

Luoyang Guoyuan Investment Holding Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	22 March 2023

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

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Jianxi District, Luoyang City (“Jianxi government”) would provide strong support to LGIH if needed, in light of its indirect full ownership of LGIH, LGIH’s strategic importance as the sole local investment and development company (“LIDC”) that is responsible for infrastructure construction and state-owned asset operation in Jianxi District, Luoyang City (“Jianxi”), and the linkage between the Jianxi government and LGIH, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing operational and financial support. In addition, the Jianxi government may face significant negative impact on its reputation and financing activities if LGIH encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Luoyang High-tech Industrial Development Zone Management Committee (“LHZMC”), as the de facto controller of LGIH, indirectly holds 60% of the company’s shares through the Luoyang Comprehensive Center for Free Trade Services (“Luoyang FTC”), while the remaining 40% is owned by the Finance Bureau of Jianxi District, Luoyang City (“Jianxi FB”). The Financial Committee of Jianxi District 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, it also has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Jianxi and Strategic Alignment: The Jianxi government integrated state-owned enterprises in the region in 2022, after which LGIH became the sole LIDC in the region. LGIH is mainly responsible for infrastructure construction and state-owned assets operation in Jianxi with strong franchise advantages. The company undertakes most of the important municipal infrastructure projects in the region, and is responsible for the construction of affordable housing, urban renewal, industrial operation, cultural tourism and other industrial fields in the region under the planning of the Jianxi government. LGIH plays an important role in promoting the economic and social development of Jianxi. Its business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: LGIH received operational and financial support from the Jianxi government. LGIH received a total subsidy amount of c. RMB2.4 billion from 2019 to the first nine months of 2022, mainly including operating subsidies and tax breaks, etc. The Jianxi government will repurchase some infrastructure and affordable housing construction projects through the LHZMC and provide policy supports to LGIH to ensure its business

Key Figures of Jianxi and LGIH

(RMB billion)	2020	2021
Jianxi		
GDP	63.1	69.8
GDP growth rate (%)	2.9	5.7
Budgetary revenue	3.1	4.4
Government fund	0.0	0.1
Transfer payment	3.1	4.0
Budgetary expenditure	3.6	5.0
LGIH		
Assets	27.6	35.1
Equity	10.4	16.2
Revenue	1.6	2.1

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

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Applicable Criteria

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

operation. Besides, the Jianxi government increased the company's registered capital through cash injection and continued to inject equity and land assets into LGIH. Given the franchise advantage in infrastructure construction and affordable housing construction in Jianxi, LGIH has advantages to obtain land resources and major projects. We believe LGIH is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

LGIH's Financial Matrix and Liquidity Position: LGIH's total assets showed a continuous growth trend in the past years and reached RMB36.4 billion at end-September 2022, mainly due to the growth of inventories resulting from the construction of projects relating to its main business. The current asset accounted for a large proportion in total asset. LGIH's financial leverage (total liabilities to total assets) was relatively stable at c. 53%-62% in the past three years. Its adjusted debt increased to c. RMB14.3 billion at end-September 2022 from c. RMB8.7 billion at end-2019, where the short-term debt accounted for 28.3%. The liquidity of LGIH was tight, with unrestricted cash and unused credit facilities of c. RMB0.3 billion and RMB0.2 billion at end-September 2022, respectively, compared with its debt due within one year of c. RMB3.8 billion. Having said that, LGIH has access to various financing channels, including bank loans, bond issuance and non-traditional financing (e.g., trust loans), to support its debt repayment and business operations.

Economy and Fiscal Condition of Jianxi: Jianxi is an administrative district of Luoyang City, Henan Province ("Luoyang"), located in the northwestern part of the central city of Luoyang, which is an urban industrial area with mechanical industry as the mainstay. Luoyang High-tech Industrial Development Zone ("Hi-tech Zone") was merged into Jianxi in 2021. Jianxi recorded stable economic growth in the past three years, achieving a GDP of c. RMB69.8 billion in 2021, with a year-on-year growth of 5.7%. Jianxi's economic growth was almost entirely fueled by the secondary and tertiary industries in the past few years, which accounted for 44.8% and 55% in 2021, respectively.

The Jianxi government's aggregate fiscal revenues are mainly derived from budgetary revenue and transfer payment, of which the budgetary revenue grew steadily and reached RMB4.4 billion in 2021. The tax revenue accounted for 48%-61% of its budgetary revenue between 2019 and 2021. Non-tax revenue was mainly derived from the usage of state-owned assets. The fiscal self-sufficiency rate of the Jianxi government was sufficient. Having said that, the volume of government fund income was relatively small. The debt ratio (i.e., total government debt divided by aggregate revenue) of the Jianxi government was relatively low. At end-2021, the total outstanding amount of government debt increased to RMB0.9 billion from RMB0.5 billion at end-2019, mainly due to the increase in general debt.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Jianxi

Jianxi is a municipal district of Luoyang, and is located in the northwest of the central urban areas of Luoyang. Jianxi is an urban industrial zone, focusing on the machinery industry. Jianxi has jurisdiction over 12 streets and an industrial cluster with a total land area of c. 89 square kilometers. Jianxi had a residential population of c. 0.7 million with an urbanization rate of 80.7% at end-2021.

Jianxi realized a GDP of RMB69.8 billion in 2021, representing a growth rate of 5.7%. Jianxi's economic growth was mainly fueled by the secondary and tertiary industries, which accounted for 44.8% and 55% of Jianxi's GDP, respectively, in 2021. The fixed asset investment also recorded steady growth in the past three years. Meanwhile, Jianxi District's GDP per capita reached c. RMB96,600 in 2021.

Jianxi's GDP and Fixed Asset Investment			
(RMB billion)	2019	2020	2021
GDP	60.1	63.1	69.8
-Primary industry (%)	0.3	0.3	0.2
-Secondary industry (%)	44.6	43.1	44.8
-Tertiary industry (%)	55.1	56.6	55.0
GDP growth rate (%)	7.6	2.9	5.7
Fixed asset investment	19.7	20.8	22.1
Fixed asset investment growth rate (%)	8.2	5.6	6.3
Population (million)	0.5	0.5	0.7

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Jianxi

The aggregate fiscal revenue of the Jianxi government was mainly derived from the budgetary revenue and transfer payment. The budgetary revenue of the Jianxi government maintained a steady growth in the past three years, reaching c. RMB4.35 billion with a year-on-year increase of 40.7% in 2021, which was mainly contributed by the growth of tax revenue. The tax revenue accounted for 48-61% of the budgetary revenue in 2019-2021. On the other hand, the non-tax revenue was mainly derived from the usage of state-owned assets. The government-managed fund income was relatively small with less than RMB100 million in the past three years.

The budget deficit of the Jianxi government increased in 2020, but retreated to a low level of 13.9% in 2021. The debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Jianxi government was relatively low. The local government's outstanding debt increased from c. RMB0.5 billion at end-2019 to c. RMB0.9 billion at end-2021, mainly due to the increase in general debt.

Jianxi's Fiscal Condition			
(RMB billion)	2019	2020	2021
Budgetary revenue	2.9	3.1	4.4
Budgetary revenue growth rate (%)	7.6	7.5	40.7
Tax revenue	1.5	1.5	2.7
Tax revenue (% of budgetary revenue)	51.0	47.9	60.9
Government fund income	0.0	0.0	0.1
Transfer payment	1.1	3.1	4.0
Aggregate revenue	4.0	6.2	8.5
Budgetary expenditure	3.2	3.6	5.0
Budget deficit¹ (%)	10.5	17.7	13.9

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

LGIH was established in 2018 with an initial registered capital of RMB5 million, funded by Luoyang High-tech Industrial Group Co., Ltd. In May 2022, the registered capital of the company was increased to RMB5 billion through equity contribution from the Jianxi FB and the Luoyang FTC (a subordinate organization of the LHZMC). Subsequently, there was a change in the controlling shareholder of the company to the Luoyang FTC from the Jianxi FB in November 2022. As a result, the LHZMC has become the actual controller of the company.

At end-2022, LGIH had a shareholding structure in which the Luoyang FTC, as the controlling shareholder, held 60% of the company's equity. The remaining 40% equity was held by the Jianxi FB.

Strategic Importance and Government Linkage

Strategic Importance of LGIH to Jianxi

In May 2022, following the guidance of the Jianxi government, Jianxi completed the reorganization and merger of state-owned enterprises, resulting in LGIH becoming the sole LIDC in the Jianxi. LGIH is primarily responsible for the infrastructure construction and operation of state-owned assets within the region with strong franchised advantages. The company undertakes most of the important municipal infrastructure projects in the region, and is responsible for the construction of affordable housing, urban renewal, industrial operation, cultural and cultural tourism and other industrial fields in the region under the planning of the Jianxi government. As the sole entity for state-owned asset management and operation in Jianxi, LGIH plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government's development plans.

Linkage with the Local Government

LGIH's linkage with the local government is strong as LHZMC and Jianxi FB hold the full ownership of the company. LHZMC is the de facto controller of LGIH. The Financial Committee of Jianxi District 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, it also has

assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

Government Support

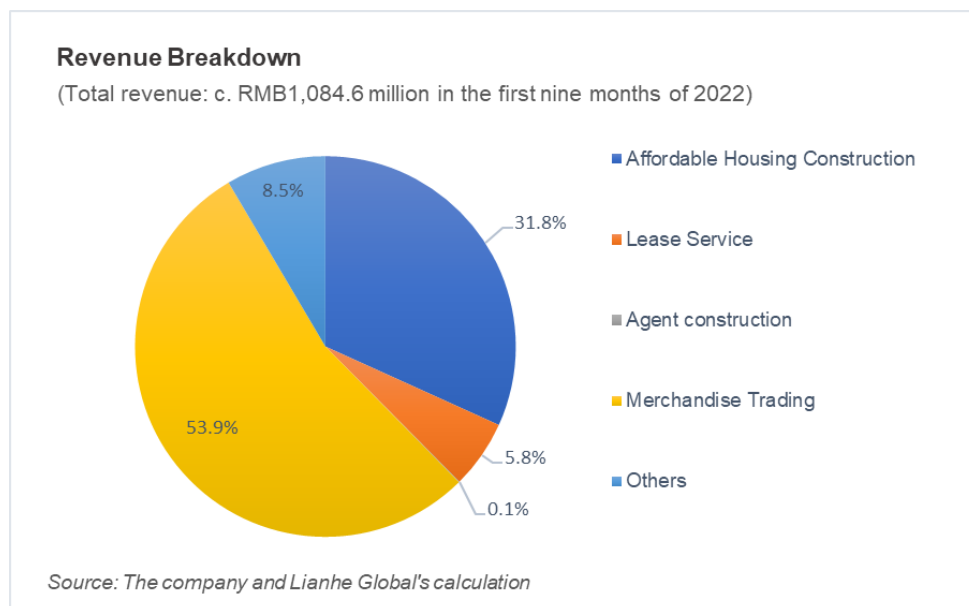
LGIH continued to receive financial subsidies, mainly including operating subsidies and tax breaks, from the local government to maintain its business operation. LGIH received subsidies of c. RMB408.5 million, RMB566.6 million, RMB715.7 and RMB728.2 million in 2019, 2020, 2021 and first nine months of 2022, respectively. The Jianxi government will repurchase some infrastructure and affordable housing construction projects through the LHZMC and provide policy supports to LGIH to ensure its business operation. The Jianxi government increased the company's registered capital through cash injection and continued to inject equity and land assets into LGIH. Given the franchise advantage in infrastructure construction and affordable housing construction in Jianxi, LGIH has advantages to obtain land resources and major projects. We believe LGIH is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

Business Profile

The Sole Entity Responsible for Infrastructure Construction, and State-owned Asset Operation in Jianxi

LGIH, as the sole LIDC in Jianxi, is mainly responsibility for infrastructure and affordable housing construction, as well as the operation of state-owned assets within the region. The company's strong franchise advantage enables it to undertake important infrastructure construction projects, urban renewal, cultural tourism, industrial investment and operation, all under the coordination plan of the Jianxi government. Moreover, the Jianxi government has also entrusted the company with functions related to housing construction and public management services. As the sole infrastructure construction and state-owned asset operating body within the district, LGIH plays a vital role in promoting economic and social development within the region.

The primary sources of operating revenue for LGIH included its agent construction, affordable housing construction and merchandise sales. The company experienced steady revenue growth over the past three years, with revenue reaching of c. RMB1.4 billion, RMB1.6 billion and RMB2.1 billion for 2019, 2020 and 2021, respectively. In the first three quarters of 2022, it recorded revenue of c. RMB1.1 billion. The fast revenue growth in 2021 was primarily attributable to its new merchandise sales business. Despite the introduction of the low-margin new merchandise sales segment, the overall gross profit margin of LGIH remained stable at 8.2%-11.8% for 2019, 2020 and 2021. Having said that, the gross profit margin of the company declined to 5.8% in the first three quarters of 2022, which was mainly due to the lower portion of the revenue from agent construction segment. According to the company's management, the gross margin of LGIH will remain stable for the full year of 2022. In general, LGIH's business was diversified, and it has regional advantages in its major businesses.



Agent Construction

LGIH is the sole entity responsible for infrastructure construction in Jianxi. The company carries out municipal and other infrastructure projects in the region through entrusted construction mode, where LHZMC is the main entrusting party. LHZMC settles with LGIH by paying the actual costs plus an additional margin of 5%-10%. The company's monopoly on infrastructure construction in Jianxi gives it a strong franchise advantage in the region. Its revenue in this segment was relatively stable over the past years, with RMB580 million, RMB670 million, RMB680 million, and RMB0.6 million generated in 2019, 2020, 2021 and the first nine months of 2022, respectively. The gross profit margin remained steady as well. The low revenue in the first nine months of 2022 was due to the settlement practice, as most of the company's construction revenue are recognized towards the end of the year.

LGIH has completed various construction projects. Currently, the company is working on several large-scale projects, thus it incurs high capital expenditure pressure. Furthermore, the management plans to operate the company's infrastructure construction projects through urban renewal funds in the future.

Affordable Housing Construction

The Jianxi government has entrusted the construction of affordable housing and related supporting infrastructure projects in the district to LGIH. The company is responsible for engineering design, financing, project management, and construction, while the government pays for the project costs and a certain percentage of additional margin as the project revenue. The segment revenue reached RMB600 million, RMB660 million, RMB630 million and RMB305 million in 2019, 2020, 2021 and the first nine months of 2022, respectively, with a stable gross profit margin of 15%-20%. The company operates affordable housing business under two models: entrusted construction and self-operated. Per management, LGIH plans to focus mainly on the latter mode in the future. This means that the company will sell the housing units through direct sales and earn additional income through rental income (e.g., ground floor rents and parking spaces rents) at a later stage. At end-September 2022, the company still had ongoing housing construction project. The scale of

project under construction is large, thus LGIH may face a high capital expenditure pressure in the future.

Merchandise Trading

LGIH diversified its business operations in 2021 by adding the merchandise trading business to complement its main operations. The company's primary trading commodities are aluminum ingots and alumina, with a high concentration of both suppliers and customers. While this segment generated revenues of RMB454 million and RMB584 million in 2021 and the first nine months of 2022, respectively, its gross margin remained relatively low at below 1%, and had a small contribution to the company's overall profits.

Per management, the company's current merchandising approach remains supply chain-oriented. Having said that, given more investment and cooperation with companies located in the Jianxi, the company's management expects a significant improvement in the gross margin of the merchandise trading segment.

Other Businesses

Other businesses of LGIH include public management services, heating business, engineering construction and housing leasing, etc., with each segment accounted for a relatively small proportion of the company's total revenue. Other businesses mainly play the role of supplementing the revenue of the main business. In addition, public management services, heating and labor services are more in line with the development direction of LGIH as a regional integrated urban service provider, which improves the efficiency of urban operation in Jianxi and enhance the level of basic public services.

Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Sep 2022
Total Asset	19,442	27,555	35,065	36,388
Equity	8,202	10,385	16,160	17,166
Debt	8,741	11,957	14,192	14,261
Debt / (Debt + Equity) (%)	51.6	53.5	46.8	45.4
LT Debt	7,753	10,457	10,125	10,221
LT Debt / (LT Debt + Equity) (%)	48.6	50.2	38.5	37.3

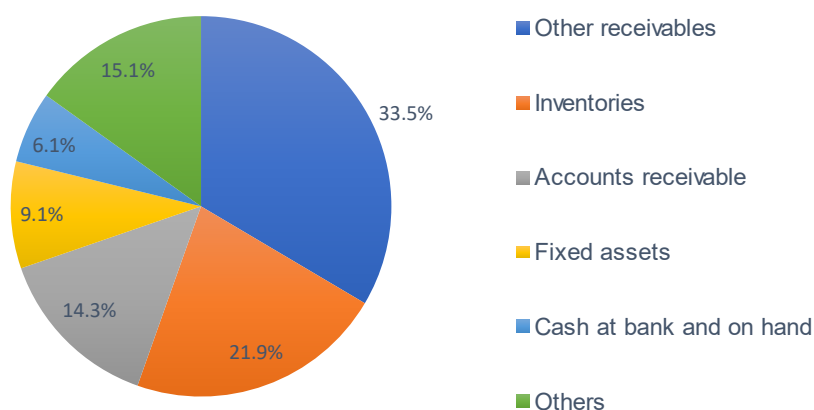
Source: Company Information and Lianhe Global's calculations

LGIH's total assets showed a continuous growth in the past few years, with a growth rate of 41.7%, 27.3% and 3.8% at end-2020, end-2021 and end-September 2022, respectively, and reached RMB36.4 billion at end-September 2022. The increase of LGIH's total assets was largely due to its inventories, which has steadily increased in tandem with the company's infrastructure and affordable housing construction projects. At end-September 2022, current assets constituted the major proportion of the company's asset structure, accounting for c. 81.6% of its total assets. LGIH's assets mainly consisted of other receivables, inventories, accounts receivable, fixed assets, and cash at bank and on hand. Other receivables primarily comprised transactions with related parties in Jianxi, which had an aging period of mostly within two years, with controllable counterparty risk and low bad debt provision. Inventories included development costs associated with LGIH's core business operations, such as engineering construction costs, which increased in parallel with the growth of the

relevant projects. Accounts receivable were mainly aroused from the Jianxi FB and the LHZMC for construction projects. Though LGIH had considerable current assets, its assets were relatively illiquid, primarily due to the significant proportion of costs associated with construction projects and the receivables. Having said that, as the company's fixed assets, such as industrial parks and affordable houses, increase in the future, the percentage of its non-current assets will likewise increase.

Asset Breakdown

(Total assets: RMB36.4 billion at end-September 2022)



Source: The company and Lianhe Global's calculation

LGIH's financial leverage (total liabilities to assets) reached 57.8%, 62.3%, 53.9% and 52.8% at end-2019, end-2020, end-2021 and end-September 2022, respectively, which fluctuates slightly but tends to be at a stable level. In view of the relevant guidelines of the Jianxi government, we expect the financial leverage of LGIH to stabilize at this level. LGIH's adjusted total debt increased significantly from c. RMB8.7 billion at end-2019 to c. RMB14.3 billion at end-September 2022, with short-term debt accounting for c. 28.3% of the total debt. There was no significant change in the ownership equity structure of LGIH at end-September 2022, compared with that at end-2021. The capital surplus increased to RMB10.8 billion at end-September 2022. LGIH mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure and affordable housing related projects under construction and to be constructed in the future.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	9M2022
Cash Inflows from Operation	2,428	4,498	7,482	5,522
Cash Outflows from Operation	5,183	5,157	8,675	5,394
Net CF from Operation	-2,755	-659	-1,193	129
Cash Inflows from Investment	9	0	7	35
Cash Outflows from Investment	704	529	875	1,041
Net CF from Investment	-695	-528	-868	-1,006
Cash Inflows from Financing	6,125	4,848	6,241	3,500
Cash Outflows from Financing	2,475	3,390	4,473	2,725
Net CF from Financing	3,650	1,459	1,768	774
Net Increase in Cash and cash equivalent	200	271	-292	-103

Source: LGIH's financial reports

Debt Servicing Capability

The liquidity of LGIH was moderately tight. At end-September 2022, LGIH had a cash balance and unused credit facilities of c. RMB2.2 billion and RMB0.2 billion, respectively, but a relatively high proportion of cash of RMB1.9 billion was restricted, compared with its debt due within one year of c. RMB3.8 billion at the same time. Having said that, per management, most of the interest-bearing debts of LGIH can be rolled over without principal repayment pressure, which provides some relief to the overall tight liquidity position. Besides, LGIH has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

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