

Credit Opinion

17 August 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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Jiangsu Furu Donghai Development Group Co., Ltd.

Initial credit rating report

CCXAP assigns first time long-term credit rating of BBB_g- to Jiangsu Furu Donghai Development Group Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Jiangsu Furu Donghai Development Group Co., Ltd. (“FDDG” or the “Company”) reflects (1) the Donghai County Government’s relatively strong capacity to provide support; and (2) the local government’s extremely high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of Donghai County Government’s capacity to provide support reflects its ongoing economic growth, but is constrained by its relatively small economic scale and relatively weak fiscal balance.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) full ownership by the Donghai County Government; (2) essential role in the economic development of Donghai County; and (3) good track record of receiving government support.

However, the rating is constrained by the Company’s (1) medium business risk to commercial activities; (2) certain exposure to non-standard financing; and (3) medium level of contingent risk.

The stable outlook on FDDG’s rating reflects our expectation that the local government’s capacity to provide support will remain stable, and the Company will maintain its important position in the development of Donghai County.

Rating Drivers

- Essential role in the economic development of Donghai County
- Medium business risk to commercial activities
- Good track record of receiving government support
- Increasing debt level to support investment in infrastructure construction projects
- Certain exposure to non-standard financing
- Medium level of contingent risk

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the Donghai County Government's ability to provide support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as improving financing ability and materially increasing strategic importance.

What could downgrade the rating?

The rating could be downgraded if (1) the Donghai County Government's ability to provide support weakens; or (2) the Company's characteristics change in a way that decreases the local government's willingness to provide support, such as reduced policy significance or material deteriorated debt management.

Key Indicators

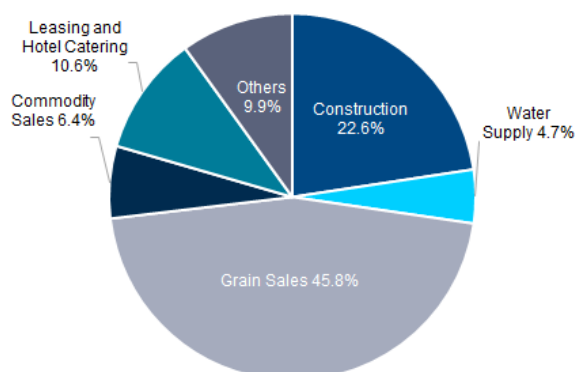
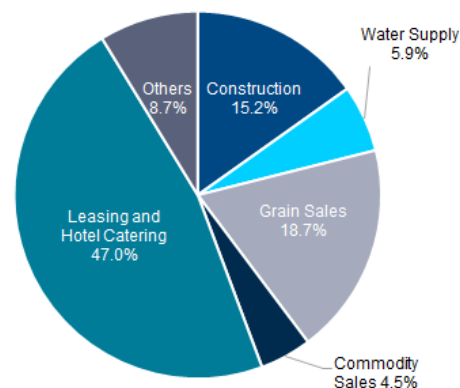
	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	19.9	21.3	21.8	23.0
Total Equity (RMB billion)	8.6	8.9	9.1	9.1
Total Revenue (RMB billion)	0.8	0.9	1.1	0.3
Total Debt/Total Capital (%)	47.1	49.7	52.7	55.5

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

Source: CCXAP research

Corporate Profile

Established in 2003, FDDG is one of the key local infrastructure investment and financing companies ("LIIFCs") in Donghai County. It mainly engages in infrastructure construction, water supply, grain sales, commodity sales, and property leasing, hotel and catering in Donghai County. As of 31 March 2023, Donghai County Government was the ultimate controller of FDDG, directly holding 100% shares of the Company. The Company's total assets were RMB23.0 billion as of 31 March 2023.

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 Donghai County Government has a relative strong capacity to provide support to the Company, given its ongoing economic growth over the past few years. However, its fiscal balance was relatively weak.

Jiangsu Province is one of the leading developed provinces in China. It is home to many of the world's leading electronic equipment, chemical, and textile enterprises, and is the second largest province in China by gross regional products ("GRP"), after Guangdong Province. In 2022, Jiangsu Province's total GRP amounted to RMB12.3 trillion, a year-over-year ("YoY") increase of 2.8%. The per capita GRP of the same period was RMB144,390, ranking first among all provinces in the country.

Lianyungang City is one of the first 14 Chinese coastal cities opening to the outside world and has one of the major ports of China — the Lianyun Port. With geographic advantages, it has developed industries such as petrochemicals, ferrous metallurgy, and mechanical equipment manufacturing. Currently, Lianyungang City also promotes new industries such as new medicine, new materials, new energy, and high-end equipment industries. From 2020 to 2022, Lianyungang City's economic strength improved steadily with GRP increasing from RMB327.7 billion to RMB400.5 billion, ranking as one of the Top 100 prefecture-level cities in China. However, affected by the government policy of tax rebates, in 2022, Lianyungang Municipal Government's tax revenue decreased by 41.5% to RMB12.7 billion from 2021, while its general budget revenue decreased to RMB21.3 billion and fiscal stability (tax/general budget revenue) decreased to 59.9%. Moreover, the fiscal balance of Lianyungang Municipal Government was relatively weak, with fiscal balance ratios (General Budgetary Revenue/ General Budgetary Expenditure) less than 50% over the past three years, indicating high reliance on government fund revenue and fiscal support from high-tier governments. The local government's outstanding debt amounted to RMB68.0 billion as of the end of 2022, accounting for about 17% of GRP.

Exhibit 3. Key economic and fiscal indicators of Lianyungang City

	2020FY	2021FY	2022FY
GRP (RMB billion)	327.7	372.8	400.5
GRP Growth (%)	3.0	8.8	2.4
General Budgetary Revenue (RMB billion)	24.5	27.5	21.3
General Budgetary Expenditure (RMB billion)	50.2	53.4	53.6
Local Government Debt (RMB billion)	61.4	65.8	68.0

Source: Statistics Bureau of Lianyungang City, CCXAP research

Donghai County is a county-level city under the jurisdiction of Lianyungang City, located at the junction of Jiangsu Province and Shandong Province. It is well-known for its rich silicon mineral resources, famed as the “crystal county” in China, and ranks as one of the top 100 counties for high-quality development in China. Donghai County has developed several core industries, including silicon product processing industry, food manufacturing industry, new building material manufacturing industry, mechanical equipment manufacturing industry and textile industry. From 2020 to 2022, Donghai County’s economic strength improved steadily with GRP increasing from RMB55.4 billion to RMB68.4 billion, ranking third among all districts and counties in Lianyungang City. Donghai County Government’s general budgetary revenue also continued to increase and reached RMB3.0 billion in 2022. Tax revenue is a stable contribution to the general budgetary revenue, accounting for over 70% over the past three years. However, Donghai County Government’s fiscal balance is relatively low with fiscal balance ratios around 30% over the past three years. It relies highly on governmental fund income and payments from high-tier governments to balance its fiscal budget. Its outstanding government debt amounted to RMB9.1 billion at end-2022, accounting for about 13.3% of GRP.

Exhibit 4. Key economic and fiscal indicators of Donghai County

	2020FY	2021FY	2022FY
GRP (RMB billion)	55.4	63.3	68.4
GRP Growth (%)	4.1	9.1	4.2
General Budgetary Revenue (RMB billion)	2.5	3.0	3.0
General Budgetary Expenditure (RMB billion)	7.8	8.4	7.9
Local Government Debt (RMB billion)	8.0	8.8	9.1

Source: Statistics Bureau of Donghai County, CCXAP research

Government’s Willingness to Provide Support Essential role in the development of Donghai County

FDDG is one of the key state-owned enterprises in Donghai County, playing an essential role in the development, construction, and operation of Donghai County. It is primarily responsible for promoting the development of local industries and conducting construction including infrastructure construction and factories in Donghai County.

FDDG undertakes infrastructure construction mainly in rural areas under both agency construction and self-operated mode. Under the agency mode, the Company signs construction agreements with the local government and carries out the construction work accordingly. The client pays the Company based on the investment amount plus 15% as a management fee upon completion. As of 31 March 2023, the Company had completed 4 key projects, with a total investment of RMB2.8 billion and 4 key projects under construction, including the construction of a kindergarten and safe water projects, with a total investment of RMB1.6 billion. The Company had no agency projects under planning and the expenditure pressure on agency projects was

light. Furthermore, the Company is expected to undertake urban renewal projects designated by the local government in the future, including the construction of infrastructure and supporting facilities. Such projects are essential to the sustainable development of Donghai County and are beneficial to the local livelihood.

FDDG engages in water supply covering both the urban and rural areas of Donghai County. The business scope covers the water supply and sewage treatment of residential water, commercial water, and industrial water in Donghai County. As of 31 March 2023, the Company owned two water supply plants with a total water supply capacity of 700,000 tons per day and around 19,571 kilometers of pipelines. The Company also undertakes the function of policy grain storage and circulation. It is the sole entity responsible for the acquisition, storage, and conversion of county-level grain reserves in Donghai County, and the scale of reserves is determined by the local government. The Company is allowed to sell the policy grain to the public market, which contributes a main component of its revenue. As of 31 March 2023, FDDG had 106 grain warehouses for policy grain storage, with 109,540 tons of grain in storage. The Company receives management fees and enjoys fiscal subsidies for the policy grain storage business.

Medium commercial business risk

FDDG diversified into other business segments such as self-operated construction, leasing, and trading. While the commercial activities generate supplemental income, they may also pose higher operational and business risks than public-policy businesses. The Company has medium exposure to commercial activities, accounting for less than 30% of the Company's total assets, according to our assessment.

FDDG also undertakes self-operated construction projects, including industrial parks, factory buildings and grain warehouses. The investment in such self-operated projects will be balanced by the future operating income, such as rental and sales revenue, which may expose the Company to higher business risks. As of 31 March 2023, the Company had completed 5 key self-operated projects with a total investment of RMB1.5 billion. As all self-operated projects had just been completed and had not yet generated income to the Company as of 31 March 2023, the future income of these businesses is on the watching list. At the same time, there were large outstanding investments in self-operated projects. As of 31 March 2023, the Company had 6 key projects under construction, with a total investment of RMB1.3 billion and an outstanding amount of RMB785 million. The large future investment would increase the pressure on FDDG's capital expenditure.

FDDG diversified its business to leasing and trading business. The leasing business provides additional recurring income to the Company, including office buildings and shopping malls. As of 31 March 2023, the Company had a total leasable area of 54,300 square meters, most of which were leased out. The trading business mainly involves trading in building materials, such as steel and concrete, and food, with a small profit margin. The Company mainly adopts demand-on-purchase mode which means orders to upstream suppliers would be placed only when the sale contracts are signed with downstream customers. The concentration risks from upstream and downstream customers are high. One of the Top 5 downstream customers, Jiangsu Construction Engineering Group Co., Ltd., was listed as a Dishonest Judgment Debtor.

Solid track record of receiving government support

In recognition of the strategic importance of FDDG's businesses to the development of Donghai County, the Company has received comprehensive support from the local government, in terms of capital injections, project repayments, and operating subsidies. The Company is expected to receive government payments in the future for its infrastructure construction projects as the related agreement is signed with the local government. However, the government payment was slow, subject to annual government fiscal arrangement. As of 31 March 2023, the

Company received a total of RMB2.3 billion in project repayments.

In addition, the Company has received equity shares of some state-owned enterprises (“SOEs”) from the local government such as shopping mall companies, which increased capital strength and overall competitiveness of the Company. Furthermore, the local government provided continuous operating subsidies with total amount of more than RMB915.3 million from 2020 to 2022. We expect FDDG to receive ongoing government support given its essential role in infrastructure construction and public services in Donghai County.

Diversified funding sources but certain exposure to non-standard financing

FDDG reported fast debt growth mainly owing to its infrastructure construction over the past few years. As of 31 March 2023, the Company’s total debt increased to RMB11.4 billion from RMB7.6 billion at end-2020. At the same time, the total capitalization ratio, as measured by total debt to total capital, also increased to 55.5% from 47.1% at end-2020. Although the debt structure of the Company continues to improve, the short-term debt remained a relatively large portion of total debt. As of 31 March 2023, the proportion of short-term debt to total debt decreased to 40.3% from 52.7% as of end-2021. Furthermore, the cash to short-term debt ratio increased to 0.9x from 0.6x as of end-2021. Considering the time lag in government payments, the outstanding investment in these projects may rely on external financing.

FDDG has diversified funding sources, including bank borrowing, debt capital market and non-standard financing, which may partially release its large investment needs. FDDG has maintained good relationships with large domestic banks such as policy banks, national joint-stock commercial banks and state-owned large commercial banks. As of 31 March 2023, it had total credit facilities of approximately RMB8.8 billion with an unused portion of around RMB2.7 billion, which were provided by diversified banks. FDDG also has access to the onshore debt capital market and issued different financial products in the onshore bond market such as corporate bonds, MTNs and PPNs. From January 2022 to June 2023, it issued 3 tranches of bonds with coupon rates from 3.00% to 6.5%, raising RMB760 million. However, FDDG had certain exposure to nonstandard financing, accounting for around 20% of the total debt as of 31 March 2023, mainly provided by financial leasing companies.

Medium level of contingent risk

FDDG’s credit profile is constrained by its external guarantees, which could potentially increase its repayment obligations. As of 31 March 2023, the Company had external guarantees of RMB5.3 billion, accounting for more than 50% of its net assets, which exposes the Company to substantial contingent liabilities. The guarantees were provided to other state-owned enterprises within Donghai County. If a credit event occurs in Donghai County, it may lead to large-scale cross-effects. However, we estimate most of these local SOEs are likely to be supported by the local government when necessary so that contingent risk would be controllable.

ESG Considerations

FDDG faces environmental risks because it has undertaken infrastructure construction projects. Such risks could be moderated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

FDDG bears social risks as it implements public policy initiatives by building public infrastructure in Donghai County. 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.

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

Structural Consideration

FDDG's senior unsecured debt rating is in line with its long-term credit rating. We believe that government support will flow through the Company given its important position in the development of Donghai County, 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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