

## Credit Opinion

27 June 2024

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	A <sub>g</sub> -
Outlook	Stable

### Analyst Contacts

Olivia Feng +852-2860 7133

Senior Credit Analyst

[olivia\\_feng@ccxap.com](mailto:olivia_feng@ccxap.com)

Karissa Du +852-2860 7126

Credit Analyst

[karissa\\_du@ccxap.com](mailto:karissa_du@ccxap.com)

Elle Hu +852-2860 7120

Executive Director of Credit Ratings

[elle\\_hu@ccxap.com](mailto:elle_hu@ccxap.com)

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

### Client Services

Hong Kong +852-2860 7111

## Zhejiang Changsanhe Holding Group Co., Ltd.

### Surveillance credit rating report

**CCXAP affirms Zhejiang Changsanhe Holding Group Co., Ltd.'s long-term credit rating of A<sub>g</sub>-, with stable outlook.**

### Summary

The A<sub>g</sub>- long-term credit rating of Zhejiang Changsanhe Holding Group Co., Ltd. ("ZCHG" or the "Company") reflects (1) Huzhou Municipal Government's very strong capacity to provide support, and (2) the local government's very high willingness to provide support, based on our assessment of the Company's characteristics.

Our assessment of Huzhou Municipal Government's capacity to support reflects its good geographic advantage, with ongoing economic growth and outstanding fiscal quality. Yangtze River Delta Industrial Cooperation Zone (Huzhou) ("YICZ") was initiated to support the implementation of the national strategy of Yangtze River Delta Integrated Development in Huzhou City, which is a key area for the development of strategic emerging industries.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) monopoly position in the regional development of YICZ; and (2) good track record of receiving ongoing government payments.

However, the rating is constrained by the Company's (1) relatively large capital expenditure pressure; (2) moderate assets liquidity; and (3) moderate access to funding.

The stable outlook on ZCHG's rating reflects our expectation that the local government's capacity to support will remain stable, and the Company will maintain its monopoly position in the development of YICZ.

## Rating Drivers

- Monopoly position in the development of YICZ
- Relatively large capital expenditure pressure
- Good track record of receiving ongoing government payments
- Low but increasing exposure to commercial activities
- Increasing debt burden and moderate asset liquidity
- Moderate access to funding

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) the local 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 improvement in access to funding or asset quality.

### What could downgrade the rating?

The rating could be downgraded if (1) the local 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 its strategic significance; decrease in government payments; or increase in exposure to commercial activities.

## Key Indicators

	2021FY	2022FY	2023FY
Total Asset (RMB billion)	14.5	19.6	23.2
Total Equity (RMB billion)	14.4	16.8	16.9
Total Revenue (RMB billion)	0.6	0.7	0.7
Total Debt/Total Capital (%)	0.1	11.7	21.7

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

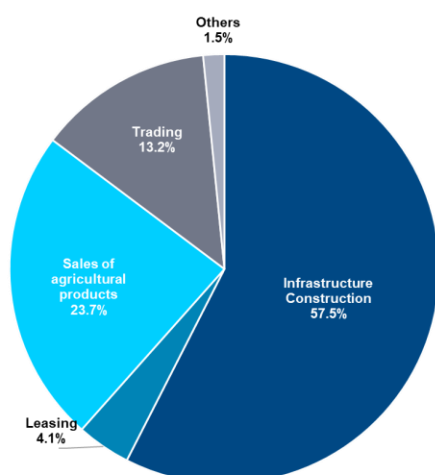
Source: Company data, CCXAP research

## Corporate Profile

Reorganized and established in 2022, ZCHG is authorized to be exclusively responsible for the development, construction, and investment of YICZ, mainly for the planning and development of 86.9 square kilometers of core area in the YICZ. The Company also engaged in commercial business such as assets leasing, trading of agricultural products and fund investment.

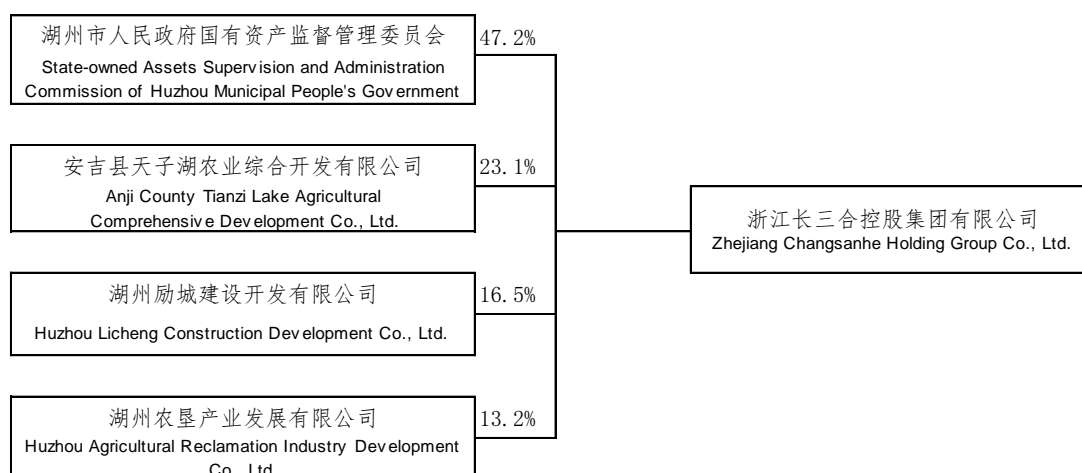
As of 31 December 2023, the State-owned Assets Supervision and Administration Commission of Huzhou Municipal People's Government ("Huzhou SASAC") was the Company's ultimate controller, directly holding 47.2% of the Company's shares, and indirectly holding 29.7% of the shares through the two companies, with a total shareholding of 76.9%. Anji County Tianzi Lake Agricultural Comprehensive Development Co., Ltd. held 23.1% of the Company's shares. The Management Committee of YICZ has been delegated control and oversight over the Company's daily operation and project investment by Huzhou SASAC.

## Exhibit 1. Revenue structure in 2023



Source: Company information, CCXAP research

## Exhibit 2. Shareholding and organization chart as of 31 December 2023



Source: Company information, CCXAP research

## Rating Considerations

### Government Capacity to Provide Support

We believe that Huzhou Municipal Government has a very strong capacity to provide support as reflected by its good geographic advantage and good fiscal stability. However, the capacity to support is constrained by its relatively weak debt profile.

Located in the northern part of Zhejiang Province, Huzhou City is the node city connecting the north and south areas of the Yangtze River Delta region. Huzhou City has four leading industries including information technology, high-end equipment, health and tourism. It has achieved a significant increase in gross regional product ("GRP") over the past three years. In 2023, Huzhou City recorded a GRP of RMB401.5 billion, increasing by 5.8% year-over-year ("YoY"). Due to the economic recovery and industry growth, Huzhou Municipal Government's general budgetary revenue increased from RMB38.7 billion in 2022 to RMB41.1 billion in 2023.

It also has good fiscal stability, with tax income accounting for around 90% of general budgetary revenue for the past three years. Its fiscal balance remained at a moderate level, with a general budgetary revenue to general budgetary expenditure ratio of 67.6% in 2023. However, Huzhou Municipal Government's debt burden was heavy with an outstanding direct government debt of RMB136.4 billion at end-2023, accounting for 34.0% of its GRP and 98.6% of its total fiscal revenue.

### Exhibit 3. Key Economic and Fiscal Indicators of Huzhou City

	2021FY	2022FY	2023FY
GRP (RMB billion)	364.5	385.0	401.5
GRP Growth (%)	9.5	3.3	5.8
General Budgetary Revenue (RMB billion)	41.4	38.7	41.1
General Budgetary Expenditure (RMB billion)	52.4	60.2	60.7
Local Government Debt (RMB billion)	102.3	118.9	136.4

Source: Statistics Bureau of Huzhou City, CCXAP research

Established in January 2022, YICZ is located at the intersection of the Hangzhou-Nanjing Economic Belt and the G60 Science and Technology Innovation Corridor. The core area of YICZ includes Si'an Town, Changxing County and part of Tianzihu Town, Anji County, with a planned area of 86.9 square kilometers. The start-up area of YICZ is located between Si'an Town and Tianzihu Town, with a total area of 24.3 square kilometers. It focuses on the layout of strategic emerging industries such as high-end equipment and new materials, and builds a "2+N" modern industrial system. As the sole development and construction entity in YICZ, ZCHG has great development opportunities in the development of infrastructure and supporting facilities. During the 14<sup>th</sup> Five-Year Plan period, ZCHG will focus on promoting the construction of 24.3 square kilometers of the start-up area in the zone.

### Government Willingness to Provide Support Monopoly position in the development of YICZ

As the sole development and construction entity in YICZ, ZCHG is authorized to carry out various construction projects, such as municipal roads, infrastructure, and resettlement housing in the YICZ. Apart from engaging in construction projects, the Company also takes responsibility for public utilities and industrial operations within the YICZ. Throughout the 14<sup>th</sup> Five-Year Plan period, there are sufficient construction projects in the pipeline, ensuring high business sustainability for the Company. Overall, as the sole development entity of YICZ, we expect that the Company's monopoly position will be maintained in the foreseeable future given the sustainability of its policy-related business.

The Company adopts the agency model and the repurchase model to conduct infrastructure construction projects. For the repurchase model, the Company entered into the entrusted construction agreement and charged 115% of the actual investment amount for project payment. The project funds in the repurchase model are self-raised. Under the agency construction model, the Company's subsidiaries signed the agent construction agreement with related parties. Under this model, special government bond funds cover part of the project construction funds, alleviating the financial burden on the Company's capital expenditure. As of the end of 2023, the Company had completed infrastructure projects with a total investment of RMB2.1 billion and a collected payment of RMB1.6 billion, mainly from projects under the repurchase model. At the same time, the Company had 11 infrastructure construction projects under construction, with an uninvested amount of RMB377.9 million.

The Company also participated in public utility services. It holds the pipe network use right, with a value of approximately RMB1.7 billion, which was obtained through the asset injection from the Management Committee of YICZ. The Company signed a three-year lease agreement with Changxing Si'an Oasis Sewage Treatment Co., Ltd in 2022, with an annual rental income of around RMB30 million. As of 31 December 2023, the Company had one drainage pipe renewal project in the Changxing area and Anji area under construction, with a total estimated investment of RMB520 million, of which RMB24 million has been invested.

### **Low but increasing exposure to commercial activities**

ZCHG's commercial businesses mainly include property leasing and industrial investment. We consider the Company's exposure to commercial businesses to be low, accounting for less than 10% of its total assets.

ZCHG engaged in the construction of self-operated projects, such as a manufacturing industrial park project and an energy storage power station. As of 31 December 2023, it had 5 major self-operated projects under construction or planning. The Company primarily relies on self-raised funds for the construction of these projects, which causes a large pressure on its capital expenditure. The Company will achieve capital balance by generating rental and sales income. Given the large amount of construction in self-operating projects, it is anticipated that the Company will increase its commercial activities exposure in the future.

The Company started its trading business in 2023, with products mainly including agricultural products and rebar. The Company's business model is purchase based on sales, with a settlement cycle of one month. The trading business contributes largely to the Company's total revenue. In 2023, the trading business recorded a revenue of RMB266.5 million, but its gross profit margin accounted for less than 1%. In addition, the Company has a high reliance on its top 5 customers and top 5 suppliers. If suppliers have related problems in product quality, supply capacity, and capital turnover, the Company may not be able to deliver goods to downstream customers on time.

ZCHG also participates in industrial investment projects. As of 31 December 2023, the Company had established 5 industrial funds with a total fund amount of RMB2.1 billion. These funds primarily target the new energy, high-end manufacturing, pharmaceutical, and information technology industries within YICZ. The industrial investment will attract high-quality enterprises and promote the development of YICZ, which will bring investment income to the Company in the future.

ZCHG has received 126 properties from the local government, with a total area of around 173.9 thousand square meters. All of these properties are located in Huzhou City. The Company has rented out these assets to generate rental income since 2022. However, these properties have a low overall occupancy rate and contribute little to the Company's revenue. The Company also owns many mines transferred by the Management Committee of YICZ, including quartz and sandstone mines, with a total reserve of 263 million tons and a total estimated value of RMB5.2 billion. The mineral resources primarily serve the purpose of project construction in YICZ. The Company takes responsibility for the supply of raw materials and sale of finished products, which may potentially generate mineral sales revenue in the future.

### **Good track record of receiving ongoing government payments**

ZCHG has a proven track record of receiving government support in the form of capital injection, asset transfers, and financial subsidies. The Company received a capital injection from the government at the beginning of the reorganization, and its paid-in capital increased from RMB31.5 million in 2021 to RMB2.3 billion at the end of 2023. Since 2020, the Huzhou Municipal Government transferred assets including minerals, pipe network and

real estate, into the Company, increasing its total capital reserve by RMB10.6 billion, which significantly enhanced its capital strength and broadened its business mix. From 2021 to 2023, the Company received RMB201.4 million in government subsidies to support its operation. Moreover, it has also received government special bonds of a total of RMB274.2 million as of the end of 2023. Due to its significant role in YICZ, we expect that the local government will continue to provide ongoing support to the Company in the future.

### **Increasing debt burden and moderate asset liquidity**

Due to the investment in construction projects, the Company is experiencing a growing debt scale. The Company's adjusted total debt increased significantly from RMB2.2 billion at end-2022 to RMB4.7 billion at end-2023. However, its debt leverage remains at a relatively low level, with a total capitalization ratio of 21.7%. The Company's short-term debt accounted for about 11.5% of its total debt, indicating a good debt structure. Nevertheless, as YICZ continues to develop and the Company undertakes more projects, we expect that there will be increasing pressure on capital expenditure in the future. This will primarily require reliance on external financing to meet the financial needs.

The Company's asset liquidity is moderate as its total assets are mainly inventories with weak liquidity. As of 31 December 2023, the Company's inventories amounted to RMB9.8 billion, accounting for 42.2% of total assets, and mainly consisted of construction costs caused by infrastructure construction projects and lands. In addition, as of 31 December 2023, the Company had pledged assets of RMB1.5 billion for loans, accounting for 6.4% of net assets. The moderate liquidity asset may undermine the Company's financing flexibility, which is credit negative.

### **Access to funding mainly from commercial banks**

As a newly established entity, the Company faces limitations in accessing funds, and therefore heavily relies on bank loans. Nevertheless, the Company is high profile in terms of its policy role and status to the Huzhou Municipal Government, the government directed state-owned financial institutions to finance ZCHG. The Company maintains a good relationship with several banks, including policy banks such as the Agricultural Development Bank and Commercial Banks such as the Industrial and Commercial Bank of China. As of 31 December 2023, the Company had obtained a total of RMB11.4 billion in bank credit facilities, with an available credit of RMB7.1 billion. However, the Company has not entered the bond market, and its debt is solely sourced from bank loans, with an average interest rate of 4.4%. The Company plans to issue bonds on both onshore and offshore markets, aiming to expand its financing channels.

## **ESG Considerations**

ZCHG assumes environmental risks through its infrastructure construction projects and drainage pipe renewal construction projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

In terms of social awareness, ZCHG has played a crucial role in the social welfare of YICZ by involving the construction of ecological restoration and greening system projects in YICZ.

In terms of corporate governance, ZCHG's governance considerations are also material as the Company is subject to local government oversight and reporting requirements, reflecting its public-policy role and status as a government-owned entity. As a newly established entity, the Company's corporate governance and management systems need to be improved.

## 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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**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](http://www.ccxap.com)

Email: [info@ccxap.com](mailto:info@ccxap.com)

Tel: +852-2860 7111

Fax: +852-2868 0656