

Nanxun Communications Investment Group Co., Ltd.

Initial Issuer Report

Summary

| | |
|---------------|------------------------------------|
| Issuer Rating | BBB- |
| Outlook | Stable |
| Location | China |
| Industry | Local Government Financing Vehicle |
| Date | 9 November 2022 |

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Nanxun Communications Investment Group Co., Ltd. (“NCIG” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Nanxun District (“Nanxun government”) would provide strong support to NCIG if needed, in light of its 100% ownership of NCIG, NCIG’s strategic importance as the sole state-owned entity for transportation related infrastructure investment, construction and operation and the important entity for water conservancy infrastructure construction in Nanxun District (“Nanxun”), and the linkage between the Nanxun government and NCIG, including control and supervision over the management, strategic alignment and ongoing operational and financial support. In addition, the Nanxun government may face significant negative impact on its reputation, business and financing activities if NCIG encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that NCIG’s strategic importance would remain intact while the Nanxun government will continue to ensure NCIG’s stable operation.

Rating Rationale

Nanxun Government’s Ownership and Supervision: The Nanxun government, through the Finance Bureau of Nanxun District, Huzhou City (“Nanxun Finance Bureau”), holds 100% equity of NCIG. It is the ultimate controller of the company. The Nanxun government supervises the company, including control and supervision over the management, decisions on strategic development and investment and financing plans etc. In addition, the Nanxun government has assessment mechanism over the company and it will appoint auditor to supervise the operating performance and financials on a periodic basis.

Strategic Importance to Nanxun and Strategic Alignment: NCIG is the important state-owned infrastructure investment and construction entity in Nanxun. The company is mainly responsible for the investment, construction and subsequent operation of transportation and water conservancy related infrastructure projects. The highways, railroads, rail transit and related integrated transportation hubs constructed by NCIG played an important role in promoting economic development in Nanxun and surrounding areas. NCIG’s business operation and development have been aligned with the government’s development plans. In the future plan of the Nanxun government, NCIG will continue to be responsible for the transportation development of Nanxun to support the local economy.

Ongoing Government Support: NCIG received support from the Nanxun government, including equity injection, asset injection, operation subsidy and policy support. Meanwhile, as the sole state-owned entity for transportation related infrastructure construction in Nanxun, NCIG has certain advantages in project and resource acquisition. At end-September 2022, the company’s paid-in capital increased from the initial of RMB203 million to RMB803 million. The Nanxun government also continued to inject various assets and equity to the company. In addition, NCIG also enjoys a variety of policy support, such as tax deduction and financial subsidies. NCIG had received a total subsidy amount of c. RMB1.2 billion from 2019 to the first nine months of 2022. We believe NCIG is likely going to receive

Key Figures of Nanxun and NCIG

| (RMB billion) | 2020 | 2021 |
|-----------------------|------|------|
| Nanxun | | |
| GDP | 46.8 | 52.9 |
| GDP growth rate (%) | 3.3 | 8.5 |
| Budgetary revenue | 4.0 | 4.3 |
| Government fund | 7.2 | 7.7 |
| Transfer payment | 2.6 | 2.4 |
| Budgetary expenditure | 5.5 | 6.6 |
| NCIG | | |
| Assets | 27.8 | 37.9 |
| Equity | 13.7 | 16.1 |
| Revenue | 0.8 | 1.6 |

Source: Public information, NCIG and Lianhe Global’s calculations

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Applicable Criteria

China Local Government Financing Vehicle Criteria (31 December 2021)

government support in the form of operational and/or financial subsidies, to support its daily business operation and transportation and water conservancy related infrastructure construction.

NCIG's Financial Matrix and Liquidity Position: NCIG's total assets showed a significant growth trend in the past years and reached RMB37.4 billion at end-September 2022, mainly due to the increase of construction in progress, intangible assets and inventories. NCIG's financial leverage (total liabilities to assets) remained stable at around 51%-58% from end-2019 to end-September 2022 and its adjusted debt increased to c. RMB17.1 billion at end-September 2022. The liquidity of NCIG was sufficient. NCIG had a cash balance and unused credit facilities of c. RMB2.8 billion and RMB3.8 billion at end-September 2022, compared with its debt due within one year of c. RMB2.2 billion. Besides, NCIG has access to various financing channels, including bank loans, onshore and offshore bond issuance and non-traditional financing, to support its debt repayment and business operations.

Economy and Fiscal Strength of Nanxun: As an administrative region under the jurisdiction of Huzhou City, Nanxun is located with advantageous position for transportation. Nanxun's economy maintained steady growth, with GDP reaching RMB52.9 billion in 2021, up 8.5% year-on-year. The GDP was mainly fueled by the second and tertiary industries, which accounted for 58.5% and 36.1% of total GDP in 2021.

The aggregate fiscal revenue of the Nanxun government was mainly derived from the budgetary revenue and government fund. The Nanxun government's budgetary revenue grew steadily, and its tax revenue accounted for c. 90% of its budgetary revenue. On the other hand, the government fund income increased rapidly due to the increase of revenue from the transfer of state-owned land use rights. The fiscal self-sufficiency rate of the Nanxun government was insufficient, thus it continued to receive subsidies from higher governments. At end-2021, the total outstanding amount of government debt increased to c. RMB9.2 billion from c. RMB6.4 billion at end-2019, mainly due to the increase in special purpose bonds. The debt ratio (i.e. total government debt divided by aggregate revenue) of the Nanxun government was c. 64% at end-2021, slightly down from c. 66% at end-2019.

Rating Sensitivities

We would consider downgrading NCIG's rating if (1) there is perceived weakening in support from the Nanxun government, particularly due to its reduced strategic importance with diminished government functions, or (2) there is a significant reduction of the Nanxun government's ownership of NCIG, or (3) there is a downgrade in our internal credit assessment on the Nanxun government.

We would consider upgrading NCIG's rating if (1) there is strengthened support from the Nanxun government, or (2) there is an upgrade in our internal credit assessment on the Nanxun government.

Operating Environment

Economic Condition of Nanxun

Nanxun, as an administrative region under the jurisdiction of Huzhou City, Zhejiang Province, is located in the central heartland of the YRD city group and the junction of Jiangsu Province, Zhejiang Province and Shanghai City, indicating good region and transportation advantages. Established in 2003, Nanxun has jurisdiction over 8 towns, 2 streets and a provincial development zone with a total land area of 702 square kilometers. The district's residential population reached c. 0.6 million with an urbanization rate of c. 57% at end-2021. Nanxun's economy has maintained steady growth, with GDP reaching RMB52.9 billion in 2021, up 8.5% year-on-year. The GDP was mainly fueled by the second and tertiary industries, which accounted for 58.5% and 36.1% of total GDP in 2021, respectively. During the same period, Nanxun's GDP per capita was approximately RMB97,145.

| Nanxun's GDP and Fixed Asset Investment | | | |
|--|-------------|-------------|-------------|
| (RMB billion) | 2019 | 2020 | 2021 |
| GDP | 45.8 | 46.8 | 52.9 |
| -Primary industry (%) | 5.2 | 5.7 | 5.4 |
| -Secondary industry (%) | 59.7 | 57.9 | 58.5 |
| -Tertiary industry (%) | 35.1 | 36.4 | 36.1 |
| GDP growth rate (%) | 7.3 | 3.3 | 8.5 |
| Fixed asset investment | 26.8 | 28.9 | 37.5 |
| Fixed asset investment growth rate (%) | 13.5 | 7.6 | 29.8 |
| Population (million) | 0.5 | 0.5 | 0.6 |

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Nanxun

The aggregate fiscal revenue of the Nanxun government was mainly derived from the budgetary revenue and government fund income. The Nanxun government's budgetary revenue grew steadily from 2019 to 2021, and its tax revenue accounted for c. 90% of its budgetary revenue. On the other hand, the government fund income increased 118.6% and 7.6% in 2020 and 2021, respectively, due to the increase of revenue from the transfer of state-owned land use rights. The fiscal self-sufficiency rate of the Nanxun government was insufficient, thus it continues to receive subsidies from higher governments. At end-2021, the total outstanding amount of government debt increased to c. RMB9.2 billion from c. RMB6.4 billion at end-2019, mainly due to the increase in special purpose bonds. The debt ratio (i.e. total government debt divided by aggregate revenue) of the Nanxun government was c. 64% at end-2021, slightly down from c.66% at end-2019.

| Nanxun's Fiscal Condition | | | |
|--------------------------------------|-------------|-------------|-------------|
| (RMB billion) | 2019 | 2020 | 2021 |
| Budgetary revenue | 3.8 | 4.0 | 4.3 |
| Budgetary revenue growth rate (%) | 7.9 | 6.7 | 6.4 |
| Tax revenue | 3.5 | 3.7 | 3.9 |
| Tax revenue (% of budgetary revenue) | 91.2 | 92.4 | 90.5 |
| Government fund income | 3.3 | 7.2 | 7.7 |
| Transfer payment | 2.5 | 2.6 | 2.4 |
| Aggregate revenue | 9.6 | 13.9 | 14.5 |
| Budgetary expenditure | 4.9 | 5.5 | 6.6 |
| Budget deficit ¹ (%) | 29.2 | 36.5 | 53.7 |

¹ Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%

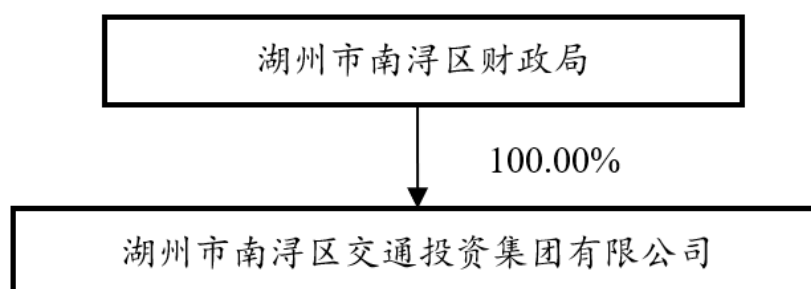
Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

NCIG was established with an initial registered capital of RMB250 million and a paid-up capital of RMB203 million by Huzhou Nanxun District State-owned Assets Investment Holding Company Limited ("Nanxun Investment") in 2017. In the same year, Nanxun Investment transferred 100.0% of NCIG's equity to the Finance Bureau of Nanxun District, Huzhou City ("Nanxun Finance Bureau"), after which the latter in turn became the sole shareholder of NCIG. In 2019, Nanxun Finance Bureau increased NCIG's capital by RMB750 million, resulting in an increase in its registered capital to RMB1 billion. The paid-in capital was increased to RMB803 million in 2021. In all, the registered capital of NCIG was RMB1 billion while the paid-in capital was RMB803 million as of end-September 2022, the outstanding capital will be paid up by 2040.

The shareholding structure of NCIG at end-September 2022:



Source: The Company

Strategic Importance and Government Linkage

Strategic Importance of NCIG to Nanxun

NCIG, as the important state-owned infrastructure investment and construction entity in Nanxun, is mainly responsible for the investment, construction and subsequent operation of transportation and water conservancy related infrastructure projects. The highways, railroads, rail transit and related integrated transportation hubs constructed by NCIG played an important role in promoting economic development in Nanxun and surrounding areas. The company completed major transportation infrastructure projects in the region (such as the 318 National Highway Nanxun section, some sections of the Sudai high-speed and Huzhou Lake Railway, etc.) to improve the integrated transportation network in Nanxun. NCIG's business operation and development have been aligned with the government's development plans. In the future plan of the Nanxun government, NCIG will continue to be responsible for the transportation development of Nanxun to support the local economy.

Linkage with the Local Government

The Nanxun government, through the Nanxun Finance Bureau, holds 100% equity of NCIG at end-September 2022. It is the sole shareholder and ultimate controller of the company. The equity interests of NCIG held by Nanxun Finance Bureau are not pledged or frozen at end-September 2022. The Nanxun government supervises the company, including management appointment, decision on its strategic development and investment plan,

supervision of its major funding decisions and daily operation. In addition, the Nanxun government has assessment mechanism over the company and it will appoint auditor to supervise the operating performance and financial position on a periodic basis.

Government Support

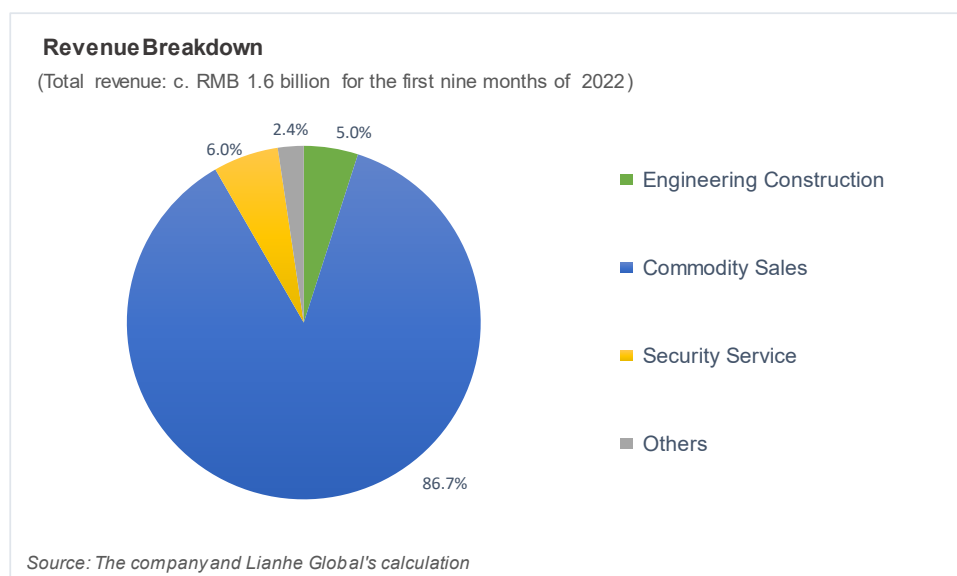
NCIG has received support from the local government, including equity injection, asset injection, operation subsidy and policy support from the Nanxun government. Meanwhile, as the sole state-owned entity for transportation related infrastructure construction in Nanxun, NCIG has certain advantages in project and resource acquisition. At end-September 2022, the company's paid-in capital increased from the initial of RMB203 million to RMB803 million. Apart from the capital injection, the Nanxun government also continued to inject various assets and equity to the company, such as 100% equity interest in Huzhou Nanxun Transportation and Water Resources Investment and Construction Group Co. In addition, NCIG also enjoys a variety of policy support, such as tax deduction for urban land use and property and financial subsidies. NCIG had received a total subsidy amount of c. RMB1.2 billion from 2019 to the first nine months of 2022. We believe NCIG is likely going to receive government support in the form of operational and/or financial subsidies, to support its daily business operation and transportation and water conservancy related infrastructure construction

Business Profile

The Sole State-owned Entities Responsible for Transportation Infrastructure Investment and Construction in Nanxun

NCIG is mainly responsible for the investment, construction and subsequent operations of infrastructure projects related to transportation and water conservancy in Nanxun. The highways, railroads, rail transit and related integrated transportation hubs constructed by NCIG has played an important role in promoting economic development in Nanxun and surrounding areas. NCIG, as the sole transport infrastructure construction and operation entity in Nanxun, has certain regional franchise advantages in the area. Its business covers engineering construction, commodity sales, security services, road maintenance and parking space rental etc.

NCIG's revenue maintained a steady growth over the past three years, reaching about RMB560 million, RMB850 million and RMB1.61 billion in 2019-2021, respectively. Also, NCIG's revenue reached approximately RMB1.6 billion in the first nine months of 2022. The main sources of NCIG's revenue are commodity sales and engineering construction. Commodity sales' contribution to NCIG's total revenue continued to increase from 65.5% in 2019 to 86.7% in the first nine months of 2022. The low margin nature of the commodity sales segment places downward pressure on the overall gross margin of NCIG, especially considering its increasing proportion in the total revenue. Together with the negative operating gross profit of the education services, property management and parking business segments, NCIG recorded negative gross profit margin in 2019, 2021 and the first nine months of 2022.



Engineering Construction Business

As an important component of NCIG's revenue, the revenue from engineering construction business reached RMB60 million, RMB280 million, RMB320 million and RMB80 million in 2019, 2020, 2021 and the first nine months of 2022, respectively, with gross margins of c. 2.5%-6.8%. Given the important position of NCIG as the sole entity that responsible for the construction of transportation related infrastructure in Nanxun, NCIG has certain regional franchise advantages in the engineering construction segment. However, NCIG's business diversification strategy led to the declining proportion of engineering construction segment's income in the total revenue. NCIG's engineering construction business is mainly divided into the agent construction segment and self-operated segment.

Agent Construction

NCIG's agent construction segment mainly focuses on the highways and other related transportation infrastructure projects. Entrusted by the Traffic Bureau of Nanxun District, Huzhou City and other state-owned enterprises or government agencies responsible for infrastructure construction in Nanxun District, NCIG participates in the construction of transportation infrastructure projects in the area through the form of agent construction. In the initial phase, the project is financed by the company's own funds (not more than 50%) and external financing borrowings. The entrusting party will repurchase the project with an added margin (5%-10%) on top of the total construction cost upon completion and handover. NCIG completed some major infrastructure projects in agent construction mode, such as the Nanxun section of National Highway 318 and Nanxun South Intersection Landscape Project at end-September 2022. However, the overall payback period is relatively long. Considering the large scale of the projects under construction or to be constructed, NCIG may face a high pressure on its capital expenditure.

Self-operated

NCIG's self-operated segment accounts for a higher proportion to the engineering construction business compared with agent construction. It mainly includes the construction of industrial parks in Nanxun and some transportation infrastructure projects such as the Sutai Expressway. NCIG obtains investment income from the subsequent operations after

the completion of the self-operated projects, such as property sales/rental, parking fee collection, highway tolls and viaduct tolls, etc. The investment scale of the projects under construction or to be constructed in the self-operated segment is large, which leads to a high capital expenditure pressure to NCIG.

Commodity Sales Business

NCIG's commodity sales business is large in scale. The products sold are mainly plastics, steel, cement and metals. The company mainly adopts the procurement mode of "sell to order" and the sales mode of "direct sales". The profit is mainly generated from the price difference between sale and purchase. NCIG established long-term cooperative relationships with upstream producers through centralized and bulk purchasing, which offers the company the opportunity to purchase at lower prices. Also, NCIG sells to downstream enterprises in a decentralized manner with a higher price to realize the price difference. The company's top five suppliers and customers account for more than 50% of the total, indicating a high concentration of upstream and downstream counterparties.

The revenue generated from commodity sales segments reached RMB370 million, RMB420 million, RMB1.09 billion and RMB1.40 billion in 2019, 2020, 2021 and the first nine months of 2022, respectively, accounting for a relatively high and gradually increasing share of the total revenue (except for 2020). Due to the nature of the industry and fierce downstream competition in the market, the gross profit margin of the commodity sales segment maintained at below 1% in 2019-2021, but rose to 2.7% in the first nine months of 2022, as a result of economy of scale.

Security Business

NCIG's security business mainly focuses on the security services, including security guards, patrols, guarding and other services, where the customers are mainly financial institutions, government agencies, and other enterprises in Nanxun. The company signs service contracts with relevant customers through bidding or negotiation, after which it sends security personnel to the site and provides services and collects service fees. The pricing of the corresponding security services is determined through negotiations between the service commissioner and the company.

Other Businesses

NCIG's business is diversified. It engages in businesses such as education services business, property management business, rental business, highway maintenance business and housing rental business, etc., among which the education services business, property management business and parking business are in loss due to the relatively large operating costs in the early stage. The road maintenance business covers roads at all levels in Nanxun, where the pricing of maintenance is determined by negotiation between the service commissioner and the company. The company's housing rental business income grew rapidly in 2019 after the injection of rental property projects from the Nanxun government.

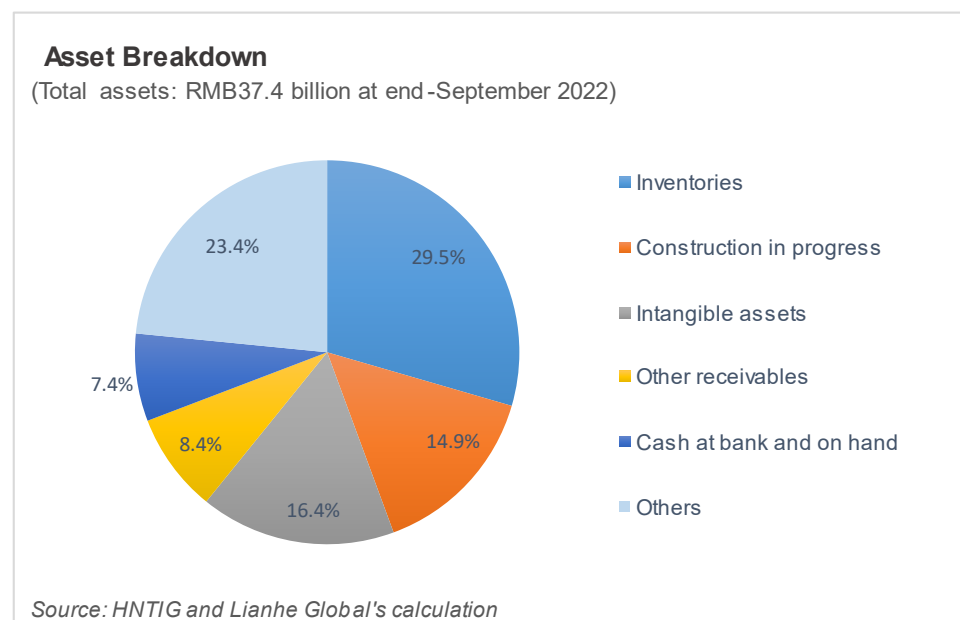
Financial Profile

Balance Sheet Structure and Quality

| Balance Sheet Structure and Quality | | | | |
|-------------------------------------|--------|--------|--------|----------|
| (RMB million) | 2019 | 2020 | 2021 | Sep 2022 |
| Total Asset | 12,206 | 27,835 | 37,911 | 37,445 |
| Equity | 5,198 | 13,700 | 16,104 | 16,008 |
| Debt | 4,147 | 9,883 | 16,614 | 17,063 |
| Debt / (Debt + Equity) (%) | 44.4 | 41.9 | 50.8 | 51.6 |
| LT Debt | 3,126 | 7,480 | 13,142 | 14,611 |
| LT Debt / (LT Debt + Equity) (%) | 37.6 | 35.3 | 44.9 | 47.7 |

Source: Company Information and Lianhe Global's calculations

NCIG's total assets showed a significant growth in the past few years, with a growth rate of 128.0% and 36.2% at end-2020 and end-2021, respectively, before a slight decline in its asset size at end-September 2022. The significant increase in total assets in 2020 was mainly caused by the transfer of assets and related operating right assets from the Nanxun government. With the injection of real estate and operating assets from the Nanxun government, the proportion of current assets of NCIG is decreasing. The non-current assets and current assets accounted for 49% and 51%, respectively, at end-September 2022. The asset structure of NCIG was largely unchanged in the past few years, which mainly composed of inventory, construction in progress, intangible assets and receivables. Inventory was mainly composed of contract performance costs and expendable biological assets, while most of the construction in progress committed to the transport infrastructure construction projects (such as Sutai Expressway) and industrial park construction projects (such as 2025 Industrial Park) in the region. The asset liquidity of NCIG was moderately weak due to the large proportion of project construction costs, operating right assets and receivables.



NCIG's financial leverage (total liabilities to assets) remained stable at around 57.5% from end-2019 to end-September 2022, except for the dropping to 50.8% in 2020. NCIG's adjusted total debt increased significantly from c. RMB4.2 billion at end-2019 to c. RMB17.1 billion at the end-September 2022 due to the increase in bonds payable and long-term

borrowings, with long-term debt accounting for approximately 85.6% of its total debt in the same period. However, the rapid expansion of asset size in the corresponding period kept its financial leverage stable. There was no significant change in the ownership equity structure of NCIG as of end-September 2022 compared with that at end-2021. NCIG mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its larger-scale transportation and water infrastructure projects under construction and to be constructed in the future.

Cash Flow

| Cash Flow (RMB million) | 2019 | 2020 | 2021 | 9M2022 |
|--|--------------|---------------|---------------|---------------|
| Cash Inflows from Operation | 2,102 | 2,890 | 4,388 | 2,666 |
| Cash Outflows from Operation | 2,173 | 4,802 | 4,506 | 3,300 |
| Net CF from Operation | -70 | -1,911 | -117 | -634 |
| Cash Inflows from Investment | 530 | 1 | 313 | 11 |
| Cash Outflows from Investment | 1,191 | 4,530 | 5,570 | 3,079 |
| Net CF from Investment | -661 | -4,529 | -5,256 | -3,068 |
| Cash Inflows from Financing | 2,482 | 9,310 | 12,190 | 8,013 |
| Cash Outflows from Financing | 11 | 1,792 | 895 | 95 |
| Net CF from Financing | 2,414 | 7,081 | 10,669 | 6,535 |
| Net Increase in Cash and cash equivalent | 57 | 437 | 626 | 1,383 |

Source: The Company

Debt Servicing Capability

The liquidity of NCIG was sufficient. At end-September 2022, NCIG had a cash balance and unused credit facilities of c. RMB2.8 billion (restricted cash accounted for c. 1%) and RMB3.8 billion, respectively, as well as available issuance quota of RMB5 billion and USD130 million in the onshore and offshore market, compared with its debt due within one year of c. RMB2.2 billion at the same time. Besides, NCIG has access to various financing channels, including bank loans, onshore and offshore bond issuance and non-traditional financing (such as financial leasing), to support its debt repayment and business operations. In addition, NCIG issued two offshore bonds with a total amount of USD206 million and RMB490 million in the first nine months of 2022.

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