

Xiangyin Hengyuan New Energy Development Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	28 December 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to **Xiangyin Hengyuan New Energy Development Co., Ltd.** (“XHNE” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Xiangyin County (“the Xiangyin government”) would provide very strong support to XHNE if needed. This mainly considers the Xiangyin government’s ownership of XHNE, XHNE’s strategic importance as an important local investment and development company (“LIDC”) responsible for the construction and management of industrial parks and other infrastructure projects in Xiangyin County (“Xiangyin”), and the strong linkage between the Xiangyin government and XHNE, including the appointment of senior management, strategic alignment, supervision of major investment and financing decisions and ongoing operational and financial support. In addition, the Xiangyin government may face significant negative impact on its reputation and financing activities if XHNE encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Xiangyin government is the ultimate controller of XHNE via the Finance Bureau of Xiangyin and Hunan Yangshahu Investment Holding Group Co., Ltd. (“Yangshahu Holding”). The Xiangyin government has strong control over the company, including the appointment of senior management, strategic alignment, supervision of major financing plan and investment decisions and ongoing operation and financial support. In addition, the Xiangyin government formulates 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: As a key LIDC in Xiangyin, XHNE is mainly responsible for the construction and management of industrial parks and other infrastructure projects within the region. The primary sources of operating revenue for XHNE are engineering construction, sewage treatment and property management. Its business operations and strategic planning have been aligned with the local government’s economic and social development policies.

Ongoing Government Support: The Xiangyin government provided ongoing support to XHNE. The company has had a stable track record of receiving subsidies of RMB40 million annually from the Xiangyin government every year since 2021. Besides, the company received a series of asset injections and equity allocations from the Xiangyin government in 2023. We expect XHNE to receive ongoing support from the Xiangyin government in the coming years considering its strategic importance in Xiangyin.

Economy and Fiscal Condition of Xiangyin: Xiangyin is a county under the jurisdiction of Yueyang City, Hunan Province. At end-2022, Xiangyin had a resident population of c. 0.6

Key Figures of Xiangyin and XHNE (RMB billion)

Xiangyin	2021	2022
GDP	36.9	40.1
GDP growth rate (%)	8.4	6.5
Budgetary revenue	2.6	2.6
Government fund	4.4	3.3
Transfer payment	3.1	3.5
Budgetary expenditure	5.7	4.8
XHNE	2022	2023.9
Asset	4.9	9.2
Equity	0.5	3.5
Revenue	0.2	0.1

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

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Applicable Criteria

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

million, with an urbanization rate of 54.3%. Xiangyin's economic growth remained stable in recent years, and its GDP amount reached c. RMB40.1 billion in 2022, representing a year-over-year growth rate of 6.5%.

The aggregate fiscal revenue of the Xiangyin government was mainly derived from the government fund income and transfer payment from higher government. The Xiangyin government's budgetary revenue remained relatively stable in the past three years, with its tax revenue accounting for 34%-41% of its budgetary revenue. The fiscal self-sufficiency rate of the Xiangyin government was insufficient, and it recorded a budget deficit of 86.7% in 2022. In addition, the government fund income had decreased to RMB3.3 billion in 2022 from RMB4.7 billion in 2020, mainly due to the weak property market.

The outstanding debt of the Xiangyin government continued to grow. At end-2022, the Xiangyin government's outstanding debt was RMB6.3 billion, including RMB4.0 billion of general obligations and RMB2.3 billion of special debt. Since the Xiangyin government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 67.8% at end-2022 from 42.9% at end-2020.

XHNE's Financial and Liquidity Position: XHNE's asset size grew rapidly to RMB9.2 billion at end-September 2023 from RMB0.8 billion at end-2020, largely attributed to the asset injections and equity allocations from the Xiangyin government. As a result, the company's financial leverage, as measured by debt/capitalization, decreased sharply from 68.5% at end-2022 to 29.2% at end-September 2023. The company intends to maintain the current financial leverage level by receiving further asset injection from the local government in the future.

XHNE's liquidity was tight. At end-September 2023, the company had cash of RMB361 million (restricted cash of RMB332 million), while it had short-term debt of RMB626 million. The company has access to various financing channels, including bank borrowings, to support its debt repayments and business operations. Besides, it also had unused bank line of RMB141 million at end-September 2023.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Xiangyin

Xiangyin is a county under the jurisdiction of Yueyang City, Hunan Province. At end-2022, Xiangyin had a resident population of c. 0.6 million, with an urbanization rate of 54.3%. Xiangyin's economic growth remained stable in recent years, and its GDP amount reached c. RMB40.1 billion in 2022, representing a year-over-year growth rate of 6.5%. Xiangyin's economic growth was mainly fueled by the tertiary and secondary industries in the past few years, which accounted for 42.3% and 38.8% in 2022, respectively. Its economic

development focused on equipment manufacturing, new energy and green food industry in recent years.

Xiangyin's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	34.0	36.9	40.1
-Primary industry (%)	21.1	19.6	18.9
-Secondary industry (%)	36.8	38.3	38.8
-Tertiary industry (%)	42.2	42.1	42.3
GDP growth rate (%)	3.9	8.4	6.5
Fixed asset investment	15.0	15.3	15.7
Fixed asset investment growth rate (%)	8.9	11.5	14.6
Population (million)	0.6	0.6	0.6

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Xiangyin

The aggregate fiscal revenue of the Xiangyin government was mainly derived from the government fund income and transfer payment from higher government. The Xiangyin government's budgetary revenue remained relatively stable in the past three years, with its tax revenue accounting for 34%-41% of its budgetary revenue. The fiscal self-sufficiency rate of the Xiangyin government was insufficient, and it recorded a budget deficit of 86.7% in 2022. In addition, the government fund income had decreased to RMB3.3 billion in 2022 from RMB4.7 billion in 2020, mainly due to the weak property market.

The outstanding debt of the Xiangyin government continued to grow. At end-2022, the Xiangyin government's outstanding debt was RMB6.3 billion, including RMB4.0 billion of general obligations and RMB2.3 billion of special debt. Since the Xiangyin government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 67.8% at end-2022 from 42.9% at end-2020.

Xiangyin's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	2.5	2.6	2.6
Budgetary revenue growth rate (%)	111.6	5.2	0.01
Tax revenue	0.8	0.9	1.1
Tax revenue (% of budgetary revenue)	34.6	35.6	41.0
Government fund income	4.7	4.4	3.3
Transfer payment	3.5	3.1	3.5
Aggregate revenue	10.7	10.1	9.3
Budgetary expenditure	5.8	5.7	4.8
Budget balance ¹ (%)	-137.7	-122.4	-86.7

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

XHNE was established in July 2004 by the Management Committee of Xiangyin Yangshahu Industrial Park. After an array of capital injections and equity transfers, Yangshahu Holding is the sole shareholder of XHNE by holding 100% stake of XHNE at end-September 2023. The Finance Bureau of Xiangyin is the actual controller of XHNE, via its 97.5% ownership of Yangshahu Holding.

Strategic Importance and Government Linkage

Strategic Importance of XHNE to Xiangyin

As a key LIDC in Xiangyin, XHNE is mainly responsible for the construction and management of industrial parks and other infrastructure projects within the region. The primary sources of operating revenue for XHNE are engineering construction, sewage treatment and property management. Its business operations and strategic planning have been aligned with the local government's economic and social development policies.

Strong Linkage with the Local Government

The Xiangyin government is the ultimate controller of XHNE via the Finance Bureau of Xiangyin and Yangshahu Holding. The Xiangyin government has strong control over the company, including the appointment of senior management, strategic alignment, supervision of major financing plan and investment decisions and ongoing operation and financial support. In addition, the Xiangyin government formulates 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 Xiangyin government provided ongoing support to XHNE. The company has had a stable track record of receiving subsidies of RMB40 million annually from the Xiangyin government every year since 2021. Besides, the company received a series of asset injections and equity allocations from the Xiangyin government in 2023. We expect XHNE to receive ongoing support from the Xiangyin government in the coming years considering its strategic importance in Xiangyin.

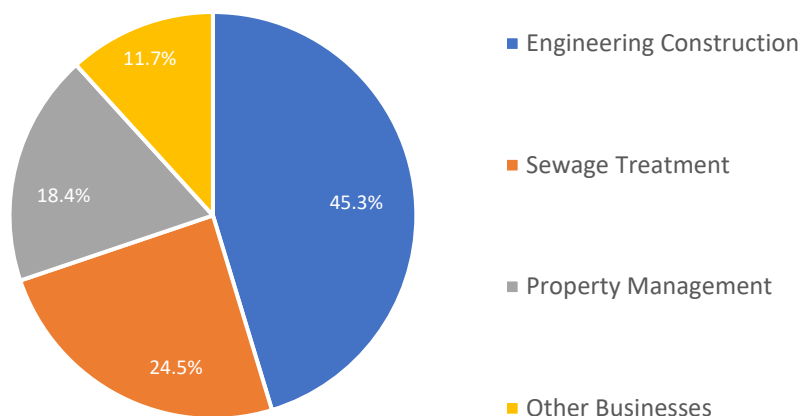
Business Profile

The Key Entity Responsible for Infrastructure Construction in Xiangyin

As a key LIDC in Xiangyin, XHNE is mainly responsible for the construction and management of industrial parks and other infrastructure projects within the region. The primary sources of operating revenue for XHNE are engineering construction, sewage treatment and property management. The company's total revenue increased rapidly in recent years, recording at c. RMB49.6 million, RMB168.1 million, RMB172.8 million and RMB107.2 billion in 2020, 2021, 2022 and the first nine months of 2023, respectively, with the high overall gross profit margin fluctuating between c. 36% and 50% over the same period. In general, XHNE's business was well diversified, while it has regional advantages in its major businesses.

Revenue Breakdown

(Total revenue: c. RMB107 million in the first three quarters of 2023)



Source: The company and Lianhe Global's Calculation

Engineering Construction

As one of the major sources of revenue, XHNE undertakes infrastructure construction within the region. The company provides construction services within the scope of the qualification owned by the company. Generally, the company recognizes revenue based on the progress of construction. Also, the company provides project management services, including survey, design, construction application, procurement, construction and cost control, etc.

Sewage Treatment

As another important source of revenue for XHNE, the sewage treatment segment makes the company's business more diversified and plays a complementary role to its main business. The company invests in the construction of sewage treatment facilities and provides sewage treatment services. The company negotiates the service price of sewage treatment with the government, and recognizes revenue based on the annual sewage treatment volume multiplied by the unit price plus the annual subsidies granted by the government. The segment gross profit margin is generally high compared with other segments.

Property Management

The company's property management mainly consists of rental and property charges. Similar with sewage treatment segment, the property management segment enjoys a high gross profit margin.

Other Businesses

Other businesses of XHNE include land transfer, building materials sales and outsourcing of labor services, etc., 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

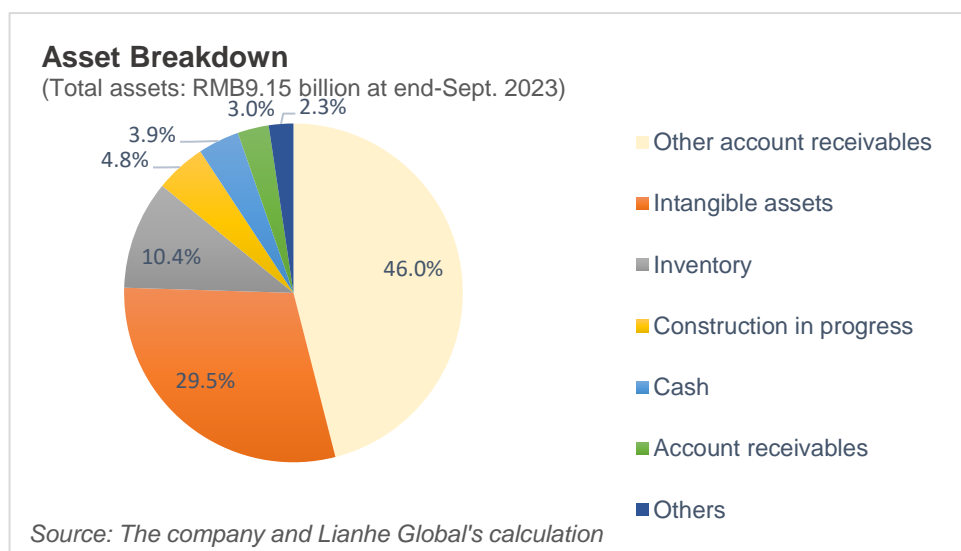
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	2023.9
Total Asset	831	2,929	4,899	9,154
Equity	236	412	467	3,484
Debt	40	404	1,014	1,434
Debt / (Debt + Equity) (%)	14.5	49.5	68.5	29.2
LT Debts	40	129	411	808
LT Debt / (LT Debt + Equity) (%)	14.5	23.8	46.8	18.8

Source: XHNE and Lianhe Global's calculations

XHNE's asset size grew rapidly to RMB9.2 billion at end-September 2023 from RMB0.8 billion at end-2020, largely attributed to the asset injections and equity allocations from the Xiangyin government. As a result, the company's financial leverage, as measured by debt/capitalization, decreased sharply from 68.5% at end-2022 to 29.2% at end-September 2023. The company intends to maintain the current financial leverage level by receiving further asset injection from the local government in the future.

XHNE's asset liquidity was weak, as it has large part of other account receivables, intangible asset and inventory. Other account receivables, amounted to RMB4.2 billion at end-September 2023, representing 46% of total asset. They are primarily due from government agencies and state-owned enterprises. The company's project construction activities accumulated sizeable inventories (lands to be developed), which accounted for 10.4% of total asset at end-September 2023. In addition, the company had a large number of intangible assets (franchise rights and land use rights), amounting to RMB2.7 billion and representing 29.5% of total asset at end-September 2023.



Debt Servicing Capability

XHNE's liquidity was tight. At end-September 2023, the company had cash of RMB361 million (restricted cash of RMB332 million), while it had short-term debt of RMB626 million. The company has access to various financing channels, including bank borrowings, to



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