

Credit Opinion

26 October 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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Sichuan Zhenwei Industrial Development Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Sichuan Zhenwei Industrial Development Group Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Sichuan Zhenwei Industrial Development Group Co., Ltd. (“Zhenwei” or the “Company”) reflects Weiyuan County Government’s (1) relatively 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 Weiyuan County Government’s capacity to support reflects that Weiyuan County is an important component of the national shale gas demonstration area, with rich shale gas resources. Its gross regional product (“GRP”) ranks 1st among 5 districts/counties in Neijiang City, but is constrained by a relatively weak fiscal profile.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) important status as the major infrastructure construction entity in Weiyuan County; (2) good sustainability for infrastructure construction and engineering construction businesses; and (3) good track record of receiving government support.

However, the rating is constrained by the Company’s (1) high capital expenditure pressure associated with large project reserves; (2) limited financing flexibility and relatively high financing cost; and (3) moderate asset liquidity.

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

Rating Drivers

- Major infrastructure construction entity in Weiyuan County with good sustainability for public projects
- High capital expenditure pressure associated with large project reserves
- Good track record of receiving government support
- Limited financing flexibility and relatively high financing cost
- Low exposure to commercial activities
- Relatively large short-term debt servicing pressure
- Moderate asset liquidity

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Weiyuan County Government's capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support such as improved funding ability.

What could downgrade the rating?

The rating could be downgraded if (1) Weiyuan County 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 decreased government support.

Key Indicators

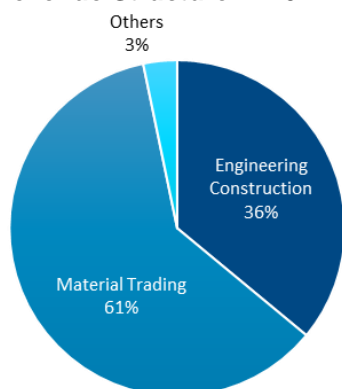
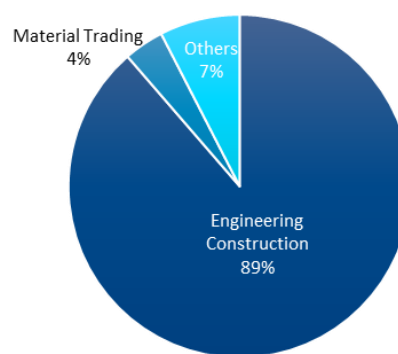
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	10.1	11.6	14.7	17.3
Total Equity (RMB billion)	7.8	8.1	8.4	11.3
Total Revenue (RMB billion)	0.6	1.5	2.1	0.9
Total Debt/Total Capital (%)	19.4	22.9	31.7	25.0

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

Source: CCXAP research

Corporate Profile

Founded in 2015 and formerly known as Sichuan Shengchang Equity Investment Management Co., Ltd., Zhenwei is one of the major infrastructure construction entities in Weiyuan County. It is primarily engaged in infrastructure construction and shantytown renovation in Weiyuan County. It also undertakes commercial activities such as material trading, engineering construction, and property leasing. As of 30 June 2023, the Company is wholly owned and ultimately controlled by the Weiyuan County Finance Bureau ("Weiyuan Finance Bureau").

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 Weiyuan County Government has a strong capacity to provide support for the Company given it is an important component of the national shale gas demonstration area, with rich shale gas resources.

Sichuan Province is a leading economic province and is recognized as one of the most developed provinces in China. In 2022, Sichuan recorded a GRP of RMB5.6 trillion, with a GRP growth rate of 2.9% year on year ("YoY"), ranking 6th in terms of GRP among all provinces in China. Its general budgetary revenue increased to RMB488.2 billion, up by 2.3% YoY. In 2023H1, Sichuan recorded a GRP of RMB2.8 trillion, with a YoY increase of 5.5%.

Neijiang City is a prefecture-level city in Sichuan Province, with a total area of 5,386 square kilometers. It is the second largest transportation hub in Sichuan Province and an important transportation intersection of southwest land. The 5 traditional pillar industries in Neijiang City are metallurgical building materials, food and beverage, machinery and auto parts, pharmaceutical and chemical industry, as well as electric power energy. Despite the 5 traditional pillar industries, Neijiang City is currently focusing on the development of 3 characteristic industries, namely electronic information, automobiles and parts, and food and medicine. In 2022, Neijiang City achieved a GRP of RMB165.7 billion, ranking 10th among all cities in Sichuan Province, with a GRP growth rate of 1.5%. Its general budgetary revenue increased from 6.6 billion in 2020 to RMB7.6 billion in 2022. However, its government fund revenue decreased from RMB10.4 billion in 2020 to RMB9.3 billion in 2022 due to the property market downturn and land sales fluctuations. Neijiang City has weak fiscal self-sufficiency, with a fiscal balance ratio of 29.4% in 2022. Neijiang Municipal Government has an increasing debt burden, the government debt was RMB62.5 billion in 2022, representing 37.7% of its GRP.

Exhibit 3. Key economic and fiscal indicators of Neijiang City

	2020FY	2021FY	2022FY
GRP (RMB billion)	146.6	160.6	165.7
GRP Growth (%)	3.9	8.5	1.5
General Budgetary Revenue (RMB billion)	6.6	7.3	7.6
General Budgetary Expenditure (RMB billion)	27.7	25.5	25.9
Local Government Debt (RMB billion)	46.6	54.4	62.5

Source: Statistic Bureau of Neijiang City, CCXAP research

Weiyuan County is located in the northwest of Neijiang City, with a total area of 1,289 square kilometers. As an important component of the national shale gas demonstration area, it has rich shale gas resources, with resource reserves of approximately 620 billion cubic meters. In 2022, Weiyuan County has built a total of 94 shale platforms, with an annual shale gas output of 3.8 billion cubic meters. Relying on its pillar industries, such as shale gas, vanadium and titanium new materials, hydrogen energy, and glass fiber, Weiyuan County has continued to develop in recent years. Weiyuan County's GRP increased from RMB35.6 billion in 2020 to RMB41.6 billion in 2022, with a GRP growth rate of 1.8%. Both its GRP and general budgetary revenue rank 1st among 5 districts/counties in Neijiang City. Weiyuan County Government's general budgetary revenue increased from RMB1.0 billion in 2020 to RMB1.3 billion in 2022, of which tax revenue accounted for 67.4%. Weiyuan County has a moderate fiscal self-sufficiency, its fiscal balance ratio was lower than 40% over the past three years. At end-2022, Weiyuan County's outstanding government debt was RMB9.0 billion, accounting for 21.6% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Weiyuan County

	2020FY	2021FY	2022FY
GRP (RMB billion)	35.6	40.0	41.6
GRP Growth (%)	3.9	8.2	1.8
General Budgetary Revenue (RMB billion)	1.0	1.2	1.3
General Budgetary Expenditure (RMB billion)	4.0	3.5	3.7
Local Government Debt (RMB billion)	7.3	7.9	9.0

Source: Statistic Bureau of Weiyuan County, CCXAP research

Government's Willingness to Provide Support**Major infrastructure construction entity in Weiyuan County with good sustainability for public projects**

There are three major Local Infrastructure Investment and Financing Companies ("LIIFCs") in Weiyuan County, namely Weiyuan County State-owned Assets Management Co., Ltd. ("WSAM"), Weiyuan Investment Holding Group Co., Ltd. ("WIHG") and Zhenwei. WSAM is mainly responsible for the construction of cultural and tourism projects in Weiyuan County. Both Zhenwei and WIHG are important public infrastructure project construction entities in Weiyuan County, and Zhenwei is mainly responsible for most of the new infrastructure construction projects.

Zhenwei undertakes infrastructure construction projects such as High-Speed Rail Station, and shantytown renovation with self-raised funds. The Company conducts infrastructure projects by signing agency construction agreements with WIHG, which would repurchase the repayment to the Company based on the construction progress. The repurchase payment is calculated based on the construction cost plus an agreed return. As of 30

June 2023, the Company had 13 major infrastructure construction projects under construction or planning, with a total investment amount of RMB9.5 billion and an outstanding amount of RMB6.3 billion. Given the sufficient amount of infrastructure projects in the pipeline, we expect the infrastructure construction business will have good sustainability but relatively large capital expenditure pressure at the same time.

Low exposure to commercial activities

Zhenwei is also engaged in commercial activities such as material trading, engineering construction, and property leasing. We consider the Company's commercial business risk to be low, because its commercial activities accounted for around 15% of its total assets.

The Company participated in engineering construction since 2021, and it undertakes engineering construction projects within Weiyuan County through public bidding. The contractor would pay up to 30% of the contract amount to the Company in advance, then pay the remaining amount to the Company based on the monthly construction progress. The Company will receive the full payment after the project is audited by the audit agency. As of 30 June 2023, the Company had 23 engineering construction projects under construction, with a total contract amount of RMB2.4 billion, indicating good business sustainability. This business also has a relatively high gross profit margin, recording a gross profit margin of 15.2% in 2022.

Material trading business is the Company's major source of income, which accounted for 60.8% of the total revenue in 2022. The Company's material trading business mainly includes electrolytic copper, ethylene glycol, steel, and purified terephthalic acid (PTA). However, the business is subject to relatively high concentration risk. As of 30 June 2023, the top 5 customers accounted for 82.0% of the sales, while the top 5 suppliers accounted for 79.4% of the procurement. In addition, the top 5 customers are all private-owned enterprises, indicating a certain payment collection risk. Moreover, the profitability of the Company's material trading business has been extremely low, with gross profit margins not exceeding 0.5%, constraining its contribution to the Company's overall profit. Other businesses such as property leasing, building material sales, and advertisement businesses provide supplementary income to the Company. However, the small operating scale of these businesses limits its contribution to the Company's overall cash flow and profit.

Good track record of receiving government support, but constrained by weak regional fiscal income

The Company has a good track record of receiving support from the local government in the past few years, including government subsidies, cash injections, and asset injections. From 2020 to 2023H1, the Company received total government subsidies of RMB79.0 million. In addition, the Company received a total cash injection of RMB450.0 million over the same period. The Company also receives regular repurchase payments for its public projects. From 2020 to 2023H1, the Company received repurchase payments of RMB1.5 billion. In 2020, the Company received an asset injection of RMB6.0 billion from the local government, mainly the sandstone operating rights.

However, government payments are largely subject to the local economy and government fiscal strength. Although Weiyuan County's fiscal income has a stable growth over the past three years, it still maintained at a relatively low level. Both Weiyuan County's general budgetary revenue and government fund income are lower than RMB2.0 billion in 2022. In addition, the slump in China's real estate market and land market also affects the government's fiscal income. Therefore, government payments and support are affected by the government's fiscal strength and the land market.

Exhibit 5. Government support from 2020 to 2023H1

(RMB million)	2020FY	2021FY	2022FY	2023H1
Government Subsidies	30	-	29	20
Repurchase repayment	549	595	246	119
Cash Injections	180	270	-	-
Asset Injections	6,009	-	160	2,849
Total	6,768	865	435	2,988

Source: Company information, CCXAP research

Relatively large short-term debt servicing pressure

Zhenwei's total debt had increased from RMB1.9 billion at the end of 2020 to RMB3.8 billion as of 30 June 2023, while its capitalization ratio increased from 19.4% to 25% over the same period, maintained at a reasonable level. However, the Company has an unbalanced debt structure. The Company's short-term debt accounted for 41.9% as of 30 June 2023, indicating a certain liquidity pressure. Given the Company's relatively large capital expenditure on construction projects, we expect the Company will have fast debt growth for the next 12-18 months.

Moderate asset liquidity

In addition, the Company has moderate asset liquidity, which may undermine its financial flexibility. The Company's total asset mainly consists of inventories, intangible assets, and receivables, accounting for 65.5% of its total assets as of 30 June 2023, which are considered low liquidity. In terms of restricted assets, the Company had restricted assets of RMB760.4 million, which were mainly land inventory used for financing, which accounted for 4.4% of its total assets as of 30 June 2023.

The Company bears manageable risks arising from external guarantees. As of 30 June 2023, the Company had outstanding external guarantees of RMB1.6 billion, representing 14.3% of its net assets. All the external guarantees are provided to state-owned enterprises in Weiyuan County or Neijiang City.

Limited financing flexibility and relatively high financing cost

As of 30 June 2023, about 94% of the Company's debt financing was provided by domestic banks, with a financing cost of around 6.0%-6.5%. As of 30 June 2023, it held a total bank credit facility of RMB6.4 billion, and the available credit facility was RMB2.1 billion, mainly from Agricultural Development Bank of China, and Bank of Sichuan. The Company has not issued any bonds in the public debt capital market. The Company had a relatively low exposure to non-standard financing, such as financial leasing, which accounted for only 6.5% of its total debt. However, The Company's non-standard financing costs are very high, reaching 11.5%-12.5%. Non-standard financing is less stable than bank financing, and the Company faces higher financing costs and greater refinancing pressure. The Company has a relatively high average financing cost of around 7.0%-7.5%, it plans to issue offshore bonds to replace the high-cost non-standard financing products.

ESG Considerations

Zhenwei bears environmental risks through its infrastructure projects. Such risks could be mitigated by conducting environmental studies and detailed planning before the commencement of the projects and close supervision during construction.

Zhenwei bears social risks as it implements public policy initiatives by building public infrastructure in Weiyuan 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.

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

Structural considerations

Zhenwei's senior unsecured debt rating is equivalent to its long-term credit rating. We believe that government support will flow through the Company given its important role in local infrastructure construction in Weiyuan 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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