

Credit Opinion

29 December 2023

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB _g +
Outlook	Stable

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Yantai Chefoo Finance Holding Group Co., Ltd

Surveillance credit rating report

CCXAP affirms Yantai Chefoo Finance Holding Group Co., Ltd's long-term credit rating at BBB_g+, with stable outlook.

Summary

The BBB_g+ long-term credit rating of Yantai Chefoo Finance Holding Group Co., Ltd ("Yantai Chefoo" or the "Company") reflects Zhifu District 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 Zhifu District Government's capacity to support reflects its sound economic fundamentals and fiscal strength, such as high fiscal balance ratio and manageable debt burden.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) ultimate control by the Zhifu District Government; (2) strategic importance in the regional development of Zhifu District; (3) solid government support through capital injections, asset transfers, and subsidies; and (4) good access to funding from banks and domestic bond market.

However, the Company's rating is constrained by its (1) medium exposure to commercial activities; and (2) relatively high debt growth due to large expenditure requirements in construction projects.

The stable outlook on Yantai Chefoo's rating reflects our expectation that the local government's capacity to support will remain stable, and the Company's characteristics, such as its essential role in urban infrastructure construction and urban renewal in Zhifu District, will remain largely unchanged over the next 12-18 months.

Rating Drivers

- Strategic importance in the regional development of Zhifu District
- Solid government support through capital injections, asset transfers, and subsidies
- Medium exposure to commercial activities
- Relatively high debt growth due to large expenditure requirements in construction projects
- Good access to funding from banks and domestic bond market

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Zhifu District Government's capacity to support the Company strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as lower the exposure to risky commercial activities and improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Zhifu District 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 reduced strategic significance, deteriorated debt management, or weakened funding ability.

Key Indicators

	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	24.6	29.3	35.2	37.1
Total Equity (RMB billion)	16.0	19.0	21.1	21.3
Total Revenue (RMB billion)	1.0	1.1	1.6	0.9
Total Debt/Total Capital (%)	32.7	33.5	37.9	40.9

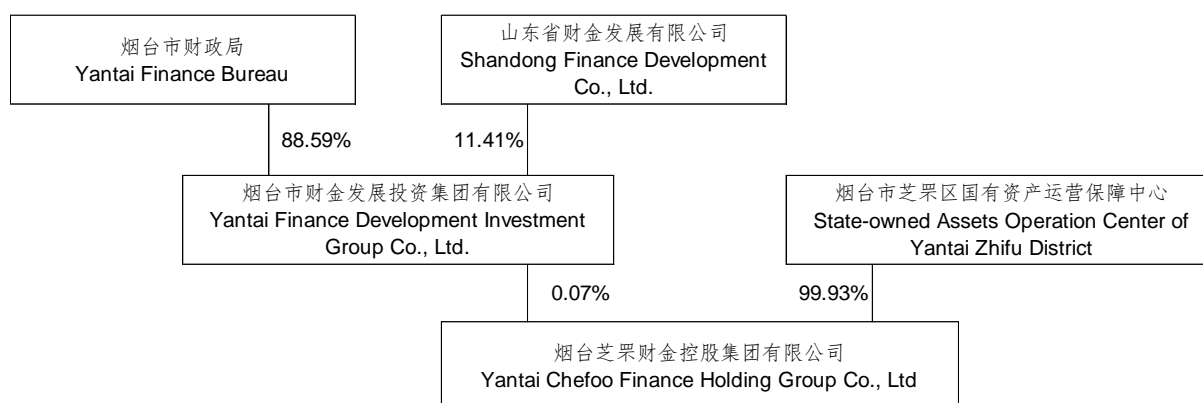
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company Information, CCXAP research

Corporate Profile

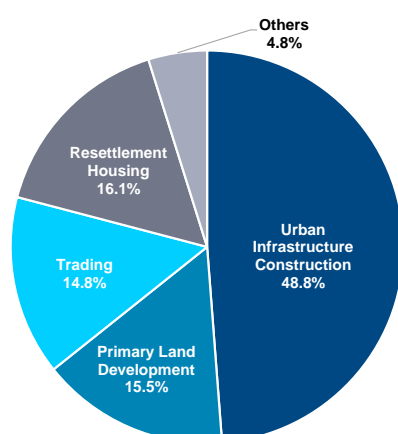
Founded in June 2017, Yantai Chefoo is the most important local infrastructure investment and financing company ("LIIFC") in Zhifu District, Yantai City, Shandong Province. The Company is the largest state-owned enterprise by asset size and primarily responsible for urban infrastructure construction, urban renewal, and operation of state-owned assets in Zhifu District. Apart from public development projects, the Company engages in some commercial activities such as property leasing and sales, and trading business. As of 31 December 2022, the Company was 99.93% owned by the State-owned Assets Operation Center of Yantai Zhifu District and 0.07% owned by Yantai Finance Development Investment Group Co., Ltd., of which Zhifu District Government was the ultimate controller of the Company.

Exhibit 1. Shareholding chart as of 31 December 2022



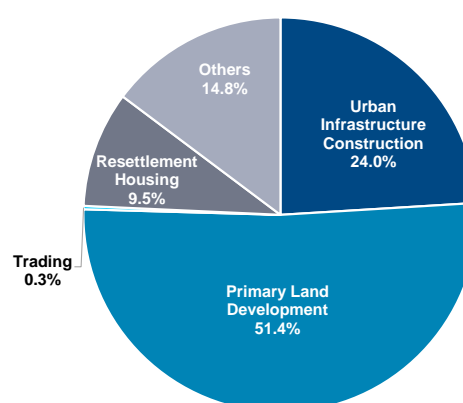
Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2022



Source: Company information, CCXAP research

Exhibit 3. Gross profit structure in 2022



Rating Considerations

Government's Capacity to Provide Support

We believe Zhifu District Government has a strong capacity to provide support given its sound economic fundamentals and fiscal strength, such as high fiscal balance ratio and manageable debt burden.

Shandong is the third largest province in China by gross regional products ("GRP") in 2022, with a solid foundation in different industries such as logistics, shipbuilding, marine technology, chemical, automotive, and agri-food. Yantai City is located in the middle of the Shandong Peninsula and has formed 8 major industries which are modern ocean, equipment manufacturing, electronic information, high-end chemical industry, medical and health, cultural tourism, modern logistics and efficient agriculture. In 2022, Yantai City reported a GRP of RMB951.6 billion, increased by 5.1% year-over-year ("YoY"), and ranked 3rd among prefecture-level cities in Shandong Province. In the first three quarters of 2023, its GRP increased by 6.7% YoY to RMB726.0 billion. Its fiscal balance was moderate, with a general budgetary revenue to general budgetary expenditure ratio of 68.8%. However, Yantai City's tax revenue decreased from RMB48.1 billion in 2021 to RMB42.6 billion in 2022 due to the tax rebate policy, accounting for around 67% of the general budgetary revenue. As of 31 December 2022, Yantai Municipal Government reported an outstanding government debt of RMB181.6 billion and accounted for 19.1% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Yantai City

	2020FY	2021FY	2022FY
GRP (RMB billion)	781.6	871.2	951.0
GRP Growth (%)	3.6	8.0	5.1
General Budgetary Revenue (RMB billion)	61.0	64.7	63.5
General Budgetary Expenditure (RMB billion)	84.5	80.3	92.3
Local Government Debt (RMB billion)	127.2	154.1	181.6

Source: Yantai Municipal Government, CCXAP research

Zhifu District is the economic and cultural center of Yantai City, focusing on the development of the pillar industries such as information technology and intelligent manufacturing, culture tourism, finance and commerce. In 2022, the GRP of Zhifu District rose by 5.0% YoY to RMB117.3 billion, ranking 3rd among 11 districts/counties in Yantai City. It has a very healthy fiscal profile, with a high fiscal balance ratio (general budgetary revenue/general budgetary expenses) of 136.0%. However, its tax revenue decreased from RMB6.3 billion in 2021 to RMB4.8 billion in 2022 due to tax and fee reduction policies, accounting for 64.4% of the general budget revenue. Zhifu District Government also had a relatively low debt burden, with outstanding government debt of RMB8.9 billion at end-2022, accounting for 7.6% of its GRP.

Exhibit 5. Key economic and fiscal indicators of Zhifu District

	2020FY	2021FY	2022FY
GRP (RMB billion)	98.5	109.7	117.3
GRP Growth (%)	2.5	8.6	5.0
General Budgetary Revenue (RMB billion)	7.1	7.5	7.4
General Budgetary Expenditure (RMB billion)	4.3	4.1	5.5
Local Government Debt (RMB billion)	5.7	7.4	8.9

Source: Zhifu District Government, CCXAP research

Started development in 2019, Happiness City project is the largest urban renewal project in Yantai City and Zhifu District and is located in the downtown area of Yantai City. This project is divided into three construction stages including starting area (“起步区”), advancing area (“推进区”), and expanding area (“拓展区”), respectively. Moreover, this key project with two-level government cooperation plays an important role in upgrading of industrial structure and conversion of old and new kinetic energy in Yantai City, which is expected to support the social and economic development in Zhifu District in foreseeable future.

Government’s Willingness to Provide Support**Strategic importance in the regional development of Zhifu District**

Yantai Chefoo’s main businesses are closely related to the economic and social development of Zhifu District, acting as a key LIIFC commissioned by the Zhifu District Government to undertake major urban infrastructure construction, resettlement housing construction and sales, state-owned asset operations, and urban renewal projects. Most importantly, the Company is the exclusive developer of the Happiness City project.

Yantai Chefoo is the major entity of Zhifu District’s urban renewal of several large-scale areas, including west of Huanhai Road, Jinglun Street District, as well as the area of Happiness City project. Based on the entrustment agreement, the Company is responsible for raising the funds for demolition and land development and the local government pays it the cost of land development plus a certain percentage of markup after the land sale. As of the end of 2022, Yantai Chefoo had completed land consolidation with 8,000 mu and ongoing land consolidation

with 5,800 mu. However, the land transfer process is largely susceptible to the local land market and government policies, which may also exert higher volatility during the downturn of China's property market. In 2021, the land transfer of Happiness City project was suspended due to the adjustment of the local government's development plans. In 2022, there were 4 plots of land of Happiness City project were transferred, with a total area of 167.6 mu and total transfer price of RMB735 million.

Yantai Chefoo also conducts urban infrastructure construction mainly in the Happiness City project on an agent construction basis. The Company signs an entrustment agreement with the local government and engages in the construction of urban infrastructure projects such as industrial parks, roads, schools, pipe networks, as well as tunnels, which also aligns with its urban renewal business. Usually, the project payment will be settled within 3 years after the construction of project is completed. As of 30 June 2023, Yantai Chefoo had 14 key infrastructure construction projects under construction or planning, with a total investment amount of RMB3.9 billion and an uninvested amount of RMB2.2 billion.

The Company expands its business to resettlement housing construction and sales through its subsidiary Yantai Longhai Real Estate Co., Ltd. ("LHRE"), which was transferred by local government in 2022. LHRE is in charge of fund raising for the construction of Longhai Jiayuan Community project, the resettlement part of which would be purchased by the local government after the project is completed.

Yantai Chefoo's public activities are relatively sustainable given its dominant position in the development of Happiness City project with large requirements in the infrastructure construction and urban renewal projects, in our view. We also expect the Company to undertake most of the public projects in the mandated areas and it is not easy to be replaced by other LIIFCs. Large-scale projects in the pipelines can ensure the sustainability of the business, but it also causes greater capital expenditure pressure on the Company.

Solid government support through capital injections, asset transfers, and subsidies

Yantai Chefoo has a solid track record of receiving support from the local government in terms of subsidies, asset transfers, and capital injections. From 2020 to 2023H1, the Company received total government subsidies of around RMB1.1 billion. During the same period, the local government totally injected cash and assets such as investment properties (mainly commercial and residential properties) and sandstone resources of more than RMB10.0 billion into the Company. Most of the injected assets are expected to generate supplementary rental or sales income for the Company, which partially mitigates its financial burden in daily operations. As of 30 June 2023, the Company totally received government payments of around RMB1.8 billion for the primary land development and infrastructure construction projects. It is expected that the Company will gradually receive payment after the projects are completed. Moreover, from 2022 to 2023H1, the local government had provided special purpose bonds with total amount of RMB1.9 billion to support Yantai Chefoo's construction projects. Given its dominant position in the urban renewal and infrastructure construction of Zhifu District, we expect the Company will continue to receive support from the local government in the foreseeable future, which will further enhance its operating and capital strength accordingly, in our view.

Medium exposure to commercial activities

Yantai Chefoo is expanding to several commercial activities such as property leasing and sales, and trading business. Although the commercial assets accounted for a relatively large proportion of total assets at the end of 2022, we estimate the Company's risk exposure to commercial activities is manageable as the majority of the assets are properties injected from the local government without upfront investment capital needs.

The Company participates in the sales and leases of residential properties, of which the Longhai Jiayuan Community project was transferred by the local government excluding the resettlement part. We consider its business risk is relatively low, as the investment for construction is completed and will not incur any large capital spending. The Company plans to sell or lease the properties, shops, office buildings, underground sheds, agricultural market stalls, as well as parking spaces in the project. The Company also engages in the leasing of office buildings, properties, and shops in Zhifu District, with a relatively high occupancy rate of over 70%, providing the Company with long-term stable income. However, the leasing business would be affected by the local operating environment and development.

Yantai Chefoo's trading business mainly includes the sales of biodiesel, building materials, decorative materials, non-ferrous metals, as well as the sandstone resources injected by the local government. The trading business contributed around 15% of the Company's revenue in 2022, but recorded a low gross profit margin of 0.6%. Moreover, the Company's trading business showed a relatively high concentration on its top 5 suppliers and customers.

Good access to funding from banks and domestic bond market

Yantai Chefoo has good access to multiple financing channels and the primary sources of funding are bank loans and bond issuances. The Company's important strategic position in Zhifu District is well-recognized by large state-owned commercial banks and national joint-stock commercial banks in China, including EverGrowing Bank Co., Limited, Bank of China Limited, and China Construction Bank Corporation. As of 30 June 2023, Yantai Chefoo obtained total credit facilities of RMB34.5 billion and the available portion was RMB29.0 billion, indicating sufficient standby liquidity. Meanwhile, the Company has moderate exposure to non-standard financing products (mainly financial leasing), with a proportion to total debt of around 18%. In addition, the Company actively participates in the domestic bond market. From January 2022 to October 2023, it issued 4 bonds in the domestic bond market totaling issued amount of RMB4.5 billion, with reasonable coupon rates ranging from 2.89% to 3.7%. The overall financing cost of the Company was about 4.3%, while that of non-standard financing was approximately 5.3%.

Relatively high debt growth due to large expenditure requirements in construction projects

Due to the ongoing investment in infrastructure construction and urban renewal in the Happiness City project, Yantai Chefoo demonstrated relatively high debt growth during the past three years. The Company's total debt increased from RMB7.7 billion as of 31 December 2020 to RMB14.8 billion as of 30 June 2023; while its total capitalization ratio rose from 32.7% to 40.9%. Moreover, short-term debt accounted for 14.3% of its total debt at the end of June 2023, indicating a well-balanced debt structure and moderate liquidity position.

Considering the ongoing investment in the Happiness City project and the funding gap between government payments and upfront investments, we believe there is a high growth potential for the Company's debt level. However, due to the strong recurring payments from the local government and good access to funding, we expect the Company's liquidity risk would be manageable in the near term.

ESG Considerations

Yantai Chefoo faces environmental risks because it has undertaken urban renewal and 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.

Yantai Chefoo bears social risks as it implements public policy initiatives by building public infrastructure in Zhifu District. 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.

Yantai Chefoo's governance considerations are also material as the Company is subject to oversight by the Zhifu District Government and has to meet several reporting requirements, reflecting its public-policy role and status as a government-owned entity.

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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