

Changshan County City Investment Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	20 January 2023

Key Figures of Changshan and CCCI

(RMB billion)	2020	2021
Changshan		
GDP	16.0	18.8
GDP growth rate (%)	3.5	9.8
Budgetary revenue	1.2	1.5
Government fund	3.6	4.4
Transfer payment	3.4	2.8
Budgetary expenditure	5.5	6.2
CCCI		
Assets	14.8	16.4
Equity	6.6	6.9
Revenue	1.1	1.6

Source: Public information, CCCI and Lianhe Global's calculations

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

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Changshan County, Quzhou City (“Changshan government”) would provide strong support to CCCI if needed, in light of its full ownership of CCCI, CCCI’s strategic importance as the important state-owned entity for infrastructure construction and land development, as well as settlement housing construction in Changshan County (“Changshan”), and the linkage between the Changshan government and CCCI, including control and supervision over the management, strategic alignment and ongoing operational and financial support. In addition, the Changshan government may face significant negative impact on its reputation, business and financing activities if CCCI encounters any operational and financial difficulties.

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

Rating Rationale

Changshan Government’s Ownership and Supervision: The Changshan government indirectly holds the full ownership of CCCI through Changshan County State-owned Assets Investment and Operation Co., Ltd. (“CCSAI”), via the The Finance Bureau of Changshan County (“Changshan FB”). The Changshan government, as the ultimate controller, supervises the company, including control and supervision over the management, decisions on strategic development and investment and financing plans etc. In addition, the Changshan 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 Changshan and Strategic Alignment: As an important state-owned entity in Changshan, CCCI is the key infrastructure construction entity in the area, mainly responsible for the construction of municipal projects, public service projects, as well as transportation and water conservancy related projects in Changshan and surrounding areas with franchise advantages. CCCI is also responsible for settlement house construction and land consolidation business in the region, so as to promote the economic and social development and enhance the comprehensive service capability of Changshan. CCCI’s business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: CCCI received support from the Changshan government, including capital injection, operation subsidy, special debt and policy support. Meanwhile, as the important state-owned entity for infrastructure investment, construction and operation in Changshan, CCCI has certain advantages in project and resource acquisition. The Changshan government also continued to inject capital, as well as special debt as project funds, to the company, while CCCI also enjoyed a variety of policy support. CCCI had received a total subsidy amount of c. RMB166 million from 2019 to the first nine months of 2022. We believe CCCI is likely going to receive government support in the form of

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Applicable Criteria

China Local Investment and Development Companies Criteria (5 December 2022)

operational and/or financial subsidies, to support its daily business operation and related infrastructure investment and construction.

CCCI's Financial Matrix and Liquidity Position: CCCI's total assets showed a significant growth trend in the past years and reached RMB18.3 billion at end-June 2022, mainly due to the increase of cash at bank and on hand and inventories. CCCI's financial leverage (total liabilities to assets) was 60.5% and its adjusted debt increased to c. RMB6.6 billion at end-June 2022. The liquidity of CCCI was moderate. CCCI had a cash balance and unused credit facilities of c. RMB2.9 billion and RMB5.5 billion at end-September 2022, compared with its debt due within one year of c. RMB430 million. Besides, CCCI has access to various financing channels, including bank loans and bond issuance, to support its debt repayment and business operations.

Economy and Fiscal Strength of Changshan: Changshan, as one of the counties under the jurisdiction of Quzhou, is located in southwest of Zhejiang Province. Changshan's economy maintained steady growth, with GDP reaching RMB18.8 billion in 2021, up 9.8% year-on-year. The GDP was mainly fueled by the secondary and tertiary industries, which accounted for 45.5% and 50.1% of total GDP in 2021. The aggregate fiscal revenue of the Changshan government was mainly derived from the budgetary revenue and government fund. The Changshan government's budgetary revenue grew steadily and increased to RMB1.5 billion in 2021, where its tax revenue accounted for more than 85% of its budgetary revenue in the past two years. Besides, Changshan's government fund income also grew steadily due to the increase in revenue from the transfer of state-owned land use rights and recognized RMB4.4 billion in 2021. The fiscal self-sufficiency rate of the Changshan 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. RMB7.3 billion from c. RMB4.6 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 Changshan government was c. 83% at end-2021, down from c. 91.1% at end-2019.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Changshan

Changshan, as one of the counties under the jurisdiction of Quzhou, is located in the southwest of Zhejiang Province. Changshan has jurisdiction over 6 towns and 3 streets and 5 townships with a total land area of c. 1,099 square kilometers. As the intersection of four provinces, namely Zhejiang, Fujian, Jiangxi and Anhui, Changshan has a well-established transportation system. In 2021, Changshan achieved a GDP of RMB18.8 billion, up 9.8% year-on-year. The GDP growth was mainly fueled by the secondary and tertiary industries, which accounted for 45.5% and 50.1% of total GDP in 2021, respectively. The district's residential population reached c. 0.3 million with an urbanization rate of c. 49.5% at end-2021.

Changshan's GDP and Fixed Asset Investment

(RMB billion)	2019	2020	2021
GDP	15.0	16.0	18.8
-Primary industry (%)	5.3	5.2	4.4
-Secondary industry (%)	41.9	42.3	45.5
-Tertiary industry (%)	52.8	52.5	50.1
GDP growth rate (%)	6.6	3.5	9.8
Fixed asset investment	13.2	13.7	16.4
Fixed asset investment growth rate (%)	0.5	3.2	20.3
Population (million)	0.3	0.3	0.3

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Changshan

The aggregate fiscal revenue of the Changshan government was mainly derived from the budgetary revenue and government fund income. The Changshan government's budgetary revenue grew steadily with a growth rate of 3.4% and 23.1% in 2020 and 2021, respectively, and recognized a revenue of RMB1.5 billion in 2021, where its tax revenue accounted for more than 85% in the past two years. The increase in 2021 was mainly caused by the increase of tax revenue. Moreover, Changshan's government fund income also grew significantly due to the increase in revenue from the transfer of state-owned land use rights and recognized RMB4.4 billion in 2021. The fiscal self-sufficiency rate of the Changshan government was insufficient, thus it continued to receive subsidies from higher governments. Despite the downward trend, the budget deficit of Changshan was still relatively high at end-2021. At end-2021, the total outstanding amount of government debt increased to c. RMB7.3 billion from c. RMB4.6 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 Changshan government was c. 83% at end-2021, down from c. 91.1% at end-2019.

Changshan's Fiscal Condition

(RMB billion)	2019	2020	2021
Budgetary revenue	1.2	1.2	1.5
Budgetary revenue growth rate (%)	7.4	3.4	23.1
Tax revenue	0.9	1.1	1.3
Tax revenue (% of budgetary revenue)	76.8	87.0	88.5
Government fund income	1.4	3.6	4.4
Transfer payment	2.4	3.4	2.8
Aggregate revenue	5.1	8.2	8.8
Budgetary expenditure	5.6	5.5	6.2
Budget deficit ¹ (%)	372.2	349.4	310.3

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

CCCI (formerly known as Changshan County Urban Development Investment Co., Ltd.) was designated by the Changshan government in 2001 and established as a wholly owned subsidiary of Changshan County State-owned Assets Investment and Operation Co., Ltd. ("CCSAI") with full capital contribution. The Finance Bureau of Changshan County ("Changshan FB") indirectly held 100% of CCCI's shares through CCSAI at end-June 2022, and is the ultimate controller of the company.

The initial registered capital of CCCI was RMB5 million and was enlarged to RMB30 million in 2004. In 2010, CCSAI transferred all CCCI's shares to Changshan FB, while the Changshan FB increased CCCI's registered capital and paid-in capital to RMB300 million, but Changshan FB transferred back all CCCI's shares to CCSAI in 2014. In 2017, by decision of the shareholders, China Agricultural Development Key Construction Fund Limited was introduced as CCCI's shareholder, but it transferred back the share it acquired to CCSAI in 2021. After several cash and equity injections from the shareholder, the registered capital of CCCI was enlarged to RMB2.255 billion at end-June 2022. CCSAI is the sole shareholder of CCCI, while the Changshan FB is the actual and ultimate controller of CCCI.

Strategic Importance and Government Linkage

Strategic Importance of CCCI to Changshan

CCCI, as an important LIDC in Changshan, is the key infrastructure construction and land development entity that mainly responsible for the construction of municipal projects, public service projects, transportation related projects, as well as settlement house construction and other business in Changshan with a franchise advantage. CCCI is also responsible for water business in the region, so as to promote the economic and social development, and enhance the comprehensive service capability of Changshan and the surrounding areas. CCCI's business operation and development have been aligned with the government's development plans.

Linkage with the Local Government

CCCI's linkage with the local government is strong as the Changshan government indirectly holds the whole ownership of CCCI through CCSAI, via the Changshan FB. It is the ultimate controller of the company. The Changshan government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Changshan 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

CCCI has received several capital injections since its establishment. The registered capital increased from the initial of RMB5 million to RMB2.255 billion at end-September 2022, mainly from the increase in cash injection from the Changshan government via CCSAI. CCCI also received other capital injections of assets or equities, mainly including investment properties and equity for debt dissolution. CCCI receives financial subsidies from the local

government to maintain its business operation, including operational subsidies, tax deduction and policy supports, etc. CCCI received a total subsidy of c. RMB166 million from 2019 to the first nine months of 2022. The Changshan government will repurchase some infrastructure projects upon completion and provide policy supports to CCCI to ensure its business operation. Given the franchise advantage in infrastructure projects' investment and construction in Changshan, CCCI has advantages to obtain land resources and main projects. We believe CCCI is likely going to receive government support in the form of operational and/or financial subsidies in the future.

Business Profile

The Key State-owned Entity Responsible for Infrastructure Construction in Changshan

CCCI is mainly responsible for the infrastructure construction, settlement house construction, as well as land consolidation business in Changshan with franchise advantages. The company has further engaged in transportation and water conservancy related projects construction after the integration of other LIDCs in Changshan into CCCI. It plays an important role in promoting the economic and social development of Changshan. In addition, CCCI is also responsible for the water related business, mainly including water supply and sewage treatments in the region.

CCCI's revenue showed an upward trend in the past three years, which reached c. RMB761 million, RMB1.1 billion and RMB1.6 billion in 2019, 2020 and 2021, respectively, while it recognized a revenue of c. RMB541.1 million in the first six months of 2022. The revenue increase in 2020 was mainly due to the increase in revenue from infrastructure construction, resulting from the recognition of few sizeable projects during the year. Despite that no revenue was recognized in infrastructure construction segment in 2021, there was still a revenue growth in the year as the revenue from settlement house construction increased substantially. Besides, the water business has complemented CCCI's main business and has expanded the diversity of CCCI's business coverage since its establishment. CCCI's overall gross profit margin was relatively stable at 9%-12% in 2019, 2020, 2021 and the first six months of 2022. Per management, CCCI's gross profit margin would remain stable for the full year of 2022. Overall, CCCI's business is well diversified, most of which have franchise advantages in Changshan. Having said that, the uncertainty of the timing of revenue recognition in some business segments may increase the volatility of CCCI's total revenue.

Infrastructure Construction

As the key entity for infrastructure construction in Changshan, CCCI undertakes the construction of municipal projects such as roads and bridges in the region, transportation and water conservancy related projects, as well as other infrastructure-related projects such as landscaping and industrial plants. Given the important position of CCCI as the key entity that is responsible for the construction-related infrastructure in Changshan, CCCI has certain regional franchise advantages in this segment. The revenue generated from this segment reached RMB661.4 million, RMB813.7 million in 2019 and 2020, respectively. In 2021, CCCI did not recognize any revenue from this segment due to the progress of project delivery.

In terms of the business model, entrusted by other state-owned enterprises or government agencies responsible for infrastructure construction in Changshan, CCCI participates in the

construction of related infrastructure projects in the area through the form of agent construction. In the initial phase, the project fund is coordinated by the company. The entrusting party will repurchase the project with an added margin of 4-18% on top of the total construction cost upon completion and handover. CCCI completed some major infrastructure projects in agent construction mode, such as some transportation related municipal projects (such as main road of Chengdong New District, the Riverside Avenue, the Changshan Bridge etc.) and other infrastructure related projects (such as railway station square and government office buildings etc.). Considering the large scale of the projects under construction or to be constructed, CCCI may face a high pressure on its capital expenditure.

Land Consolidation

CCCI engaged in the land consolidation business in Changshan with strong regional franchise. The compensation expenses for demolition and relocation, land leveling costs and other related expenses incurred during the consolidation process are coordinated by the company in the initial phase. The land was handed over to the land storage center for storage and was further supplied to the market by way of tender and auction. The auction consideration, after deducting taxes and related expenses, was returned to CCCI with an additional margin based on the agreement between CCCI and the land storage department.

CCCI did not recognize revenue in this segment from 2019 to the first six months of 2022. There were still several completed but unsettled land consolidation projects at end-June 2022, posing some payback and cash collection risk. Besides, given the fact that land disposal is susceptible to fluctuations in the real estate market and government plans, CCCI's land consolidation business may face some uncertainties.

Settlement House Construction

CCCI also developed settlement houses in Changshan with franchise advantages. CCCI acquired land for settlement house construction through auction and expropriation, while the resettled residents paid for the houses according to the demolition and resettlement agreement and the actual market situation. The remaining houses were sold to the public at market price. Besides, some of CCCI's settlement house construction was in the form of government purchase agreement, where the Changshan government signed the repurchase agreement with CCCI and entrust the company to carry out related construction progress with government budgetary funds. CCCI advanced the pre-construction funds for related projects, and the government disbursed the pre-construction funds to CCCI when the government budgetary funds were available.

CCCI recognized revenue of RMB23.6 million, RMB72.4 million, RMB989.9 million and RMB24.4 million in 2019, 2020, 2021 and the first six months of 2022, respectively. The significant revenue growth in 2021 was mainly caused by the increasing project delivery and revenue recognition during the year.

Water Business

CCCI was engaged in water business in Changshan, mainly including residential and commercial water supply, sewage treatments and water pipe construction. CCCI conducts franchise agreements with the local governments, where the latter approves the unit price of water supply according to the nature of different water usage. CCCI had 6 water supply

plants at end-June 2022 and its water supply services covered most of the Changshan's population.

The revenue generated from this segment reached RMB62 million, RMB59.3 million, RMB42.4 million and RMB23.4 million in 2019, 2020, 2021 and the first six months of 2022, respectively. Despite the downward trend in revenue, the segment's gross margin increases significantly after 2021 due to smaller purchase volume and delay in some raw water fee payment.

Other Business

CCCI's business is well diversified. CCCI's other businesses mainly included engineering construction, production and sales of building materials, public transportation operation, human resources and property leasing. The other businesses have limited impact and contribution to CCCI's total revenue due to their small business scales.

Financial Profile

Balance Sheet Structure and Quality

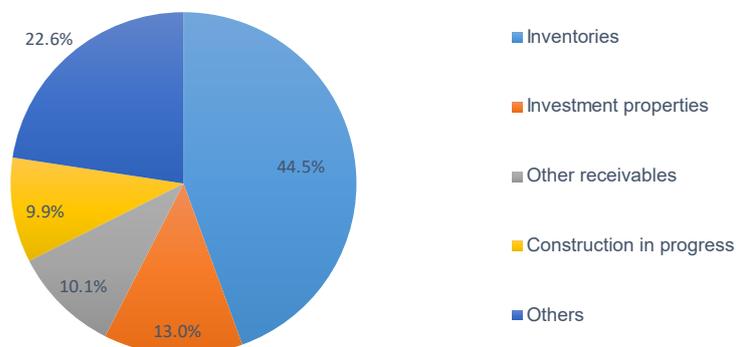
Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Jun 2022
Total Asset	8,233	14,820	16,381	18,294
Equity	3,708	6,606	6,908	7,235
Debt	1,354	2,614	5,306	6,642
Debt / (Debt + Equity) (%)	26.8	28.4	43.4	47.9
LT Debt	1,223	2,373	4,908	6,164
LT Debt / (LT Debt + Equity) (%)	24.8	26.4	41.5	46.0

Source: Company Information and Lianhe Global's calculations

CCCI's total assets showed a continuous growth in the past few years, with a growth rate of 80.0%, 10.5% and 11.7% at end-2020, end-2021 and end-June 2022, respectively, and reached RMB18.3 billion at end-June 2022. The significant increase in total assets in 2020 was mainly caused by the increase in investment properties. The asset increase at end-June 2022 was mainly due to the increase in cash at bank and on hand and inventories. The current assets of CCCI accounted for a large portion of c. 70.6% of the total assets at end-June 2022. The asset structure of CCCI has not changed significantly in recent years and was mainly composed of inventories, investment properties, other receivables and construction in progress. Inventories mainly included development costs related to CCCI's main business (e.g. infrastructure construction and settlement house construction etc.) and land to be developed, which grew in tandem with the increase in CCCI's related projects in Changshan. The investment properties were mainly houses and buildings for rent. A large portion of other receivables was related transactions with the CCSAI, which was mostly aged within 1 year and had low bad debt provision and recovery risk, while other counterparties were mostly state-owned enterprises in Changshan, representing a controllable counterparty risk. The construction in progress mainly consisted of CCCI's water projects, of which Changshan Harbor Treatment Project Phase I and Phase II occupied a large proportion of the construction in progress.

Asset Breakdown

(Total assets: RMB18.3 billion at end-June 2022)



Source: CCCI and Lianhe Global's calculation

CCCI's financial leverage (total liabilities to assets) was 55.4%, 57.8% and 60.5% at end-2020, end-2021 and end-June 2022, respectively, representing an upward trend. Given the relevant guidelines of the Changshan government, we expect the leverage of CCCI to maintain at the current level. CCCI's adjusted total debt increased significantly from c. RMB1.3 billion at end-2019 to c. RMB6.6 billion at end-June 2022, due to the increase in short-term and long-term borrowings and other non-current liabilities, with long-term debt accounting for c. 92.8% of its total debt at end-June 2022. There was no significant change in the ownership equity structure of CCCI at end-June 2022, compared with that at end-2021. CCCI mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure projects and water related projects under construction and to be constructed in the future.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	6M2022
Cash Inflows from Operation	1,697	3,093	2,635	1,347
Cash Outflows from Operation	1,967	3,014	4,571	2,830
Net CF from Operation	-270	79	-1,936	-1,483
Cash Inflows from Investment	1	21	19	0
Cash Outflows from Investment	134	929	625	81
Net CF from Investment	-133	-908	-606	-81
Cash Inflows from Financing	432	3,654	2,727	2,718
Cash Outflows from Financing	298	856	810	430
Net CF from Financing	134	2,798	1,917	2,287
Net Increase in Cash and cash equivalent	-270	1,969	-625	723

Source: The Company

Debt Servicing Capability

The liquidity of CCCI was moderate. At end-September 2022, CCCI had a cash balance and unused credit facilities of c. RMB2.9 billion and RMB5.5 billion, respectively, compared with its debt due within one year of c. RMB430 million at the same time. Having said that, CCCI has access to various financing channels, including bank loans and bond issuance, to support its debt repayment and business operations.

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