, which significantly increased the Company's business and capital strength, as well as diversified its business portfolio. Zoucheng

State-owned Asset Supervision and Administration Bureau (“Zoucheng SASAB”) remains the ultimate controller of the Company.

Exhibit 1. Revenue structure in 2024Q3**Exhibit 2. Gross profit structure in 2024Q3**

Source: Company information, CCXAP research

Exhibit 3. Shareholding Chart as of 31 December 2024

Source: Company information, CCXAP research

Rating Considerations

Major coal mining company in Zoucheng City

SHHG is a major local state-owned enterprise in Zoucheng City that mainly engages in the thermal coal business. It is recognized as an outstanding enterprise in the national coal industry and has been listed among the top 100 coal industry enterprises in China for multiple years. Another major coal mining company in Zoucheng City is Yankuang Energy Group Company Limited ("Yankuang Energy"), specializing in the production of thermal coal. Yankuang Energy is a subsidiary of Shandong Energy Group Co., Ltd, with its ultimate parent being the Shandong State-owned Assets Supervision and Administration Commission.

The business exhibits a certain degree of diversification. Except for the Company's main business of coal mining and trading, it also derives profits from coalfield management, limestone mining, ecological agriculture, and heating supply businesses. However, it has a high geographic concentration in specific regions. The Company's current clients mainly consist of power plants in Shandong province and surrounding coal chemical enterprises.

Earnings vulnerable to energy prices and industry policy adjustments

As a coal mining and trading company, SHHG's earnings are subject to various factors such as seasonal demand changes, weather conditions, and energy policies.

In China, despite the government's efforts on energy transition in recent years, coal remains a primary source of energy consumption. The downstream industries associated with coal consumption span across various sectors, including power generation, steel production, cement manufacturing, and chemical engineering. In 2024, China's thermal coal market has experienced significant price fluctuations mainly due to the weakening downstream industry demand, as well as the rapid development of renewable energy, such as hydropower, wind power, and photovoltaic power.

The closing price of Qinhuangdao Port thermal coal price (5500 kcal, Shanxi origin) was peaked at around RMB900 per ton at the beginning of 2024 but fell to RMB808.0 per ton by early April due to decreased demand of downstream industries. A brief rebound occurred in mid-April, but summer hydropower output suppressed thermal coal consumption, causing coal prices drop to RMB834.0 per ton by August. In the fourth quarter, reduced consumption and increased production led to further declines. In the context of fluctuating coal prices, both profitability and debt repayment indicators for Chinese coal companies declined in 2024. It is anticipated that the increase in thermal coal supply will be limited and accompanied by greater uncertainty in 2025, the overall thermal coal price may remain stable throughout 2025.

In the long term, with the continued advancement of dual carbon policies and the rapid development of renewable energy, coal demand and prices may remain under pressure, impacting the Company's profitability.

Small scale of coal mining production and reserves

The Company has relatively low coal mining and recoverable reserves, and there is some uncertainty surrounding the construction of backup coal mines. The average annual coal mining of the Company slightly increased from 1.4 million tons in 2022 to 1.5 million tons in 2023, maintaining at a relatively small scale compared to the industry average. As of 30 September 2024, the combined remaining recoverable reserves of the Company's two operating coal mines are relatively limited. The remaining tenor for exploration of Henghe Coalfield and Hongqi Coalfield were 9 years and 29 years, respectively. Although the Company has acquired certain coal resource reserves through purchases and allocations, investment in the exploration of reserve coal mines has been temporarily suspended due to a lack of substantial progress. The timing of future development remains uncertain. The coal production cost per ton slightly increased from RMB296.3 in end-2023 to RMB305.5 as of end-2024Q3 due to an increasing labor cost, but its negative impact on the profitability of coal mining business is limited.

Exhibit 4. Production capacity and reserve coalfield as of 30 September 2024

In million tons	Actual output (2024Q1-Q3)	Remaining recoverable reserves
Henghe Coalfield (In operation)	0.5	9.0
Hongqi Coalfield (In operation)	0.6	19.3
Xiaomeng Coalfield (Backup coalfield)	-	74.3

Pandian Coalfield (Backup coalfield)	-	46.4
Total	1.1	149.0

Source: Company information, CCXAP research.

Stable coal mining and trading business supported by solid and diversified demands

We assess the Company's coal mining and trading business is stable. The Company's primary sales regions are within Shandong Province. The downstream customers primarily consist of small and medium-sized coal trading companies, local power plants, and chemical plants. Supported by the strong downstream demands and agile business model, the Company is able to sell most of its coal extracted as reflected by its sustainably high proportion of products sold in the past few years. Despite of the overall price downward momentum in the industry, the coal selling price of the Company has been stable. The coal selling price from the self-owned coalfields increased from RMB702.3 per ton in 2023 to RMB711.5 per ton in the first three quarters of 2024. The gross margin of the coal mining business has been high, recording 57.9% and 57.4% in 2023 and the first three quarters of 2024, respectively.

Trading business is the largest contributor to the Company's revenue, of which coal trading accounted for around 70% of the segment revenue in 2024Q3. Other trade categories are mainly building materials, industrial materials, and mechanical and electrical equipment. By utilizing its resource channel advantage and regional significance, the Company is able to consolidate the demands of downstream customers regarding coal quantity and quality by leveraging its channels. As a result, the Company can secure coal supply via bulk purchasing at a price lower than the prevailing market prices. We assess the risk of this segment is low, as the Company adopts a demand-driven procurement strategy to avoid excessive accumulation of inventory and additional storage costs. Meanwhile, the concentration in both upstream and downstream enterprises has been decreasing over the years, and we believe the concentration risks on both ends are now alleviated. In the first three quarters of 2024, the Company's top 5 suppliers accounted for 33.5% of the total procurement amount while the top 5 customers accounted for 32.6% of the total sales revenue.

Meanwhile, in the first three quarters of 2024, the coal trading business recorded a revenue of RMB1.5 billion while the coal mining segment recorded a revenue of RMB0.8 billion, implying that the Company relies more on coal procurement rather than self-owned coalfield to boost overall revenue. As a result, we assess the Company's reliance on raw material procurement is high. Besides, though being the largest revenue contributor, the trading business only contributed 14.3% of total gross profit by 30 September 2024 due to a relatively low bargaining position with downstream customers.

In addition to traditional coal mining and trading business, the Company also conducts coalfield management business. The business model is that the Company primarily provides technical and managerial support without having ownership of the coal mine or control over the products. The managerial support by the Company includes personnel training, construction planning, safety management, coal sales. As a value-added service, the gross margin of coalfield management is relatively high as compared to other segments of the Company. As a result of smaller cash collection of coal sales of coal mine under management, the gross profit of this segment has seen a decline, from RMB184.0 million in first three quarters of 2023 to RMB108.0 million in the first three quarters of 2024.

Supplementary income from other businesses

Apart from the coal business, the Company also engages in other non-coal business, including ecological agriculture, heating supply, and limestone sales. These businesses contribute less to the Company's overall

revenue and profits. In the first three quarters of 2024, non-coal businesses contributed revenue of RMB1.2 billion, accounting for 18.5% of total revenue.

The ecological agriculture business is mainly about utilizing microbial fermentation and other methods to produce yeast, seasoning powder, and feed products. We assess the sustainability of this segment as low. In 2021, the yeast product manufacturing facility with an annual production capacity of 15,000 tons was transferred to Angel Yeast (Ji Ning) Pte Ltd. The future development of the current project (Phase II project of Saint Qi Modern Agricultural Biotechnology Park) faces uncertainty, hence there is impairment risk associated with the ongoing project. As of end-2023, the project has a total investment amount of RMB1.0 billion, and an outstanding amount of RMB0.5 billion. Besides, the limestone business recorded significant growth with the official launch of the processing line. The Company achieved limestone mining revenue of RMB343.0 million in 2023, with a YoY growth of over 200%. In the first three quarters of 2024, revenue from limestone mining segment recorded RMB144.0 million.

Profitability remained at a relatively high level

The total revenue of SHHG dropped from RMB5.4 billion in 2022 to RMB5.1 billion in 2023, due to the decreased coal trading business and the suspension of property development business. Its EBIT margin increased from 14.3% in 2022 to 15.1% in 2023, and meanwhile, the return on assets slightly dropped from 5.6% to 5.4% over the same period. The gross margins of its coal business are satisfactory, with the trading business, coal mining, and coalfield management business recorded at 5.4%, 57.4% and 30.8%, respectively, in 2024Q3. However, the overall gross profit margin slightly decreased from 23.9% in 2023 to 21.5% in 2024Q3, due to the increased operation cost. We assess the profitability metrics remained at a relatively high level although they modestly weakened in the first three quarters of 2024.

Relatively high debt leverage with certain debt repayment pressure

The Company demonstrated a fast debt growth due to the its rapid business development. The Company's total debt increased from RMB6.5 billion at end-2023 to RMB8.7 billion as of 30 September 2024, while its total capitalization ratio increased from 47.8% to 56.7% over the same period. Meanwhile, Zoucheng SASAB injected 100% stake of a major subsidiary of ZCUA to the Company at end-2024, namely Shandong ZouLu Asset Operation Co., Ltd. ("ZouLu Asset"), with a total asset and net asset both of RMB3.6 billion as of end-2024Q3, partly offset the surge in leverage in the first three quarters of 2024.

The Company has actively improved its debt structure since 2023. The short-term debt/total debt declined from 61.6% in 2022 to 24.1% as of 2024Q3, which implies the debt structure has improved. Nevertheless, the decline in the weight of short-term debt is a result of the repayment of short-term borrowings and an increase in long-term borrowings, which results in the increase in total debt.

We assess the Company has certain debt repayment pressure as reflected by its relatively weak credit metrics. Its EBIT/interest expense ratio has been at a low level of 2.0x in 2023. The (CFO-dividends)/total debt ratio has also been weak, which was 2.1% in 2023. Hence, we believe that the Company has weak debt servicing capability.

Moderate liquidity profile

As of the end of September 2024, the Company obtained a total bank credit line of RMB3.2 billion, with an unused limit of RMB796.0 million. The available credit facility is relatively small compared to the Company's business scale and total debt. In addition, around 74.1% of the Company's interest-bearing debt is bond

financing as of 30 September 2024. The reliance on bond financing exposed the Company to the capital market fluctuations. The Company has actively issued medium and long term onshore and offshore bonds since 2024, which improves its debt structure. In 2024, the Company issued onshore bonds with issuance amount of RMB3.0 billion. Meanwhile, the Company expanded its funding channel to offshore bond market, and completed one offshore bond issuance with issued amount of RMB379.3 million and coupon rate of 6.95%. The high reliance on the bond market may expose the Company to a high market interest rate risk. Meanwhile, the Company has little exposure to non-standard financing.

External Support

Strategic importance to its parent and the local government

As the core subsidiary of ZCUA, the Company has a high likelihood of receiving strong support from ZCUA and Zoucheng SASAB when necessary.

The Company is the only subsidiary engaging in coal mining and trading business under ZCUA. The financial impact of SHHG's default is material. In the first three quarter of 2024, SHHG recorded a revenue of RMB3.9 billion while the revenue of ZCUA was RMB7.3 billion. The after-tax profit of SHHG was RMB261.6 million while that of ZCUA was RMB243.9 million. Hence, the Company is a unique subsidiary and a key contributor to the ZCUA's profitability.

ZCUA has provided a total guarantee of around RMB905.4 million to SHHG and its subsidiaries. Besides, there are cross-default clauses associated with the offshore bonds issued by ZCUA (with the total issued amount equivalent to USD522.0 million). We believe that should a credit event of SHHG occur, the probability of default on ZCUA's offshore debt may rise significantly.

Zoucheng Municipal Government has provided strong support in terms of preferential policies and subsidies. So far, Zoucheng Municipal Government has implemented a series of supportive policies for SHHG, taking the lead in the relocation work of Xingcun in Honghe Mining Coal Mining Area, coordinating cooperation matters between Honghe Group and Yankuang Energy, as well as injecting ZouLu Asset to contain its leverage level.

Therefore, we believe the Company will remain an important state-owned enterprise and will not easily be replaced in the coming 12 to 18 months.

Rating Methodology

The methodology used in this rating is the Rating Methodology for [Mining Industry \(December 2017\)](#).

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