

## Credit Opinion

14 November 2024

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

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## Linyi Luozhuang Finance Investment Group Co., Ltd.

### Initial credit rating report

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

### Summary

The BBB<sub>g</sub>- long-term credit rating of Linyi Luozhuang Finance Investment Group Co., Ltd. (“LYFI” or the “Company”) reflects the Luozhuang District Government’s strong capacity to provide support, and the local government’s very high willingness to support, based on our assessment of the Company’s characteristics.

Our assessment of the local government’s capacity to provide support reflects Luozhuang District’s sound economic fundamentals and fiscal strength, with a manageable debt burden.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) essential role in infrastructure construction in Luozhuang District; and (2) track record of receiving government support.

However, the rating is constrained by the Company’s (1) moderate exposure to commercial activities; (2) fast growing debt with high short-term debt burden; (3) tight liquidity position with moderate funding capability; and (4) medium exposure to contingent risk from external guarantees.

The stable outlook on LYFI’s rating reflects our expectation that the Luozhuang District Government’s capacity to provide support will remain stable, and the Company will maintain its important position in the infrastructure construction of Luozhuang District over the next 12-18 months.

## Rating Drivers

- Essential role in infrastructure construction in Luozhuang District
- Moderate exposure to commercial activities
- Track record of receiving government support
- Fast growing debt with high short-term debt burden
- Tight liquidity position with moderate funding capability
- Medium exposure to contingent risk from external guarantees

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) the local government's ability to provide support strengthens; or (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as improved liquidity position or diversified financing channels.

### What could downgrade the rating?

The rating could be downgraded if (1) the local 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 materially increased exposure to risky commercial activities or a deterioration in its debt management.

## Key Indicators

	2021FY	2022FY	2023FY	2024H1
Total Assets (RMB billion)	9.6	11.8	12.9	16.3
Total Equity (RMB billion)	5.1	6.4	6.5	8.2
Total Revenue (RMB billion)	1.2	1.3	1.3	0.7
Total Debt/Total Capital (%)	24.8	25.9	32.3	31.3

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

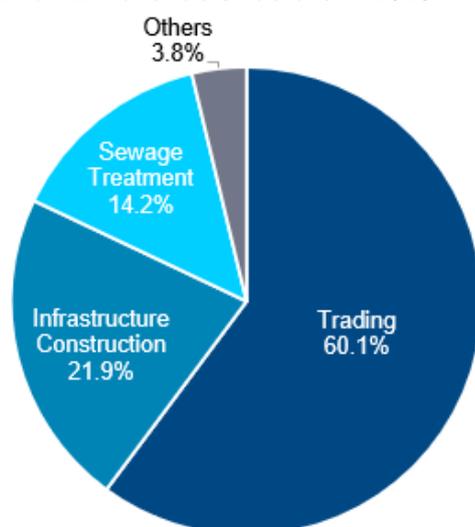
Source: Company data, CCXAP research

## Corporate Profile

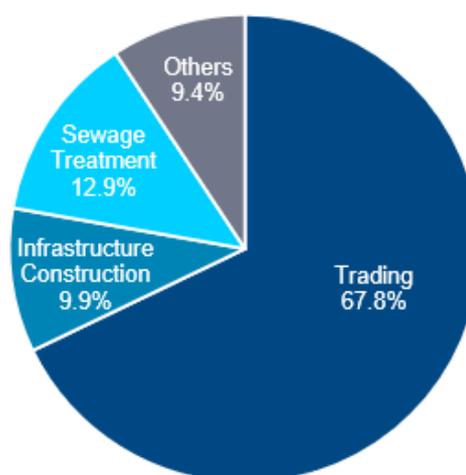
Established in 2017, LYFI is one of the essential local infrastructure investment and financing companies ("LIIFCs") in Luozhuang District, Linyi City. It is principally responsible for infrastructure construction in Luozhuang District. The Company also developed a range of commercial activities to extend its operation scale, including trading, property development, leasing, and self-operated projects. In June 2024, to promote the integration and high-quality development of state-owned enterprises, the State-owned Assets Management and Service Center of Luozhuang District, Linyi City ("Luozhuang SAMSC") transferred 100% of its shares in LYFI to Shandong Xingluo Investment Holding Co., Ltd. ("Xingluo Holdings"), which is a wholly-owned company of Luozhuang SAMSC. Luozhuang SAMSC remained as the actual controller of the Company.

**Exhibit 1. Shareholding chart as of 30 June 2024**

Source: Company information, CCXAP research

**Exhibit 2. Revenue structure in 2023**

Source: Company information, CCXAP research

**Exhibit 3. Gross profit structure in 2023****Rating Considerations****Government's Capacity to Provide Support**

We believe Luozhuang District Government has strong capacity to provide support given its sound economic fundamentals and fiscal strength, with a manageable debt burden.

Shandong Province is the third largest province in terms of gross regional product ("GRP") in China over the past three years, with a solid industrial foundation in logistics, shipbuilding and marine technology, chemical, automotive and agri-food. Linyi City is the largest city by population and area in Shandong Province, with rich water and land resources. Linyi City's key industries drive economic growth, including agriculture and food processing, manufacturing, logistics, and high-end chemicals. In 2023, Linyi City recorded a GRP of RMB610.5 billion, a year-over-year ("YoY") increase of 6.3%, ranking 5<sup>th</sup> among prefecture-level cities in Shandong Province. Furthermore, it has achieved five consecutive years of growth in its general budgetary revenue, reaching RMB44.6 billion in 2023. However, Linyi City's fiscal balance was relatively weak, as its general budgetary revenue could only cover around half of general budgetary expenses over the past three years. As of 31 December 2023, Linyi City reported a government debt of RMB169.1 billion, accounting for 27.7% of its GRP.

**Exhibit 4. Key economic and fiscal indicators of Linyi City**

	2021FY	2022FY	2023FY
GRP (RMB billion)	546.6	577.9	610.5
GRP Growth (%)	8.7	4.2	6.3
General Budgetary Revenue (RMB billion)	40.9	42.0	44.6
General Budgetary Expenditure (RMB billion)	80.7	87.5	92.0
Local Government Debt (RMB billion)	125.7	146.3	169.1

Source: Linyi Municipal Government, CCXAP research

Luozhuang District is one of the major components of the urban area of Linyi City. Backed by its abundant industrial resources and transportation advantages, Luozhuang District has developed into an important industrial town in Linyi City. It covers traditional industries such as metallurgy, building materials, coking, and ceramics. Meanwhile, with the strategy of industrial transformation and upgrading, Luozhuang District is forming a new industrial structure focusing on new ceramics, new materials, modern medicine and mechanical equipment. Luozhuang District has demonstrated consistent economic growth. In 2023, its GRP grew to RMB44.7 billion from RMB42.5 billion in 2021, ranking 4<sup>th</sup> among all the districts and counties in Linyi City over the past three years. During the same period, its general budgetary revenue decreased to RMB2.7 billion from RMB3.0 billion in 2021, mainly due to the tax cut and fee reductions policy. Nevertheless, Luozhuang District has demonstrated consistent revenue generating capability, with tax revenue representing an average of 83.0% of the general budgetary revenue over the past three years. Additionally, it has a robust fiscal self-sufficiency, and the average fiscal balance ratio (general budgetary revenue/ general budgetary expenditure) was around 84.6%. At the end of 2023, Luozhuang District Government's outstanding debt was RMB6.4 billion, which accounted for 14.4% of the GRP.

**Exhibit 5. Key economic and fiscal indicators of Luozhuang District**

	2021FY	2022FY	2023FY
GRP (RMB billion)	42.5	42.9	44.7
GRP Growth (%)	9.0	2.8	5.8
General Budgetary Revenue (RMB billion)	3.0	2.7	2.7
General Budgetary Expenditure (RMB billion)	3.4	3.2	3.2
Local Government Debt (RMB billion)	5.0	5.5	6.4

Source: Luozhuang District Government, CCXAP research

**Government's Willingness to Provide Support****Essential role in infrastructure construction in Luozhuang District**

There are three major LIIFCs in Luozhuang District, namely LYFI, Linyi Luomei Urban Construction Co., Ltd. ("LMUC") and Linyi Luokai Holding Group Co., Ltd. ("LYLK"). LYFI is one of the important infrastructure construction entities in Luozhuang District, having a clear and sustained functional position. Its parent company, Xingluo Holdings, is the regional key infrastructure and industrial investment entity. LMUC is 89.58% owned by Luozhuang SAMSC, mainly responsible for affordable housing and road construction. LYLK is wholly owned by Luozhuang SAMSC, focusing on the development of industrial parks. Given its significant policy role in Luozhuang District, we expect that the Company is unlikely to be replaced in the short-to-medium term.

LYFI conducts infrastructure construction projects through signing the entrusted management agreements with Tianyuan Construction Group Co., Ltd. ("Tianyuan Group"), which is the major contractor for managing construction projects from the local government in Linyi City. According to the agreements, LYFI is responsible

for the funding of the projects, and Tianyuan Group will settle the project payment in accordance with the agreed schedule with certain mark-up in return upon completion and acceptance of the projects. LYFI has completed a number of projects with a total investment of RMB3.3 billion, including public parks construction, road network improvements, and area renovations. As of 30 June 2024, the Company had 5 infrastructure projects under construction, with an estimated investment of RMB2.7 billion and the remaining investment of RMB899.9 million. In addition, it had 2 projects under planning with a total investment of RMB480.0 million. The substantial project reserve ensures the Company's regional importance and the sustainability of its construction business.

However, affected by the slowdown of the property market and the tight liquidity issue on some real estate developers, Tianyuan Group has been experiencing repayment problems over the past years. By the end of October 2024, there were a number of negative issues about Tianyuan Group, which was listed as a judgement debtor, involved in termination of enforcement proceedings, as well as prohibited from participating in certain bidding activities. Tianyuan Group's legal person was also restricted from high consumptions. Apart from that, Tianyuan Group's commercial bills have been overdue for multiple times. As of 31 October 2024, the outstanding overdue payments in commercial bills of Tianyuan Group was around RMB2.0 billion. Affected by the liquidity issue of Tianyuan Group, LYFI may experience some difficulties from collecting project repayment. As of end-2023, LYFI had receivables from Tianyuan Group amounting to RMB64.8 million. LYFI has implemented a range of measures to mitigate the risk of project repayment, including having Tianyuan Group's real estate assets as collateral for repayment.

LYFI is also responsible for the sewage treatment in Luozhuang District. Its main service area encompasses four streets in Luozhuang District, with a service area of around 150 square kilometers. Relying on sewage treatment plant, facilities, and pipelines allocated by the local government, the Company's annual sewage treatment capacity reached 19 million tons as of 30 June 2024.

### **Moderate exposure to commercial activities**

In addition to infrastructure construction, LYFI is engaged in a range of commercial activities, such as trading, property development, leasing, and self-operated projects. The Company's exposure to commercial activities is expected to be moderate, which accounted for approximately 20% of its total assets.

LYFI's trading business has been a significant and stable contributor to its total revenue over the past three years, with the major products covering building materials and equipment. The majority of the Company's suppliers and customers are local enterprises based in Linyi City, with moderate concentration ratios from both the top five suppliers and top five customers, at 49.0% and 63.2% in 2024H1, respectively. From 2021 to 2023, the Company's revenue from trading demonstrated consistent growth, increasing from RMB729.2 million to RMB794.4 million, contributing around 60% of the Company's total revenue.

LYFI's property development business mainly includes the construction and sale of residential properties. As of 30 June 2024, the Company had completed one property project, with a total investment amount of RMB310.0 million. The majority of the project has been sold. Meanwhile, it had one property development project under construction, with a planned investment of RMB1.7 billion and an outstanding investment of RMB1.2 billion. LYFI would face uncertainty in terms of the investment fund balancing and the future return under the circumstance of volatile property market.

LYFI's leasing business consists of leasing of property, sand mining rights, and pipe network, which have generated supplementary revenue to the Company. An office building was leased to the Education and Sports Bureau of Luozhuang District, with a leasing period of 5 years and annual rent of RMB11.7 million. LYFI's sand

mining rights were leased to a local private-owned enterprise from 2022 to 2024, with an annual rental income of more than RMB30 million. While the leasing period is expiring soon, the future revenue from leasing of the sand mining rights is subject to uncertainty. The Company is currently in discussions with the lessee regarding the extension of the leasing period.

LYFI is also engaged in the development of several self-operated projects, which are anticipated to achieve fund balancing through sales and operation, such as leasing and providing service. As of 30 June 2024, LYFI had 3 self-operated projects under construction, including hospitals, vocational schools and financial centers, with a total investment of RMB5.5 billion and an outstanding investment of RMB4.5 billion. At the same time, the Company had 2 projects under planning, focusing on new energy and new materials, with an estimated total investment of RMB346.7 million. The large investment need would pose high capital expenditure pressure to the Company, and the estimated payback periods are expected to be long, with uncertainty on the return of the investment.

### **Track record of receiving government support**

As the important infrastructure construction entity, LYFI has a close relationship with the local government and has a track record of receiving government support, including asset injections and financial subsidies. From 2021 to 2024H1, the Company received continuous government subsidies totaling RMB15.1 million, supporting its construction investment and debt repayment. In terms of asset injection, the local government transferred several municipal road projects and sand mining right to the Company in 2022, increasing its capital reserve by RMB1.2 billion. Positioned as a major constructor of essential public infrastructure, LYFI has played a pivotal role in the regional construction, and the robust project reserve helped to maintain its functionality. We believe that the local government will continue to provide support to LYFI over the next 12 to 18 months, including providing liquidity support to Tianyuan Group in order to alleviate the project repayment uncertainty of the Company.

### **Fast growing debt with high short-term debt burden**

LYFI has shown fast debt growth over the past three years, dedicating to the investment of infrastructure construction and self-operated projects. As of 30 June 2024, the Company's total interest-bearing debt increased to RMB3.8 billion from RMB1.7 billion as of end-2021, representing a compound annual growth rate of more than 35.0%. Meanwhile, its capitalization ratio, calculated by total debt to total capital, increased from 24.8% to 31.3%. In addition, LYFI bears high short-term debt burden. As of end-2023, the Company's short-term debt was RMB2.5 billion, accounting for 80.0% of the total debt, while the unrestricted cash was only RMB15.4 million. As of 30 June 2024, LYFI's cash to short-term debt ratio was 0.3x, indicating certain short-term debt repayment pressure. Considering the significant investment needs for the projects under construction and planning, we anticipate the total debt will continue to grow over the next 12-18 months.

### **Tight liquidity position with moderate funding capability**

LYFI's assets mainly consist of receivables, inventories, and intangible assets with low liquidity, accounting for more than 80% of the total assets. With the progress of construction projects, LYFI's inventories constituted a substantial proportion of total assets, mainly including development costs of infrastructure projects. Moreover, LYFI and its subsidiaries are experiencing tightened liquidity issues. Some of LYFI's assets, including cash and investment properties, were restricted as loan collateral, which placed the Company under certain short-term liquidity pressure. Its subsidiaries had several cases involving termination of enforcement proceedings for with total execution amount of around RMB756.7 million, which is expected to receive support from the local

government. Considering the important role of the Company in infrastructure construction in Luozhuang District, LYFI is expected obtain liquidity support from the local government when necessary.

LYFI has moderate access to funding. Bank loans are the main source of funding, which accounted for around 65.8% of the total debt as of 30 June 2024. The Company's total bank credit facilities amounted to RMB3.2 billion, most of which were provided by large state-owned commercial banks and urban commercial banks such as China Construction Bank and Laishang Bank Co., Ltd., while the available portion was RMB150.0 million, indicating insufficient standby liquidity. LYFI's exposure to non-standard financing was relatively large, accounting for around 15.2% of the total debt. The Company's non-standard products were mainly financial leasing and with relatively high costs and short maturity terms.

### **Medium exposure to contingent risk from external guarantees**

The credit profile of LYFI is constrained by its external guarantees, which could potentially increase its repayment obligations. As of 30 June 2024, the outstanding balance of external guarantees was approximately RMB1.7 billion, representing 21.1% of net assets. In particular, the majority of these guarantees were provided to another state-owned enterprise, LMUC, as well as LMUC's subsidiary. In the event of a credit event in the region, the Company may be exposed to certain contingent liability risks. Additionally, LYFI has contingent risk exposure from external guarantees provided to a private-owned enterprise, amounting to RMB9.8 million, or 0.6% of the total external guarantees. Overall, we anticipate that the credit risk of the guarantee is moderately controllable, taking the local government's support to local state-owned enterprises in times of need into account.

### **ESG Considerations**

LYFI faces environmental risks because it has undertaken construction business. 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.

LYFI bears social risks as it implements public policy initiatives by building public infrastructure in Luozhuang 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.

LYFI's governance considerations are also material as the Company is subject to oversight by the Luozhuang District Government and must 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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