

Hengyang City Construction Investment Development Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	A-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	21 March 2024

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘A-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Hengyang City Construction Investment Development Group Co., Ltd. (“HCIDG” or “the company”)

Summary

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

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

Rating Rationale

Hengyang Government’s Ownership and Supervision: The Hengyang government holds 100% ownership of HCIDG through the Hengyang State-owned Asset Supervision and Administration Committee of the People’s Government of Hengyang (“Hengyang SASAC”). The Hengyang SASAC is sole shareholder and actual controller of the company. The Hengyang government has the final decision-making authority and supervision over the company, including appointment and supervision of the senior management, strategy alignment and major investment, and financing plan decisions. In addition, the Hengyang government has assessment mechanism over the company and appoints auditors to review the operating performance and financials position on a periodic basis.

Strategic Importance and Alignment: HCIDG, as the most important LIDC in Hengyang, is mainly responsible for the urban infrastructure construction within Hengyang and Hengyang Riverside New District (“Hengyang RND”). The company’s strong franchise advantage enables it to undertake important infrastructure construction projects under the instruction of the Hengyang government. It focusses on construction projects such as roads, bridges, affordable housing, land consolidation and development, while it also engaged in commercial concrete product sales, housing sales and property services, etc. The company’s business operation and strategic planning have been aligned with the government’s development plans, playing a significant role in promoting the economic and social development of the region.

Ongoing Government Support: HCIDG received ongoing government support in forms of capital/asset injections and financial subsidies to support its business operations and enhanced the capital strength and profitability of the company. We believe that the Hengyang government support will remain intact given the company’s strategic importance in Hengyang. The company received financial subsidies amounting to RMB6.7 billion

Key Figures of Hengyang and HCIDG

(RMB billion)

	2022	2023
Hengyang		
GDP	409.0	419.1
GDP growth rate (%)	5.2	5.3
Budgetary revenue	19.5	20.3
Government fund	22.2	26.6
Transfer payment	38.3	36.2
Budgetary expenditure	59.7	62.5
HCIDG		
Asset	146.6	154.9
Equity	61.0	61.1
Revenue	3.0	1.7

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

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Applicable Criteria

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

between 2020 and the first nine months of 2023 from the Hengyang government to maintain its business operation. Over the same period, the company also received asset injections in the form of cash and equity transfers, which reached RMB14.6 billion.

Economy and Fiscal Condition of Hengyang: Hengyang is a prefecture-level city under the jurisdiction of Hunan Province (“Hunan”), and is located in the south of Mount Hengshan and south-central part of Hunan. It is the second largest city in Hunan. Hengyang’s GDP reached RMB419.1 billion in 2023, representing a year-over-year (y-o-y) growth rate of 5.3%, and its GDP amount was ranked 4th among all prefecture-level cities in Hunan. Its economic development focused on non-ferrous metals, new energy vehicles, rail transportation, fine chemicals, textiles and garments industry in recent years.

The Hengyang government’s budgetary revenue maintained steady growth in the past three years and reached RMB20.3 billion in 2023, with the tax revenue accounting for 70.1% of budgetary revenue. The fiscal self-sufficiency rate of the Hengyang government was low and it recorded a budget deficit of 208.7% in 2023. Meanwhile, Hengyang’s government fund income, mainly generated by land sales, increased by 20.31% y-o-y to RMB26.6 billion in 2023. Given the Hengyang government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 156.4% at end-2023 from 128.3% at end-2021.

HCIDG’s Financial and Liquidity Position: As HCIDG actively participated in infrastructure development within the region, its total assets increased moderately to RMB154.9 billion at end-September 2023 from RMB127.6 billion at end-2020, representing a growth rate of 21.4%. HCIDG’s total debt continued to grow in the past few years and reached RMB89.2 billion at end-September 2023. The company’s financial leverage, as measured by debt/capitalization was on an upward trend in the past few years, increasing from 52.0% at end-2020 to 59.4% at end-September 2023.

The liquidity of HCIDG was moderately weak. At end-September 2023, the company had unrestricted cash balance of RMB11.7 billion, compared with its debt due within one year of RMB18.7 billion. Nevertheless, HCIDG has accessed to various financing channels, including bank loans, bond issuance and non-traditional financing (such as financial lease), to support its debt repayments and business operations. At end-September 2023, the company has unused credit facilities of RMB31.4 billion and available onshore and offshore bond issuance quota of about RMB15.6 billion.

Rating Sensitivities

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

We would consider upgrading HCIDG’s rating if there is an upgrade in our internal credit assessment on the Hengyang government.

Operating Environment

Economic Condition of Hengyang

Hengyang is a prefecture-level city under the jurisdiction of Hunan, and is located in the south of Mount Hengshan and south-central part of Hunan. Hengyang, traditionally known

as the “land of fish and rice”, is an important commercial grain production base in southern China, and is also one of the pilot cities of “Made in China 2025”. As the second largest city in Hunan, Hengyang has jurisdiction over 5 districts, 5 counties and 2 county-level cities, with a total area of 15,300 square kilometers. At end-2022, Hengyang had a resident population of 6.6 million, with an urbanization rate of 55.8%.

Hengyang continued to promote its “Real Economy Revitalization Plan” and maintained medium to high economic growth in recent years. Hengyang’s GDP reached RMB419.1 billion in 2023, representing a y-o-y growth rate of 5.3%, and its GDP amount was ranked 4th among all prefecture-level cities in Hunan. Hengyang’s economic growth was mainly fueled by the tertiary and secondary industries in the past few years, which accounted for 55.9% and 33.1% in 2023, respectively. Its fixed-asset investment growth rate fell from 9.5% in 2021 to 6.4% in 2023, mainly due to the weak property market. Its economic development focused on non-ferrous metals, new energy vehicles, rail transportation, fine chemicals, textiles and garments industry in recent years.

Hengyang’s GDP and Fixed Asset Investment			
(RMB billion)	2021	2022	2023
GDP	384.0	409.0	419.1
-Primary industry (%)	11.6	11.5	11.0
-Secondary industry (%)	33.9	34.0	33.1
-Tertiary industry (%)	54.5	54.5	55.9
GDP growth rate (%)	8.1	5.2	5.3
Fixed asset investment growth rate (%)	9.5	9.7	6.4
Population (million)	6.6	6.6	6.6

Source: Public information and Lianhe Global’s calculations

Fiscal Condition of Hengyang

The Hengyang government’s aggregate fiscal revenues are mainly derived from transfer payment and government fund income. The Hengyang government’s budgetary revenue maintained steady growth in the past three years and reached RMB20.3 billion in 2023, with the tax revenue accounting for 70.1% of budgetary revenue. The fiscal self-sufficiency rate of the Hengyang government was low and it recorded a budget deficit of 208.7% in 2023. Meanwhile, Hengyang’s government fund income, mainly generated by land sales, increased by 20.31% y-o-y to RMB26.6 billion in 2023. In addition, Hengyang’s transfer payment remained stable in recent years, and continued to play a key role in Hengyang government’s aggregate fiscal revenue.

The outstanding debt of the Hengyang government continued to grow. At end-2023, the Hengyang government’s outstanding debt was RMB133.1 billion, including RMB45.8 billion of general obligations and RMB87.3 billion of special debt. Given the Hengyang government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 156.4% at end-2023 from 128.3% at end-2021.

Hengyang's Fiscal Condition			
(RMB billion)	2021	2022	2023
Budgetary revenue	18.4	19.5	20.3
Budgetary revenue growth rate (%)	6.0	6.0	6.0
Tax revenue	12.3	13.5	14.2
Tax revenue (% of budgetary revenue)	66.9	69.0	70.1
Government fund income	28.6	22.2	26.6
Transfer payment	32.6	38.3	36.2
Aggregate revenue	79.5	80.2	85.1
Budgetary expenditure	56.5	59.7	62.5
Budget deficit ¹ (%)	-207.1	-206.1	-208.7

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

HCIDG, formerly known as Hengyang Changtong Project Construction Co., Ltd, was established in August 2015 with an initial registered capital of RMB0.1 billion, funded by Hengyang Transportation Construction Investment Co., Ltd. ("HTCI") (other LIDC fully owned by the Hengyang SASAC in Hengyang and now a subsidiary of HCIDG). In January 2022, HCIDG's 100% equity interest was transferred from the HTCI to the Hengyang SASAC without compensation, and the company's name was changed to the current name.

After an array of capital injection and equity transfer, HCIDG's registered capital and paid-in capital were RMB3.0 billion and RMB1.0 billion at end-September 2023, respectively. HCIDG had a shareholding structure in which the Hengyang SASAC, as the sole shareholder and actual controller, held 100% of the company's equity.

Strategic Importance and Government Linkage

Strategic Importance of HCIDG to Hengyang

HCIDG, as the most important LIDC in Hengyang, is mainly responsible for the urban infrastructure construction within Hengyang and the Hengyang RND. The company's strong franchise advantage enables it to undertake important infrastructure construction projects under the instruction of the Hengyang government. It focuses on construction projects such as roads, bridges, affordable housing, land consolidation and development, while it also engaged in commercial concrete product sales, housing sales and property services, etc. The company's business operation and strategic planning have been aligned with the government's development plans, playing a significant role in promoting the economic and social development of the region.

Strong Linkage with the Local Government

HCIDG's linkage with the Hengyang government is strong as the Hengyang government holds 100% ownership of HCIDG through the Hengyang SASAC. The Hengyang SASAC is sole shareholder and actual controller of the company. The Hengyang government has the final decision-making authority and supervision over the company, including appointment and supervision of the senior management, strategy alignment and major investment and financing plan decisions. In addition, the Hengyang government has assessment

mechanism over the company and appoints auditors to review the operating performance and financials position on a periodic basis.

Ongoing Government Support

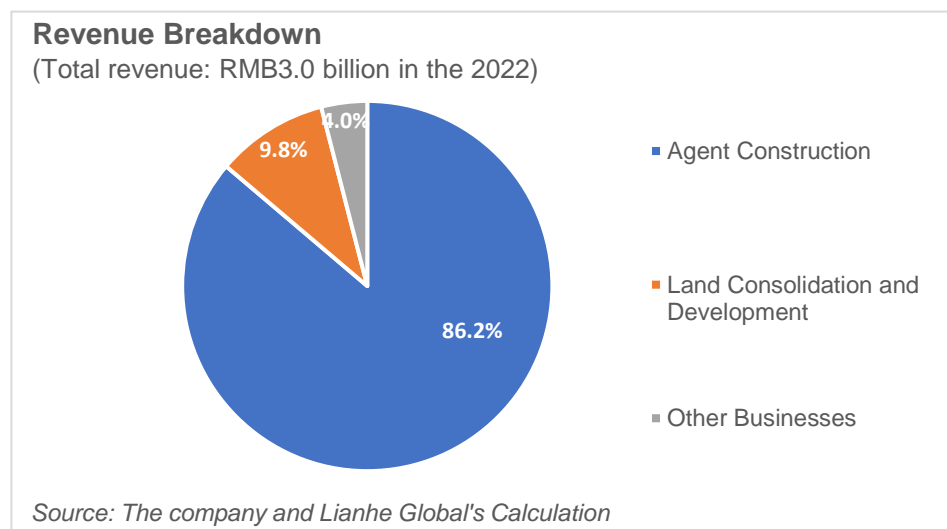
HCIDG received ongoing government support in forms of capital/asset injections and financial subsidies to support its business operations and enhanced the capital strength and profitability of the company. The company received financial subsidies amounting to RMB6.7 billion between 2020 and the first nine months of 2023 from the Hengyang government to maintain its business operation. Over the same period, the company also received asset injections in the form of cash and equity transfers, which reached RMB14.6 billion. We believe that the Hengyang government support will remain intact given the company's strategic importance in Hengyang.

Business Profile

The Most Important Entity Responsible for Infrastructure Construction in Hengyang

HCIDG, as the most important LIDC in Hengyang, is mainly responsible for the urban infrastructure construction within Hengyang and Hengyang RND. The company's strong franchise advantage enables it to undertake important infrastructure construction projects under the instruction of the Hengyang government.

The primary sources of revenue for HCIDG are agent construction, land consolidation and development, while it also engaged in commercial concrete product sales, housing sales and property services, etc. The company's total revenue reached RMB2.9 billion, RMB3.1 billion and RMB3.0 billion in 2020, 2021 and 2022, respectively, representing a steady trend. The overall gross profit margin of HCIDG increased from 12.9% to 21.8% between 2020 and 2022. In the first nine months of 2023, the total revenue was RMB1.7 billion and the gross profit margin was 20.6%. In general, HCIDG's business was relatively concentrated, and it has monopoly advantages in its major businesses.



Agent Construction

HCIDG is designated by the Hengyang government to undertake the municipal project construction, including municipal road and bridge construction and affordable housing

construction within the region. The company's monopoly on municipal project construction in Hengyang 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. 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 Consolidation and Development

The land consolidation and development business is mainly concentrated in Hengyang RND. This segment is undertaken by one of the company's subsidiaries, Hengyang Riverside New District Investment Co., Ltd. ("HRI"), which is responsible for land acquisition and demolition, compensation, personnel resettlement and land leveling within Hengyang RND. HRI signs the land development agreement with the Hengyang Finance Bureau and Natural Resources and Planning Bureau. The entrusted party repurchases the land parcel with land development and consolidation cost plus a certain percentage (generally 20%) of profit after the land consolidation is completed.

Other Businesses

Other businesses of HCIDG include commercial concrete product sales, housing sales, property services and project construction, with each segment accounting for a relatively small proportion of the company's total revenue. Other business mainly plays the role of supplementing the revenue of the main business and make the revenue structure more diversified.

Financial Profile

Balance Sheet Structure and Quality

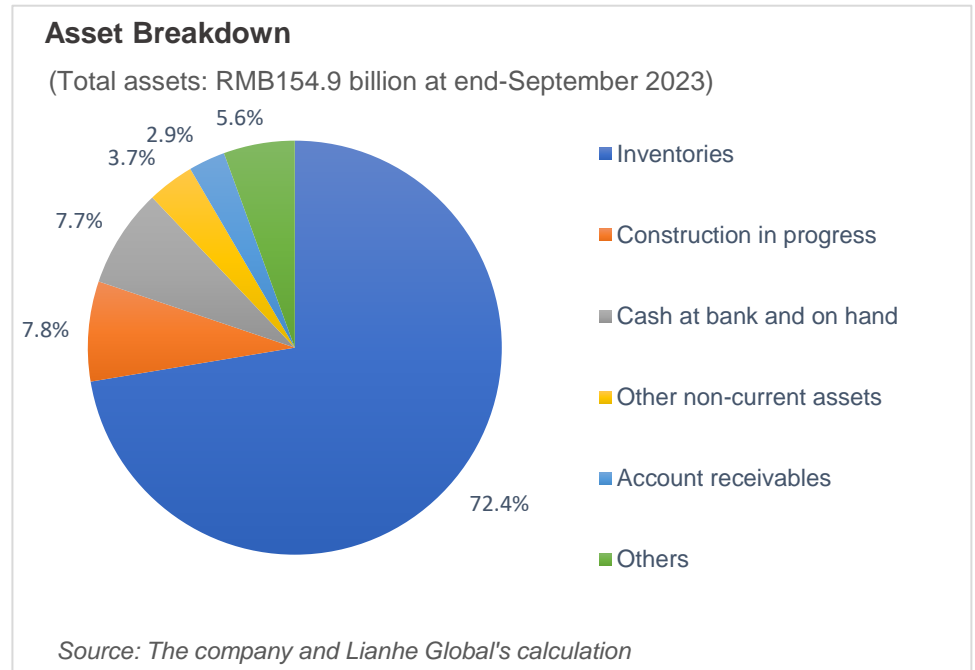
Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	Sept. 2023
Total Asset	127,638	137,796	146,583	154,943
Equity	54,318	58,839	60,993	61,115
Debt	58,720	68,406	78,806	89,242
Debt / (Debt + Equity) (%)	51.9	53.8	56.4	59.4
LT Debts	48,524	50,348	62,096	70,507
LT Debt / (LT Debt + Equity) (%)	47.2	46.1	50.4	53.6

Source: Company information and Lianhe Global's calculations

As HCIDG actively participated in infrastructure development within the region, its total assets increased moderately to RMB154.9 billion at end-September 2023 from RMB127.6 billion at end-2020, representing a growth rate of 21.4%. The increase in the company's total assets was mainly driven by the rise in inventory and projects under construction. The company relied on both borrowings and capital injections from the Hengyang government to fund its asset expansion. HCIDG's total debt continued to grow in the past few years and reached RMB89.2 billion at end-September 2023. The company's financial leverage, as measured by debt/capitalization was on an upward trend in the past few years, increasing from 52.0% at end-2020 to 59.4% at end-September 2023.

HCIDG's assets liquidity was weak, as the company's infrastructure construction activities accumulated sizable inventories and construction in progress, accounting for about 80.2% of the total assets at the end of September 2023. Inventories mainly consisted of development costs (mainly land assets) and contract performance costs (mainly

infrastructure projects and land development and consolidation costs), which usually take a long time to monetize due to the protracted construction and payment collection period. Construction in progress was input costs of infrastructure projects (such as roads, buildings, etc.), which showed an increase trend in the past few years.



Debt Servicing Capability

The liquidity of HCIDG was moderately weak. At end-September 2023, the company had unrestricted cash balance of RMB11.7 billion, compared with its debt due within one year of RMB18.7 billion. Nevertheless, HCIDG has accessed to various financing channels, including bank loans, bond issuance and non-traditional financing (such as financial lease), to support its debt repayments and business operations. At end-September 2023, the company has unused credit facilities of RMB31.4 billion and available onshore and offshore bond issuance quota of about RMB15.6 billion.



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