Lianhe Ratings Global

Huzhou Moganshan High-tech Group Co., Ltd.

Initial Issuer Report

Summary	
Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	18 April 2023

Key Figures of Deqing and HMHG (RMB billion)	2021	2022
Deqing		
GDP	61.6	65.8
GDP growth rate (%)	8.7	3.8
Budgetary revenue	8.3	8.0
Government fund	11.1	10.7
Transfer payment	1.8	2.0
Budgetary expenditure	8.0	10.2
HMHG	**2021**	**2022.9**
Assets	72.1	88.0
Equity	27.6	33.1
Revenue	2.1	1.7

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

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

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'BBB' global scale Long-term Issuer Credit Rating with Stable Outlook to Huzhou Moganshan High-tech Group Co., Ltd. ("HMHG" or "the company")

Summary

The Issuer Credit Rating reflects a high possibility that the People's Government of Deqing County, Huzhou City ("Deqing government") would provide strong support to HMHG if needed, in light of its full ownership of HMHG, HMHG's strategic importance as the major local investment and development company ("LIDC") that is responsible for infrastructure construction and land development in Deqing County, Huzhou City ("Deqing"), especially in Mogan Mountain of Huzhou Hi-tech Industry Development Zone ("MHZ"), and the linkage between the Deqing government and HMHG, 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 Deqing government may face significant negative impact on its reputation and financing activities if HMHG encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that HMHG's strategic importance would remain intact while the Deqing government will continue to ensure HMHG's stable operation.

Rating Rationale

Deqing Government's Ownership and Supervision: The Deqing government indirectly holds the full ownership of HMHG through the Mogan Mountain of Huzhou Hi-tech Industry Development Zone Management Committee ("MHZ MC"), and is the actual controller of the company. The Deqing 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, via the MHZ MC. In addition, the Deqing government has assessment mechanism over the company and it appoints auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Deqing and Strategic Alignment: HMHG is an important LIDC in Deqing, especially in MHZ, that is primarily responsible for the infrastructure construction, land development and industrial park construction and operation in MHZ with strong franchised advantages. It is the core platform designated by the MHZ MC to implement its infrastructure construction and state-owned asset management plans, and it has undertaken and completed a number of strategically important projects in the region. As the sole entity for performing government-related functions in MHZ, HMHG 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.

Ongoing Government Support: HMHG received operational and financial support from the government. HMHG had received a total subsidy amount of c. RMB8.2 billion from 2019 to the first nine months of 2022, mainly including daily operating subsidies. The Deqing government, through the MHZ MC, continued to inject cash, equity and land improvement projects into HMHG to expand its asset size and to diversify its business. MHZ MC will repurchase some infrastructure and administrative area construction projects and provide policy supports to HMHG to ensure its business operation. Given the franchise advantage in infrastructure construction and land development in MHZ, HMHG has advantages to obtain land resources and major projects. We believe HMHG is likely going to receive timely government support in the form of operational and/or financial subsidies to support its daily business operation.

HMHG's Financial Matrix and Liquidity Position: HMHG's total assets showed a continuous growth trend in the past years and reached RMB88 billion at end-September 2022, mainly due to the increase in inventories resulting from its infrastructure construction and land development projects. Although the company has a large proportion of current assets, its overall assets are less liquid due to a high proportion of development costs and receivables. HMHG's financial leverage (total liabilities to total assets) was 62.4% and its adjusted debt increased to c. RMB50.7 billion at end-September 2022. The liquidity of HMHG was tight. HMHG had a cash balance and unused credit facilities of c. RMB8.9 billion (of which RMB1.1 billion was restricted cash) and RMB3.1 billion at end-September 2022, respectively, compared with its debt due within one year of c. RMB14.7 billion. Besides, HMHG has access to various financing channels, including bank loans and non-traditional financing, to support its debt repayment and business operations.

Economy and Fiscal Condition of Deqing: Deqing is a county under the jurisdiction of Huzhou City, Zhejiang Province. Deqing recorded an economic growth in 2022, achieving a GDP of c. RMB65.8 billion, with a year-on-year growth of 3.8%. The growth rate has slowed down compared to previous years. The aggregate fiscal revenue of the Deqing government was mainly derived from the budgetary revenue and government fund income. In 2022, the budgetary revenue of the Deqing government reached c. RMB8 billion, with a year-on-year increase of 0.4% (net of the influence of value-added tax credit refunds). The budget expenditures increased to RMB10.2 billion in 2022, resulting in an increase in its fiscal deficit ratio. Meanwhile, the government fund income also decreased slightly from 2021 to c. RMB10.7 billion. Besides, the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Deqing government increased from 51.2% in 2021 to 70.9% in 2022. MHZ is a national-level high-tech industrial development zone in Deqing. Its GDP and fiscal revenue have made a certain contribution to Deqing.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Deqing

Deqing is a county under Huzhou's jurisdiction, with a total area of 936 square kilometers. In 2022, it had a resident population of c. 554,000 and an urban population of c. 347,000. The urbanization rate was c. 62.7%. Deqing's GDP scale was ranked third among the six districts and counties in Huzhou. Its economic development focused on industries, digital economy and tourism in recent years. In 2022, the GDP of Deqing reached RMB65.8 billion, representing a year-on-year growth of 3.8%. The growth was mainly driven by the secondary and tertiary industries, which accounted for 57.8% and 38.0%, respectively, in 2022.

MHZ, formerly known as Deqing Economic Development Zone, was established in 1992 and was upgraded to a national high-tech industrial development zone in September 2015 with the approval of the State Council, which is the only county-level national high-tech zone in Zhejiang province. It has a total jurisdictional area of 74.74 square kilometers. Its GDP and fiscal revenue contribution to Deqing was relatively high in past years.

Deqing's GDP and Fixed Asset Investment (RMB billion)	**2020**	**2021**	**2022**
GDP	54.4	61.6	65.8
-Primary industry (%)	4.6	4.3	4.2
-Secondary industry (%)	56.1	57.8	57.8
-Tertiary industry (%)	39.3	37.9	38.0
GDP growth rate (%)	2.6	8.7	3.8
Fixed asset investment	43.7	50.5	58.3
Fixed asset investment growth rate (%)	6.9	15.5	15.4
Population (million)	0.5	0.6	0.6

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Deqing

The aggregate fiscal revenue of the Deqing government was mainly derived from the budgetary revenue and government-managed fund income. The Deqing government's budgetary revenue decreased to RMB8 billion in 2022 from RMB8.3 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. In contrast, its budgetary expenditure increased to RMB10.2 billion from RMB8 billion. Therefore, the Deqing government's budget deficit was enlarged to -27.2% over the same period.

In addition, Deqing's government fund income, mainly generated by land sales, dropped to RMB10.7 billion in 2022 from RMB11.1 billion in 2021, owing to the weak property market. As a result, the Deqing government recorded aggregate revenue of RMB20.6 billion in 2022, downed from RMB21.3 billion in 2021. Besides, its government debt grew significantly in 2022, lifting the government debt ratio, as measured by total government debt/aggregate revenue, to 70.9% from 51.2% over the same period.

Deqing's Fiscal Condition (RMB billion)	**2020**	**2021**	**2022**
Budgetary revenue	6.7	8.3	8.0
Budgetary revenue growth rate (%)	2.2	24.1	0.4*
Tax revenue	5.9	7.4	6.5
Tax revenue (% of budgetary revenue)	88.2	89.1	81.3
Government fund income	8.9	11.1	10.7
Transfer payment	2.3	1.8	2.0
Aggregate revenue	**18.0**	**21.3**	**20.6**
Budgetary expenditure	7.8	8.0	10.2
Budget deficit[1] (%)	**-16.6**	**3.9**	**-27.2**

*[1] Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%*
**Excluding the influence of value-added tax credit refund*
Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

HMHG was established in January 2018 with an initial registered capital of RMB10 billion. At end-2022, HMHG's registered and paid-in capital was both RMB10 billion. HMHG is wholly owned by MHZ MC.

Strategic Importance and Government Linkage

Strategic Importance of HMHG to Deqing

HMHG is an important LIDC in Deqing, especially in MHZ, that is primarily responsible for the infrastructure construction, land development and industrial park construction and operation in MHZ with strong franchised advantages. It is the core platform designated by the MHZ MC to implement its infrastructure construction and state-owned asset management plans, and it has undertaken and completed a number of strategically important projects in the region. As the sole entity for performing government-related functions in MHZ, HMHG 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.

Strong Linkage with the Local Government

HMHG's linkage with the local government is strong as the Deqing government indirectly holds the full ownership of HMHG through the MHZ MC. The Deqing 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, through the MHZ MC. In addition, the Deqing government and the MHZ MC has assessment mechanism over the company and it appoints auditor to supervise the operating performance and financial position on a periodic basis.

Government Support

HMHG continued to receive financial subsidies, mainly including operating subsidies, from the local government to maintain its business operation. HMHG received subsidies of c. RMB1.1 billion, RMB1.3 billion, RMB2.6 billion and RMB3.2 billion in 2019, 2020, 2021 and first nine months of 2022, respectively. HMHG received multiple capital and equities injections in the form of equity, asset authorization (e.g., road parking toll collecting right and mining operation and management right) and other assets such as pipeline asset from the Deqing government through the MHZ MC to expand its asset size and to diversify its business. The Deqing government will repurchase some infrastructure and land development projects and provide policy supports to HMHG to ensure its business operation. Given the franchise advantage in infrastructure construction and land development in MHZ, HMHG has advantages to obtain land resources and major projects. We believe HMHG is likely going to receive timely government support in the form of operational and/or financial subsidies to support its daily business operation.

Business Profile

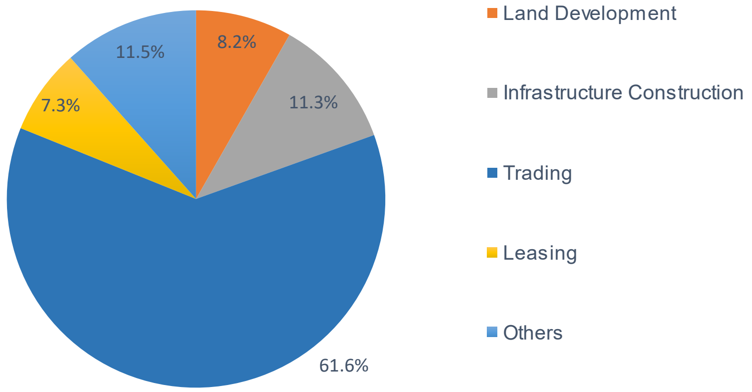
The Key Entity Responsible for Infrastructure Construction and Land Development in Deqing and MHZ

HMHG, as an important LIDC in Deqing and the sole LIDC in MHZ, is mainly responsible for land development and infrastructure construction, as well as the industrial park development and operation within the region. The company's strong franchise advantage enables it to undertake important land development and infrastructure construction projects under the instruction of the Deqing government and MHZ MC. As the core platform designated by the MHZ MC to implement its infrastructure construction and state-owned asset management plans, HMHG plays an important role in promoting economic and social development within the region.

The primary sources of operating revenue for HMHG are trading business, land development, infrastructure construction and leasing business, while it also engaged in industrial park development, property management and affordable house development. The company’s total revenue reached c. RMB2.1 billion, RMB2.0 billion, RMB2.1 billion and RMB1.7 billion in 2019, 2020, 2021 and the first nine months of 2022, respectively, representing a steady trend. The overall gross profit margin of HMHG remained stable at c. 4%-7% from 2019 to the first nine months of 2022. In general, HMHG's business was well diversified, and it has regional advantages in its major businesses.

Revenue Breakdown

(Total revenue: c. RMB1.7 billion in the first nine months of 2022)



Source: The company and Lianhe Global's calculation

Land Development

The Deqing government entrusts HMHG to undertake land development projects in MHZ, including land levelling and construction of supporting facilities. HMHG signs the land development agreement with the Deqing government. The Deqing Finance Bureau will repurchase the land parcel with investment cost plus a certain percentage of profit when the entrusted land parcels are sold. HMHG realized land development income of c. RMB273.4 million, RMB360.6 million, RMB343.1 million and RMB141 million in 2019, 2020, 2021 and first nine months of 2022, respectively, with a relatively high and stable gross profit margin of c.21%-24%. In view of a number of projects under development, HMHG is expected to continue to have pressure on capital expenditure.

Infrastructure Construction

HMHG is designated by the MHZ MC and other government agencies in Deqing to undertake the infrastructure construction business in the region. HMHG is responsible for the construction and management of a number of key construction projects in Deqing and MHZ, including pipe line construction, road construction, environment improvement projects and other infrastructure-related projects. The projects in this segment are generally conducted under the agent construction model, where the revenue recognition includes construction costs incurred plus a certain percentage of profit. The revenue in this segment was c. RMB40.6 million, RMB309.1 million, RMB225.9 million and RMB193.4 million in 2019, 2020, 2021 and the first nine months of 2022, respectively. The gross profit margin of this segment has decreased to c. 1.5% since 2021 from c. 3% in previous years. Currently, the company is working on several large-scale projects, thus it incurs high pressure on capital expenditure.

Trading

As an important source of revenue for HMHG, the trading segment makes the company's business more diversified and plays a complementary role to its main business. HMHG is mainly engaged in the sales of steel, cosmetics and construction materials. HMHG's trading business is mostly conducted in a "demand-driven" model, where it determines the type and amount of materials to be procured strictly based on the actual purchase orders placed by customers. The revenue generated from this segment reached c. RMB1.7 billion, RMB1.1 billion, RMB1.3 billion and RMB1.1 billion in 2019, 2020, 2021 and the first nine months of 2022, respectively, representing an upward trend. The gross profit margin of the segment was relatively low, which was less than 1% for the past years. The suppliers and customers of the segment are concentrated, and most of them are private enterprises, indicating a relatively high counterparty risk.

Leasing

HMHG's leasing business mainly comprises property leasing, which mainly includes the company's self-owned factories and commercial properties located in industrial parks in Deqing and MHZ. HMHG generates operating income from tenants' rental payments. The segment revenue reached c. RMB36.1 million, RMB62.8 million, RMB76.6 million and RMB125.8 million in 2019, 2020, 2021 and the first nine months of 2022, respectively.

Other Businesses

Other businesses of HMHG include industrial park development and operation, property management, affordable house development and labor dispatch, 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 and make the revenue structure more diversified.

Financial Profile

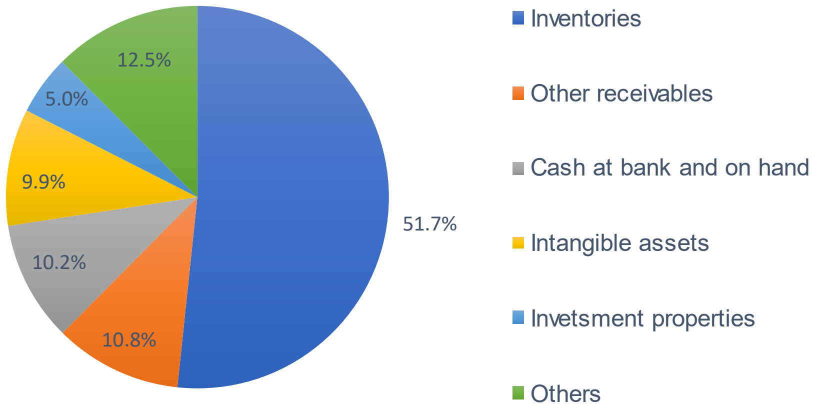
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality (RMB million)	2019	2020	2021	End-September 2022
Total Asset	47,342	56,796	72,123	88,006
Equity	17,336	20,781	27,553	33,092
Debt	26,905	32,654	41,322	50,714
Debt / (Debt + Equity) (%)	60.8	61.1	60.0	60.5
LT Debt	18,837	21,705	28,918	36,087
LT Debt / (LT Debt + Equity) (%)	52.1	51.1	51.2	52.2

Source: Company Information and Lianhe Global's calculations

HMHG's total assets showed a continuous growth in the past years, with a growth rate of 20%, 27% and 22% at end-2020, end-2021 and end-September 2022, respectively, and reached RMB88 billion at end-September 2022. The increase of HMHG's total assets was largely due to its inventories, which has steadily increased in tandem with the company's infrastructure and land development projects, as well as the intangible assets and investment properties injected from the MHZ MC. At end-September 2022, current assets accounted for c. 75.3% of its total assets. HMHG's assets mainly consisted of inventories, other receivables, cash at bank and on hand, intangible assets and investment properties. Inventories mainly included construction costs of construction projects in progress and land development costs which increased in parallel with the growth of the relevant projects. Other receivables primarily comprised transactions with MHZ MC and other state-owned enterprises in Deqing with controllable counterparty risk and low bad debt provision. Intangible assets mainly consisted of road parking toll collecting right, mining operation and management right and other right of asset use. Investment properties were mainly industrial land and urban residential land. Though HMHG had considerable current assets, its assets were less liquid, primarily due to the significant proportion of costs associated with construction projects and the receivables.

Asset Breakdown
(Total assets: RMB88 billion at end-September 2022)



Source: The companyand Lianhe Global's calculation

HMHG's financial leverage (total liabilities to assets) reached 63.4%, 63.4%, 61.8% and 62.4% at end-2019, end-2020, end-2021 and end-September 2022, respectively, indicating a stable leverage level. In view of the relevant guidelines of the MHZ MC, we expect the financial leverage of HMHG to continue to stabilize at this level. HMHG's adjusted total debt increased significantly from c. RMB26.9 billion at end-2019 to c. RMB50.7 billion at end-September 2022, with short-term debt accounting for c. 28.8% of the total debt. There was no significant change in the equity structure of HMHG at end-September 2022, compared with that at end-2021, the majority of which was capital surplus, reaching c. RMB19 billion at end-September 2022. HMHG mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure, land development and industrial park construction projects under construction and to be constructed in the future.

Cash Flow

Cash Flow (RMB million)	**2019**	**2020**	**2021**	**9M2022**
Cash Inflows from Operation	5,410	4,496	5,149	3,672
Cash Outflows from Operation	8,794	7,439	8,138	10,581
Net CF from Operation	**-3,384**	**-2,943**	**-2,989**	**-6,909**
Cash Inflows from Investment	19	2,147	207	125
Cash Outflows from Investment	1,524	3,822	2,139	300
Net CF from Investment	**-1,505**	**-1,675**	**-1,933**	**-175**
Cash Inflows from Financing	18,104	20,032	24,178	25,006
Cash Outflows from Financing	12,657	14,451	16,650	15,040
Net CF from Financing	**5,447**	**5,581**	**7,528**	**9,966**
Net Increase in Cash and cash equivalent	558	963	2,585	2,932

Source: HMHG's financial reports

Debt Servicing Capability

The liquidity of HMHG was relatively tight. At end-September 2022, HMHG had a cash balance and unused credit facilities of c. RMB8.9 billion and RMB3.1 billion, respectively, but RMB1.1 billion of cash was restricted, compared with its debt due within one year of c. RMB14.7 billion at the same time. Besides, HMHG 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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