CCXAP assigns first-time long-term credit rating of BBB_g to Zhejiang Nanxun Rural Commercial Bank Co., Ltd., with stable outlook.

Hong Kong, 13 May 2024 – China Chengxin (Asia Pacific) Credit Ratings Company Limited ("CCXAP") has assigned a first-time long-term credit rating of BBB_g to Zhejiang Nanxun Rural Commercial Bank Co., Ltd. ("NRCB" or the "Bank"), with stable outlook.

The BBB_g long-term credit rating of NRCB is underpinned by the Bank's (1) strong market franchise in Nanxun District; (2) limited exposure to market funds and solid deposit base; (3) low level of non-performing loan comparing with its peers; and (4) ongoing operating support from Zhejiang Rural Commercial United Bank ("ZRCB") in terms of business development, risk management and information system configuration.

However, the rating is constrained by the Bank's (1) squeezing profitability as a result of the narrowing net interest margin and higher credit costs; (2) asset quality which is sensitive to economic downturns because of its large exposure to small and medium-sized enterprises ("SMEs") and geographic concentration of loan portfolio; and (3) decreasing capital adequacy ratios resulting from continuous loan portfolio expansion.

The rating also incorporates our assumption that the Bank is likely to receive extraordinary support from ZRCB and the government in times of need, given its (1) moderate position in the financial system of Zhejiang Province, with strong franchise in Nanxun District; and (2) track record of receiving support from ZRCB.

Corporate Profile

NRCB was established in 2010 based on the shareholding reform of the former Nanxun Rural Credit Union founded in 1996. It is the first rural commercial bank in Zhejiang Province and is positioned to serve the local economy, SMEs, and urban and rural residents. NRCB has a dominant market position and extensive branch network in Nanxun District, Huzhou City, Zhejiang Province. It ranked first for years in the local banking market, with a market share of 44.5% in deposits and 27.8% in loans as of the end of 2023. NRCB also promotes regional expansion through the development of off-site sub-branches and village banks. It has established a total of 14 village banks in Anhui Province and Zhejiang Province, with the shareholding ratios ranging from 35% to 60%. As of 31 December 2023, NRCB reported total assets of RMB90.8 billion and net assets of RMB7.6 billion.

NRCB is one of the member banks of ZRCB under its monitoring, guidance and supervision. ZRCB is the largest bank in Zhejiang Province, formed under the restructuring of the local rural credit societies in the province in 2022, with a registered capital of approximately RMB5.0 billion.

Rating Rationale

Credit Strengths

Strong market franchise in Nanxun District, with an extensive branch network. NRCB has a strong market franchise in Nanxun District, with an extensive network of more than 40 sub-branches in the district, covering most of the county and rural areas where other banks do not have large presence, and having close ties with local community. It has ranked first for years in the local banking market with a market share of 44.5% in deposit and 27.8% in loan, as of the end of 2023. The Bank also expands its branch networks to other areas in Zhejiang Province including Huzhou City and Hangzhou City, and has 14 village banks in Anhui and Zhejiang Provinces.

Limited exposure to market funds and solid deposit base. NRCB is a deposit-funded bank and has limited exposure to market funds over the past fast five years. NRCB's market funds mainly came from the borrowings from the central bank and debt securities issued. It has limited exposure to the interbank or repurchase agreement (repo) business. NRCB's deposit base is solid and growing, underpinned by its strong franchise and branch networks in Nanxun District. It has reported double-digit percentage growth in deposits over the past five years.

Low level of non-performing loan. NRCB's non-performing loan ratio has remained low at under 1% over the past five years. Its special-mentioned loan ratio has also remained low. The Bank's low non-performing loan ratio was benefited from its good asset sales and write-offs. Most of the non-performing loans came from local individual clients in manufacturing and wholesales & retail sectors who have experienced operating difficulties during economic downturn.

Likely to receive extraordinary support from ZRCB and the government in times of need. Although NRCB does not have direct nor indirect shareholding from the government, we believe the Bank is likely to receive extraordinary support from ZRCB and the government in times of need, given its (1) moderate position in the financial system of Zhejiang Province, with strong franchise in Nanxun District; and (2) track record of receiving support from ZRCB.

Credit Challenges

Profitability challenged by the narrowing net interest margin and higher credit cost. The Bank's profitability is challenged by the narrowing net interest margin and higher credit costs. Its net interest margin is likely to trend slightly lower because of the loan prime rate reform and lowering loan pricing yields to support the real economy. NRCB is also facing swelling credit costs. We expect that the advancement of interest rate liberalization, policy requirements for fee reductions and profit concessions, and intensified peer competition may put further downward pressure on net interest margins, thereby affecting the Bank's profitability stability and sustainability.

Asset quality sensitive to economic downturns. NRCB's asset quality is constrained by its relatively high industry and geographical concentration. The majority of the Bank's lending business comes from Huzhou City and Hangzhou City and its customer base is dominated by local manufacturing, wholesale and retail enterprises. Some local manufacturers, such as those in the elevator and timber processing segments, may be adversely affected by the weak property market in China. The large exposure to SMEs, who in general have weaker credit profiles, is likely to weigh on the Bank's asset quality during an economic downturn.

Decreasing capital adequacy ratios with continuous asset growth. The Bank's capitalization is constrained by its moderating growth in profit retention and fast-growing risk-weighted asset ("RWA") base. The moderating profitability of the Bank, as seen by its lowering ROA, has weakened its endogenous capital growth, which drives the majority of capital replenishment. NRCB has actively issued perpetual bonds and secondary capital bonds, which, to a certain extent, has alleviated its capital replenishment pressure.

Rating Outlook

The stable outlook on NRCB's rating reflects our expectation that the business and financial profile of the Bank will be stable, and the Bank will maintain its important market position in Nanxun District over the next 12 to 18 months.

What could upgrade the rating?

The rating could be upgraded if (1) the likelihood of receiving government support increases; (2) the Bank's macro profile strengthens, such as higher sovereign rating for China, significant improvement in corporate debt leverage, or better credit condition in China; and (3) the Bank's financial profile improves constantly, such as improved profitability and sustainability or enhanced funding access.

What could downgrade the rating?

The rating could be downgraded if (1) the likelihood of receiving government support declines; (2) the Bank's macro profile weakens, such as lower sovereign rating for China, heightened corporate debt level, or worsened credit condition in China; or (3) the Bank's financial profile deteriorates significantly, such as declined asset quality or severely weakened liquidity.

Rating Methodology

The methodology used in this rating is the Rating Methodology for Banks (November 2021).

Regulatory Disclosures

CCXAP's Rating Symbols and Definitions are available on its website at:
http://www.ccxap.com/en/rating_services/category/6/

This rating is solicited. Please refer to CCXAP's Policy for designating and assigning Solicited and Unsolicited Credit Ratings available on its website at:
http://www.ccxap.com/en/rating_services/category/9/

The rating has been disclosed to the rated entity or its related party prior to publication, and issued with no amendment resulting from that disclosure.

CCXAP considers a rated entity or its related party to be participating when it maintains an overall relationship with CCXAP. Unless specifically noted in the Regulatory Disclosures as a non-participating entity, the rated entity or its related party is participating and the rated entity or its related party generally provides CCXAP with information for the purposes of its rating process.

Regulatory disclosures contained here apply to press release, rating report, and if applicable, the related rating outlook or rating review.

CCXAP's public ratings are available at www.ccxap.com (Rating Results) and may be distributed through media and other means.

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

Vincent Tong
Assistant Director of Credit Ratings
+852-2860 7125
vincent_tong@ccxap.com

Elle Hu
Executive Director of Credit Ratings
+852-2860 7120
elle_hu@ccxap.com

Client Services: +852-2860 7111

A credit rating is the analytical result of current credit worthiness and forward-looking opinion on the credit risk of a rated entity or a debt issue. Credit ratings issued by CCXAP are opinions on the current and relative future credit risk of the rated entities or debt issues, but do not address any other risks, including but not limited to liquidity risk, market price risk, and interest rate risk.

Credit ratings, non-credit assessments, and other opinions included in CCXAP’s publications are not recommendations for investors to buy, sell, or hold particular securities, nor measurements of market value of the rated entities or debt issues. While obtaining information from sources it believes to be reliable, CCXAP does not perform audit and undertakes no duty of independent verification or validation of the information it receives from the rated entities or third-party sources.

All information contained herein belongs to CCXAP and is subject to change without prior notice by CCXAP. CCXAP considers the information contained herein to be accurate and reliable. However, all information is provided on an "as is" and "as available" basis and CCXAP does not guarantee accuracy, adequacy, completeness, or timeliness of the information included in CCXAP’s publications.

To the extent where legally permissible, CCXAP and its directors, officers, employees, agents and representatives disclaim liability to any person or entity (i) for any direct or compensatory losses or damages, including but not limited to by any negligence on the part of, and any contingency within or beyond the control of CCXAP or any of its directors, officers, employees, agents or representatives, arising from or in connection with the information contained herein or the use of or inability to use any such information; and (ii) for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if CCXAP or any of its directors, officers, employees, agents or representatives is advised in advance of the possibility of such losses or damages.

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
Email:	info@ccxap.com
Tel:	+852-2860 7111
Fax:	+852-2868 0656