

Ningxiang Water Construction and Investment Co., Ltd.

Initial Issuer Report

Summary

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

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Ningxiang Water Construction and Investment Co., Ltd. (“NWCI” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Ningxiang City, Changsha City (“Ningxiang government”) would provide moderate strong support to NWCI if needed, in light of its indirect full ownership of NWCI, NWCI’s strategic importance as the key local investment and development company (“LIDC”) that is responsible for water-related infrastructure construction and operation, water supply, and utilization of water resources in Ningxiang City, Changsha City (“Ningxiang”), and the linkage between the Ningxiang government and NWCI, 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 Ningxiang government may face negative impact on its reputation and financing activities if NWCI encounters any operational and financial difficulties.

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

Rating Rationale

Ningxiang Government’s Ownership and Supervision: The Ningxiang government holds the full ownership of NWCI through Ningxiang City Development Investment Holding Group Co. Ltd. (“NCDI”). The Ningxiang 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 Ningxiang government has assessment mechanism over the company and appoints auditors to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Ningxiang and Strategic Alignment: NWCI, as the key LIDC in Ningxiang, is primarily responsible for the investment, development and operation of water-related infrastructure projects within the region. Serving as the sole entity in charge of water related resource management throughout the entire city, NWCI also focuses on production and supply of tap water, water pollution control and sewage treatment, as well as development and utilization of hydroelectric energy in Ningxiang with strong regional advantages. NWCI 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: NWCI received operational and financial support from the government. NWCI received a total subsidy amount of RMB105.8 million from 2020 to the first six months of 2023. The Ningxiang government continued to inject capital, pipeline network assets, sand and gravel resources and other assets into NWCI to expand its asset size, totaling to RMB8.4 billion from 2020 to the first six months of 2023. Besides, the Ningxiang government will repurchase some water-related infrastructure projects and provide policy supports to NWCI to ensure its business operation. Given that it is the key

Key Figures of Ningxiang and NWCI

(RMB billion)	2021	2022
Ningxiang		
GDP	116.7	122.7
GDP growth rate (%)	7.3	4.7
Budgetary revenue	7.3	7.9
Government fund	16.1	14.5
Transfer payment	4.0	4.3
Budgetary expenditure	12.1	13.1
NWCI	2022	2023.6
Assets	13.6	17.4
Equity	10.7	10.8
Revenue	0.6	0.4

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

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Applicable Criteria

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

entity for water-related infrastructure construction and operation in Ningxiang, NWCI has an advantage in acquiring related resources and major projects. We believe NWCI is likely going to receive government support to support its daily business operation.

NWCI's Financial Matrix and Liquidity Position: NWCI's total assets showed a continuous growth trend in the past years and reached RMB17.4 billion at end-June 2023, mainly due to the increase of other account receivables. The non-current assets of NWCI accounted for 64.2% of the total assets at end-June 2023, and the overall asset liquidity was moderately weak. NWCI's financial leverage (total liabilities to total assets) was 38% and its adjusted debt increased to RMB5.7 billion at end-June 2023 from RMB1.3 billion at end-2021. The liquidity of NWCI was sufficient. NWCI had a cash balance and unused credit facilities of RMB630.3 million and RMB3.2 billion at end-June 2023, respectively, compared with its debt due within one year of RMB2.0 billion. Besides, NWCI 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 Ningxiang: Ningxiang is a county-level city located in the west of Changsha City, Hunan Province ("Changsha"), with a total land area of 2,906 square kilometers. Ningxiang recorded an economic growth in 2022, achieving a GDP of RMB122.7 billion, with a year-on-year growth of 4.7%. Its GDP scale was ranked 7th among all districts and counties under the jurisdiction of Changsha in 2022. The aggregate fiscal revenue of the Ningxiang government was mainly derived from the budgetary revenue and government fund income.

The Ningxiang government's budgetary revenue increased to RMB7.9 billion in 2022 from RMB6.1 billion in 2020, with tax revenue accounting for 75.6%-77.5% of budgetary revenue. At the same time, the government fund income dropped to RMB14.5 billion in 2022 from RMB16.1 billion in 2021, owing to the weak property market. The budget deficit of the Ningxiang government was 65% at end-2022, while the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Ningxiang government increased to 76.4% at end-2022 (2021: 63.4%). The special purpose debt constituted a high proportion of the total debt.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Ningxiang

Ningxiang is a county-level city of Changsha City, Hunan Province ("Changsha"), and is located in the west of Changsha. Ningxiang is a picturesque city with many national scenic towns and eco-villages. Besides, Ningxiang is also a vital production site for commercial foodstuff and farm produce. Ningxiang has a total land area of c. 2,906 square kilometers. The residential population of Ningxiang was around 1.3 million and the urbanization rate was 61.1% at end-2021.

Ningxiang's economic growth fluctuated in the past three years, and its GDP growth rate was 4.7% in 2022. The GDP amount of Ningxiang reached c. RMB122.7 billion in 2022, ranked 7th among districts and counties under the jurisdiction of Changsha. The economy was mainly fueled by the secondary and tertiary industries, which accounted for 42.7% and 46.0% of GDP in 2022, respectively. The GDP per capita of Ningxiang was RMB96,353 in 2022, which was lower than that of Changsha (RMB136,397) but higher than that of China (RMB85,698).

Ningxiang's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	110.6	116.7	122.7
-Primary industry (%)	11.9	11.3	11.3
-Secondary industry (%)	42.2	42.2	42.7
-Tertiary industry (%)	45.9	46.5	46.0
GDP growth rate (%)	2.7	7.3	4.7
Fixed asset investment	135.9	147.2	148.7
Fixed asset investment growth rate (%)	4.0	8.3	1.0
Population (million)	1.3	1.3	1.3

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Ningxiang

The aggregate fiscal revenue of the Ningxiang government was mainly derived from budgetary revenue and government fund income. From 2020 to 2022, Ningxiang government's budgetary revenue increased from c. RMB6.1 billion to c. RMB7.9 billion, with tax revenue accounting for 75.6%-77.5% of budgetary revenue. The financial self-sufficiency rate of Ningxiang was insufficient and the budget deficit rate reached 65.0% in 2022. The government fund income decreased from RMB16.1 billion in 2021 to RMB14.5 billion in 2022, but remained the major source of aggregate fiscal revenue.

The outstanding amount of the Ningxiang government's debt was RMB20.4 billion at end-2022, of which the general obligations and special debt was RMB5.2 billion and RMB15.2 billion, respectively. The debt ratio, measured as total government debt/aggregate revenue, was lifted to 76.4% in 2022 from 63.4% in 2021, mainly due to the increase in special debt.

Ningxiang's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	6.1	7.3	7.9
Budgetary revenue growth rate (%)	1.0	19.0	8.6
Tax revenue	4.7	5.6	6.0
Tax revenue (% of budgetary revenue)	77.5	77.0	75.6
Government fund income	11.6	16.1	14.5
Transfer payment	4.5	4.0	4.3
Aggregate revenue	22.3	27.4	26.7
Budgetary expenditure	11.2	12.1	13.1
Budget balance ¹ (%)	-82.6	-65.6	-65.0

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

The company, originally named Ningxiang County Water Resources Construction Investment and Development Co., Ltd., was initially funded by the Ningxiang government,

with an initial registered capital of RMB30 million. On October 19, 2018, according to the notification on promoting the integration of municipal state-owned companies, the company was integrated into NCDI. Its registered capital and paid in capital were enlarged to RMB1.0 billion after several capital injections from the Ningxiang government.

Strategic Importance and Government Linkage

Strategic Importance of NWCI to Ningxiang

NWCI, as the key LIDC in Ningxiang, is primarily responsible for the investment, development and operation of water-related infrastructure projects within the region. Serving as the sole entity in charge of water related resource management throughout the entire city, NWCI also focuses on production and supply of tap water, water pollution control and sewage treatment, as well as development and utilization of hydroelectric energy in Ningxiang with strong regional advantages. NWCI 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

NWCI's linkage with the local government is strong as the Ningxiang government holds the full ownership of NWCI through NCDI. The Ningxiang 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 Ningxiang government has assessment mechanism over the company and it appoints auditors to supervise the operating performance and financial position on a periodic basis.

Government Support

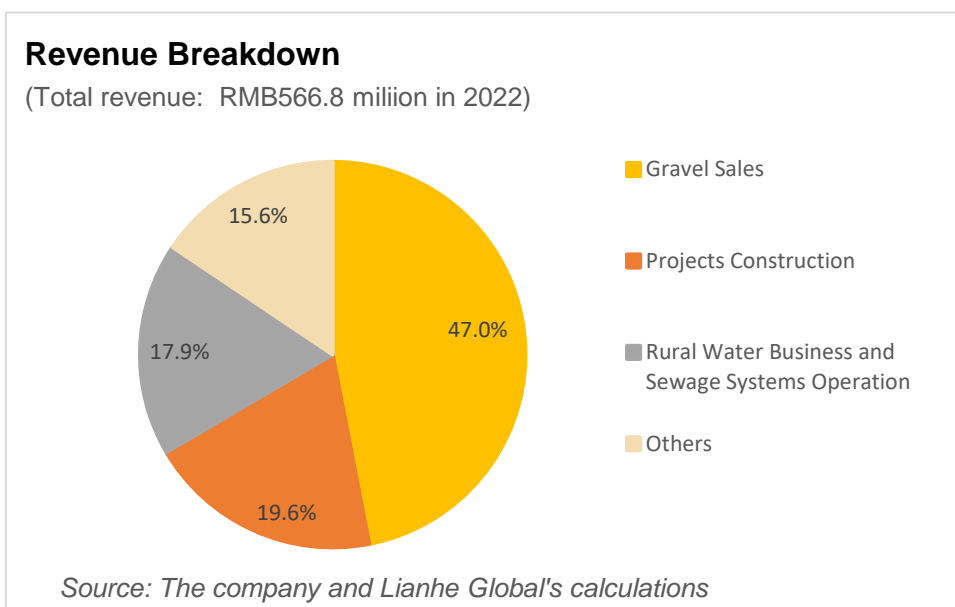
NWCI received operational and financial support from the government. NWCI received a total subsidy amount of RMB105.8 million from 2020 to the first six months of 2023. The Ningxiang government continued to inject capital, pipeline network assets, sand and gravel resources and other assets into NWCI to expand its asset size, totaling RMB8.4 billion from 2020 to the first six months of 2023. Besides, the Ningxiang government will repurchase some water-related infrastructure projects and provide policy supports to NWCI to ensure its business operation. Given that it is the key entity for water-related infrastructure construction and operation in Ningxiang, NWCI has an advantage in acquiring related resources and major projects. We believe NWCI is likely going to receive government support to support its daily business operation.

Business Profile

The Key Entity Responsible for Water-related Infrastructure Construction, Water Supply and Sewage Treatment in Ningxiang

NWCI, an important LIDC in Ningxiang, is responsible for gravel sales, project construction, rural water business and some other businesses within the region. The company's total revenue reached RMB827.1 million, RMB566.8 million and RMB385.1 million in 2021, 2022 and the first half of 2023, respectively. The overall gross profit margin of NWCI was recorded

at 19.2%, 18.3% and 3.1% in 2021, 2022 and the first six months of 2023, respectively. The primary sources of operating revenue for NWCI are gravel sales and project construction, while it is also engaged in rural water business, sewage systems operation and other businesses. In general, NWCI's business was well diversified, and it has regional advantages in its major businesses.



Projects Construction

NWCI undertakes water-related infrastructure construction within Ningxiang, including road and pipeline network construction, integrated urban and rural water supply project and village renovation, sewage interception projects and other water-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. NWCI signs agreements with the Ningxiang government or other entrusting parties. Ningxiang Fiscal Settlement Centre or some third-party intermediaries will examine the projects and check the total cost after completion. The qualified projects will be transferred to the Ningxiang government or other entrusting parties, and the company receive payment as income. The projects construction income was RMB315.3 million and RMB111.0 million in 2021 and 2022, respectively. The gross margin was 16.7% in both 2021 and 2022, representing a stable trend.

Gravel Sales

As an important source of revenue for NWCI, the gravel sales segment makes the company's business more diversified and plays a complementary role to its main business. NWCI first signs contracts with buyers, then mines gravel and delivers them to the buyers according to the contracts' terms. The income generated from the gravel sales business was RMB404.2 million and RMB266.3 million in 2021 and 2022, respectively. The gross margin was 12.4% and 9.8% in 2021, 2022, respectively.

Rural Water Business and Sewage Systems Operation

The company participates in rural water business and sewage systems operation as well. The revenue from rural water business and sewage systems operation reached RMB100.7

million and RMB101.2 million in 2021 and 2022, respectively. The gross margin was 52.8%, and 53.4% in 2021 and 2022, respectively.

Other Businesses

Except for the above businesses, the company also operates in coal trading and some other businesses, making the company's income structure more diversified while forming a better complement to the company's overall income.

Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	June 2023
Total Asset	4,047	6,191	13,647	17,372
Equity	2,579	4,287	10,698	10,771
Debt	986	1,263	2,088	5,668
Debt / (Debt + Equity) (%)	27.6	22.8	16.3	34.5
LT Debt	513	683	610	3,681
LT Debt / (LT Debt + Equity) (%)	16.6	13.7	5.4	25.5

Source: Company information and Lianhe Global's calculations

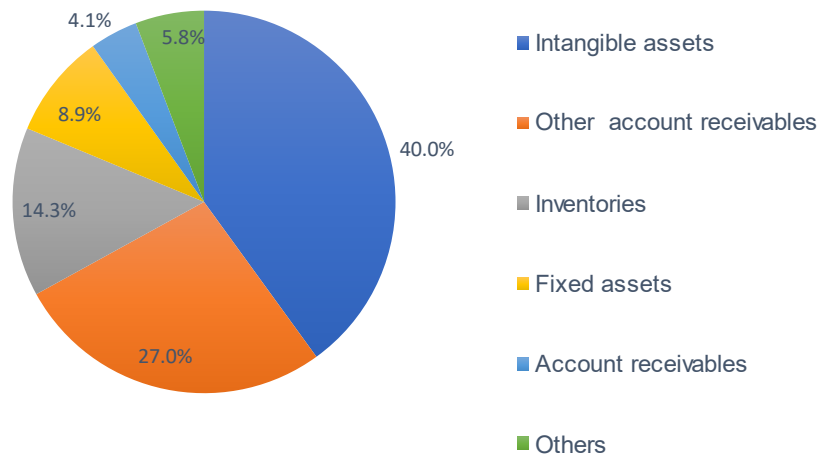
NWCI's total assets showed a continuous growth in the past few years, with a growth rate of 53%, 120.4% and 27.3% in 2021, 2022 and the first six months of 2023, respectively, and reached RMB17.4 billion at end-June 2023. The increase of NWCI's total assets in 2023 was largely due to the increase in other account receivables, resulting from the transaction payment receivables of around RMB1.0 billion from Hunan Jianzhao Construction Engineering Co., Ltd.

NWCI's assets mainly consisted of intangible assets and receivables, accounting for 71.1% of the total asset at end-June 2023. The majority of the intangible assets was land use rights and government-injected franchises. Receivables mainly pertained to interchanges of funds and project payments with government agencies and cooperative enterprises within Ningxiang, with relatively high concentration of indebted parties, controllable counterparty risk and low bad debt provision. Inventories mainly included project development costs associated with NWCI's project construction business.

NWCI witnessed growth in both its current assets and non-current assets in the past three years. The proportion of current assets and non-current assets in the total assets experienced slight fluctuations, but remains predominantly skewed towards non-current assets, indicating an illiquid asset structure.

Asset Breakdown

(Total assets: RMB17.4 billion at end-June 2023)



Source: The company and Lianhe Global's calculation

NWCI's financial leverage (total liabilities to assets) reached 36.3%, 30.8%, 21.6% and 38% at end-2020, end-2021, end-2022 and end-June 2023, respectively. It experienced fluctuations, showing a declining trend from 2020 to 2022, but saw an increase in 2023 due to the rise in non-traditional financings, such as financing leases, although it still remained at a relatively low level. The potential increase is contingent upon the requirements of ongoing project construction, with a limit set to comply with government oversight. NWCI's total adjusted debt increased from RMB985.7 million at end-2020 to RMB5.7 billion at end-June 2023, with short-term debt accounting for 35.1% of the total debt. NWCI 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 NWCI was sufficient. At end-June 2023, NWCI had a cash balance and unused credit facilities of RMB630.3 million and RMB3.2 billion, respectively, compared with its debt due within one year of RMB2.0 billion. Besides, NWCI has access to various financing channels, including bank loans and non-traditional financing, to support its debt repayment and business operations.

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