

Credit Opinion

17 December 2024

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

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Dongying Kenli District Financial Development Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Dongying Kenli District Financial Development Group Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Dongying Kenli District Financial Development Group Co., Ltd. ("KLFD" or the "Company") reflects the Kenli District Government's (1) relatively strong capacity to provide support, and (2) very high willingness to provide support based on our assessment of the Company's characteristics.

Our assessment of the local government's capacity to provide support reflects Kenli District's high gross regional products ("GRP") growth rate, with relatively good fiscal balancing capacity.

The rating also reflects the local government's willingness to provide support, based on the Company's (1) status as the largest local infrastructure investment and financing company ("LIIFC") by total assets in Kenli District; and (2) position in infrastructure construction with clear and strong regional importance in Kenli District.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities; (2) moderate funding capability; and (3) high contingent liabilities risk caused by external guarantee for private-owned enterprises.

The stable outlook on KLFD's rating reflects our expectation that the local government's capacity to provide support will remain stable, and the Company's characteristics such as its important role in the infrastructure construction of Kenli District will remain unchanged over the next 12-18 months.

Rating Drivers

- The largest local LIIFC by total assets in Kenli District
- Responsible for infrastructure construction with clear and strong regional importance in Kenli District
- Medium exposure to commercial activities
- Track record of receiving government support
- Increasing debt burden driven by the continuous investment in construction projects
- Moderate funding capability
- High contingent liability risk caused by external guarantees for private-owned enterprises

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's capacity to support strengthens; and (2) the Company's characteristics change in a way that enhances the local government's willingness to support, such as reduced exposure to risky commercial activities, and improved financing capability.

What could downgrade the rating?

The rating could be downgraded if (1) the local 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 decreased government payments.

Key Indicators

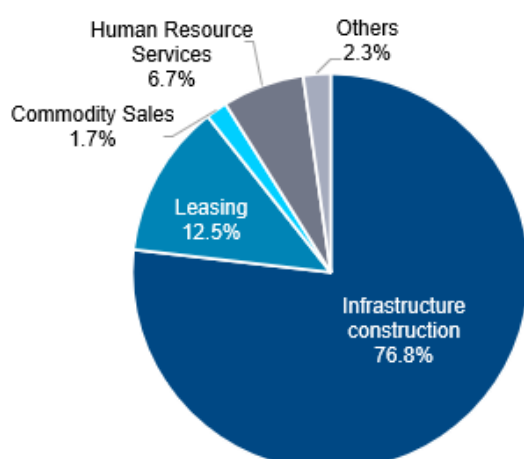
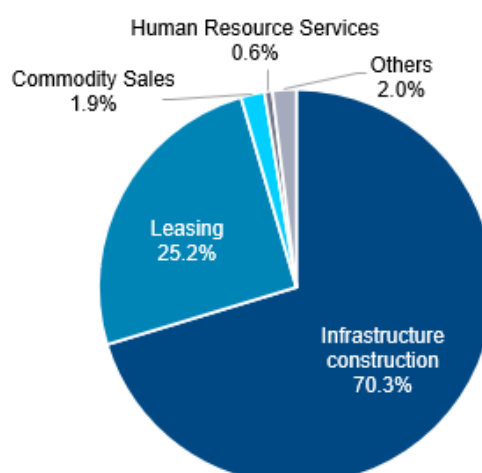
	2021FY	2022FY	2023FY	2024Q3
Total Asset (RMB billion)	5.5	6.5	8.9	9.5
Total Equity (RMB billion)	2.3	2.3	3.0	2.9
Total Revenue (RMB billion)	0.2	0.6	0.6	1.4
Total Debt/Total Capital (%)	48.2	52.6	55.2	59.2

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

Source: Company data, CCXAP research

Corporate Profile

Founded in 2020, KLFD is one of the key local LIIFCs in Kenli District, Dongying City. The Company undertakes the role of infrastructure construction in the Xicheng Area and the Economic Development Zone in Kenli District. It also engages in commercial activities such as leasing, commodity sales and human resource service. As of 30 September 2024, KLFD was wholly owned and controlled by the State-owned Assets Management Service Centre of Kenli District, Dongying City.

Exhibit 1. Revenue structure in 2023**Exhibit 2. Gross profit structure in 2023**

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe Kenli District Government has a relatively strong capacity to provide support given its high GRP growth rate, with relatively good fiscal balancing capacity.

Shandong is the third largest province in China by GRP, with a solid foundation in different industries such as logistics, shipbuilding, marine technology, chemical, automotive, and agri-food. Dongying City is a prefecture-level city located in the northeast part of Shandong Province. Dongying City owns rich oil and gas resources, 80% of Shengli Oilfield's oil geological reserves and 85% of production are concentrated in Dongying City. The petrochemical industry is the most important pillar industry in Dongying City. After industrial transformation and upgrading, Dongying City has also developed some emerging industries including new energy and new materials, high-end chemical industry, as well as high-end equipment.

In 2023, Dongying City's GRP increased to RMB389.9 billion, recording an economic growth of 7.0% year-over-year ("YoY"). Dongying City's GRP ranked 9th among 16 prefecture-level cities in Shandong Province, recognizing an improvement from 2022, and its GRP per capita has ranked first for years. Dongying City has continuous growth in fiscal strength. In 2023, Dongying City's general budgetary revenue increased to RMB28.5 billion from RMB26.2 billion in 2021. Its average general budgetary revenue to general budgetary expenditure ratio was 77.8% on average over the past three years. As of 31 December 2023, Dongying City Government reported an outstanding government debt of RMB90.5 billion and accounted for 23.2% of its GRP. In the first three quarters of 2024, Dongying City reported a GRP of RMB313.1 billion, representing 6.5% YoY growth.

Exhibit 3. Key economic and fiscal indicators of Dongying City

	2021FY	2022FY	2023FY
GRP (RMB billion)	344.1	362.1	389.9
GRP Growth (%)	8.5	4.3	7.0
General Budgetary Revenue (RMB billion)	26.2	26.5	28.5
General Budgetary Expenditure (RMB billion)	30.1	36.9	38.2
Local Government Debt (RMB billion)	61.6	74.5	90.5

Source: Dongying Municipal Government, CCXAP research

Kenli District is located at the estuary of the Yellow River, with good ecological environment and rich natural resources. Meanwhile, 45% of the proven reserves and 43% of the oil and gas production of the Shengli Oilfield have come from the Kenli District since its development. Supported by the rich resources, Kenli District has developed several pillar industries, including high-end chemicals, automobiles and components, high-end equipment manufacturing, biomedicine, new energy and new materials. Kenli District recognized continued economic and fiscal growth. In 2023, its GRP reached RMB37.6 billion, ranking third among the districts and counties in Dongying City, representing a significant increase compared to 2021. Meanwhile, the general budgetary revenue increased to RMB3.1 billion from RMB2.9 billion in 2021. The average fiscal balance ratio was 91.7% over the past three years. As of 31 December 2023, Kenli District Government reported an outstanding government debt of RMB7.6 billion, representing for 20.3% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Kenli District

	2021FY	2022FY	2023FY
GRP (RMB billion)	31.7	34.8	37.6
GRP Growth (%)	11.0	5.4	8.2
General Budgetary Revenue (RMB billion)	2.9	3.0	3.1
General Budgetary Expenditure (RMB billion)	2.6	3.9	3.7
Local Government Debt (RMB billion)	5.2	6.7	7.6

Source: Kenli District Government, CCXAP research

Government's Willingness to Provide Support

The largest local LIIFC by total assets in Kenli District

There are three major first-level LIIFCs in Kenli District, including KLFD, Dongying Kenli District Urban Development Group Co., Ltd. ("KLUD"), and Dongying Kenli District Natural Resources Comprehensive Development Group Co., Ltd. ("KLNR"), and each of them has a clear functional division under the local government's authorization. KLFD is the largest in terms of total assets as at end-2023 and the major infrastructure construction and state-owned asset operation entity, covering infrastructure construction projects mainly in Xicheng Area and the Economic Development Zone in Kenli District. KLUD is the major comprehensive urban utilization entity, which is responsible for the construction and operation of public utilities, including water supply and heating projects. KLNR is responsible for land reserves, resource development and other businesses based on natural resources in Kenli District.

Responsible for infrastructure construction with clear and strong regional importance in Kenli District

Along with the development of Kenli District, KLFD has undertaken several major infrastructure construction projects in the area. The Company is primarily responsible for the projects such as the rehabilitation of public services and the treatment of water sources, which are closely linked to livelihoods in Kenli District. KLFD conduct infrastructure construction mainly through entrusted construction model. The Company signs entrusted construction agreements with some state-owned enterprises in Kenli District. After the project is completed and examined, the entrusted parties would pay KLFD the construction cost plus 30% markup. As of 30 September 2024, the Company had 4 infrastructure construction projects completed, including ecological pasture planting base and pipeline upgrading and improvement, with a total investment of RMB2.3 billion. Meanwhile, it had one water conservation project under construction, with an estimated investment amount of RMB1.2 billion and uninvested amount of RMB661.0 million. The Company's reserves for infrastructure construction projects are limited, and future construction needs depend on the local government's development plan.

Medium exposure to commercial activities

KLFD's commercial activities covers leasing, commodity sales, human resource service, security service and emergency transfer loan businesses. While the commercial activities generate supplemental income, they may pose higher operational and business risks than its infrastructure construction businesses. We estimated the Company's exposure to commercial activities is medium, which accounted for around 15%-20% of total assets.

KLFD's leasable assets are mainly from government allocations and purchases, including commercial buildings, residential areas, and factories in Kenli District. The properties mainly leased to local state-owned enterprises, as well as some private enterprises and individuals. Over the past three years, the rental revenue increased from RMB66.0 million to RMB79.0 million. In 2024Q3, the revenue was small as part of the revenue will be recognized at the end of the year. The Company's occupancy rate is high as the majority of its assets are under whole-lease model. However, some rental repayment is lagging without clear payment schedule. As of 30 September 2024, receivables from leasing business were over RMB84.6 million. In addition, the Company has launched the construction of two industrial park projects to enhance its business strength, with a total investment of RMB1.8 billion, of which approximately RMB1.4 billion is still required. These two projects are expected to generate revenue mainly from leasing.

KLFD is mainly engaged in commodity sales through its subsidiaries, trading in natural rubber, crude oil and copper, of which natural rubber is a major component. The Company adopts sales-on-purchase trading model and profits from spreads. Company is also exposed to customer and supplier concentration risks, which may lead to weaken the Company's bargaining power. In 2024Q3, the top five suppliers and customers accounted for 98.1% and 100% of total procurement and total sales, respectively. In addition, most of the downstream customers are privately owned and several are under the control of the Wanda Holding Group, indicating a potential risk of fund recovery. The revenue of commodity sales further increased to RMB1.1 billion in the first three quarters of 2024, mainly due to the change in revenue recognition to the full amount method. However, the gross profit margin remained low.

KLFD also carries out other businesses such as human resource service, security service, and financial business. These businesses broaden the Company's business diversity and complement the Company's revenues. However, the volume of these businesses is currently small.

Track record of receiving government support

KLFD has a track record of receiving support from Kenli District Government in terms of subsidies, capital injection, and asset injection. In 2022, KLFD received capital injection in cash from the local government, with the total amount of RMB93.4 million, increasing the Company's capital strength. Benefited from the continuous asset injection, the Company's capital reserve increased from RMB2.2 billion at end-2021 to RMB2.6 billion as of 30 September 2024. Meanwhile, KLFD has a proven track record of receiving payment from the local government. From 2021 to 2023, the local government has provided a total of RMB4.0 million in subsidies for the Company. Moreover, the Company received project payment for infrastructure construction of RMB167.7 million from the local government as of 30 September 2024. Given the Company's important position and function role in Kenli District, we believe that KLFD will continue to receive various kinds of support from the local government.

Increasing debt burden driven by the continuous investment in construction projects

KLFD's total debt has increased rapidly over the last three years, mainly due to the increased operational and investment needs. From 2021 to 2023, the total debt increased from RMB2.1 billion to RMB3.7 billion, with the compounded annual growth rate of 31.5%. The debt continued to increase to RMB4.2 billion as of the third quarter of 2024. The total capitalization ratio, calculated by total debt to total capital, also increased from 48.2% at end-2021 to 59.2% as of 30 September 2024. In 2024, the Company optimized its debt structure and replaced short-term debt with long-term debt, which has reduced the Company's short-term debt pressure. As of 30 September 2024, the short-term debt amounted to RMB597.3 million, accounting for 14.2% of the total debt. Meanwhile, the cash to short-term ratio was 0.6x, representing manageable short-term repayment burden. The Company primarily depends on external financing, such as bank loans, to maintain its operation and investment. Considering the future investment needs for the construction projects, we expect the Company's debt to continue to increase and its leverage ratio to remain at a relatively high level.

The Company's asset liquidity is medium. Its assets are primarily constituted by receivables, inventories, and fixed assets. As of 30 September 2024, receivables, inventories, and fixed assets accounted for approximately 77% of total assets. Receivables are mainly from construction, leasing, and commodity sales businesses, inventories mainly consist of the construction investments in infrastructure projects, and fixed assets are mainly the sewerage network and real estate. All of these assets were considered low liquidity.

Moderate funding capability

KLFD's access to finance is mainly through bank loans and non-standard products, the 95% of which are bank loans as of 30 September 2024. KLFD has maintained good relationships with policy banks, state-owned commercial banks, and regional commercial banks. For example, more than 30% of the Company's loans are from the Agricultural Development Bank, with long loan terms and relatively low interest rates. As of 30 September 2024, the Company had total bank credit facilities of RMB6.1 billion, and the available portion was RMB1.4 billion. KLFD also had exposure to non-standard financing products, representing for around 5% of the total debt.

High contingent liability risk caused by external guarantees for private-owned enterprises

KLFD bears high contingent risk resulting from large external guarantees, which includes guarantees to private-owned enterprises. As of 30 September 2024, the Company's external guarantees amounted to RMB2.7 billion, which accounted for more than 90% of its net assets. Apart from the guarantees to local state-owned enterprises, the Company also provided guarantees to private-owned enterprises with a total balance of RMB880.5 million. Moreover, some of the Company's guarantors were involved in negative public opinion such as being included in the list of dishonest entities subject to enforcement, equity pledge, and administrative penalties, and the related guarantee balance was RMB870.5 million. The Company has plans for managing contingent risk, such as establishing the re-guarantee mechanism and implementing counter-guarantee measures. It also limits the absolute amount of external guarantees.

ESG Considerations

KLFD is exposed to environmental risks due to undertaking key infrastructure construction. 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.

The Company bears social risks as it implements public policy initiatives by playing an important role in the social welfare of Kenli 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.

KLFD's governance considerations are also material as the Company is subject to oversight by Kenli 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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