

Credit Opinion

30 November 2023

Ratings

Senior Unsecured Debt Rating	BBB _g -
Long-Term Credit Rating	BBB _g -
Outlook	Stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

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Linzhou City Investment Holdings Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Linzhou City Investment Holdings Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Linzhou City Investment Holdings Co., Ltd. (“LZIH” or the “Company”) reflects Linzhou City Government’s (1) strong capacity to provide support, and (2) very high willingness to provide support based on our assessment of the Company’s characteristics.

Our assessment of Linzhou City Government’s capacity to support reflects Linzhou City’s status as the largest county or district by gross regional product (“GRP”) in Anyang City for years, with growing economy, but constrained by moderate fiscal metrics.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) dominant role in local shantytown renovation and infrastructure construction; and (2) good track record of receiving government support.

However, the Company’s rating is constrained by its (1) medium and increasing exposure to commercial activities; (2) increasing debt burden and moderate asset liquidity; and (3) moderate level of contingent risk.

The stable outlook on LZIH’s rating reflects our expectation that the Linzhou City Government’s capacity to provide support will be stable, and the Company’s characteristics such as its importance in social and economic development of Linzhou City will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Dominant role in local shantytown renovation and infrastructure construction
- Good track record of receiving government support
- Medium and increasing exposure to commercial activities
- Increasing debt burden and moderate asset liquidity
- Moderate level of contingent risk

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Linzhou City 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 improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Linzhou City Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to provide support, such as reduced regional significance or materially increased exposure to risky commercial activities.

Key Indicators

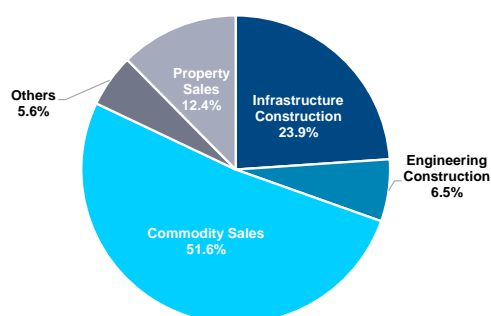
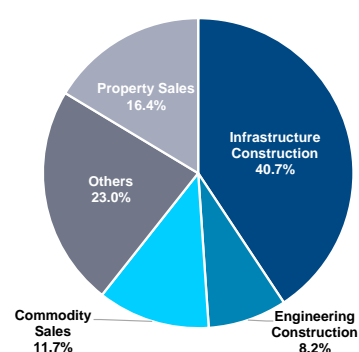
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	21.1	24.4	29.1	28.7
Total Equity (RMB billion)	8.9	9.3	14.9	15.0
Total Revenue (RMB billion)	2.7	5.4	5.8	2.6
Total Debt/Total Capital (%)	48.9	55.4	44.6	44.4

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

Source: Company information, CCXAP research

Corporate Profile

Established in December 2016, LZIH is the most important infrastructure investment and financing company ("LIIFC") in Linzhou City, responsible for infrastructure construction and water supply in Linzhou City. The Company has also diversified into other commercial business, including property sales, engineering construction, and commodity sales. As of 30 June 2023, the Company has been wholly owned and controlled by the Finance Bureau of Linzhou City.

Exhibit 1. Revenue Structure in 2022**Exhibit 2. Gross Profit Structure in 2022**

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe that the Linzhou City Government has a strong capacity to provide support, reflects Linzhou City's status as the largest county or district by GRP in Anyang City for years with growing economic, but constrained by its moderate fiscal metrics.

Henan Province is located at the junction of the three major regions in China, including eastern, central and western regions. It has a strategic position as an important transportation and communication hub, and a material distribution center in China. With the good transportation and location advantages, Henan Province's GRP ranked 5th among all provinces in China in 2022. Anyang City is located in the north of Henan Province, which is the regional central city in the border area of Henan, Shaanxi and Hebei Provinces. Anyang City has four pillar industries, namely new energy vehicles and parts, fine steel and deep processing, high-end equipment manufacturing, as well as cultural tourism industries. In 2022, it reported a GRP of RMB251.2 billion, representing 2.4% year-over-year ("YoY") growth. The Anyang Municipal Government's general budget revenue increased to RMB22.2 billion from RMB17.5 billion in 2020. However, The Anyang Municipal Government has relatively low fiscal balance ratio (general budgetary revenue/general budgetary expenditure), ranging from 40.5% to 51.8% over the past three years, indicating its high reliance on fiscal support from higher-tier government. In 2022, it received transferring income of around RMB26.1 billion from the Henan Provincial Government. As of end-2022, its government debt balance amounted to RMB62.2 billion, accounting for 24.8% of GRP.

Exhibit 3. Key economic and fiscal indicators of Anyang City

	2020FY	2021FY	2022FY
GRP (RMB billion)	230.0	243.6	251.2
GRP Growth (%)	3.3	5.0	2.4
General Budgetary Revenue (RMB billion)	17.5	20.1	22.2
General Budgetary Expenditure (RMB billion)	43.1	37.4	42.8
Local Government Debt (RMB billion)	38.4	49.5	62.2

Source: Anyang Municipal Government, CCXAP research

Linzhou City is located in the northwest region of Henan Province, which is the county-level city under the jurisdiction of Anyang City and the birthplace of The Red Flag Canal spirit. Linzhou City comprises sixteen towns, one national-level economic and technological development zone, and one provincial-level industrial agglomeration zone. After years of development, Linzhou City has formed three pillar industries, including manufacturing, construction and cultural tourism. Linzhou City demonstrated ongoing economic growth over the

past three years. It recorded GRP of RMB56.0 billion, RMB61.5 billion, and RMB65.7 billion in 2020, 2021, and 2022, with growth rates of 4.6%, 6.3%, and 4.8%, respectively. Linzhou City's GRP ranked first among all the districts or counties in Anyang City for years. In 2022, Linzhou City Government's general budgetary revenue increased to RMB4.4 billion from RMB3.3 billion in 2020. Tax, a relatively stable income source, was recorded at RMB3.2 billion in 2022, accounting for 74.0% of its general budgetary revenue. Meanwhile, Linzhou City maintained a moderate fiscal balance with an average fiscal balance ratio over 57% the past three years. As of 31 December 2022, the outstanding debt of Linzhou City Government was RMB8.2 billion, accounting for 12.5% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Linzhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	56.0	61.5	65.7
GRP Growth (%)	4.6	6.3	4.8
General Budgetary Revenue (RMB billion)	3.3	4.0	4.4
General Budgetary Expenditure (RMB billion)	7.0	6.7	6.8
Local Government Debt (RMB billion)	7.1	7.8	8.2

Source: Linzhou City Government, CCXAP research

Government's Willingness to Provide Support

Dominant role in local shantytown renovation and infrastructure construction

As the largest LIIFC in Linzhou City in terms of total assets, LZIH is the most important LIIFC in Linzhou City with dominant role in local shantytown renovation and infrastructure construction. It also carries out essential public services in Linzhou City, such as water supply and provision of public transportation.

The Company mainly undertakes shantytown renovation and infrastructure construction through agency construction model, government purchase model and PPP model. The Company transfers the project ownership to the entrusting parties after the project is completed and examined, and will receive payments based on the total cost plus a certain markup in return. As of 30 June 2023, there were several projects under construction and planning under agency construction model and government purchase model, mainly including resettlement housing construction, urban renewal, hospital, river regulation, and upgrading of pipe network projects, with a total investment amount of RMB20.0 billion and uninvested amount of RMB11.9 billion.

Under PPP model, the Company is in charge of the project financing, construction, and operation work, and will receive government payments after the projects are completed. As of 30 June 2023, there were 2 PPP projects under construction, which were public service center construction and river improvement projects, with a total investment amount of RMB2.4 billion and uninvested amount of RMB1.1 billion. The large number of projects under construction and planning can ensure the sustainability of LZIH's infrastructure construction business, but also bring capital expenditure pressure to the Company.

LZIH also undertakes the responsibilities of providing essential public services in Linzhou City, including water supply and bus operation. The Company is responsible for the water supply of Linzhou City and the domestic sewage treatment in urban area of Linzhou City. As of 31 March 2023, LZIH owned water supply pipeline network with a total length of 322 kilometers and daily water supply capacity of 220 thousand cubic meters. The Company also engages in public transportation service in Linzhou City. As of end-2022, the Company owned 252 buses covering 23 routs in Linzhou City. We believe that the replacement cost for the Company's role is high as these public services are essential for the region.

Good track record of receiving government support

LZIH has a good track record of receiving support from the local government in the form of project payments, asset injections, and operating subsidies to support its investments and the operation of its businesses. In 2022, the local government injected assets into LZIH, including farmland irrigation system, sewage pipeline network and facilities, properties, and equity shares of other state-owned enterprises in Linzhou City, increasing capital reserve of the Company by RMB5.3 billion. In 2021, LZIH received capital injection in cash of RMB200 million from the local government. Apart from that, the local government also transferred 100% share of Linzhou Investment Group Co., Ltd. (“LZIG”) to the Company in 2020, which enlarged LZIH’s business scope and further strengthened its capital base.

In addition, LZIH also has a track record of receiving government payments. From 2020 to 2023H1, the local government provided subsidies of RMB110 million to the Company to support its operation and development. As of 30 June 2023, LZIH has received total project repayments of RMB3.5 billion from the local government for its infrastructure construction. Considering its strategic role in social and economic development of Linzhou City, we expect the local government will continuous to provide support to the Company.

Medium and increasing exposure to commercial activities

LZIH participates in different commercial activities such property sales, commodity sales and engineering construction. The Company’s commercial activities accounted for 15% to 20% of its total assets and the business risks are considered medium. However, with the ongoing investment in property sales, we expect its exposure to commercial activities would increase especially during the downturn of the real estate market.

LZIH engages in property sales business through its subsidiaries. The Company developed the properties independently or cooperatively with other local property developers in Linzhou City. As of 30 June 2023, most of the completed commercial housings were sold. There were 2 commercial residential housing under construction as of the same date, with a total investment amount of RMB1.4 billion and uninvested amount of RMB585 million. Meanwhile, there were 2 commercial residential housing under planning, with a total investment amount of RMB1.0 billion. This may expose the Company to certain business risks. Moreover, under the downturn of the real estate market, increasing investment in property development may bring more operating uncertainty and financial risks to the Company.

LZIH also conducts engineering construction business with relevant qualifications. The Company owns the first-grade qualification for general contracting of construction engineering, the first-grade qualification for professional contracting of foundation engineering, the second-grade professional contracting of steel structure engineering, and the third-grade qualification for general contracting of municipal public construction. As of 30 June 2023, the Company had 5 contracts on hand with a total contract amount of 2.0 billion. Majority of the Company’s engineering construction projects was from other LIIFCs in Linzhou City and related to real estate projects, which could be easily affected by the changes in real estate market.

In addition, the Company expands its business to commodity sales to support local construction industry development. The main products of commodity sales business are construction materials, rubber, sand and gravel, and aluminum ingots. To support the development of local construction industry, some customers may receive payment periods of around 90 days. However, most of these customers are required to provide guarantee or assets as collaterals for the business, which could partially mitigate the Company’s exposure to recovery risk. The Company also bears relatively high concentration risks. As of 31 December 2022, the top 5

suppliers and customers accounted for 77% and 88% of its total procurements and total sales, respectively. Moreover, the gross profit margin of this business sector is relatively low.

Increasing debt burden and moderate asset liquidity

Due to the continuous investment in infrastructure construction projects, LZIH's total debt has been growing over the past three years. As of 30 June 2023, LZIH's total debt increased to RMB11.9 billion from RMB8.5 billion as of end-2020. The Company has maintained moderate debt leverage. Its total capitalization ratio, as measured by total debt to total capital, was recorded at 44.4% as of the same date. Apart from that, the Company also faced short-term debt burden. As of 30 June 2023, its short-term debt was RMB3.3 billion, accounting for 27.9% of total debt. Meanwhile, the cash to short-term debt ratio was only 0.3x, which could not fully cover the short-term debt. Considering the large number of uninvested amounts of construction projects, we estimate the Company would continue to rely on external financing such as bank loans and bonds issuance to support its business, and its total debt would further increase over the next 12-18 months.

LZIH's asset liquidity was moderate. As of 30 June 2023, the Company had pledged some assets for loans, including cash, inventories, and investment properties, with a total restricted amount of RMB4.9 billion, accounting for 32.5% of net assets. On top of that, on 30 June 2023, the Company's inventories, contract assets, other receivables, and investment properties accounted for more than 70% of the total assets. The Company's inventories and contract assets mainly include the cost of construction works, while other receivables are mainly receivables from the local government, which are considered low liquidity.

Furthermore, there's a risk of recovery from some private-owned enterprises. The Company's other receivables account contains loans provided to local private-owned enterprises, some of which have been listed as dishonest judgment debtors. The Company had a total amount of loan receivables of around RMB64.5 million from these private-owned enterprises as of 30 June 2023, and the likelihood of receiving repayments was considered low. At the same time, LZIH had account receivables of RMB11.6 million from a private-owned enterprise as of 30 June 2023, namely Henan Yuhong Construction Engineering Co., Ltd., which has been listed as judgment debtors. Moreover, the Company had RMB9.6 million receivable from two private-owned enterprises namely Linzhou Times Trading Co., Ltd. and Henan Dacheng Construction Engineering Co., Ltd., which had been provisioned for bad debts in 2022.

Fair access to funding channels

LZIH has a fair access to funding channels such as bank loans, onshore bonds, and non-standard financing. Bank loans contribute the majority of total debt, which accounted for more than 80% as of 30 June 2023. The Company maintains long-term and close relationships with policy banks, state-owned commercial banks, and joint-stock commercial banks, such as China Development Bank, Agricultural Development Bank of China, and Industrial and Commercial Bank of China Limited. As of 30 June 2023, the Company had total bank facilities of RMB13.2 billion, with an unutilized portion of RMB2.9 billion.

The Company also has a track record for fund-raising activities in capital market. From January 2022 to September 2023, the Company's subsidiary LZIG issues 2 tranches of domestic bonds, raising RMB600 million. Meanwhile, the Company had a manageable exposure to non-standard financing, accounting for less than 10% of total debt. However, these types of financing generally have high financing cost and short-term borrowing period, which may enlarge LZIH' refinancing pressure. Thanks to the large portion of bank loans, especially the loans from policy banks, which accounted for more than 60% of the total bank loans as of 30 June 2023, the average financing cost of the Company was around 5.5%.

Moderate level of contingent risk

The credit profile of LZIH is constrained by its large number of external guarantees, which could potentially increase its repayment obligations. As of 30 June 2023, the Company's external guarantees amounted to RMB4.1 billion, accounting for 27.7% of its net assets, most of which were provided to local SOEs. Apart from that, some SOEs were listed as judgement debtors, accounting for around 4.7% of the total external guarantees, which may expose the Company to higher contingent risks. The SOEs listed as judgement debtors are under negotiation to resolve relevant disputes.

ESG Considerations

LZIH bears environmental risks through its shantytown renovation and infrastructure construction projects. Such risks could be mitigated by conducting environmental studies and detailed planning before the commencement of the projects and close supervision during construction.

LZIH bears social risks as it implements public policy initiatives by building public infrastructure in Linzhou City. 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.

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

Structural considerations

LZIH'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 importance in social and economic development of Linzhou City, 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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