

Hunan Yuanjiang Qionghu Investment Construction Development Group Co., Ltd.

Initial Issuer Report

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

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Hunan Yuanjiang Qionghu Investment Construction Development Group Co., Ltd. (“HYQI” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Yuanjiang (“the Yuanjiang government”) would provide very strong support to HYQI if needed, in light of its 90% ownership of HYQI, the strategic importance of HYQI as the most important local investment and development company responsible for infrastructure investment and development in Yuanjiang, and the linkage between the Yuanjiang government and HYQI, including management appointment, supervision over HYQI’s strategic development, major investment and financing plans, strategic alignment and ongoing operational and financial support. In addition, the local government may face significant negative impact on its reputation and financing activities if HYQI encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Yuanjiang government holds 90% ownership of HYQI through Yuanjiang State-owned Assets Service Center (“Yuanjiang SASC”). The Yuanjiang government has strong control over HYQI, including management appointment and supervision of the strategic development, major investment and financing plans. In addition, the local government has formulated a performance assessment mechanism for the company and regularly appoints auditors to review the company’s financial position.

Strategic Importance and Strategic Alignment: HYQI is Yuanjiang’s most important investment and development entity. The company is mainly responsible for developing important infrastructure, resettlement housing and industrial park projects under the instruction of the Yuanjiang government. As the core platform of Yuanjiang, HYQI’s business operation has been aligned with the local government’s social and economic development plans.

Ongoing Government Support: HYQI has received ongoing support from the local government, including capital and assets injection, operational subsidies, etc. The company received cash capital injections of RMB212 million, 1,037 million and 93 million in 2020, 2021 and 2022, respectively, from the Yuanjiang government. The local government also injected assets, including equity of other SOE and LIDCs in Yuanjiang, cash, land use rights and properties, amounting to RMB2.8 billion between 2020 and 2022.

Key Figures of Yuanjiang and HYQI (RMB billion)		
	2021	2022
Yuanjiang		
GDP	29.2	30.0
GDP growth rate (%)	8.3	2.3
Budgetary revenue	1.2	1.3
Government fund	1.1	1.5
Transfer payment	3.7	3.2
Budgetary expenditure	5.0	5.5
HYQI		
Asset	18.3	21.4
Equity	7.9	9.6
Revenue	1.3	1.7

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

Analysts

Roy Luo, FRM
 +852 3462 9582
roy.luo@lhratingsglobal.com

Toni Ho, CFA, FRM
 +852 3462 9578
toni.ho@lhratingsglobal.com

Applicable Criteria

China Local Investment and Development Criteria (5 December 2022)

In addition, the Yuanjiang government provides operational subsidies of RMB185 million to HYQI in the past three years, to support the company's operations in relation to providing public services. We expect HYQI to receive strong support from the local government in the future in light of its strategic importance.

Economy and Fiscal Strength of Yuanjiang: Yuanjiang is a county-level city under the administration of Yiyang City and is located in northern Hunan Province. Lay in the south of Dongting Lake, Yuanjiang is a city featured with a land of fish and rice. The primary industry's contribution is significant to Yuanjiang's economy, representing 25.0% of its GDP in 2022. Yuanjiang is promoting its industrial development, focusing on the supply chain development of machinery manufacturing, shipbuilding, ecological and green food, textile and garment industries. However, its industrial-added value dropped by 1.7% in 2022. Yuanjiang's GDP growth rate fluctuated in the past three years, owing to Covid's disruption, which was 3.5%, 8.3% and 2.3% in 2020, 2021 and 2022, respectively. Yuanjiang's GDP reached c. RMB30.0 billion in 2022, and was ranked 3rd among six districts and counties under the jurisdiction of Yiyang. GDP per capita of Yuanjiang reached c. RMB 53,600 in 2022, lower than Hunan (c. RMB73,600) and China (c. RMB85,700).

The Yuanjiang government's budgetary revenue grew significantly to RMB1.3 billion in 2022 from 0.8 billion in 2020, representing a high compound annual growth rate of 33.9% ("CAGR"). However, the Yuanjiang government's budgetary revenue scale remained small, and its fiscal self-sufficiency capacity was weak, with a high budget deficit -301.5% in 2022. The outstanding debt of the Yuanjiang government continued to grow in the past three years and reached RMB6.1 billion at end-2022, up from RMB4.1 billion at end-2020, representing a CAGR of 21.7%. This was mainly due to the new issuance of special debts supporting Yuanjiang's project developments. As measured by the total government debt/aggregate revenue, the government debt ratio was lifted to 100.0% in 2022 from 64.8% in 2020.

HYQI's Financial Matrix and Liquidity Position: HYQI's total asset grew steadily to RMB21.4 billion at end-2022 from RMB16.1 billion at end-2020, representing a CAGR of 15.1%. The company relied on both capital injections and borrowings to fund its asset expansion. HYQI received multiple capital injections in recent years, enlarging its paid-in capital and capital reserve to RMB1.1 billion and RMB7.1 billion at end-2022 from RMB340 million and RMB5.5 billion, respectively. Over the same period, the company's total debt increased to RMB8.4 billion from 7.0 billion. Its financial leverage, as measured by debt/capitalization, stayed at a manageable level of 46.8% at end-2022.

HYQI's liquidity was tight. At end-2022, the company had a cash balance of RMB426 million, compared with its short-term debt of RMB2.6 billion. The company has access to multiple financing channels, such as bank borrowings, bond issuances and other non-traditional financings. At end-2022, the company has unused credit lines of RMB1.2 billion and an available bond issuance quota of RMB250 million. Still, rolling over its short-term bank borrowings (c. RMB560 million at end-2022) and receiving timely cash payment and support from the local government is essential for HYQI to maintain its liquidity.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Yuanjiang

Yuanjiang is a county-level city under the administration of Yiyang City and is located in northern Hunan Province. Yuanjiang has jurisdiction over ten towns, two streets and two wetland reserves, with a total area of 2,019.7 square kilometers. At end-2022, Yuanjiang had a resident population of c. 0.6 million, with an urbanization rate of 50.4%.

Lay in the south of Dongting Lake, Yuanjiang is a city featured with a land of fish and rice. The primary industry's contribution is significant to Yuanjiang's economy, representing 25.0% of its GDP in 2022. Yuanjiang is promoting its industrial development, focusing on the supply chain development of machinery manufacturing, shipbuilding, ecological and green food, textile and garment industries. However, its industrial-added value dropped by 1.7% in 2022.

Yuanjiang's GDP growth rate fluctuated in the past three years, owing to Covid's disruption, which was 3.5%, 8.3% and 2.3% in 2020, 2021 and 2022, respectively. Yuanjiang's GDP reached c. RMB30.0 billion in 2022, and was ranked 3rd among six districts and counties under the jurisdiction of Yiyang. GDP per capita of Yuanjiang reached c. RMB 53,600 in 2022, lower than Hunan (c. RMB73,600) and China (c. RMB85,700).

Yuanjiang's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	27.0	29.2	30.0
-Primary industry (%)	25.5	23.9	25.0
-Secondary industry (%)	39.1	40.7	40.0
-Tertiary industry (%)	35.4	35.4	35.0
GDP growth rate (%)	3.5	8.3	2.3
Fixed asset investment growth rate (%)	9.6	13.6	27.5
Population (million)	0.57	0.56	0.56

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Yuanjiang

The Yuanjiang government's aggregate fiscal revenues are mainly derived from government fund income and transfer payments from the higher government, contributing to 16.3% and 71.7% of Yujiang government's aggregate revenue, respectively. The Yuanjiang government's budgetary revenue grew significantly to RMB1.3 billion in 2022 from 0.8 billion in 2020, representing a CAGR of 33.9%. However, the Yuanjiang government's budgetary revenue scale remained small, and its fiscal self-sufficiency capacity was weak, with a high budget deficit -301.5% in 2022.

The outstanding debt of the Yuanjiang government continued to grow in the past three years and reached RMB6.1 billion at end-2022, up from 4.1 billion at end-2020, representing a CAGR of 21.7%. This was mainly due to the new issuance of special debts supporting Yuanjiang's project developments. As measured by the total government debt/aggregate revenue, the government debt ratio was lifted to 100.0% in 2022 from 64.8% in 2020.

Yuanjiang's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	0.8	1.2	1.3
Budgetary revenue growth rate (%)	3.7	59.7	12.2
Tax revenue	0.5	0.6	0.7
Tax revenue (% of budgetary revenue)	67.3	48.1	48.1
Government fund income	1.0	1.1	1.5
Transfer payment	4.6	3.7	3.2
Aggregate revenue	6.4	6.0	6.1
Budgetary expenditure	6.0	5.0	5.5
Budget deficit ¹ (%)	-688.7	-309.4	-301.5

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

Source: Public information and Lianhe Global's calculations

Ownership Structure and Profile

Government's Full Ownership

HYQI was established in January 2019 by Yuanjiang State-owned Assets Management Bureau with initial registered capital of RMB3.3 billion. In 2021, 10% shares of HYQI were transferred to Hunan State-owned Assets Investment and Operation Co., Ltd., an SOE owned by Hunan Provincial Government, to subsidize Social Security Fund.

At end-2022, HYQI's registered and paid-in capital were RMB3.3 billion and RMB1.1 billion, respectively. Yuanjiang SASC holds 90% shares of HYQI and is the ultimate controller of the company.

Strategic Importance and Government Linkage

Strategic Importance of HYQI to Yuanjiang

HYQI is the most important platform in Yuanjiang, controlling all major LIDCs in the city, including Yuanjiang Urban Construction Investment Development Co., Ltd. and Hunan Yuanjiang Jucheng Industrial Development Investment Co., Ltd. ("YJID"). HYQI is responsible for developing important infrastructure, resettlement housing and industrial park projects under the instruction of the Yuanjiang government. As the core platform of Yuanjiang, HYQI's business operation has been aligned with the local government's social and economic development plans.

Linkage with the Local Government

HYQI's linkage with the local government is strong as the local government holds a 90% stake in HYQI through Yuanjiang SASC. The local government has strong supervision over HYQI, including management appointment and supervision of the strategic development, major investment and financing plans. In addition, the local government has formulated a performance assessment mechanism for the company and regularly appoints auditors to review the company's financial position.

Government Support

HYQI has received ongoing support from the local government, including capital and assets injection, operational subsidies, etc. The company received cash capital injections of RMB212 million, 1,037 million and 93 million in 2020, 2021 and 2022, respectively. The local

government also injected assets, including equity of other SOE and LIDCs in Yuanjiang, cash, land use rights and properties, amounting to RMB2.8 billion between 2020 and 2022. The local government also provides operational subsidies of RMB185 million to HYQI in the past three years, to support the company's operations in relation to providing public services. We expect HYQI to receive strong support from the local government in the future in light of its strategic importance.

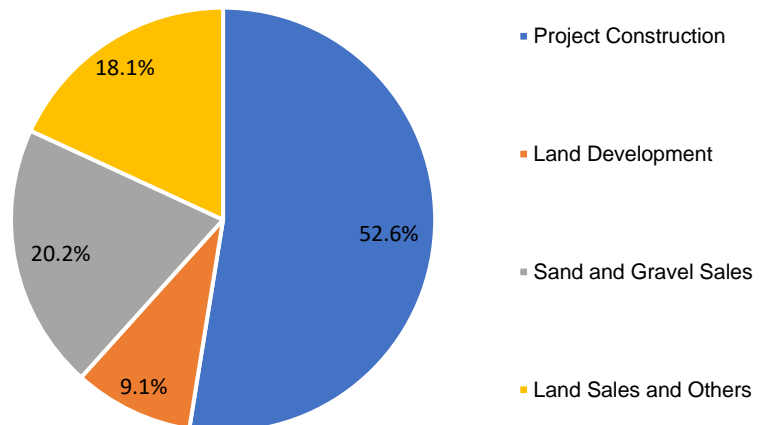
Business Profile

The Most Important Investment and Development Entity in Yuanjiang

HYQIC, as the most important LIDC in Yuanjiang, is mainly responsible for project construction, land development, sand and gravel sales, land sales and other businesses within the region. The company's strong franchise advantage enables it to undertake important infrastructure, resettlement housing and industrial park projects under the instruction of the Yuanjiang government. The company realized revenue of RMB1.0 billion, 1.3 billion and 1.7 billion in 2020, 2021 and 2022, respectively, representing an upward trend.

Revenue Breakdown

(Total revenue: RMB1.7 billion in 2022)



Source: The company and Lianhe Global's Calculation

Project Construction and Land Development

The Yuanjiang government designates HYQI to undertake important infrastructure, resettlement housing and land development projects in Yuanjiang. 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 (usually 15%) of profit. However, the actual payment may be subject to the fiscal conditions of the local government and thus pose some uncertainties on the company's cash collection schedule.

HYQI has a strong project pipeline with an array of projects, including roads and bridges, public facilities, hospitals, schools and industrial parks, scheduled to be developed in the coming years.

Sand and Gravel Sales

As an important source of revenue for HYQI, the sand and gravel sales segment makes the company's business more diversified and plays a complementary role to its main business. This segment adopts the advanced payment model. The company provides higher discounts to buyers who make larger advance payments. The revenue from this segment reached RMB234 million, RMB413 million and RMB341 million in 2020, 2021 and 2022, respectively.

Land Sales and Others

HYQI recorded revenue of RMB298 million from land sales in 2022. Other businesses of HYQI include property leasing and dock leasing, etc., with each segment accounting for a very small proportion of the company's total revenue. The leasing properties were mainly standardized plants built by YJID, a subsidiary of HYQI, for companies investing in Yuanjiang. Despite relatively small rental income, this business facilitates Yuanjiang's industrial development.

Financial Profile

Balance Sheet Structure and Quality

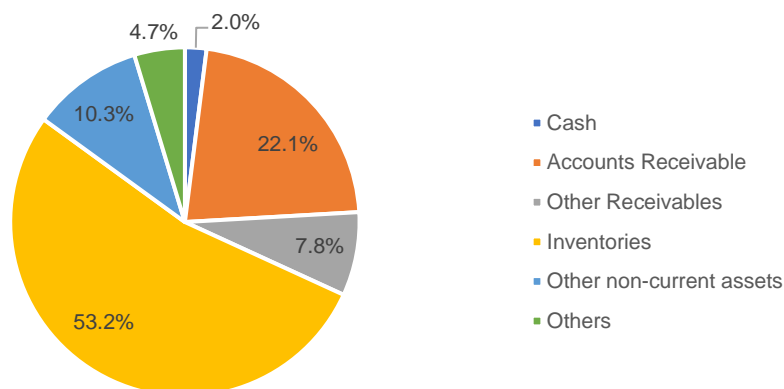
Balance Sheet Structure and Quality			
(RMB million)	2020	2021	2022
Total Asset	16,127	18,284	21,361
Equity	6,987	7,850	9,590
Debt	7,044	7,435	8,448
Debt / (Debt + Equity) (%)	50.2	48.6	46.8
LT Debt	4,818	4,657	5,859
LT Debt / (LT Debt + Equity) (%)	40.8	37.2	37.9

Source: Company Information and Lianhe Global's calculations

HYQI's total asset grew steadily to RMB21.4 billion at end-2022 from RMB16.1 billion at end-2020, representing a CAGR of 15.1%. The company relied on both capital injections and borrowings to fund its asset expansion. HYQI received multiple capital injections in recent years, enlarging its paid-in capital and capital reserve to RMB1.1 billion and RMB7.1 billion at end-2022 from RMB340 million and RMB5.5 billion, respectively. Over the same period, the company's total debt increased to RMB8.4 billion from 7.0 billion. Its financial leverage, as measured by debt/capitalization, stayed at a manageable level of 46.8% at end-2022.

Asset Breakdown

(Total assets: RMB21.4 billion at end-2022)



Source: The company and Lianhe Global's calculation

HYQI's asset liquidity and asset quality were moderately weak. At end-2022, inventories, mainly consisting of construction costs (c. RMB5.5 billion) and lands use rights (c. RMB3.0 billion), contributed 53.2% to HYQI's total asset. The former was primarily generated by the company's project construction activities, while the latter was mainly injected by the local government. At the same time, the company's construction activities accumulated sizeable account receivables, amounting to RMB4.7 billion and representing 22.1% of the company's total assets. We expect these project-related assets usually take a long time to monetize due to the protracted construction, delivery and payment collection period. The realizability of HYQI's inventory lands is also subject to the local government's planning and property market conditions.

In 2022, the local government transferred a large part of the payment obligations for HYQI's account receivables from Finance Bureau of Yuanjiang to other local SOEs. The local government may also use non-cash assets to settle the account receivables. These could further weaken the liquidity and quality of HYQI's assets. In addition, other accounts receivable, which were primarily due from government agencies and other LIDCs in Yuanjiang without a specified repayment schedule, accounted for 10.3% of HYQI's total asset. HYQI's other non-current assets mainly comprised concession rights of sand and gravel sales, which have generated considerable income for the company in recent years.

Debt Servicing Capability

HYQI's liquidity was tight. At end-2022, the company had a cash balance of RMB426 million, compared with its short-term debt of RMB2.6 billion. The company has access to multiple financing channels, such as bank borrowings, bond issuances and other non-traditional financings. At end-2022, the company has unused credit lines of RMB1.2 billion and an available bond issuance quota of RMB250 million. Still, rolling over its short-term bank borrowings (c. RMB560 million at end-2022) and receiving timely cash payment and support from the local government is essential for HYQI to maintain its liquidity.

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