CCXAP assigns first-time long-term credit rating of BBB_g- to Shandong Honghe Holding Group Co., Ltd, with stable outlook.

Hong Kong, 8 February 2024 – China Chengxin (Asia Pacific) Credit Ratings Company Limited ("CCXAP") has assigned first time long-term credit rating of BBB_g- to Shandong Honghe Holding Group Co., Ltd. ("SHHG" or the "Company"), with stable outlook.

The BBB_g- long-term credit rating of SHHG 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) ongoing revenue growth and good profitability.

The rating also reflects the parent's willingness to support, which is based on the Company's 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.

However, the rating is 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 and weak asset liquidity; and (4) a moderate liquidity profile with limited credit facilities.

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. As of 30 September 2023, the Company was wholly owned by ZCUA, the largest LIIFC by asset scale in Zoucheng City; and it is ultimately controlled by the State-owned Asset Supervision and Administration Bureau of Zoucheng City ("Zoucheng SASAB").

Rating Rationale

Credit Strengths

Major coal mining company in Zoucheng City with a concentration in coal mining and trading. SHHG is a significant local state-owned enterprise in Zoucheng City that 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.

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

Good profitability benefiting from overall coal market condition. From 2020 to 2022, SHHG's after-tax profit rose from RMB229.6 million to RMB413.8 million, thanks to the robust performance of the overall coal market and the Company's competitive presence in the local market. The main growth engines of the revenue growth were the coal trading business and the coalfield management business.

Credit Challenges

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. The nationwide increase in commodity prices has led to higher raw material costs, significant increases in employee wages, and an overall rise in production costs due to enhanced coal mine security measures. Additionally, various taxes and fees, such as resource taxes, have also increased. These costs increase in this particular area and are expected to be largely irreversible in the short term.

Small scale of coal mining production and reserves. The Company has relatively small-scale of 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 from 2020 to 2022 was 1.4 million tons, which is relatively small compared to the industry average.

Relatively high debt leverage with certain debt repayment pressure. Due to the industry nature, coal mining enterprises generally have a high debt leverage. As of 30 September 2023, the Company's total capitalization ratio increased to 47.1% in 2023Q3 from 40.3% in 2020, and the debt/asset ratio stood at 51.0% as of 2023Q3, compared to 52.3% in 2020. Its EBIT/interest expense ratio has been at a low level, ranging between 1.9x to 2.2x from 2020 to 2022. The (CFO- dividends)/total debt ratio has also been weak, which was 2.7% in 2022. Hence, we believe that the Company is weak in terms of debt servicing capability.

Moderate liquidity profile. As of the end of September 2023, the Company has obtained a total bank credit line of RMB2.2 billion, with an unused limit of RMB292.0 million. The available credit facility is relatively small compared to the Company's business scale and total debt. In contrast, around 66.0% of the Company's interest-bearing debt is debt financing as of 30 September 2023.

Rating Outlook

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.

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.

Rating Methodology

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

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