

Credit Opinion

26 September 2024

Ratings	
Guaranteed Debt Rating	A _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.

Surveillance credit rating report

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

Summary

CCXAP has upgraded the long-term credit rating of Linzhou City Investment Holdings Co., Ltd. ("LZIH" or the "Company") to BBB_g from BBB_g-, reflecting LZIH's dominant role in the shantytown renovation and infrastructure construction in Linzhou City and the Company's enhancing financing ability.

The BBB_g long-term credit rating of LZIH reflects Linzhou City Government's (1) 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 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; (2) good track record of receiving government support; and (3) good access to funding channels.

However, the rating is constrained by the Company's (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
- Good access to funding channels
- 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; or (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

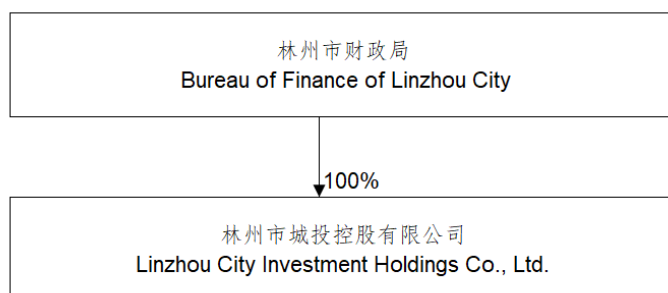
	2021FY	2022FY	2023FY	2024H1
Total Assets (RMB billion)	24.4	29.1	32.0	34.0
Total Equity (RMB billion)	9.3	14.9	15.5	15.8
Total Revenue (RMB billion)	5.4	5.8	4.4	1.3
Total Debt/Total Capital (%)	55.4	44.6	45.2	48.1

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

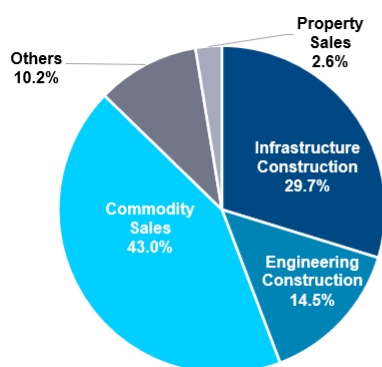
Source: Company data, CCXAP research

Corporate Profile

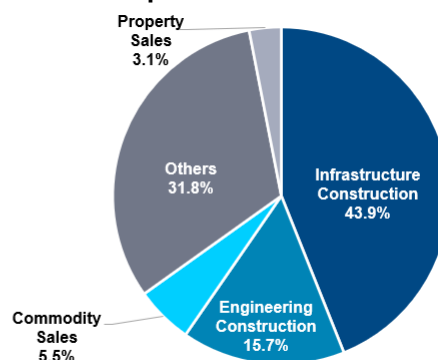
Established in December 2016, LZIH is the most important local infrastructure investment and financing company ("LIIFC") in Linzhou City, responsible for infrastructure construction and water services in Linzhou City. The Company has also diversified into other commercial business, including property sales, engineering construction, and commodity sales. As of 30 June 2024, the Company is directly owned and ultimately controlled by the Finance Bureau of Linzhou City.

Exhibit 1. Shareholding chart as of 30 June 2024

Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2023

Source: Company information, CCXAP research

Exhibit 3 Gross profit structure in 2023**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 one of the most developed provinces in China. It 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 6th among all provinces in China in 2023 with a GRP of RMB5.9 trillion and growth rate of 4.1% year-on-year ("YoY"). Meanwhile, its general budgetary revenue increased to RMB451.8 billion, an increase of 6.3% YoY. During the first half of 2024, Henan Province's GRP was RMB3,123.1 billion, a YoY increase of 4.9%.

Located in the north of Henan Province, Anyang City 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 2023, it reported a GRP of RMB248.6 billion, representing a YoY growth rate of 3.2%. In the first half of 2024, Anyang City achieved a GRP of RMB126.4 billion, with a YoY growth rate of 3.4%. Meanwhile, the Anyang Municipal Government's general budget revenue steadily grew to RMB23.6 billion in 2023 from RMB20.1 billion in 2021, of which tax income each year accounted for over 60%, indicating a relatively good fiscal quality. However, the Anyang Municipal Government has moderate fiscal balance ratio (general budgetary

revenue/general budgetary expenditure), averaging 52.7% over the past three years, indicating its high reliance on fiscal support from higher-tier government. In 2023, the Anyang Municipal Government received transferring income of around RMB25.2 billion from the Henan Provincial Government. As of end-2023, its government debt balance increased to RMB71.3 billion from RMB62.2 billion at end-2022, accounting for 28.7% of GRP.

Exhibit 4. Key economic and fiscal indicators of Anyang City

	2021FY	2022FY	2023FY
GRP (RMB billion)	243.6	251.2	248.6
GRP Growth (%)	5.0	2.4	3.2
General Budgetary Revenue (RMB billion)	20.1	22.2	23.6
General Budgetary Expenditure (RMB billion)	37.4	42.8	44.7
Local Government Debt (RMB billion)	49.5	62.2	71.3

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. Linzhou City's GRP ranked first among all the districts or counties in Anyang City for the past few years. It recorded a GRP of RMB65.1 billion in 2023, representing a YoY growth rate of 3.4%. In 2023, its general budgetary revenue grew to RMB5.0 billion, of which tax revenue accounted for 70.9%, indicating a relatively good fiscal quality. Meanwhile, Linzhou City maintained a moderate fiscal balance with an average fiscal balance ratio of over 64% for the past three years. As of 31 December 2023, the outstanding debt of Linzhou City Government amounted to RMB9.0 billion, accounting for 13.9% of its GRP.

Exhibit 5. Key economic and fiscal indicators of Linzhou City

	2021FY	2022FY	2023FY
GRP (RMB billion)	61.5	65.7	65.1
GRP Growth (%)	6.3	4.8	3.4
General Budgetary Revenue (RMB billion)	4.0	4.4	5.0
General Budgetary Expenditure (RMB billion)	6.7	6.8	7.3
Local Government Debt (RMB billion)	7.8	8.2	9.0

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 a dominant role in local shantytown renovation and infrastructure construction. It also carries out essential public services in Linzhou City, except for the Hongqiqu Economic and Technological Development Zone, such as water supply, sewage treatment, and provision of public transportation. We believe that the replacement cost for the Company's role is high as these public services are essential for local residents and regional development.

As the main developer in Linzhou City, LZIH has high sustainability in undertaking shantytown renovation and infrastructure construction projects in the region. The Company mainly undertakes projects 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 2024, the PPP projects, namely the public service center construction and river improvement projects, have been completed, and there is no subsequent PPP project under construction or planning. For projects under agency construction and government purchase model, as of 30 June 2024, the Company had 10 projects under construction, mainly including shantytown renovation, urban renewal, river regulation, and upgrading of pipe network projects, with a total investment amount of RMB12.3 billion and an uninvested amount of RMB1.5 billion. At the same time, the Company had 3 agency construction projects under planning with a total estimated investment amount of RMB6.8 billion. The relatively large number of projects under construction and planning could ensure the sustainability of LZIH's infrastructure construction business, yet also bring certain capital expenditure pressure to the Company.

LZIH also undertakes the responsibility of providing essential public services in Linzhou City, including water supply, sewage treatment, and bus operation. The Company is responsible for the water supply of Linzhou City and the domestic sewage treatment in the urban area of Linzhou City. As of 30 June 2024, LZIH owned and operated 3 water supply plants with a daily water supply capacity of 220,000 square meters, and water supply pipeline network with a total length of 326.8 kilometers. Moreover, the Company is responsible for sewage treatment service via one sewage treatment plant with daily sewage treatment capacity of 50,000 tons, and sewage pipe network of 157 kilometers, covering an area of 27 square kilometers. The Company also engages in public transportation service in Linzhou City and is the only entity operating public transportation business in Linzhou City. LZIH owned 150 buses covering 28 routes in Linzhou City. Overall, 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 asset injections, capital injections, and operating subsidies to support its investments and the operation of its businesses. Since its establishment, the local government injected assets and equity shares of other state-owned enterprises in Linzhou City, which increased the Company's capital reserve significantly from RMB8.1 billion at end-2021 to RMB13.6 billion as of 30 June 2024. In addition, LZIH also has a track record of receiving government payments. As of the same date, the Company has received government purchase service fees totaling of RMB3.5 billion for its construction projects under government purchase model. In 2023, the Company received cash injection from the local government, increasing its paid-in capital from RMB284.7 million as of end-2022 to RMB600.0 million as of end-2023. Meanwhile, the local government provided subsidies of RMB93.5 million to the Company, to support its operation and development. Considering its strategic role in social and economic development of Linzhou City, we expect the local government will continue to provide support to the Company.

Medium and increasing exposure to commercial activities

In addition to public activities, LZIH participates in various commercial activities such property sales, commodity sales and engineering construction. We consider the Company's exposure to commercial businesses to be medium, as its commercial assets accounted for 15% to 20% of its total assets as of 30 June 2024. However, considering the Company's ongoing investment in the property development, we expect its exposure to commercial activities would increase in the future.

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 2024, most of the completed commercial housings were sold. There were 3 commercial residential housing under

construction as of the same date, with a total investment amount of RMB1.6 billion and uninvested amount of RMB313.2 million. As of the same date, the average destocking ratio of these projects was 72.6%, indicating relatively good sales progress, especially given the recent recession in the real estate market. Meanwhile, there were 2 commercial residential housing units under planning, with a total investment amount of RMB1.1 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 2024, the Company had 11 contracts on hand with a total contract amount of 4.0 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, LZIH engages in commodity sales to support local construction industry development, mainly construction-related products. However, affected by the slowdown of local property market, LZIH recorded a drop in revenue from RMB3.0 billion in 2022 to RMB1.9 billion in 2023. The scope of the commodity sales business has narrowed from a variety of products, such as building materials, rubber, sand, and gravel, to only electrolytic copper. The Company will adjust its product range according to market demand and market conditions. In addition, the commodity sales business bears relatively high concentration risks. As of 31 December 2023, the top 5 suppliers and customers accounted for 83.1% and 65.3% 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 ongoing financing for construction projects, LZIH's has demonstrated ongoing debt growth and increasing debt leverage. As of 30 June 2024, LZIH's total debt increased to RMB14.6 billion from RMB11.9 billion as of 30 June 2023, while its total capitalization ratio, as measured by total debt to total capital, increased to 48.1% from 44.4% over the same period. In addition, the Company faced certain short-term debt burden, with the short-term debt accounting for 29.4% of the total debt. The Company's cash to short-term debt ratio decreased from 0.3x to 0.2x over the same period, indicating a relatively high refinancing need to cover its short-term debt. Considering the Company's funding needs for its ongoing and planned construction projects, we expect that the Company would continue to rely on external financing to support its business, and its total debt level would further increase over the next 12-18 months.

LZIH's asset liquidity was moderate. As of 30 June 2024, the Company had pledged some assets for loans, including cash, inventories, and investment properties, with a total restricted amount of RMB4.8 billion, accounting for 14.0% of total assets and 30.2% of net assets, respectively. On top of that, on 30 June 2024, the Company's inventories (22.5%), contract assets (22.4%), other receivables (11.9%), and fixed properties (16.5%) 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 is a risk of recovery associated with the receivables 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 2024, and the likelihood of receiving repayments was considered low.

Good access to funding channels

LZIH has good access to funding channels, including bank loans, bond issuance, and non-standard financing. Bank loans account for the majority of total debt, more than 70%, as of 30 June 2024. 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 28 August 2024, the Company had total bank facilities of RMB13.5 billion, with an unutilized portion of RMB2.5 billion.

The Company also has a track record for fund-raising activities in the debt capital market. In 2023, the Company's subsidiary Linzhou Investment Group Co., Ltd. issued 2 tranches of private placement corporate bonds, raising RMB600 million in the onshore bond market. In 2024, the Company further expanded its funding channels to the offshore debt capital market. In 2024, the Company issued 2 tranches of offshore bonds to raise RMB1.1 billion. Moreover, the Company had a manageable exposure to non-standard financing, accounting for less than 10% of total debt. Taking into account the Company's important status as the most important LIIFC in Linzhou City, we expect the Company to maintain access to stable funding and retain good refinancing capabilities.

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 2024, the Company's external guarantees increased to RMB4.9 billion, accounting for 30.8% 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 4.3% 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

The guaranteed debt rating was assigned to the bonds (ISIN: HK0001037859) issued by LZIH and unconditionally and irrevocably guaranteed by Henan Zhongyu Credit Promotion Co., Ltd. ("HZCP"). The rating of bond is based on the rating of HZCP, who is the first provincial credit enhancement company in Henan

Province, founded under the guidance of the State-owned Assets Supervision and Administration Commission of Henan Provincial Government in February 2022. We believe HZCP has a high likelihood of receiving government support given its indirect ownership and ultimate control by the Henan Provincial Government, very high strategic function for the financial environment of Henan Province, and solid support record of receiving from the government and major local SOEs.

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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