

Jiangyou Hongfei Investment (Group) Co., Ltd.

Initial Issuer Report

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

Summary

The Issuer Credit Rating reflects a high possibility that the Jiangyou People’s Government (“the Jiangyou government”) would provide very strong support to JHIG if needed, in light of its majority ownership of JHIG, JHIG’s strategic importance as the most important local investment and development company (“LIDC”) responsible for infrastructure construction, industrial development and public utility operation in Jiangyou and the linkage between the Jiangyou government and JHIG, including the appointment of the senior management, strategic alignment, supervision of major financing plan and investment decisions and ongoing operational and financial support. In addition, the Jiangyou government may face significant negative impact on its reputation and financing activities if JHIG encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Jiangyou government holds 67% shares of JHIG through Finance Bureau of Jiangyou (Jiangyou State-owned Assets Supervision and Administration Office) (“Jiangyou SASAO”); the higher government, Mianyang Municipal People’s Government (“the Mianyang government”) owns the rest shares indirectly.

The local government has strong control over the company, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government has formulated a performance assessment policy for the company, and regularly appoints auditors to review the company’s operating performance and financial position.

Strategic Importance and Strategic Alignment: JHIG is the most important LIDC responsible for infrastructure construction, industrial development and public utility operation in Jiangyou. It undertakes major land consolidation, road construction, resettlement housing development, environment improvement and other infrastructure-related projects. It also provides critical public services in Jiangyou, including gas supply, water supply, public transportation and waste garbage disposal.

JHIG’s strategic development plan has been aligned with the local government’s economic and social policies. JHIG and Mianyang Investment Holding (Group) Co., Ltd. (“MIHG”), an important prefecture-level LIDC owned by the Mianyang government, jointly founded Mianyang Miantai Industrial Co., Ltd. (“MMIC”) in

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	5 May 2023

Key Figures of Jiangyou and JHIG (RMB billion)

	2021	2022
Jiangyou		
GDP	52.8	60.1
GDP growth rate (%)	8.6	3.9
Budgetary revenue	2.4	3.0
Government fund	4.3	3.7
Transfer payment	2.5	3.2
Budgetary expenditure	9.2	9.8
JHIG	2021	2022.9
Asset	29.6	30.9
Equity	11.7	11.9
Revenue	1.6	1.3

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

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Applicable Criteria

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



2021, aiming to enhance the coordination between prefecture-level and county-level LIDCs, and to support industrial development in Jiangyou. MMIC has invested RMB1.5 billion into a flagship production plant of lithium iron phosphate cathode material in Jiangyou with a 33.33% stake. It is expected to be the first project with an annual production value exceeding RMB10 billion in Jiangyou after being put into operation and to drive the development of the related industry chain.

Ongoing Government Support: The company received ongoing operational subsidies from the Jiangyou government in relation to providing public services, amounting to RMB1,532 million between 2019 and the first nine months of 2022. In addition, the Jiangyou government injected cash capital of RMB383 million into JHIG in 2020, enlarging its paid-in capital to RMB500 million from RMB117 million. The local government also injected assets such as equity of other LIDC, state-owned properties and sewage pipe network, amounting to RMB1,625 million, into JHIG between 2019 and 2021. We expect the company to continue receiving government support in the future, considering its strategic importance in Jiangyou.

Economy and Fiscal Condition of Jiangyou: Jiangyou is an important industrial base in Sichuan Province, specializing in producing special steel and machinery. As the hometown of Li Bai, a renowned Chinese poet who lived during the Tang Dynasty, Jiangyou has been leveraging this advantage to develop its tourism industry in recent years. Jiangyou's economic development has experienced fluctuation over the past three years due to the impact of Covid, with GDP growth rates of 4.1%, 8.6% and 3.9% in 2020, 2021 and 2022, respectively.

The Jiangyou government's budgetary revenue increased significantly to RMB3.0 billion in 2022 from RMB2.3 billion in 2020. However, the tax revenue's contribution stayed at a low level of 42-55% over the same period. Its fiscal self-sufficiency was improving but remained weak, with budget deficits of -95.4%, -88.9% and -78.1% in 2020, 2021 and 2022, respectively. Therefore, the Jiangyou government highly relied on transfer payments from higher government and government fund income. Yet the latter, mainly generated by land sales, dropped to c. RMB3.7 billion in 2022 from RMB8.4 billion in 2020 and RMB4.3 billion in 2021, owing to the weak property market.

JHIG's Financial and Liquidity Position: JHIG's asset size grew steadily to RMB30.9 billion at end-September 2022 from RMB21.5 billion at end-2019. Its total debt increased by 26.7% to RMB14.1 billion from RMB11.1 billion over the same period. As the company received multiple capital and asset injections, its financial leverage was largely stable in the past three years.

The liquidity of JHIG was very tight. At end-September 2022, JHIG had a cash balance of RMB281 million (including restricted cash of RMB68 million) compared with its debts due within one year of RMB6.4 billion. JHIG only had unused bank credit lines of RMB3.2 billion to support its debt repayments and business operations. Therefore, the company has to successfully roll over its short-term bank borrowings (end-September 2022: RMB2.9 billion) and obtain additional financing sources or government support to maintain its liquidity.

Rating Sensitivities

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

We would consider upgrading JHIG's rating if there is an upgrade in our internal credit assessment on the Jiangyou government.

Operating Environment

Economic Condition of Jiangyou

Jiangyou is a county-level city directly under the jurisdiction of Sichuan Province and managed by Mianyang City on behalf of Sichuan Province. Jiangyou has jurisdiction over 23 towns, one street and one provincial high-tech industrial area, with a total area of 2,719 square kilometers. At end-2021, Jiangyou had a resident population of 0.7 million, with an urbanization rate of 54.6%.

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Jiangyou's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	47.8	52.8	60.1
-Primary industry (%)	12.8	11.6	10.3
-Secondary industry (%)	41.5	42.8	46.7
-Tertiary industry (%)	45.7	45.6	43.0
GDP growth rate (%)	4.1	8.6	3.9
Fixed asset investment growth rate (%)	22.0	12.3	5.5
Population (million)	0.7	0.7	0.7*

Source: Public information and Lianhe Global's calculations

Note: 2021's data

Fiscal Condition of Jiangyou

The Jiangyou government's budgetary revenue increased significantly to RMB3.0 billion in 2022 from RMB2.3 billion in 2020. However, the tax revenue's contribution stayed at a low level of 42-55% over the same period. Its fiscal self-sufficiency was improving but remained weak, with budget deficits of -95.4%, -88.9% and -78.1% in 2020, 2021 and 2022, respectively. Therefore, the Jiangyou government highly relied on transfer payments from higher government and government fund income. Yet the latter, mainly generated by land sales, dropped to c. RMB3.7 billion in 2022 from RMB8.4 billion in 2020 and RMB4.3 billion in 2021, owing to the weak property market.

The outstanding debt of the Jiangyou government continued to grow. At end-2022, the Jiangyou government's outstanding debt was RMB10.4 billion,

including RMB3.3 billion of general obligations and RMB7.1 billion of special debt. Given that the Jiangyou government borrowed heavily through special debts to support its public projects, its government debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 106.4% at the end-2022 from 49.0% at the end-2020.

Jiangyou's Fiscal Condition

(RMB billion)	2020	2021	2022
Budgetary revenue	2.3	2.4	3.0
Budgetary revenue growth rate (%)	1.2	6.0	23.2*
Tax revenue	1.1	1.3	1.3
Tax revenue (% of budgetary revenue)	49.6	54.5	42.9
Government fund income	8.4	4.3	3.7
Transfer payment	2.7	2.5	3.1
Aggregate revenue	13.4	9.2	9.8
Budgetary expenditure	4.5	4.6	5.4
Budget deficit ¹ (%)	-95.4	-88.9	-78.1

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

Source: Public information and Lianhe Global's calculations

Note*: Excluding the influence of value-added tax credit refund

Ownership Structure

Government Ownership

JHIG was established in December 2003 with an initial registered capital of RMB0.5 billion, funded by Jiangyou SASAO. In August 2021, JHIG and MIHG jointly founded MMIC, aiming to enhance the coordination between prefecture-level and county-level LIDCs, and to support industrial development in Jiangyou. JHIG and MIHG held 29.83% and 69.61% stakes in MMIC, respectively. In December 2021, Jiangyou SASAO transferred 33% of shares of JHIG to MMIC. At end-2022, Jiangyou SASAO held a 67% stake in JHIG, and MMIC had the remaining 33%.

Strategic Importance and Government Linkage

Strategic Importance of JHIG to Jiangyou

JHIG is the most important LIDC responsible for infrastructure construction, industrial development and public utility operation in Jiangyou. It undertakes major land consolidation, road construction, resettlement housing development, environment improvement and other infrastructure-related projects. It also provides critical public services in Jiangyou, including gas supply, water supply, public transportation and waste garbage disposal.

Its strategic development plan has been aligned with the local government's economic and social policies. JHIG and MIHG jointly founded MMIC in 2021, aiming to enhance the coordination between municipal-level and county-level LIDCs, and to support industrial development in Jiangyou. MMIC has invested RMB1.5 billion into a flagship production plant of lithium iron phosphate cathode material with a 33.33% stake. It is expected to be the first project with an annual production value exceeding RMB10 billion in Jiangyou after being put into operation and to drive the development of the related industry chain.



Linkage with the Local Government

JHIG has a strong linkage with the local government. Jiangyou government holds majority shares of JHIG through Jiangyou SASAO. The local government has strong control over the company, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government has formulated a performance assessment policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

Ongoing Government Support

The company received ongoing operational subsidies from the Jiangyou government in relation to providing public services, amounting to RMB355 million, 421 million, 466 million and 290 million in 2019, 2020, 2021 and the first nine months of 2022, respectively.

In addition, the Jiangyou government injected cash capital of RMB383 million into JHIG in 2020, enlarging its paid-in capital to RMB500 million from RMB117 million. The local government also injected assets such as equity of other LIDC, state-owned properties and sewage pipe networks, amounting to RMB19 million, 772 million and 834 million in 2019, 2020 and 2021, respectively.

Business Profile

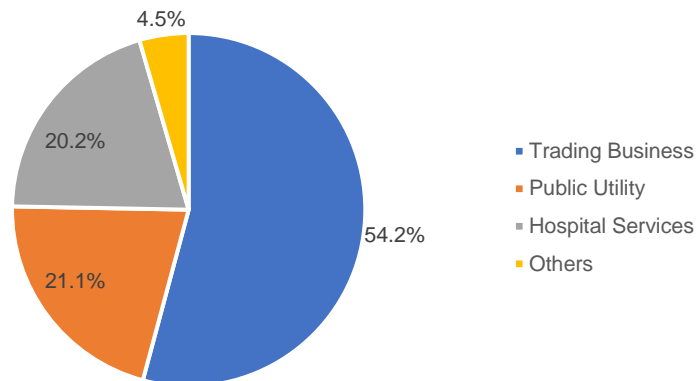
The most important LIDC responsible infrastructure construction, industrial development and public utility operation in Jiangyou

JHIG is the most important LIDC in Jiangyou responsible for infrastructure construction, industrial development and public utility operation in Jiangyou. The company's strong franchise advantage enables it to undertake important land consolidation, infrastructure construction and resettlement housing development projects under the instruction of the Jiangyou government. JHIG also engages in the operation of the city's public utilities, including gas supply, water supply and public transportation. As the core platform in Jiangyou, JHIG plays a critical role in promoting economic and social development within the region.

The primary sources of operating revenue for JHIG were public utility, infrastructure construction, trading business and hospital services. The company's total revenue reached RMB1.3 billion, RMB1.4 billion, RMB1.6 billion and RMB1.3 billion in 2019, 2020, 2021 and the first nine months of 2022, respectively, representing a steady growing trend.

Revenue Breakdown

(Total revenue: RMB1.3 billion in the first nine months of 2022)



Source: The company and Lianhe Global's Calculation

Infrastructure Construction

JHIG is designated by the Jiangyou government to undertake the infrastructure construction projects in the region. JHIG is responsible for constructing and managing an array of key projects in Jiangyou, including land consolidation, pipeline construction, road construction, resettlement housing development, environmental improvement 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. At end-September 2022, the company had four infrastructure construction projects under construction, with a total planned investment of RMB4.7 billion, of which RMB1.6 billion was scheduled to be invested in the next one to two years.

During the first nine months of 2022, JHIG did not record revenue from its infrastructure construction segment due to the company's settlement policy. Typically, most of the construction revenue is recognized towards the end of the year. The infrastructure construction segment generated revenue of RMB 448 million in 2022.

Public Utility and Hospital Services

As an important public utility operator in Jiangyou, JHIG provides critical public services in Jiangyou, including gas supply, water supply, public transportation, garbage disposal, as well as pipe network installation and maintenance. The company's monopoly on public utilities in Jiangyou gives it a strong regional franchise advantage. JHIG also has 90% ownership of Jiangyou Second People's Hospital, a comprehensive hospital serving Jiangyou and surrounding areas.

Trading Business

The trading segment has become JHIG's largest source of revenue since 2020. The company is mainly engaged in the sales of cement, coal, steel and electrolytic copper. It purchases by inquiry and sells to local and surrounding construction enterprises. The trading business diversifies the company's revenue structure. Yet its gross profit margin was relatively low, which was less than 3%

for the past years. The suppliers and buyers of the segment are highly concentrated, and most of them are private enterprises, indicating a relatively high counterparty risk.

Others

Other businesses of JHIG include leasing, driving test and labor services, with each segment accounting for a relatively small proportion of the company's total revenue. They mainly play a supplementary role and have little impact on JHIG's financial position and creditworthiness.

Financial Profile

Balance Sheet Structure and Quality

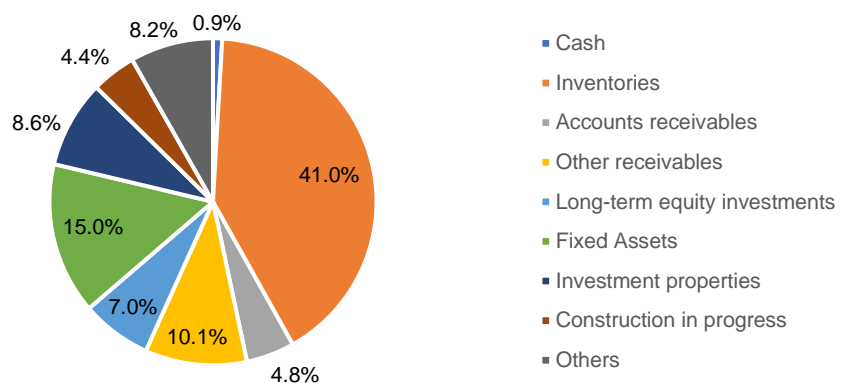
Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Sep 2022
Total Asset	21,514	24,044	29,573	30,871
Equity	7,737	8,985	11,744	11,912
Debt	11,118	11,944	12,672	14,073
Debt / (Debt + Equity) (%)	59.0	57.1	51.9	54.2
LT Debt	8,762	8,164	7,369	7,664
LT Debt / (LT Debt + Equity) (%)	53.1	47.6	38.6	39.1

Source: The company's financial reports and Lianhe Global's calculations

JHIG's asset size grew steadily to RMB30.9 billion at end-September 2022 from RMB21.5 billion at end-2019. Its debt increased by 26.7% to RMB14.1 billion from RMB11.1 billion over the same period. As the company received multiple capital and asset injections, its financial leverage was largely stable in the past three years.

Assets Breakdown

(Total Asset: RMB30.8 billion at end-September 2022)



Source: The company and Lianhe Global's calculation

JHIG's asset liquidity was weak. Its active participation in Jiangyou's land consolidation and infrastructure construction activities accumulated sizeable inventories (mainly lands to be developed and construction costs), accounts receivables and construction in progress, amounting to RMB12.6 billion, 1.5 billion and 1.4 billion at end-September 2022, respectively. These assets would take a long time to monetize due to the long construction, recognition and cash



collection period. In addition, JHIG had other receivables of RMB3.1 billion, mainly due from government agencies and other LIDCs in Jiangyou. The company usually takes two to three years to collect them.

Moreover, JHIG had fixed assets of RMB4.6 billion, mainly properties, land use rights and equipment. Some were public interest assets, such as sewage pipe networks at end-September 2022. The company also had investment properties for leasing of RMB2.7 billion and long-term equity investments of RMB2.1 billion, which mainly was the equity of MMIC.

Debt Servicing Capability

The liquidity of JHIG was very tight. At end-September 2022, JHIG had a cash balance of RMB281 million (including restricted cash of RMB68 million) compared with its debts due within one year of RMB6.4 billion. JHIG only had unused bank credit lines of 3.2 billion to support its debt repayments and business operations. Therefore, the company must successfully roll over its short-term bank borrowings (end-September 2022: RMB2.9 billion) and obtain additional financing sources or government support to maintain its liquidity.

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