Luoyang Guosheng Investment Holding Co., Ltd.

Initial Issuer Report

Summary	
Issuer Rating	A-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	19 July 2023

Key Figures of Luoyang and LYGI

(RMB billion)	2021	2022
Luoyang		
GDP	538.4	567.5
GDP growth rate (%)	4.5	3.0
Budgetary revenue	39.8	39.8
Government fund	26.3	15.6
Transfer payment	30.7	31.0
Budgetary expenditure	64.2	62.3
LYGI		
Asset	183.3	191.3
Equity	76.9	73.8
Revenue	14.1	14.1

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

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

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'A-' global scale Long-term Issuer Credit Rating with Stable Outlook to Luoyang Guosheng Investment Holding Co., Ltd. ("LYGI" or "the company")

Summary

The Issuer Credit Rating reflects a high possibility that the People's Government of Luoyang City ("Luoyang government") would provide very strong support to LYGI if needed, in light of its full ownership of LYGI, the strategic importance of LYGI as the flagship LIDC responsible for infrastructure investment, affordable houses, and other city development and operation functions in Luoyang, and the linkage between the Luoyang government and LYGI, including management appointment, supervision over LYGI's strategic development, major investment and financing plans, strategic alignment and ongoing operational and financial support. In addition, the Luoyang government may face significant negative impact on its reputation and financing activities if LYGI encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that LYGI's strategic importance would remain intact while the Luoyang government will continue to ensure LYGI's stable Operation.

Rating Rationale

Government's Ownership and Supervision: The Luoyang government holds 100% ownership of LYGI through State-owned Assets Supervision and Administration Commission of Luoyang Municipal People's Government ("Luoyang SASAC"). The Luoyang government has strong control over LYGI, 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 to Luoyang and Strategic Alignment: In 2021, the Luoyang government initiated a state-owned enterprises consolidation and reconstruction, aiming to make LYGI the flagship LIDC responsible for infrastructure investment, affordable houses, and other city development and operation functions in Luoyang. As the largest and the most important LIDC in Luoyang, LYGI's business operation has been aligned with the local government's development plans.

Ongoing Government Support: LYGI has received ongoing support from the Luoyang government, including capital and assets injection, operational subsidies, etc. The company received capital injections of RMB19.3 billion in the past three years. The injected assets mainly included cash, state-owned enterprises' equity, state-owned properties, fixed assets, etc. Over the same period, the Luoyang government also provides operational subsidies of c. RMB2.0 billion to support LYGI's operations in relation to providing public services. We expect LYGI to receive strong support from the Luoyang government in the future in light of its strategic importance.

Economy and Fiscal Strength of Luoyang: Luoyang realized an aggregate GDP of RMB567.5 billion in 2022 and was ranked 2nd among 17 prefecture-level cities in Henan.

However, its GDP growth rate fluctuated in the past three years, which was 3.0%, 4.5% and 3.0% in 2020, 2021 and 2022, respectively. As an important industrial city in the central region of China, Luoyang has developed five leading industries, namely advanced equipment manufacturing, new materials, high-end petrochemicals, IT and tourism in recent years.

The Luoyang government's aggregate fiscal revenue demonstrated a downward trend between 2020 and 2022. This was due to the significant drop in the government fund income, mainly generated by the land-use right concession, amid the property downturn. Nevertheless, the Luoyang government's budgetary revenue was largely stable over the same period. Its fiscal self-sufficiency rate was moderately low but improved, with a budget deficit of -58.2% in 2022, narrowing from 68.9% in 2020.

The outstanding debt of the Luoyang government continued to grow in the past three years, mainly due to the large new issuance of special debts to support the development of transportation, shanty town renovation and healthcare projects, rising its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue.

LYGI's Financial Matrix and Liquidity Position: LYGI's total asset grew steadily to RMB196.6 billion at end-March 2023 from RMB157.8 billion at end-2020, mainly due to the company's active participation in Luoyang's project construction and equity investment. The company relied on both borrowings and capital injections from the local government to fund its asset expansion, lifting its total debt and financial leverage (measured by debt/capitalization). LYGI's liquidity was moderate. Its cash coverage to short-term debts was relatively low at end-March 2023. Nevertheless, the company has access to multiple financing channels, including bank borrowing, bond issuance, and non-traditional financing, with sufficient unused credit lines.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Luoyang

Luoyang is a prefecture-level city in the western part of Henan. It is one of the first national historical and cultural cities announced by the State Council, a national regional center city, and a sub-center city in the Central Plains City Cluster. Luoyang has jurisdiction over seven counties and seven districts, with a total area of 15,200 square kilometers. Besides, two national-level and eleven provincial-level economic development zones are located in Luoyang. By end-2022, Luoyang had a resident population of 7.1 million, with an urbanization rate of 66.5%. As an important industrial city in the central region of China, Luoyang has developed five leading industries in recent years: advanced equipment manufacturing, new materials, high-end petrochemicals, IT and tourism.

Luoyang realized an aggregate GDP of RMB567.5 billion in 2022 and was ranked 2nd among 17 prefecture-level cities in Henan. However, its GDP growth rate fluctuated in the past three years, which was 3.0%, 4.5% and 3.0% in 2020, 2021 and 2022, respectively. Luoyang's economic growth was mainly fueled by the secondary and tertiary industries, which accounted for 43.6% and 51.9% in 2022, respectively.

Luoyang's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	512.8	538.4	567.5
-Primary industry (%)	5.0	4.8	4.5
-Secondary industry (%)	44.4	43.1	43.6
-Tertiary industry (%)	50.6	52.1	51.9
GDP growth rate (%)	3.0	4.5	3.0
Fixed asset investment growth rate (%)	5.9	-6.5	2.4
Population (million)	7.1	7.1	7.1

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Luoyang

The Luoyang government's aggregate fiscal revenue demonstrated a downward trend between 2020 and 2022. This was due to the significant drop in the government fund income, mainly generated by the land-use right concession, amid the property downturn. Nevertheless, its budgetary revenue and transfer payments received from higher governments were largely stable over the same period, and the tax revenue accounted for c. 65% of its budgetary revenue. The Luoyang government's fiscal self-sufficiency rate was moderately low but improved, with a budget deficit of -58.2% in 2022, narrowing from -68.9% in 2020.

The outstanding debt of the Luoyang government continued to grow in the past three years. At end-2022, the Luoyang government's outstanding debt was RMB77.5 billion, representing a year-over-year growth rate of 23.1%, mainly due to the large new issuance of special debts to support the development of transportation, shanty town renovation and healthcare projects. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 89.4% at end-2022 from 65.0% at end-2021.

Luoyang's Fiscal Condition

(RMB billion)	2020	2021	2022
Budgetary revenue	38.4	39.8	39.5
Budgetary revenue growth rate (%)	3.8	4.8	3.0*
Tax revenue	24.9	25.8	25.8
Tax revenue (% of budgetary revenue)	64.8	64.8	64.9
Government fund income	32.3	26.3	15.6
Transfer payment	35.6	30.7	31.0
Aggregate revenue	106.4	97.0	86.7
Budgetary expenditure	68.9	64.2	62.3
Budget deficit[1] (%)	-79.5	-61.3	-58.2

*[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 and Profile

Government's Full Ownership

LYGI, formerly known as Luoyang Administrative Business Asset Operation Co., Ltd., was established in November 2007 with an initial registered capital of RMB30 million, funded by Luoyang Finance Bureau. In December 2008, Luoyang Finance Bureau transferred its 100.0% holding of the LYGI to Luoyang Urban Development Investment Group Co., Ltd. ("LUDIG"), a major LIDC focusing on infrastructure construction in Luoyang.

In 2021, the Luoyang government initiated a state-owned enterprises consolidation and reconstruction, aiming to make LYGI the flagship LIDC responsible aiming to make LYGI the flagship LIDC that is responsible for infrastructure investment, affordable houses, and other city development and operation functions in Luoyang.

After the consolidation, LYGI has been 100% owned by Luoyang SASAC, controlling major LIDCs and SOEs, including LUDIG, Luoyang Urban and Rural Construction and Investment Co., Ltd., Luoyang Hongyi Public Utility Investment Development Group Co., Ltd., and Luoyang Nonferrous Mining Group Co., Ltd. ("LNMG"). The company has strong control over its subsidiaries, including centralized financial management.

At end-2022, LYGI's registered and paid-in capital both was RMB20 billion.

Strategic Importance and Government Linkage

Strategic Importance of LYGI to Luoyang

LYGI is the flagship LIDC responsible for infrastructure investment, affordable houses, and other city development and operation functions in Luoyang. As the largest and the most important LIDC in Luoyang, LYGI's business operation has been aligned with the local government's development plans.

Linkage with the Local Government

LYGI's linkage with the local government is strong as the Luoyang government holds a 100% stake in LYGI through Luoyang SASAC. The Luoyang government has strong supervision over LYGI, 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

LYGI has received ongoing support from the Luoyang government, including capital and assets injection, operational subsidies, etc. The company received capital injections of RMB9.6 billion and RMB9.7 billion in 2020 and 2021, respectively. The injected assets mainly included cash, state-owned enterprises' equity, state-owned properties, fixed assets, etc. However, the Luoyang government transferred the 60% equity of Luoyang Transportation Construction and Investment Co., Ltd., a major transportation development entity, to another LIDC in Luoyang in 2022 amid the state-owned enterprise's reconstruction in Luoyang.

The Luoyang government also provides operational subsidies of RMB676 million, 806 million and 558 million in 2020, 2021 and 2022, respectively, to support LYGI's operations in relation to providing public services. We expect LYGI to receive strong support from the Luoyang government in the future in light of its strategic importance.

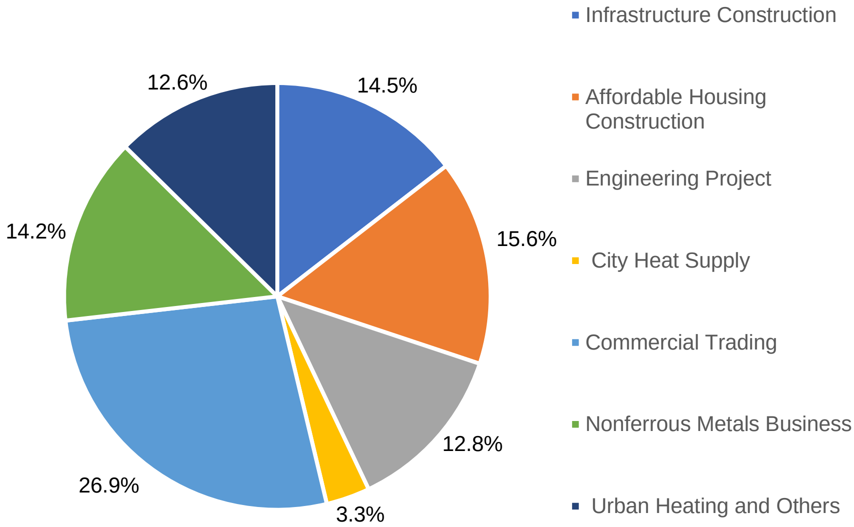
Business Profile

The Flagship LIDC Responsible for Infrastructure Investment, Affordable Houses, and other City Development and Operation Functions in Luoyang

LYGI is the most important infrastructure investment and construction entity in Luoyang. The company's strong franchise advantage enables it to undertake key projects designated by the Luoyang government. LYGI also involves utilities in Luoyang, such as heat supply and heat supply-related projects. In addition, LYGI has diversified into trading, nonferrous metals and other businesses. LYGI company realized revenue of RMB9.7 billion, RMB14.1 billion and RMB14.1 billion in 2020, 2021 and 2022, respectively, with gross margin fluctuating between 10%-18%.

Revenue Breakdown

(Total revenue: RMB14.1 billion in 2022)



Source: The company and Lianhe Global's Calculation

Infrastructure and Affordable Housing Construction

The local government designated LYGI to undertake an array of key projects, including city infrastructures, affordable housing, shantytown renovation, land consolidation, public facilities, schools, hospitals and roads., etc., in Luoyang. These projects were primarily conducted under the agent construction agreements signed with different government agencies of Luoyang. The company is usually responsible for fundraising and constructing entrusted projects, then recognizes construction costs incurred plus a certain percentage of profit as revenue based on project progress. Yet the cash collection schedule may be subject to the fiscal conditions of the local government. LYGI also undertakes a self-operated project, Luoyang Olympic Center, which relies on commercial operation to cover construction costs and generate returns. LYGI has an extensive project pipeline supporting the segment's development in the next two to three years, yet it could incur high capital expenditure pressure.

Heat Supply and Engineering Projects

LYGI supplies heat to residential and commercial users in major urban areas of Luoyang. The company purchases heat from thermal power plants and delivers it to end-users through its self-owned heat supply network and heating stations. The segment usually generates negative gross margin and relies on government subsidies to support the operation. Nevertheless, it enhances LYGI's importance in Luoyang, given that the heat supply is an essential public utility for a northern city. The company also engages in heat supply related-engineering projects like heat supply networks and heating equipment installation. In addition, LYGI participates in other engineering projects, such as landscaping and Water engineering.

Nonferrous Metals Business and Commercial Trading

The nonferrous metals business was operated by LYGI's subsidiary, LNMG, which is mainly engaged in mineral resources mining, smelting, investment management and deep processing, and the sale of mineral products. LNMM owns four mines with related processing facilities in Luoyang.

LYGI also engages in the trading of steel, cement, molybdenum and petroleum products. The trading segment diversifies the company's business profile. It generated revenue of RMB2.6 billion, RMB2.7 billion and RMB3.8 billion in 2020, 2021 and 2022, respectively, representing an upward trend and becoming an important revenue source for LYGI. However, the segment's gross profit margin was relatively low (2022:2.6%). Moreover, the suppliers and customers of the segment are highly concentrated, and most of them are private enterprises. The company mainly adopts cash settlements to mitigate counterparty risks.

Other Businesses

Other businesses of LYGI mainly include property development and muck transportation, with each segment accounting for a relatively small proportion of the company's total revenue.

Financial Profile

Balance Sheet Structure and Quality

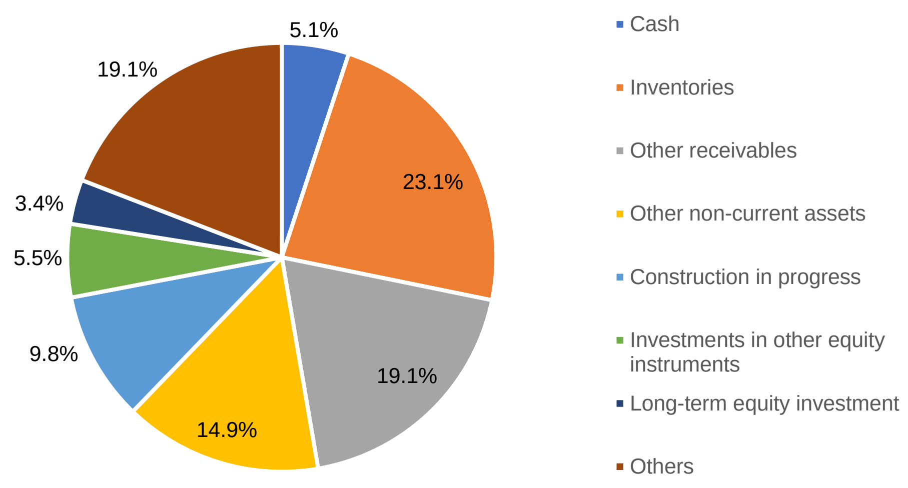
Balance Sheet Structure and Quality

(RMB million)	2020	2021	2022	March 2023	March 2023 (Adjusted)
Total Asset	157,863	183,317	191,271	196,595	196,595
Equity	65,387	76,905	73,755	74,413	74,277
Debt	78,950	92,962	99,308	105,360	105,496
Debt / (Debt + Equity) (%)	54.7	54.7	57.4	58.6	58.7
LT Debt	47,818	54,514	51,842	63,481	63,617
LT Debt / (LT Debt + Equity) (%)	42.2	41.5	41.3	46.0	46.1

*Note:*Adjusted numbers and ratios reflect disguised debts reallocating long-term debts and total debts from equity*
Source: Company Information and Lianhe Global's calculations

LYGI's total asset grew steadily to RMB196.6 billion at end-March 2023 from RMB157.8 billion at end-2020, mainly due to the company's active participation in Luoyang's project construction and equity investment. The company relied on both borrowings and capital injections from the local government to fund its asset expansion. The company's total debt increased by 33.5% to RMB105.4 billion at end-March 2023 from RMB79.0 billion at end-2020. The company received a net capital injection of RMB12.7 billion between 2020 and 2022, including cash, state-owned enterprises' equity, state-owned properties, fixed assets, etc. At end-March 2023, LYGI's financial leverage, as measured by debt/capitalization, reached 58.6% (58.7% after adjusting disguised debts reallocating long-term debts and total debts from equity), up from 54.7% at end-2020.

Asset Breakdown
(Total asset: RMB196.6 billion at end-March 2023)



Source: The company and Lianhe Global's calculation

LYGI's asset liquidity and asset quality were moderately weak. The company's project construction activities accumulated sizeable inventories (mainly lands and construction costs) and construction in progress, amounting to RMB45.5 billion and RMB19.2 billion, and representing 23.1% and 9.8% of LYGI's total asset, respectively, at end-March 2023. These assets usually take a long time to monetize due to the protracted construction and payment collection period. At the same time, LYGI had other non-current assets of RMB29.4 billion, mainly infrastructure projects, land development and water conservancy projects. Some of them were public interest assets. In addition, other accounts receivable, which were primarily due from government agencies and other LIDCs in Luoyang, accounted for 17.6% of LYGI's total asset. The age of a part of other accounts receivable is as long as five years, and the repayment is far behind schedule.

Debt Servicing Capability

LYGI's liquidity was moderately tight. At end-March 2023, the company had a cash balance of RMB9.9 billion, compared with its short-term debt of RMB41.9 billion. Nevertheless, the company has access to multiple financing channels, including bank borrowing, bond issuance, and non-traditional financing. At end-March 2023, the company had unused credit lines of RMB66.3 billion.

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