

## Credit Opinion

31 October 2023

Ratings	
Senior Unsecured Debt Rating	BBB <sub>g</sub>
Long-Term Credit Rating	BBB <sub>g</sub>
Outlook	Stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

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## Pizhou Industrial Investment Holding Group Co., Ltd.

### Initial credit rating report

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub> to Pizhou Industrial Investment Holding Group Co., Ltd., with stable outlook.**

### Summary

The BBB<sub>g</sub> long-term credit rating of Pizhou Industrial Investment Holding Group Co., Ltd. (“PZII” or the “Company”) reflects (1) the Pizhou City Government’s 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 the Pizhou City Government’s capacity to provide support reflects Pizhou City’s status as one of the Top 100 counties in China, with ongoing economic growth over the years. However, its fiscal balance is relatively weak.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) important role in infrastructure construction and industrial development in Pizhou City, particularly in the Economic Development Zone of Pizhou City (“Pizhou EDZ”) and the High-tech Industrial Development Zone of Pizhou City (“Pizhou HIDZ”); (2) good track record of receiving government support; and (3) diversified funding channels.

However, the rating is constrained by the Company’s (1) medium exposure to commercial activities; (2) increasing debt burden from investment in infrastructure construction and factory construction; and (3) medium level of contingent risk.

The stable outlook on PZII’s rating reflects our expectation that the Company’s position in Pizhou City will remain stable, and the Company will maintain its important role in the infrastructure construction and local industrial development of Pizhou City over the next 12-18 months.

## Rating Drivers

- Importance role in infrastructure construction and industrial development in Pizhou City, particularly in Pizhou EDZ and Pizhou HIDZ
- Medium exposure to commercial activities
- Good track record of receiving government support
- Increasing debt burden from ongoing investment
- Diversified funding channels
- Medium level of contingent risk

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) the Pizhou City 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 reduced exposure to commercial activities and reduction in the exposure to external guarantees.

### What could downgrade the rating?

The rating could be downgraded if (1) the Pizhou City 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 increase in commercial activities.

## Key Indicators

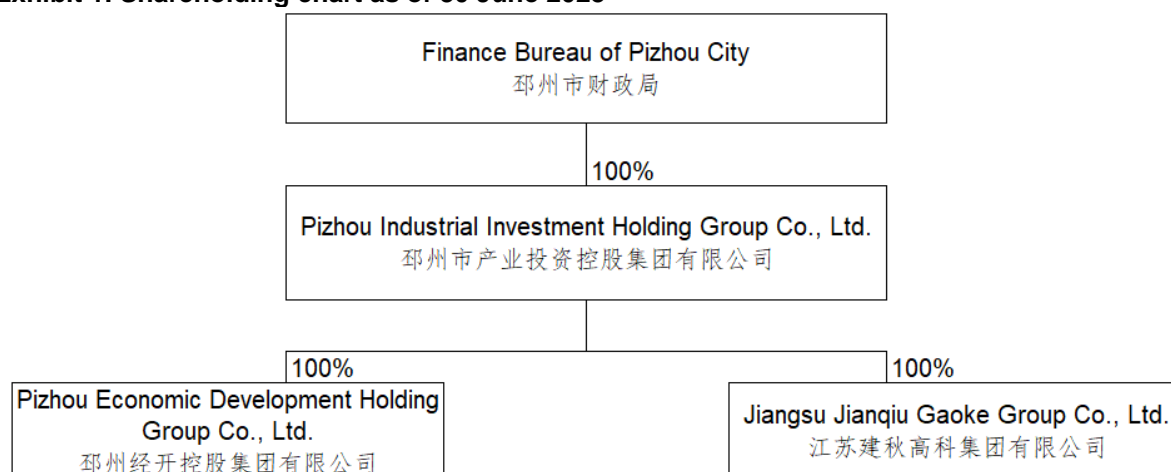
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	29.5	37.2	40.0	43.0
Total Equity (RMB billion)	12.3	18.9	19.3	20.3
Total Revenue (RMB billion)	1.0	1.0	1.1	0.4
Total Debt/Total Capital (%)	54.7	45.2	46.2	49.9

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

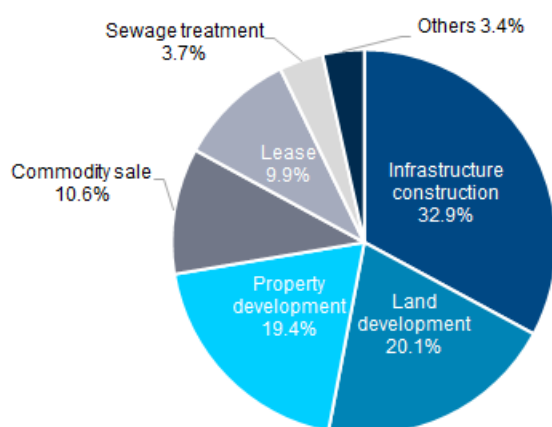
Source: Company information, CCXAP research

## Corporate Profile

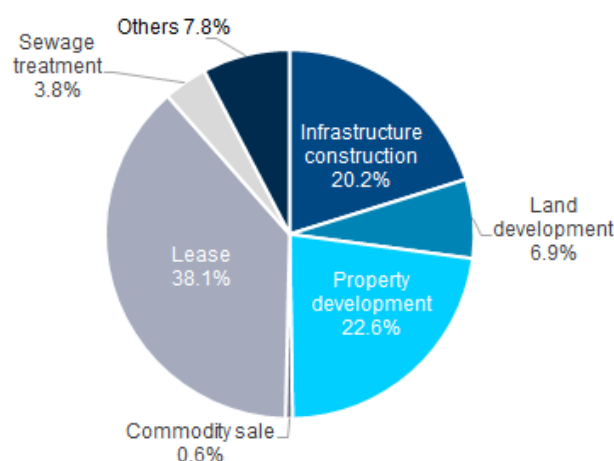
Established in 2014, PZII is one of the key local infrastructure investment and financing companies ("LIIFCs") in Pizhou City, Xuzhou City. The local government has transferred 100% shares of Pizhou Economic Development Holding Group Co., Ltd. ("PZED") and Jiangsu Jianqiu Gaoke Group Co., Ltd. ("JQGK") to the Company in 2021. PZII is positioned as an important entity for infrastructure construction and industrial development in Pizhou City. It has engaged in different businesses through the Company itself and its subsidiaries in Pizhou City, particularly in Pizhou EDZ and Pizhou HIDZ, which include infrastructure construction, resettlement housing, land consolidation, sewage treatment, leasing, and commodity sales. As of 30 June 2023, the Company was wholly owned by the Finance Bureau of Pizhou City.

**Exhibit 1. Shareholding chart as of 30 June 2023**

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 that the Pizhou City Government has a strong capacity to provide support to the Company, given its as one of the CCID Top 100 Counties in China, and its ongoing economic growth over the past few years. However, its fiscal balance is relatively weak.

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

Xuzhou City is a prefecture-level city administrated under Jiangsu Province and is located in the northern part of Jiangsu Province. It is a comprehensive transportation hub, with a total area of 11,765 square kilometers. From 2020 to 2022, Xuzhou City's economic strength improved steadily with GRP increasing to RMB845.8 billion from RMB732.0 billion, ranking 6<sup>th</sup> among all prefecture-level cities in Jiangsu Province. Affected by the

tax rebate policy, Xuzhou Municipal Government's general budgetary revenue in 2022 decreased to RMB51.7 billion. Tax revenue is a stable source of general budgetary revenue, accounting for over 75% over the past three years. However, the fiscal balance ratio kept at a moderate level of over 50% over the past three years. Its outstanding government debt amounted to RMB152.2 billion at end-2022, accounting for about 18.0% of GRP.

#### Exhibit 4. Key economic and fiscal indicators of Xuzhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	732.0	811.7	845.8
GRP Growth (%)	3.4	8.7	3.2
General Budgetary Revenue (RMB billion)	48.2	53.7	51.7
General Budgetary Expenditure (RMB billion)	95.8	100.4	103.2
Local Government Debt (RMB billion)	117.4	133.2	152.2

Source: Xuzhou Municipal Government, CCXAP research

Pizhou City is a county-level city under the administration of Xuzhou City. It ranked 43<sup>th</sup> among the 2023 Top 100 counties in China released by the CCID Consulting County Economic Research Center. Pizhou City continues to upgrade its industry structure and has developed six core industries including high-end equipment manufacturing, carbon-based new materials, semiconductor materials and equipment, energy conservation and environmental protection, green food, and ecological home furnishings. Pizhou City's economic strength improved steadily with GRP increasing steadily to RMB115.7 billion in 2022, a YoY increase of 4.2%, ranking 2<sup>nd</sup> in Xuzhou City. Pizhou City Government's fiscal strength also improved along with the economic growth. In 2022, the general budgetary revenue amounted to RMB4.3 billion, of which tax revenue, a relatively stable income source, represented 74.4%. If excluding the effect of tax rebates, the general budgetary revenue would have increased by 1.9%. However, the Pizhou City Government's self-sufficiency remained relatively weak. In 2022, its fiscal self-sufficiency ratio (general budgetary revenue/ general budgetary expenditure) was recorded at 34.5%. As of end-2022, Pizhou City Government's outstanding debt amounted to RMB17.1 billion, accounting for about 14.8% of GRP.

#### Exhibit 5. Key economic and fiscal indicators of Pizhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	100.1	110.8	115.7
GRP Growth (%)	3.9	9.5	4.2
General Budgetary Revenue (RMB billion)	4.4	4.7	4.3
General Budgetary Expenditure (RMB billion)	12.6	12.7	12.5
Local Government Debt (RMB billion)	13.8	15.0	17.1

Source: Pizhou City Government, CCXAP research

Pizhou EDZ was approved as a provincial-level development zone by Jiangsu Provincial Government in 2006 and Pizhou HIDZ was approved as a provincial-level high-tech zone by Jiangsu Provincial Government in 2016. Pizhou EDZ has formed three core industries, including carbon-based new materials, semiconductor materials and equipment, and high-end equipment manufacturing industries. Some Fortune 500 and industry-leading companies have settled in Pizhou EDZ, such as Cabot Corporation, Nippon Steel Corporation, and Fangda Carbon New Material Co., Ltd. Pizhou HIDZ has developed four pillar industries, Intelligent manufacturing, energy conservation and environmental protection, new materials and new energy, and has attracted Great Wall Motor and Mind Electronics Appliance Co., Ltd. to settled in. In 2022, the general budgetary revenue of Pizhou

EDZ amounted to RMB2.7 billion, accounting for around 63% of the general budgetary revenue of Pizhou City, with a relatively high fiscal self-sufficiency ratio of 93.9%.

### **Government's Willingness to Provide Support**

#### **Importance role in infrastructure construction and industry development in Pizhou City, particularly in Pizhou EDZ and Pizhou HIDZ**

PZII is one of the key LIIFCs and the second largest one by total assets of Pizhou City. As an essential entity for urban construction and operation, the Company is mainly responsible for infrastructure construction, resettlement housing construction, land consolidation, and sewage treatment in Pizhou EDZ and Pizhou HIDZ. The Company undertakes these businesses mainly through PZED and JQGK. PZED and JQGK are the main entities for infrastructure construction and resettlement housing construction in Pizhou EDZ and Pizhou HIDZ, respectively. Considering the Company's large project reserves, we believe that the potential substitution of PZII is relatively low and the Company is expected to maintain its importance for Pizhou City Government.

PZII mainly undertakes infrastructure construction under agency construction mode and carries out the construction work accordingly. The Company would receive project payments based on the actual cost plus a markup in return. The Company completed a number of projects, such as road, river regulation, and industrial park constructions. As of 30 June 2023, the Company also had 19 projects under construction and 3 projects under planning, with a total investment of RMB2.9 billion and an outstanding investment of RMB1.2 billion.

The Company is engaged in resettlement housing for households affected by demolition. The orientation placement resettlement housing will be transferred and settled on prices set by the local government that are slightly higher than the costs. Some of the remaining houses will be sold at market prices. As of 30 June 2023, the Company had completed some resettlement housing construction projects, with a total investment of RMB1.2 billion. The Company also had 8 projects under construction, with a total investment of RMB6.6 billion and an outstanding investment of RMB1.3 billion. The large project reserve ensures the sustainability of the Company.

PZII conducts land consolidation in Pizhou EDZ under agency construction mode, which mainly involves land acquisition, demolition and land leveling work to coordinate with the construction of infrastructure and resettlement housing in the Pizhou EDZ. The settlement prices are calculated based on the actual cost plus a markup in return. As of 30 June 2023, the Company had 8 projects under consolidation and 2 projects under planning, with a total investment of 2.3 billion and an outstanding investment of RMB884.8 million.

The Company is also the sole entity for sewage treatment in the Circular Economy Industrial Park in Pizhou HIDZ. The Circular Industrial Park is a sub-industrial park of Pizhou HIDZ. In 2011, it was recognized as a national urban mineral demonstration base by the National Development and Reform Commission and the Ministry of Finance. The Company provides sewage treatment service at prices guided by the local government. As of 30 June 2023, PZII had one sewage treatment plant, with a sewage treatment capacity of 50,000 tons per day. The Company also had one sewage treatment project under construction, with a total investment of RMB276 million, and is expected to increase the sewage treatment capacity by 50,000 tons per day in the future.

### **Medium exposure to commercial activities**

Apart from public activities, PZII also engages in other commercial activities including leasing, commodity sales, equity investment, and self-operated construction. While commercial activities generate supplemental income, they may pose higher business risks than resettlement housing and infrastructure construction businesses. The

Company's exposure to commercial activities is considered medium, which accounted for around 30% of its total assets, based on our assessment.

PZII owns factory buildings that generate recurring leasing income and sound gross profit. These factory buildings were acquired through government allocation and self-construction, and were leased out to enterprises within Pizhou EDZ and Pizhou HIDZ. As of 30 June 2023, the Company had a total leasable area of around 1.6 million square meters, with an occupancy ratio of over 60%. The Company also had projects under construction, with an outstanding investment of around RMB3.2 billion. To attract more enterprises to settle in Pizhou EDZ and Pizhou HIDZ, the tenants are expected to have rent exemption period of three years. The rent will increase by 5% every year starting from the fifth year of the lease term. As more industrial parks are completed and rent exemption periods expire in the future, the leasable area and rental income are expected to increase. However, considering its ongoing investments in industrial park construction, the Company may face a certain capital expenditure burden.

PZII conducts industrial investments in Pizhou City, with a high strategic policy role in local industrial support and upgrade. The Company conducts equity investment through equity funds and direct investment, and focuses on some core industries in Pizhou City, such as semiconductor materials and electronic device manufacturing. As of 30 June 2023, PZII had direct equity investment in 23 companies and had invested in 9 funds, with an investment portfolio of RMB876 million and RMB1.2 billion, respectively. The Company mainly exits its investment through share buybacks and equity transfer, and has achieved a total investment gain of RMB353 million as of 30 June 2023. However, most of PZII's investments require long holding periods and are easily affected by changes in industry cycles, which may expose the Company to larger investment and execution risks.

The Company also takes part in self-operated construction projects with relatively large capital expenditures, such as industrial heating pipelines, health care and tourist resort projects. As of 30 June 2023, PZII had 3 projects under construction and 4 projects under planning, with an uninvested amount of around RMB5.6 billion. These projects are less dependent on government payments but expose the Company to greater funding and business risks. The construction costs of such projects will be balanced by future operating income.

PZII's commodity sale business is mainly trading dried fruit food, such as corn, pistachios, cashew nuts, and almonds. The Company mainly adopts a demand-on-purchase model and makes the confirmation on volume and prices with downstream customers before procurement. The downstream customers need to pay certain portion of deposit when placing the order and make full payments before shipping. However, the customer and supplier concentration risks were high as the Top 5 customers and Top 5 suppliers accounted for more than 85% of the total sales and total procurements in 2022, respectively.

### **Good track record of receiving government support**

In recognition of the importance of PZII to Pizhou City, the Company has received comprehensive support from the government in terms of capital injections, asset injections, project repayments, and operating subsidies. From 2020 to 2023H1, the Company received capital injection of RMB3.8 billion from the Finance Bureau of Pizhou City, substantially enhancing the capital strength of PZII.

PZII also has a good track record of receiving government payments. From 2020 to 2023H1, the Company continuously received operating subsidies from the local government with a total amount of around RMB800 million. In addition, it had received project repayments of RMB2.1 billion from infrastructure construction, resettlement housing and land consolidation projects over the same period. With the strengthening of

investment attraction policy and the continuous inbound investment in Pizhou City, we expect the Company to receive ongoing government support to sustain the further construction of government-mandated public projects and investments.

### **Increasing debt burden from continuous investment**

PZII shows a rising debt burden owing to its expansion in the construction of public-policy projects over the past few years. From 2020 to 2023H1, the Company's total debt increased to RMB20.2 billion from RMB14.9 billion. Its capitalization ratio, as measured by total debt to total capital, was recorded at a relatively high level of 49.9%. At the same time, the Company had a relatively high short-term debt burden with the short-term debt accounting for 30.7% of the total debt. The cash to short-term debt ratio was around 0.3x as of 30 June 2023, indicating that its cash balance was insufficient to cover its short-term debt. We expect the Company may rely on external financing for its future infrastructure construction, resettlement housing, land consolidation, industrial park, and factory building projects, and its debt leverage will be maintained at a high level in the next 12 to 18 months.

Besides, PZII's asset liquidity was influenced by its large restricted assets. As of 30 June 2023, the Company's pledged a number of assets for loans, including cash, inventories, and investment properties, with a total restricted amount of RMB9.9 billion, accounting for 48.7% of net assets. On top of that, as of 30 June 2023, the Company's inventories and other receivables account for around 57% of the total assets. The Company's inventories mainly include the cost of construction works, which are considered illiquid and could undermine the Company's financial position.

### **Diversified funding channels**

PZII has good access to funding including capital markets, bank borrowing and non-standard financing, which could partially release the pressure on debt repayment and capital expenditure. Bank borrowing accounts for most total debts and the Company maintains good relationships with large domestic banks such as policy banks, large state-owned banks, and large joint-stock commercial banks. As of 30 June 2023, the Company has obtained total credit facilities of around RMB15.5 billion, with an unutilized amount of around RMB5.6 billion. The Company has good access to onshore capital markets. For example, the Company's subsidiaries PEZD and JQ GK have issued several tranches of corporate bonds from January to September 2023, raising around RMB1.7 billion. PZII also had certain exposure to nonstandard financing, accounting for less than 10% of the total debts as of 30 June 2023, mainly provided by financial leasing companies.

### **Medium level of contingent risk**

The credit profile of PZII is constrained by its external guarantees, which could potentially increase its repayment obligations. As of 30 June 2023, the Company had a relatively large amount of outstanding external guarantees of RMB12.6 billion, accounting for 62.3% of its net assets. Most of the guarantees are provided to other state-owned enterprises within Pizhou City such as Jiangsu Runcheng City Investment Holding Group Co., Ltd. If a credit event occurs in the region, the Company may face certain contingent liability risks. However, we believe that the credit risk of the guarantee is moderately controllable, taking the local government's support to some of these local state-owned enterprises in times of need into account. Moreover, the Company provided external guarantees to a private-owned entity, namely Xuzhou Runhao Magnetic Materials Trading Co., Ltd. ("XRMM"), with no counter-guarantee measure. The number of guarantees provided to XRMM was RMB9.9 million as of 30 June 2023, accounting for around 0.1% of the total external guarantees.

## ESG Considerations

PZII faces environmental risks because it has undertaken public policy 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.

PZII bears social risks as it implements public policy initiatives by building public infrastructure in Pizhou City. 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.

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

## Structural Considerations

PZII'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 role in infrastructure construction and industry development in Pizhou City, 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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