

Credit Opinion

16 May 2023

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

Analyst Contacts

Peter Chong +852-2860 7124

Senior Analyst

peter_chong@ccxap.com

Jonathan Kwong +852-2860 7132

Assistant Analyst

jonathan_kwong@ccxap.com

Elle Hu +852-2860 7120

Executive Director of Credit Ratings

elle_hu@ccxap.com

**The first name above is the lead analyst for this rating and the last name above is the person primarily responsible for approving this rating.*

Client Services

Hong Kong +852-2860 7111

Huizhou Zhongkai City Development Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g to Huizhou Zhongkai City Development Group Co., Ltd, with stable outlook.

Summary

The BBB_g long-term credit rating of Huizhou Zhongkai City Development Group Co., Ltd (“HZCD” or the “Company”) reflects (1) Huizhou Zhongkai High-tech Industrial Development Zone (“Zhongkai HTZ”) Government’s relatively 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 Zhongkai HTZ Government’s capacity to provide support reflects Zhongkai HTZ’s continued growth in economic and fiscal strength, with good fiscal balance.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) strong market position as the sole investment and financing entity in Zhongkai HTZ, after consolidating local state-owned assets and resources; (2) dominant role in undertaking local public activities with high sustainability; and (3) track record of receiving government payments.

However, the rating is constrained by the Company’s (1) high exposure to commercial activities; (2) rapid debt growth with large capital expenditure needs; and (3) moderate asset quality.

The stable outlook on HZCD’s rating reflects our expectation that Zhongkai HTZ Government’s capacity to provide support will remain stable, and the Company will maintain its dominant role in undertaking local public activities in Zhongkai HTZ over the next 12 to 18 months.

Rating Drivers

- Strong market position as the sole investment and financing entity in Zhongkai HTZ
- Dominant role in undertaking local public activities, with high sustainability
- High exposure to commercial activities, with manageable business risks
- Track record of receiving government payments
- Diversified access to funding
- Rapid debt growth and moderate asset quality

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Zhongkai HTZ 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 expansion of its policy role, material decrease in commercial activities exposure, or improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Zhongkai HTZ 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 decrease in importance of its policy role, material decrease in government payments, or deteriorated debt management.

Key Indicators

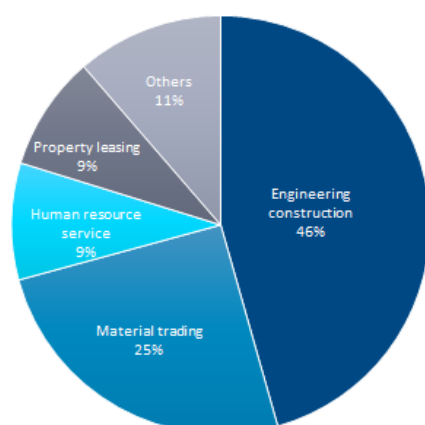
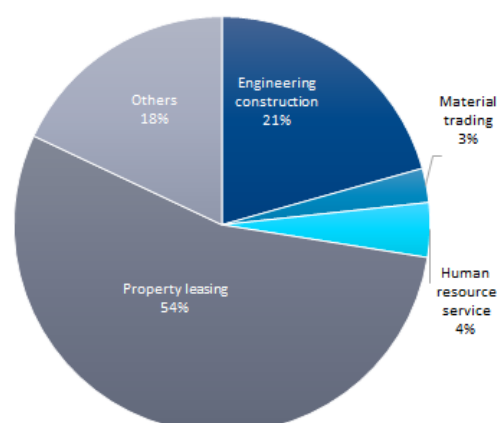
	2020FY	2021FY	2022FY
Total Asset (RMB billion)	5.9	8.4	24.3
Total Equity (RMB billion)	3.3	3.4	9.7
Total Revenue (RMB billion)	0.4	0.5	1.3
Total Debt/Total Capital (%)	40.1	56.3	54.3

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

Source: CCXAP research

Corporate Profile

Founded in 2003, and after consolidating 7 state-owned industrial park development enterprises, HZCD has become the sole local infrastructure investment and financing company ("LIIFC") in Zhongkai HTZ. It plays the most important role in the local public policy activities, such as infrastructure construction, industrial park development, and sewage treatment. Besides, the Company also engages in some commercial activities such as supply chain, property leasing, engineering construction and fund investment. As of 31 December 2022, the Company was directly and wholly owned by State-owned Assets Affairs Center of Huizhou Zhongkai HTZ.

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 the Zhongkai HTZ Government has a strong capacity to provide support given its continued growth in economic and fiscal strength, with good fiscal balance.

Huizhou City is located in the south-central part of Guangdong Province, with a total area of 11,599 square kilometers. It has formed a modern transportation network supported by deep-water ports, railways, highways, and airports. With the ongoing industrial development, the economic strength of Huizhou City has grown at a fast pace. In 2022, the GRP of Huizhou City increased by 4.2% year-on-year ("YoY") to RMB540.1 billion, with GRP and GRP growth rate ranking 5th and 1st respectively among 21 prefectural-level cities in Guangdong Province. Its general budgetary revenue increased from RMB41.2 billion in 2020 to RMB44.2 billion in 2022, of which tax income contributed for 60.9%. Its fiscal balance is relatively good with general budgetary revenue/general budgetary expenditure ratio of 63.7%. However, Huizhou's outstanding government debt amounted to RMB105 billion with an increasing trend, accounting for 19.4% of its GRP.

Exhibit 3. Key economic and fiscal indicators of Huizhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	422.2	497.7	540.1
GRP Growth (%)	1.5	10.1	4.2
General Budgetary Revenue (RMB billion)	41.2	45.5	44.2
General Budgetary Expenditure (RMB billion)	63.7	66.3	69.3
Local Government Debt (RMB billion)	71.8	88.7	105.0

Source: Statistic Bureau of Huizhou City, CCXAP research

Approved by the State Council in 1992, Zhongkai HTZ is one of the first batch of state-level HTZs in China. Zhongkai HTZ covers a total area of 345 square kilometers and it contains 4 major industrial parks, namely Zhongkai High-tech Industrial Park, Dongjiang High-tech Industrial Park, Huinan High-tech Industrial Park, China Overseas Talent Development Base. According to the 2022 National High-tech Zone Comprehensive Evaluation Results released by the Torch Center of the Ministry of Science and Technology, Zhongkai HTZ

ranked 32nd among 173 state-level HTZs in China. With ongoing development of its pillar industries such as intelligent terminals, smart energy, artificial intelligence, Zhongkai HTZ has continued to grow and develop in recent years. In 2022, the GRP of Zhongkai HTZ increased from RMB63.2 billion in 2020 to RMB 90.6 billion in 2022. Its general budgetary revenue also grew from RMB3.1 billion in 2020 to RMB4.1 billion in 2022, with tax revenue accounting for 67% on average over the same period. Zhongkai HTZ has good fiscal self-sufficiency, with an average fiscal balance ratio of 84% over the past three years. In addition, Zhongkai HTZ has a manageable debt burden. In 2022, Zhongkai HTZ Government recorded an outstanding debt of RMB13.5 billion, accounting for 14.9% of its GRP.

Exhibit 4. Key Economic and Fiscal Indicators of Zhongkai HTZ

	2020FY	2021FY	2022FY
GRP (RMB billion)	63.2	80.8	90.6
GRP Growth (%)	0.1	17.9	6.4
General Budgetary Revenue (RMB billion)	3.1	3.8	4.1
General Budgetary Expenditure (RMB billion)	4.0	4.2	4.7
Local Government Debt (RMB billion)	7.9	10.3	13.5

Source: Statistic Bureau of Zhongkai HTZ, CCXAP research

Government's Willingness to Provide Support

Strong market position as the sole investment and financing entity in Zhongkai HTZ

After the consolidation of 7 state-owned industrial park development enterprises in September 2022, HZCD's market position has significantly enhanced, and it has become the sole investment and financing entity in Zhongkai HTZ. Positioned as an urban construction and operation service provider, the Company focuses on four major business sectors: urban construction, urban operation, industrial park operation, and industrial investment. Considering its high strategic significance to the development of Zhongkai HTZ, we believe the Company is unlikely to be replaced by other local state-owned enterprises in the foreseeable future.

Dominant role in undertaking local public activities, with high sustainability

Mandated by the local government, HZCD plays a dominant role in undertaking local public activities that are vital to local economic and social development, such as urban infrastructure construction, industrial park development, and sewage treatment. Given sufficient projects under construction, we consider the sustainability of the public-related businesses to be high, but the Company may face large capital expenditure pressure.

HZCD and its subsidiaries are responsible for a large number of infrastructure construction projects, such as highways, bus stations, and supporting facilities in industrial parks. The Company is responsible for project construction funds, and receives operating income during the operation period to achieve a balance of financial revenue and expenditure. As of 31 December 2022, the Company had 11 major infrastructure construction projects under construction or planning, with a total estimated investment of RMB11.5 billion and uninvested amount of RMB6.6 billion, exerting large capital expenditure pressure. In addition, the Company also assumes infrastructure construction management function in Zhongkai HTZ. It is responsible for the construction management for urban infrastructure projects, whose construction funds are raised by the entrusting parties, and receive construction management fee, typically 1%-2% of the construction costs, upon project completion.

HZCD owns the franchise for the integration of drainage and sewage treatment in Zhongkai HTZ, indicating strong regional position. The Company is responsible for the construction, management, and maintenance of sewage treatment plant, pumping stations, and drainage pipe network in the region. As of 31 December 2022,

the Company had 4 major sewage treatment construction projects under construction or planning, with a total estimated investment of RMB1.6 billion and uninvested amount of RMB1.4 billion, exerting certain capital expenditure pressure.

High exposure to commercial activities, with manageable business risks

In addition to public activities, HZCD is also involved in various commercial activities such as supply chain, property leasing, fund investment, and construction engineering. We consider its commercial business exposure to be high, accounting for more than 30% of its total assets. However, the business risk for the commercial businesses is manageable as most of them show good development momentum and provide positive cash flows to the Company.

Benefited by the region consolidation in September 2022, HZCD owns a large number of leasable state-owned properties with total values of RMB5.9 billion as of 31 December 2022. These properties are mainly office buildings, factories, and commercial stores, with total leasable area of 388.5 thousand square meters and an occupancy rate of about 80%, providing recurring rental income to the Company. However, it has a relatively large amount of property leasing projects under construction by self-raised funds, exerting high capital expenditure pressure. As of 31 December 2022, the Company had 12 major property leasing projects under construction or planning, with a total estimated investment of RMB14.1 billion and uninvested amount of RMB9.3 billion. We believe the rental income will further increase after completion of construction for these projects.

In addition, the Company undertakes engineering construction projects in Zhongkai HTZ. In 2022, its engineering construction income significantly increased to RMB368.3 million, with collected payment of RMB344.4 million. As of 31 December 2022, the Company expected to generate engineering construction income of RMB1.1 billion from the major construction projects under progress. With the improvement of construction qualification and the consolidation of industrial park construction entity, we expect that the engineering construction income will further increase in the future.

HZCD newly engaged in supply chain business in 2022, mainly involving sales of building materials, such as steel, zinc ingots and polyvinyl chloride, to construction companies or trading companies. However, the business is subject to certain concentration risks as the top 5 customers accounted for 64.3% of total sales and the top 5 suppliers accounted for 54.4% of total procurement as of 31 December 2022. In addition, the gross profit for the business is low at 1.5% in 2022.

The Company also participated in funds investment business in 2022, supported by government funding and self-raised funds. As of 31 December 2022, it had invested in 13 funds, with a total fund size of RMB2.7 billion. However, the paid-in amount and the cumulative investment amount are relatively low, which amounted to RMB684 million and RMB397 million at end-2022, respectively. As most of its investment are private projects or at the initial investment stage, we will pay attention to the operation risk and financial performance of its investment.

Track record of receiving government payments

HZCD has a track record of receiving payments from the local government. These payments take various forms, such as government subsidies, capital injections, and asset transfers. The Company regularly receives government subsidies to support its business operation. In 2022, the local government injected paid-in capital and resettlement houses, and transferred the equity interests of 7 state-owned enterprises to the Company, with total amount of about RMB5.0 billion, enhancing its capital strength and broadening its business mix.

Overall, given the Company's important position and its contribution to regional economic development, we believe that it will receive strong government support in times of need.

Exhibit 5. Government Support from 2020 to 2022

(RMB million)	2020FY	2021FY	2022FY
Government Subsidies	43	50	228
Capital Injections	35	3	1,286
Equity Transfers	-	-	3,672
Total	78	53	5,186

Source: Company information, CCXAP research

Rapid debt growth and moderate asset quality

With ongoing financing for its construction projects and the consolidation of regional resources in recent years, HZCD has a rapid debt growth. The Company's total debt increased from RMB2.2 billion at end-2020 to RMB11.5 billion at end-2022, with total capitalization of 54.3%. In addition, the Company has a reasonable debt structure. As of 31 December 2022, the Company's short-term debt accounted for 11.9% of its total debt, and its cash to short-term debt ratio was 1.0x, indicating relatively good short-term debt servicing capability. We expect that, given its large future capital expenditure needs, the Company has a high reliance on government payments and external financing, while its debt leverage will maintain at a relatively high level in the next 12 to 18 months.

Furthermore, HZCD has moderate asset liquidity. The Company's total asset mainly consists of inventories and non-current assets, which accounted for 83.6% of its total asset as of 31 December 2022. The inventories are mainly investment costs for infrastructure construction projects, while the non-current assets are mainly investment properties and construction in progress, which are considered low liquidity. In addition, the Company has a relatively large amount of restricted asset. As of 31 December 2022, the Company owned restricted asset of RMB5.8 billion, which accounted for 24% of its total asset. The moderate asset liquidity may undermine the Company's financial.

Diversified access to funding

HZCD has diversified access to funding as reflected by its good banking relationships and access to the onshore debt capital market. As of 31 December 2022, it held total credit facilities of RMB33.2 billion and available credit facilities of RMB12.5 billion, indicating sufficient standby liquidity. The Company has also diversified its financing channel to onshore debt capital market since 2021. As of end-2022, it had raised about RMB2.0 billion in onshore debt market, with a coupon range between 3.5% and 4.9%. Additionally, the Company has low reliance on non-standard financing.

ESG Considerations

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

The Company is also exposed to social risks as a public services provider in Zhongkai HTZ. Demographic changes, public awareness and social priorities shape government's target for HZCD, or affect the government's propensity to support the Company.

HZCD's governance considerations are also material as the Company is subject to oversight and reporting requirements to the local government, 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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China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 1904-1909, 19/F, Jardine House,
1 Connaught Place, Central, Hong Kong

Website: www.ccxap.com

Email: info@ccxap.com

Tel: +852-2860 7111

Fax: +852-2868 0656