

Credit Opinion

24 January 2025

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

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Jiaozuo State-owned Capital Operation (Holding) Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Jiaozuo State-owned Capital Operation (Holding) Group Co., Ltd., with stable outlook.

Summary

The BBB_g long-term credit rating of Jiaozuo State-owned Capital Operation (Holding) Group Co., Ltd. ("JZSC" or the "Company") reflects the Company's (1) main entity to support the industrial development of Jiaozuo City, including food processing industry; and (2) important role in state-owned asset operation and urban construction in Jiaozuo City.

However, the rating is constrained by the Company's (1) operating uncertainties of self-operated construction projects, which are easily affected by the local investment and business environment; (2) moderate revenue scale and profitability; and (3) rising debt level with increased pressure on debt servicing.

The rating also reflects a high likelihood of government support from the Jiaozuo Municipal Government when needed, which is based on the Company's (1) direct ownership and ultimate control by the Jiaozuo Municipal Government; (2) regional importance in state-owned asset operation and industrial development in Jiaozuo City; and (3) solid track record of receiving support from the local government including subsidies, capital injections and asset transfers.

The stable outlook on JZSC's rating reflects our expectation that the Company will maintain its regional competitiveness and importance in industrial development of Jiaozuo City over the next 12-18 months. We also expect that the Company will continue to receive ongoing support from the local government.

Rating Drivers

- Main entity to support the industrial development of Jiaozuo City including food processing industry
- Important role in state-owned asset operation and urban construction in Jiaozuo City
- Diversified revenue streams but limited by geographic concentration
- Moderate revenue scale and profitability
- Rising debt level with increased pressure on debt servicing
- High likelihood of support from the Jiaozuo Municipal Government

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the likelihood of government support for the Company improves; or (2) the Company's stand-alone credit profile improves significantly, such as improvement in debt structure and asset profitability.

What could downgrade the rating?

The rating could be downgraded if (1) the likelihood of government support for the Company decreases; or (2) the Company's stand-alone credit profile weakens significantly, such as a deterioration in financial leverage and liquidity position.

Key Indicators

	2022FY	2023FY	2024H1
Total Assets (RMB billion)	23.6	25.4	26.4
Total Equity (RMB billion)	19.0	18.8	19.4
Total Revenue (RMB billion)	3.2	3.0	1.2
Net Profit (RMB billion)	0.2	0.3	0.1
EBIT Margin (%)	11.9	17.6	-
Return on Assets (%)	1.6	2.2	-
Total Debt/Total Capital (%)	11.0	17.1	17.5
Total Debt/EBITDA (x)	4.2	5.3	-
EBITDA/Interest (x)	4.7	5.2	-
FFO/Total Debt (%)	21.1	16.4	-

All ratios and figures are calculated using CCXAP's adjustments. All the financial data is based on pro forma financial statements, considering the equity transfers and asset injections as of 30 June 2024. Indicators marked with "-" are not applicable or not comparable.

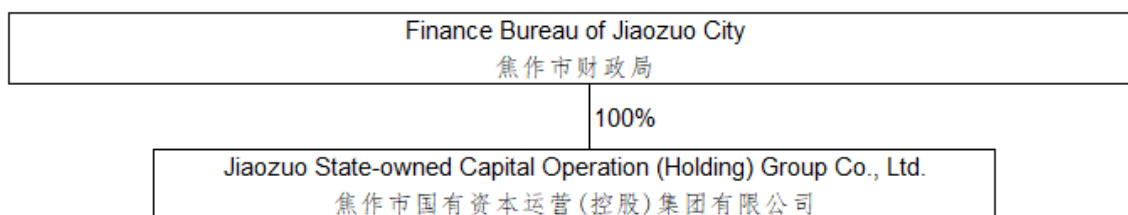
Source: Company data, CCXAP research

Corporate Profile

Established in April 2011, JZSC is a local state-owned enterprise mainly operating in Jiaozuo City, Henan Province. To promote the regional industrial development and improve state-owned asset operation, the local government consolidated local state-owned assets and resources in 2023, and transferred large amount of assets and equities to JZSC. In June 2024, the Company transferred 51% of the equity of its wholly-owned subsidiary, Jiaozuo Urban Development Investment (Holding) Group Co. Ltd. to Finance Bureau of Jiaozuo City in order to promote market-based transformation of JZSC. After the consolidation and reorganization, the

Company is positioned as a key entity in industrial investment and state-owned asset operation in Jiaozuo City, with different business scopes covering project construction, food processing, highway construction and operation, human resources service and commercial property sales. As of 30 June 2024, the Company was directly and wholly-owned by the Finance Bureau of Jiaozuo City; JZSC reported total assets of RMB26.4 billion.

Exhibit 1. Shareholding chart as of 30 June 2024



Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2023

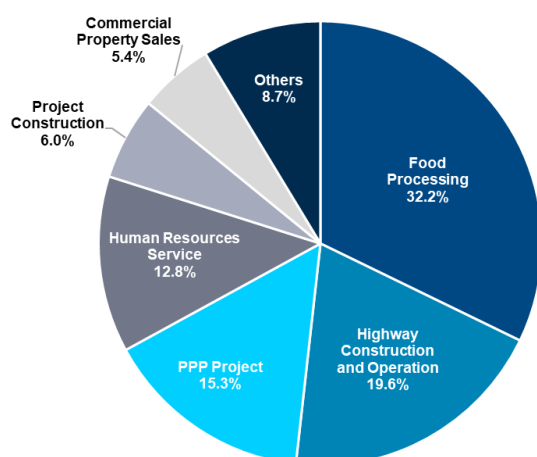
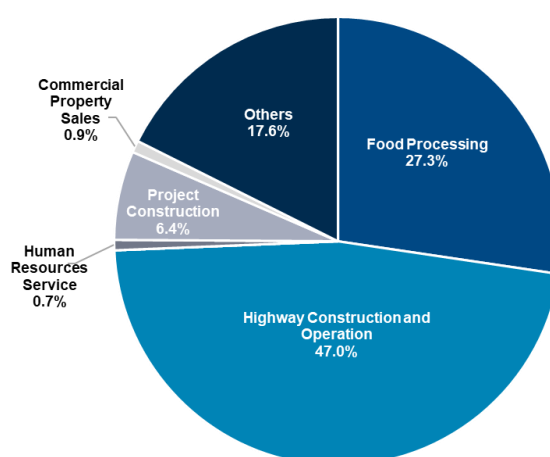


Exhibit 3. Gross profit structure in 2023



Source: Company information, CCXAP research

Rating Considerations

Business Profile

Main entity to support the industrial development of Jiaozuo City including food processing industry

The Company participates in the food processing business mainly through its subsidiary, Henan Bonong Industrial Group Co, Ltd. ("Bonong Group"), in which the Company holds 90% of equity. Bonong Group's products mainly include instant noodles and dairy products, which are sold to multiple provinces and cities in China and are export overseas, and have a relatively high recognition in Jiaozuo City. The majority of customers are wholesalers, such as state-owned supermarkets and hypermarkets. Over the past two years, the food processing business has achieved a consistent growth in production and sales, with revenues exceeding RMB900 million annually. The gross profit margin also increases from 13.1% in 2022 to 19.6% in 2023, making a significant contribution to the Company's total income and profitability. Overall, we anticipate that Bonong Group would maintain its good market position in food processing industry, which will benefit JZSC through the sustained growth in business.

To support the industrial development in Jiaozuo City, the Company is expected to construct some self-operated projects, mainly industrial parks. The Company constructs the projects mainly through external financing, and balances the funds through business income such as operating and leasing. As of end-2023, the Company had 5 self-constructed projects under planning, with a total investment amount of around RMB3.6 billion. Such projects ensure the sustainability of the Company's business. However, the relatively large future investment may put some investment pressure on the Company. Apart from that, there are uncertainties regarding the future operations of these self-operated projects as they are easily affected by local investment and business environment.

The Company is also involved in cultural tourism business to promote the development of tourist industry, which also expands the diversity of the Company's business and complement the Company's revenues. The cultural tourism business includes theater performance, cultural tourism, and hotel management, which has realized revenue of RMB49.9 million and RMB88.6 million in 2022 and 2023 respectively. Meanwhile, the Company also had cultural and education base under construction, with total investment of RMB147.0 million.

Important role in state-owned asset operation and urban construction in Jiaozuo City

As the main state-owned asset operation and urban construction entity in Jiaozuo City, JZSC mainly undertakes projects such as road construction, river management, ecological restoration, PPP projects, and highway operation in Jiaozuo City. Some of these businesses are of great significance in improving the living standards of local residents in line with Jiaozuo City's urban planning.

JZSC participates in urban construction mainly under agency construction model. Under the agency construction model, the Company is entrusted with the entrusting parties to construct urban construction projects. The funding of the projects come from the entrusting parties and self-raised fund. The Company receives project payments from the entrusting parties based on actual costs plus a mark-up during the construction phase. As of 31 December 2023, the Company had projects under construction with an outstanding investment of RMB187.0 million. With the completion of the agency construction projects, the revenue recognized from these projects in 2023 decreased from RMB406.1 million in 2022 to RMB182.5 million.

In addition, the Company undertakes PPP projects by establishing project companies with the local government, and is responsible for the project's construction and operation. As of 30 June 2024, the Company had one river ecological regulation PPP project under operation, with an estimated total investment of RMB1.9 billion. The fund balancing is expected to be achieved through operating income such as water supply and government subsidies. However, these urban construction projects were mostly completed, while the government payments for these projects were prolonged. As the PPP project was put into operation in 2024, the revenue generated from this project is small which is insufficient to cover the costs. The Company will undertake more self-operated industrialization projects in the future, supporting the industrial development in Jiaozuo City.

The Company participates in highway operation business and is mainly responsible for operating and managing two sections of the Zheng-Jiao-Jin Expressway, with a total length of around 72.8 kilometers and operating right of 30 years. The expressway was constructed by JZSC and was fully completed in December 2002, with a total investment of RMB2.6 billion. In terms of the business model, all the toll fees collected at the toll stations are handed over to the highway management bureau, and the Company then receives management fees based on the actual mileage and traffic volume. The traffic volume of this expressway has increased over the past two years, driving the revenue from this business increased from RMB514.8 million in 2022 to RMB595.8 million in 2023, providing supplementary revenue to the Company. JZSC also achieved relatively high gross profit margin

of around 50% over the past two years. The Company will hold the toll collection rights till 2032, which is expected to generate relatively stable revenue in the future.

Diversified revenue streams but limited by geographic concentration

JZSC is also involved in other businesses, including human resources service, commercial property sales, and cultural tourism service, which diversified its income sources. However, the Company is exposed to certain regional concentration risks as most of these businesses are concentrated in Jiaozuo City.

JZSC engages in real estate development business for the construction and sales of residential and commercial properties in Jiaozuo City. As of end-2023, the Company had 2 completed projects in the progress of sale, with total saleable area of 140.4 thousand square meters and unsold area of 8.9 thousand square meters. However, the Company has certain capital expenditure needs for its projects under construction. At end-2023, the Company had 3 residential and commercial properties under construction, with a total investment of RMB2.1 billion and an outstanding investment of RMB962.0 million. Apart from that, the profit and sale progress of these projects are highly subject to the changes in the current property market. Affected by the downturn in the property market, the selling progress of the properties has slowed down, around 34.1% of the property under construction had been sold as of end-2023. The revenue from this business sector largely decreased from RMB643.0 million in 2022 to RMB165.5 million in 2023, and the gross profit margin decreased from 14.8% to 3.6%.

JZSC provides human resources services through its subsidiary, and generates service fees. The business mainly provides labor services to local government departments and large enterprises in Jiaozuo City, generating supplementary income of more than RMB300 million per year. However, the gross profit margin of this business is relatively low at 1.3% in 2023. Revenue from the human resources services business has declined over the last years due to a reduction in the demand for labor as a result of the economic downturn and the establishment of new human resources companies in the region. The Company also engages in the operation of sand and gravel and geothermal resources, which generate small revenues.

Financial Profile

Moderate revenue scale and profitability

Driven by the reduction in infrastructure construction projects and decline in property sales, JZSC's total revenue slightly decreased from RMB3.2 billion in 2022 to RMB3.0 billion in 2023 and remains comparatively small. In 2023, the food processing business was the main contributor of JZSC's revenue, accounting for 32.2% of its total revenue, followed by highway construction and operation (19.6%), PPP project (15.3%) and human resources service (12.8%).

The profitability of JZSC is relatively weak, indicated by the low return on asset ratio. However, with the increase in EBIT from 2022 to 2023, JZSC's return on assets slightly increased from 1.6% to 2.2%. The weak return on assets was mainly caused by the Company's large non-income producing assets. As of 30 June 2024, the Company's sand and gravel, as well as geothermal resources accounted for over 35% of the total assets, and these assets have only generated little revenue. However, the Company is planning to replace the sand and gravel assets with other income producing assets. From 2022 to 2023, the Company's EBIT margin increases from 11.9% to 17.6%, but still remains at a moderate level. We anticipated JZSC's revenue and profitability would remain moderate in the next 12 to 18 months.

Rising debt level with increased pressure on debt servicing

Due to the expansion of its business scope and large capital expenditure on its construction development projects, JZSC's total debt increased rapidly over the past two years. The Company's total debt increased to RMB4.1 billion as of 30 June 2024 from RMB2.3 billion as of end-2022. However, the ongoing capital injection from the government keeps the capitalization leverage ratio, measured by total debt to total capital, at a manageable level of 17.5% at the end of June 2024.

JZSC's stand-alone debt servicing metrics are weak given its moderate profitability. The Company's two-year average EBITDA coverage ratio (EBITDA/interest expense) was relatively low at around 5.0x, and the two-year average total debt/EBITDA ratio was around 4.8x. Moreover, the Company's FFO/total debt ratio decreased to 16.4% in 2023 due to its ongoing investment in project construction. Considering the future investment in property development and industrial park construction, its debt scale may further increase in the future. The Company's financing needs for the construction projects can be partially met by its standby liquidity cushion. As of 30 June 2024, JZSC's financing channels are concentrated which consisted of bank borrowing. It has a good access to bank borrowing, and is mainly cooperated with large state-owned commercial banks and national joint-stock commercial banks. As of 30 June 2024, it had total bank credit facilities of around RMB15.8 billion, with an available portion of RMB11.0 billion.

External Support

High likelihood of support from the Jiaozuo Municipal Government

We expect JZSC has a high likelihood of receiving support from the Jiaozuo Municipal Government in times of need. This expectation incorporates our considerations of the Company's (1) direct ownership and ultimate control by the Jiaozuo Municipal Government; (2) regional importance in state-owned asset operation and industrial development in Jiaozuo City; and (3) solid track record of receiving support from the local government including subsidies, capital injections and asset transfers.

Jiaozuo City is committed to build three industrial clusters, including high-end equipment, green food and new materials, contributing to regional industrial upgrading. Jiaozuo City's economic strength is moderate, with GRP ranking 13th among 18 jurisdictions in Henan Province. At the same time, Jiaozuo Municipal Government's general budgetary revenue was RMB14.4 billion, of which tax income accounted for 76.2%.

Jiaozuo Municipal Finance Bureau maintains a high degree of control over JZSC's operations, including the formulation of business strategies and the appointment of the board of directors and key management personnel. The Company is also required to report its annual budget, objectives, plans and performance to the Finance Bureau of Jiaozuo City. Its strategy and investment are aligned with Jiaozuo Municipal Government's policies of investing in industries, such as food industry, to promote industrial upgrading in the region.

Given its strategic and economic importance in Jiaozuo City, JZSC receives solid supports from the Jiaozuo Municipal Government via assets and capital injections, subsidies and granting of franchise rights. From 2023 to 2024, the Finance Bureau of Jiaozuo City has transferred assets including sand and gravel resources, geothermal resources, and equity of several companies to the Company, broadening its business scope and enhancing its competitiveness. As of 30 June 2024, the paid-in capital has increased to RMB 4.6 billion from RMB1.4 billion at the end of 2022, mainly due to the transfer of these assets. From 2022 to 2024H1, the local government has provided subsidies of RMB12.2 million to the Company to support its operations. Overall, given JZSC's regional importance in Jiaozuo City, we believe the local government will continue to support the Company in the form of financial subsidies, capital injections, or asset injections.

Rating Methodology

The methodology used in this rating is the Rating Methodology for [General Corporate \(April 2019\)](#).

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