

Heshan Public Asset Management Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	2 August 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Heshan Public Asset Management Co., Ltd. (“HPAM” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Heshan City, Guangdong Province (“Heshan government”) would provide strong support to HPAM if needed, in light of its full ownership of HPAM, HPAM’s strategic importance as the key local investment and development company (“LIDC”) that is responsible for infrastructure construction and state-owned asset operation in Heshan City, Jiangmen City (“Heshan”), and the linkage between the Heshan government and HPAM, 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 Heshan government may face significant negative impact on its reputation and financing activities if HPAM encounters any operational and financial difficulties.

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

Rating Rationale

Heshan Government’s Ownership and Supervision: The Heshan government indirectly holds the full ownership of HPAM through the Heshan Asset Management Committee Office (“HAMCO”), via Heshan Assets Management Co., Ltd (“HAM”). The Heshan government is the actual controller of the company. It 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, the Heshan government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Heshan and Strategic Alignment: HPAM, as the key LIDC in Heshan, is primarily responsible for infrastructure construction and state-owned asset management within the region. Serving as the key entity in charge of infrastructure projects in major regions of the city, HPAM focuses on constructing municipal roads and engineering projects. In addition, the company is also responsible for the land development, industrial platform construction, renovation projects, sewage treatment and other state-owned asset management and operation business within Heshan, with strong regional advantages. HPAM 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: HPAM received operational and financial support from the government. HPAM received a total subsidy amount of c. RMB287.9 million from 2020 to 2022, mainly including operating subsidies. The Heshan government continued to inject capitals, equities, land and other assets into HPAM to expand its asset size. Besides, the Heshan government will repurchase some infrastructure projects and provide policy supports to HPAM to ensure its business operation. Given it is the key entity for infrastructure construction and land development in Heshan, HPAM has an advantage in acquiring land

Key Figures of Heshan and HPAM (RMB billion)

	2021	2022
Heshan		
GDP	44.1	45.9
GDP growth rate (%)	9.7	2.8
Budgetary revenue	3.7	3.6
Government fund	2.2	1.7
Transfer payment	1.4	1.4
Budgetary expenditure	5.0	4.9
HPAM		
Assets	19.4	20.4
Equity	10.4	10.5
Revenue	0.9	0.9

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

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Applicable Criteria

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

resources and major projects. We believe HPAM is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

HPAM's Financial Matrix and Liquidity Position: HPAM's total assets showed a continuous growth trend in the past years and reached RMB20.4 billion at end-2022, mainly due to the inventories and other receivables, which have steadily increased in tandem with the company's infrastructure construction projects. The non-current assets of HPAM accounted for c. 51.9% of the total assets at end-2022, and the overall assets were less liquid. HPAM's financial leverage (total liabilities to total assets) was 48.4% and its adjusted debt increased to c. RMB8.3 billion at end-2022. The liquidity of HPAM was tight. HPAM had an unrestricted cash balance and unused credit facilities of c. RMB468 million and RMB778 million at end-2022, respectively, compared with its debt due within one year of c. RMB2.7 billion. Having said that, HPAM has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

Economy and Fiscal Condition of Heshan: Heshan is a county-level city of Guangdong Province and managed by Jiangmen City, with a total land area of c. 1,083 square kilometers. Heshan recorded an economic growth in 2022, achieving a GDP of c. RMB45.9 billion, with a year-on-year growth of 2.8%. Its GDP scale was ranked 4th among all districts and counties of Jiangmen in 2022. The aggregate fiscal revenue of the Heshan government was mainly derived from the budgetary revenue and government fund income. The Heshan government's budgetary revenue decreased to c. RMB3.6 billion in 2022 from c. RMB3.7 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. At the same time, the government fund income dropped to c. RMB1.7 billion in 2022 from c. RMB2.2 billion in 2021, owing to the weak property market. The budget deficit of the Heshan government was c. 37% at end-2022, while the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Heshan government increased to 136.9% at end-2022 from 60.8% at end-2020.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Heshan

Heshan is a county-level city directly under the jurisdiction of Guangdong Province and managed by Jiangmen City on behalf of Guangdong Province. As the bridge connecting the Guangdong-Hong Kong-Macao Greater Bay Area with the western part of Guangdong Province, Heshan has convenient waterway transportation, including a 3,000-ton national Class I port and the 17-kilometer Xijiang Golden Waterway. Heshan has jurisdiction over 9 towns and 1 street, with a total area of 1,083 square kilometers. At end-2022, Heshan had a resident population of c. 0.5 million, with an urbanization rate of 63.5%.

Heshan's GDP growth rate fluctuated in the past three years, which was 3.2%, 9.7% and 2.8% in 2020, 2021 and 2022, respectively. Heshan's GDP reached c. RMB45.9 billion in 2022, ranked the 4th among all districts and counties of Jiangmen. Heshan's economic growth was mainly fueled by the secondary and tertiary industries in the past few years, which accounted for 52.5% and 39.6% in 2022, respectively. Its economic development focused on information technology, new materials, high-end equipment manufacturing, printing and packaging industry in recent years.

Heshan's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	37.5	44.1	45.9
-Primary industry (%)	8.3	7.2	7.9
-Secondary industry (%)	46.8	50.6	52.5
-Tertiary industry (%)	44.9	42.2	39.6
GDP growth rate (%)	3.2	9.7	2.8
Fixed asset investment	30.0	29.5	29.1
Fixed asset investment growth rate (%)	8.1	6.2	5.0
Population (million)	0.5	0.5	0.5

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Heshan

The Heshan government's aggregate fiscal revenues are mainly derived from budgetary revenue and government fund income. The Heshan government achieved a budgetary revenue of c. RMB3.6 billion in 2022, with the tax revenue accounted for 53.8% of its budgetary revenue. Its budgetary expenditure decreased by 1.3%, to c. RMB4.9 billion in 2022. Heshan's fiscal self-sufficiency remained weak, with budget deficits reaching -31.1%, -35.6% and -37.0% in 2020, 2021 and 2022, respectively. In addition, Heshan's government fund income, mainly generated by land sales, dropped by 24.4% to c. RMB1.7 billion in 2022, owing to the weak property market.

The outstanding debt of the Heshan government continued to grow. At end-2022, the Heshan government's outstanding debt was c. RMB9.2 billion, including RMB2.1 billion of general obligations and RMB7.1 billion of special purpose debt. Given the Heshan government borrowed heavily in special purpose debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 136.9% at end-2022 from 60.8% at end-2020.

Heshan's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	3.4	3.7	3.6
Budgetary revenue growth rate (%)	5.1	8.0	-2.1
Tax revenue	2.2	2.3	1.9
Tax revenue (% of budgetary revenue)	64.1	64.0	53.8
Government fund income	1.6	2.2	1.7
Transfer payment	1.3	1.4	1.4
Aggregate revenue	6.3	7.3	6.7
Budgetary expenditure	4.4	5.0	4.9
Budget deficit ¹ (%)	-31.1	-35.6	-37.0

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

HPAM was established in November 2002 with an initial registered capital of RMB3 million, funded by HAM. After several capital increases and expansions, at end-2022, both the registered and paid-in capital of the company were RMB100 million. HPAM had a shareholding structure in which HAM, as the sole controlling shareholder, held 100% of the company's equity. The actual controller of the company is HAMCO.

Strategic Importance and Government Linkage

Strategic Importance of HPAM to Heshan

HPAM, as the key LIDC in Heshan, is primarily responsible for infrastructure construction and state-owned asset management within the region. Serving as the key entity in charge of infrastructure projects in certain regions of the city, HPAM focuses on constructing municipal roads and engineering projects. In addition, the company is also responsible for the land development, industrial platform construction, renovation projects, sewage treatment and other state-owned asset management and operation business within Heshan, with strong regional advantages. HPAM 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

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

Government Support

HPAM continued to receive financial subsidies, mainly including operating subsidies (such as urban public facility construction targeted subsidies, urban public utilities subsidies, sewage treatment subsidies and tax breaks), from the local government to maintain its business operation. HPAM received subsidies of c. RMB19.8 million, RMB139.3 million, and RMB128.8 million in 2020, 2021 and 2022, respectively. Besides, the Heshan government injected some real estate assets, land assets and government investment projects, as well as all shares of three local companies to the company in 2020, amounted to RMB300.4 million. The government will repurchase some infrastructure projects constructed by HPAM, purchase land resources developed by HPAM, and provide policy supports to ensure its business operation. Given it is the key entity for infrastructure construction and land development in Heshan, HPAM has an advantage in acquiring land resources and major projects. We believe HPAM is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

Business Profile

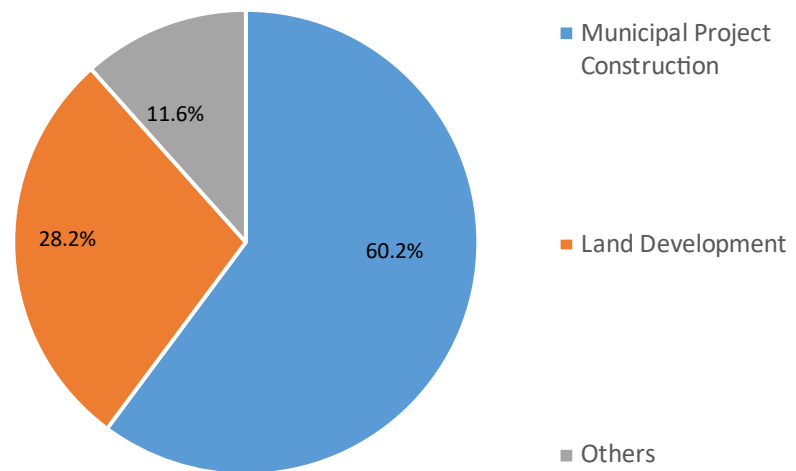
The Key Entity Responsible for Infrastructure Construction in Heshan

HPAM, as an important LIDC in Heshan, is mainly responsible for urban infrastructure construction, land development and other businesses. The company's strong franchise advantage enables it to undertake important infrastructure construction projects under the instruction of the Heshan government.

The primary sources of operating revenue for HPAM are municipal project construction and land consolidation, while it also engaged in housing rental, sanitation services, car sales and sewage, etc. The company's total revenue reached c. RMB1.0 billion, RMB0.9 billion and RMB0.9 billion in 2020, 2021 and 2022, respectively, representing a steady trend. The overall gross profit margin of HPAM remained stable at c. 16%-20% from 2020 to 2022. In general, HPAM's business was relatively concentrated, and it has regional advantages in its major businesses.

Revenue Breakdown

(Total revenue:c. RMB0.9 billion in 2022)



Source: The company and Lianhe Global's Calculation

Municipal Project Construction

HPAM is designated by the Heshan government to undertake municipal project construction within the region. The company's monopoly on infrastructure construction in Heshan gives it a strong franchise advantage in the region. 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. Its revenue in this segment was relatively stable over the past years, with c. RMB0.5 billion, RMB0.6 billion and RMB0.6 billion in 2020, 2021 and 2022, respectively. The gross margin in this segment was relatively

stable, with 12%-13% between 2020 and 2022. Currently, the company's projects under construction and to be constructed still require a large scale of investment, thus it incurs high pressure on capital expenditure.

Land Development

The Heshan government entrusts HPAM to undertake land consolidation and development, including housing demolition, land acquisition and compensation, etc. HPAM signs the land development agreement with the Heshan government and other government agencies. The entrusted party will repurchase the land parcel with investment cost plus a certain percentage of profit when the entrusted land parcels are sold. HPAM realized land development income of c. RMB0.4 billion, RMB0.1 billion and RMB0.3 billion in 2020, 2021 and 2022, respectively, with a gross profit margin of c.12%-20%.

Other Businesses

Other businesses of HPAM include housing rental, sanitation services, car sales and sewage treatment, 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

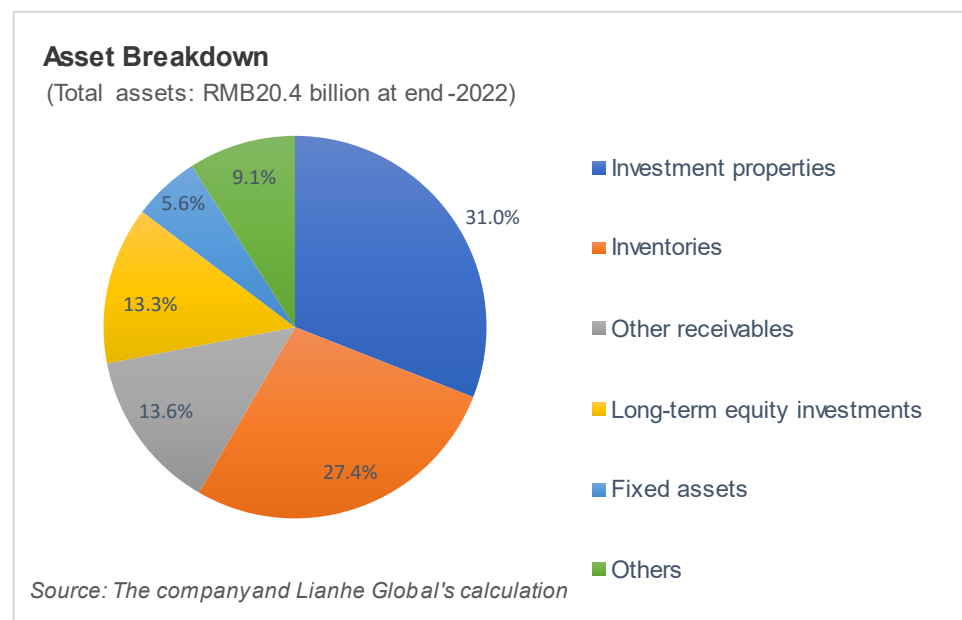
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality			
(RMB million)	2020	2021	2022
Total Asset	17,308	19,354	20,431
Equity	10,327	10,412	10,535
Debt	5,407	7,349	8,329
Debt / (Debt + Equity) (%)	34.4	41.4	44.2
LT Debt	4,464	5,722	5,618
LT Debt / (LT Debt + Equity) (%)	30.2	35.5	34.8

Source: Company information and Lianhe Global's calculations

HPAM's total assets showed a continuous growth in the past few years, with a growth rate of 11.8% and 5.6% at end-2021 and end-2022, respectively, and reached RMB20.4 billion at end-2022. The increase of HPAM's total assets was largely due to the inventories and other receivables, which have steadily increased in tandem with the company's infrastructure construction projects. HPAM's assets mainly consisted of investment properties, inventories, other receivables, long-term equity investments and fixed assets. Investment properties primarily consisted of houses and buildings used for self-operating business, and land acquired through government allocation, acquisition and auction. Inventories mainly included land use rights and project development costs associated with HPAM's infrastructure construction business. Other receivables mainly pertained to interchanges of funds with government agencies and cooperative enterprises within Heshan, with moderate concentration of indebted party, controllable counterparty risk and low bad debt provision. Additionally, all of the HPAM's other receivables were relatively recent, with an aging period of within 2 years. Long-term equity investments were investment in subsidiaries and joint ventures, where the investment in a property management company represented a significant portion of the portfolio, especially following the land transfer from the government to the company in 2020, amounting to RMB2.4 billion. HPAM witnessed

growth in both its current assets and non-current assets in the past three years. The proportion current assets in the total assets experienced slight growth in the past three years, reached 48.1% at end-2022. Having said that, the company's assets were relatively illiquid, primarily due to the significant proportion of investment properties and costs associated with construction projects.



HPAM's financial leverage (total liabilities to assets) reached 40.3%, 46.2% and 48.4% at end-2020, end-2021 and end-2022, respectively, representing an increasing trend. Given the relevant guidelines of the Heshan government, we expect the leverage of HPAM to maintain at this level in the future. HPAM's total adjusted debt increased from c. RMB5.4 billion at end-2020 to c. RMB8.3 billion at end-2022, with short-term debt accounting for c. 32.6% of the total debt. There was no significant change in the ownership equity structure of HPAM at end-2022, compared with that at end-2020. HPAM mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure related projects under construction and to be constructed in the future.

Debt Servicing Capability

The liquidity of HPAM was tight. HPAM had an unrestricted cash balance and unused credit facilities of c. RMB468 million and RMB778 million at end-2022, respectively, compared with its debt due within one year of c. RMB2.7 billion. Having said that, HPAM 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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