

## Credit Opinion

11 October 2023

### Ratings

Senior Unsecured Debt Rating	BBB <sub>g</sub> -
Long-Term Credit Rating	BBB <sub>g</sub> -
Outlook	Stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

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## Dongying Dongying District Municipal Holding Group Co., Ltd.

### Initial credit rating report

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub>- to Dongying Dongying District Municipal Holding Group Co., Ltd., with stable outlook.**

### Summary

The BBB<sub>g</sub>- long-term credit rating of Dongying Dongying District Municipal Holding Group Co., Ltd. (“DYM” or the “Company”) reflects the Dongying District Government’s (1) relatively strong capacity to provide support, and (2) extremely high willingness to provide support based on our assessment of the Company’s characteristics.

Our assessment of Dongying District Government’s capacity to provide support reflects Dongying District’s increasing economic strength and moderate fiscal metrics.

The rating also reflects the local government’s willingness to provide support, based on the Company’s (1) important role in local infrastructure construction and public services; and (2) good track record of receiving government support.

However, the rating is constrained by the Company’s (1) increasing debt burden driven by the continuous investment in construction projects; (2) weak liquidity profile with limited bank standby facilities; and (3) medium contingent liabilities risk caused by mutual guarantee for local state-owned enterprises (“SOEs”).

The stable outlook on DYM’s rating reflects our expectation that the local government’s capacity to provide support will remain stable, and the Company’s characteristics such as its important role in the infrastructure construction and public services of Dongying District will remain unchanged over the next 12-18 months.

## Rating Drivers

- Important role in local infrastructure construction
- High sustainability in provision of public services
- Good track record of receiving government support
- Increasing debt burden driven by the continuous investment in construction projects
- Weak liquidity profile with limited bank standby facilities
- Medium contingent liabilities risk caused by mutual guarantee for local SOEs

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) the Dongying District Government's capacity to support strengthens; and (2) the Company's characteristics change in a way that enhances the local government's willingness to support, such as improved financing ability.

### What could downgrade the rating?

The rating could be downgraded if (1) the Dongying District 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 reduced strategic significance, deteriorated financing ability, or decreased government payments.

## Key Indicators

	2020FY	2021FY	2022FY
Total Asset (RMB billion)	9.2	10.1	11.3
Total Equity (RMB billion)	5.4	5.5	5.7
Total Revenue (RMB billion)	0.6	0.7	0.7
Total Debt/Total Capital (%)	18.4	29.5	36.1

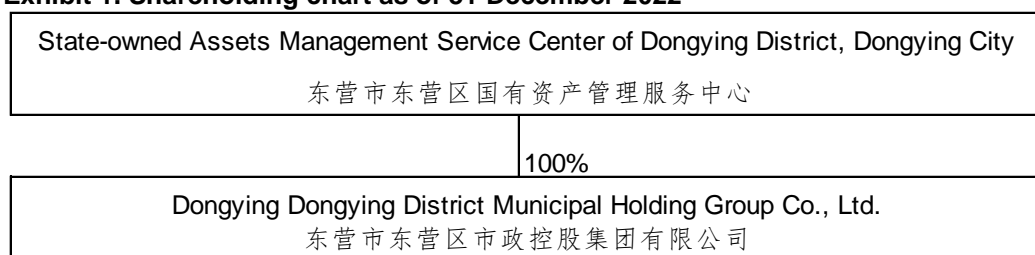
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company information, CCXAP research

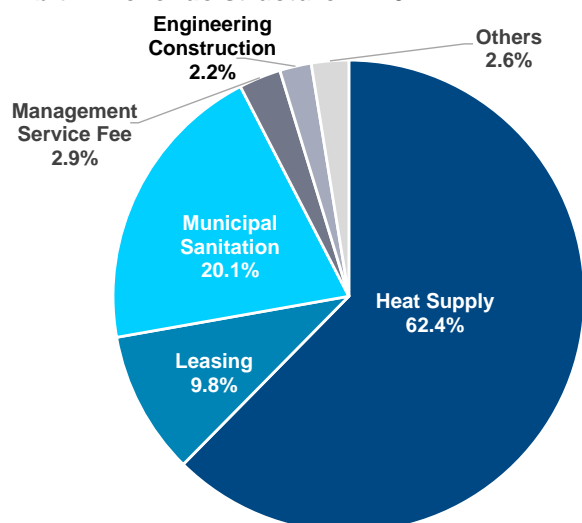
## Corporate Profile

Founded in 2018, DYMH is one of the key local infrastructure investment and financing companies ("LIIFCs") in Dongying District. The Company shoulders the major responsibility of carrying out local public activities, including infrastructure construction, heat supply, and municipal sanitation. It also engages in commercial activities such as leasing and engineering construction. As of 31 December 2022, DYMH was wholly owned and controlled by the State-owned Assets Management Service Center of Dongying District, Dongying City.

### Exhibit 1. Shareholding chart as of 31 December 2022



Source: Company information, CCXAP research

**Exhibit 2. Revenue structure in 2022**

Source: Company information, CCXAP research

## Rating Considerations

### Government's Capacity to Provide Support

We believe Dongying District Government has a relatively strong capacity to provide support given its increasing economic strength and moderate fiscal metrics.

Shandong is the third largest province in China by gross regional products ("GRP"), with a solid foundation in different industries such as logistics, shipbuilding, marine technology, chemical, automotive, and agri-food. Dongying City is a prefecture-level city located in the northeast part of Shandong Province. Dongying City owns rich oil and gas resources, 80% of Shengli Oilfield's oil geological reserves and 85% of production are concentrated in Dongying City. The petrochemical industry is the most important pillar industry in Dongying City. After industrial transformation and upgrading, Dongying City has also developed some emerging industries including new energy and new materials, high-end chemical industry, as well as high-end equipment.

In 2022, Dongying City recorded a GRP of RMB362.1 billion, recoding an economic growth of 4.3% year-over-year ("YoY") and ranking 10<sup>th</sup> among 16 prefecture-level cities in Shandong Province. Dongying City has relatively strong fiscal strength and moderate fiscal balance. In 2022, Dongying City's general budgetary revenue was RMB26.5 billion, and tax revenue accounted for 65.5% of the general budgetary revenue. Its average general budgetary revenue to general budgetary expenditure ratio was 59.7% over the past three years. As of 31 December 2022, Dongying City Government reported an outstanding government debt of RMB74.5 billion and accounted for 20.6% of its GRP.

**Exhibit 3. Key economic and fiscal indicators of Dongying City**

	2020FY	2021FY	2022FY
GRP (RMB billion)	298.1	344.1	362.1
GRP Growth (%)	3.8	8.5	4.3
General Budgetary Revenue (RMB billion)	24.9	26.2	26.5
General Budgetary Expenditure (RMB billion)	31.1	30.1	37.2
Local Government Debt (RMB billion)	48.2	61.6	74.5

Source: Statistics Bureau of Dongying City, CCXAP research

Dongying District locates in the northeast of Shandong Province and is the central district of Dongying City. Supported by rich oil and gas resources, Dongying District has developed 3 pillar industries, including petrochemical industry, high-end equipment industry and digital economy. Shengli Oilfield's base, the second largest oil field in China, locates in Dongying District. Dongying District is also the largest petroleum equipment industry base and petroleum equipment product export base in China. In 2022, Dongying District reported a GRP of RMB56.7 billion, recording an economic growth of 5.4% YoY. Its fiscal balance was relatively good, with average general budgetary revenue to general budgetary expenditure ratio of 98.7% over the past three years. However, the ratio decreased to 75.5% in 2022, due to the significant increase in general budgetary expenditure and slight decrease in general budgetary revenue. Meanwhile, Dongying District's tax revenue decreased from RMB3.0 billion in 2021 to RMB2.5 billion in 2022 due to tax rebate policy, accounting for 63.8% of its general budget revenue. Moreover, Dongying District relies on the transfer income to balance its excess government fund expenditure. As of 31 December 2022, Dongying District Government reported an outstanding government debt of RMB6.9 billion and accounted for 12.3% of its GRP.

#### **Exhibit 4. Key economic and fiscal indicators of Dongying District**

	2020FY	2021FY	2022FY
GRP (RMB billion)	45.2	53.1	56.7
GRP Growth (%)	8.1	11.8	5.4
General Budgetary Revenue (RMB billion)	4.1	4.1	3.9
General Budgetary Expenditure (RMB billion)	3.6	3.9	5.1
Local Government Debt (RMB billion)	3.2	4.3	6.9

Source: Statistics Bureau of Dongying District, CCXAP research

### **Government's Willingness to Provide Support**

#### **Important role in local infrastructure construction**

There are 3 major LIIFCs in Dongying District under the control of Dongying District Government. Each of them has a clear position under the government's planning. Among them, DYM is the key entity in infrastructure construction and provision of public services in Dongying District, such as heat supply, road construction and improvement, river management, and municipal sanitation.

DYM carries out various infrastructure construction projects mainly through self-construction model. Under self-construction model, the Company is responsible for the fund raising of the projects and achieves fund balancing from revenue in other commercial projects. However, the revenue from commercial projects has more uncertainties than direct government payment, which may bring larger financial repayment pressure to the Company under self-construction model. As of 31 of March 2023, there were lots of infrastructure projects under construction, with a planned investment of RMB12.9 billion, mainly including geothermal energy comprehensive utilization project, hospital, national fitness center, and roads. The investment demand for infrastructure projects under construction in 2023 was RMB3.6 billion, which would cause certain capital expenditure pressure for the Company. Nevertheless, parts of projects are supported by special fund, which may mitigate the Company's capital expenditure pressure.

#### **High sustainability in provision of public services**

DYM is the regional dominant heat supplier in urban district of Dongying District by providing heat energy to residential and commercial customers with pipe network length of around 280 kilometers, serving over 196 thousand residential users and 7.3 thousand non-resident users. However, given the public utility nature of heat

supply, the Company's heat supply business aims to assure local people's livelihood and charges at a price lower than cost, resulting operating loss in recent years. The heat supply business highly relies on the government subsidies.

Moreover, DYMH is in charge of the municipal sanitation business with municipal utility operating license, including environmental sanitation and cleaning, garbage classification, property services, greening maintenance, garbage collection and transportation and smart parking. The Company is mainly responsible for cleaning of a total of 388 roads in Donying District, with a total road cleaning area of approximately 14.5 million square meters. The Company also takes part in landscaping maintenance, covering an area of approximately 1.2 million square meters.

Considering the indispensability and high sustainability of these public services, we believe the replacement cost of the Company is very high.

### **Good track record of receiving government support**

DYMH has a good track record of receiving support from Dongying District Government in terms of subsidies, capital injection, special funds, and equity transfer. In 2018, the Dongying District Government transferred rainwater sewage pipe network and heating pipe network with a book value of RMB4.1 billion and cemetery assets with a book value of RMB608 million to the Company. From 2020 to 2022, the local government consistently provided a total of RMB385.7 million in subsidies for the Company, supporting its operation of public services. In 2022, the local government allocated fiscal funds with RMB507 million to DYMH, which enhanced its capital strength. Given the Company's important role in Dongying District, we believe that DYMH will continue to receive various kinds of support from the local government.

### **Low exposure to commercial activities**

Apart from the public policy activities, DYMH also engages in commercial activities such as leasing. Given the proportion of commercial assets to total assets was less than 15%, we estimate the DYMH's exposure to commercial activities is low.

The Company's main leasable assets are rainwater and sewage pipe network and properties. DYMH signed a pipe network leasing contract with the Dongying District Comprehensive Administrative Law Enforcement Bureau, with an annual rent of RMB56 million and 10-year leasing period started at 2019. Besides, as of 31 March 2023, the Company had a total property leasing area of 40 thousand square meters as of 31 March 2023, with more than 95% average occupancy rate. The main leasable property assets are the Administrative Approval Hall, Huatai International Financial Center, stadium and parking lots. Administrative Approval Hall and Huatai International Financial Center are self-purchased properties, while other leasable assets are transferred by local government. The leasing business could provide supplementary revenue to the Company. In 2022, the revenue from leasing business was RMB66.5 million, accounting for 9.8% of its total revenue. The main lessees are government related departments. However, some rents are in arrears without clear payment schedule. As the most of leasable assets are transferred by the local government, the actual investment amount of the Company in leasing business was not large. We believe that the risk caused by leasing business is controllable.

### **Increasing debt burden driven by the continuous investment in construction projects**

DYMH's total debt increased from RMB1.2 billion as of 31 December 2020 to RMB3.4 billion as of 31 December 2022 due to the continuous investment in construction projects in Dongying District. Meanwhile, DYMH's capitalization ratio increased from 18.4% to 37.7%. As of 31 December 2022, the Company's short-term debt

was RMB1.1 billion and its short-term debt to total debt ratio was 30.9%, indicating certain refinancing pressure. Due to the large uninvested amount of construction projects and maturing debt, we estimate the Company would continue to rely on external financing such as bank loans and its total debt would further increase over the next 12-18 months.

### **Weak liquidity profile with limited bank standby facilities**

DYMH's access to funding is fair. Bank loans accounts for the majority of the Company's total debt. The Company showed low standby liquidity. As of 30 June 2023, the Company had obtained total bank facilities of RMB3.5 billion, but the available bank facilities were limited. Moreover, the Company's bank loans were concentrated on regional banks, such as Dongying Bank. Loans from Dongying Bank accounted for around 31% of total debt, which may bring higher financing costs and uncertainties in future refinancing due to the concentration on regional banks. In addition to regional banks, DYMH also established long-term borrowing relationship with large domestic banks such as Industrial and Commercial Bank of China Limited, Bank of China Limited, and Agricultural Development Bank of China. The Company's exposure to non-standard financing is moderate, and financing leasing accounted for less than 15% of total debt.

Considering the Company's limited available credit facilities, relatively high refinancing pressure, and large investment amount on its infrastructure projects under construction, an additional funding channel is required to fulfil the increasing capital expenditure needs.

### **Medium contingent liability risk caused by mutual guarantee for local SOEs**

DYMH bears moderate contingent risk resulting from large external guarantees. As of 31 December 2022, the Company's external guarantees amounted to RMB2.5 billion, accounting for 44% of its net assets, and were provided to SOEs. 86.7% of its external guarantees was provided to Dongying District Urban Development Investment Group Co., Ltd. The practice of mutual guarantees among local SOEs is common phenomenon in Dongying District. In case a credit event occurs, the Company may face certain contingent liability risks and cross-default risks. Considering the important role of state-owned enterprises in Dongying District, we expect that the local government would provide support when necessary.

## **ESG Considerations**

DYMH is exposed to environmental risks due to undertaking key infrastructure construction. Such risks could be moderated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

The Company bears social risks as it implements public policy initiatives by playing an important role in the social welfare of Dongying District. Demographic changes, public awareness and social priorities shape the Company's development targets and ultimately affect the local government's propensity to support the Company.

DYMH's governance considerations are also material as the Company is subject to oversight by Dongying District Government and has to meet several reporting requirements, reflecting its public-policy role and status as a government-owned entity.

## **Structural considerations**

DYMH's senior unsecured debt rating is equal to its long-term credit rating. We believe that government support will flow through the Company given its important role in local infrastructure construction and provision of public services, thereby mitigating any differences in an expected loss that could result from structural subordination.

## 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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