

Luoyang Guoyuan Investment Holding Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	26 March 2024

Key Figures of Luoyang and LGIH (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
LGIH		
	2022	2023.9
Assets	36.3	39.9
Equity	15.6	17.8
Revenue	2.4	2.3

Source: Luoyang government, Finance Bureau of Luoyang, LGIH and Lianhe Global's calculations

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Luoyang Guoyuan Investment Holding Group Co., Ltd. (“LGIH” or “the company”)

Summary

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

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

Rating Rationale

Luoyang Government’s Majority Ownership: The Luoyang government holds 60% stake of LGIH through the State-owned Assets Supervision, Administration Committee of Luoyang City (“Luoyang SASAC”), and is the actual controller of the company. The remaining stake is held by the Finance Bureau of Jianxi District, Luoyang City (“Jianxi FB”). The Luoyang 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 Luoyang 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 Luoyang and Jianxi, and Strategic Alignment: The People’s Government of Jianxi District, Luoyang City (“Jianxi government”) integrated state-owned enterprises in the region in 2022, after which LGIH became the sole LIDC in the region. LGIH is mainly responsible for infrastructure construction and state-owned assets operation in Jianxi with strong regional advantages. The company undertakes most of the important municipal infrastructure projects in the region, and is responsible for the construction of affordable housing, urban renewal, industrial operation, rural revitalization, medical rehabilitation, cultural tourism and other industrial fields in the region under the planning of the Luoyang government and Jianxi government. LGIH plays an important role in promoting the economic and social development of Jianxi. Its business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: LGIH received operational and financial support from the local government. LGIH received a total subsidy amount of RMB2.8 billion from 2020 to the first nine months of 2023, mainly including operating subsidies and tax breaks, etc. The

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Applicable Criteria

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

Jianxi government will repurchase some infrastructure and affordable housing construction projects and provide policy supports to LGIH to ensure its business operation. Besides, the local government increased the company's registered capital through cash injection and continued to inject equity and land assets into LGIH. Given the regional advantage in infrastructure construction and affordable housing construction in Jianxi, LGIH has advantages to obtain land resources and major projects. We believe LGIH is likely going to receive government support in the form of operational or financial subsidies to support its daily business operation.

LGIH's Financial Matrix and Liquidity Position: LGIH's total assets showed a continuous growth trend in past three years and reached RMB39.9 billion at end-September 2023, mainly due to the large increase in inventories and other account receivables. The financial leverage (total liabilities to assets) and total debt capitalization ratio of LGIH were 55.5% and 47.5% at end-September 2023, respectively. The total adjusted debt of LGIH increased from RMB14.2 billion at end-2021 to RMB16.0 billion at end-September 2023. The liquidity of LGIH was tight. LGIH had a cash balance of approximately RMB1.7 billion and unused credit facilities of RMB0.3 billion at end-September 2023, compared with debt within one year of RMB5.7 billion at the same time. However, LGIH has established cooperative relationship with banks to obtain a certain amount of liquidity support and medium- and long-term loans, and it has maintained a normal bank loan financing ability. LGIH has financing channels including bank loans, bond issuance and non-traditional financing etc. to support its debt repayment and business operation.

Economy and Moderate 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 Province ("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 79.5% 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. 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.

Rating Sensitivities

We would consider downgrading LGIH'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 LGIH, or (3) there is a downgrade in our internal credit assessment on the Luoyang government.

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

Operating Environment

Economic Conditions 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: Luoyang government and Lianhe Global's calculations

Fiscal Conditions 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 79.5% 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 Conditions			
(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 balance ¹ (%)	-79.5	-61.3	-58.2

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

*Excluding the influence of value-added tax credit refund

Source: Finance Bureau of Luoyang and Lianhe Global's calculations

Ownership Structure and Profile

Government's Ownership and Shareholders

LGIH was established in 2018 with an initial registered capital of RMB5 million, funded by Luoyang High-tech Industrial Group Co., Ltd. In May 2022, the registered capital of the company was increased to RMB5 billion through equity contribution from the Jianxi FB and the Luoyang Luoyang Comprehensive Center for Free Trade Services (a subordinate organization of the Luoyang High-tech Industrial Development Zone Management Committee ("LHZMC")).

On 21 August 2023, LHZMC transferred 60% of the equity of LGIH to Luoyang SASAC. At end-September 2023, LGIH had a shareholding structure in which the Luoyang SASAC, as the controlling shareholder, held 60% of the company's equity. The remaining 40% equity was held by the Jianxi FB.

Strategic Importance and Government Linkage

Importance of LGIH to Luoyang and Jianxi

The Jianxi government integrated state-owned enterprises in the region in 2022, after which LGIH became the sole LIDC in the region. LGIH is mainly responsible for infrastructure construction and state-owned assets operation in Jianxi with strong regional advantages. The company undertakes most of the important municipal infrastructure projects in the region, and is responsible for the construction of affordable housing, urban renewal, industrial operation, rural revitalization, medical rehabilitation, cultural tourism and other industrial fields in the region under the planning of the Luoyang government and Jianxi government. LGIH plays an important role in promoting the economic and social development of Jianxi. Its business operation and development have been aligned with the government's development plans.

Linkage with the Luoyang Government

The Luoyang government holds 60% stake of LGIH through Luoyang SASAC, and is the actual controller of the company. The remaining stake is held by the Jianxi FB. The Luoyang 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 Luoyang government has assessment mechanism over the company and appoints auditors to supervise the operating performance and financial position on a periodic basis.

Government Support

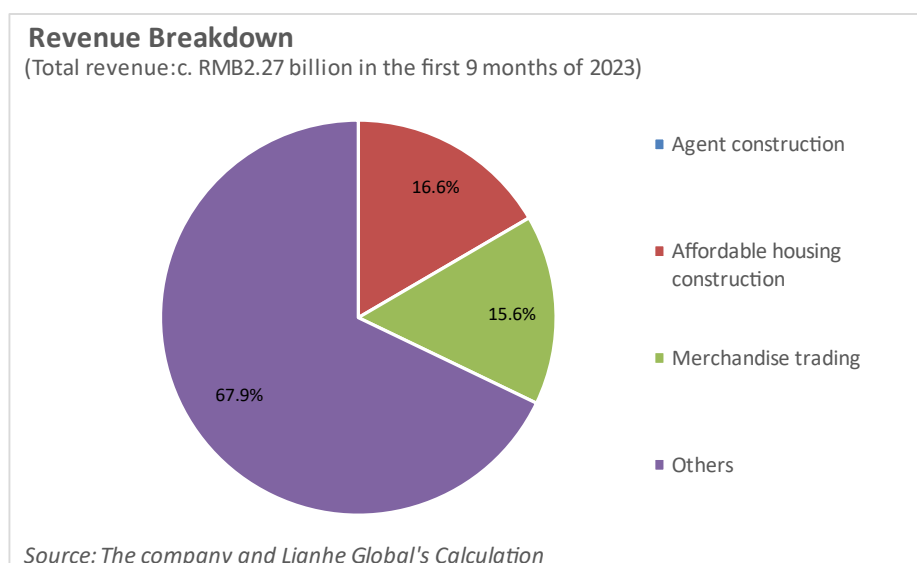
LGIH received operational and financial support from the local government. LGIH received a total subsidy amount of RMB2.8 billion from 2020 to the first nine months of 2023, mainly including operating subsidies and tax breaks, etc. The Jianxi government will repurchase some infrastructure and affordable housing construction projects and provide policy supports to LGIH to ensure its business operation. Besides, the local government increased the company's registered capital through cash injection and continued to inject equity and land assets into LGIH. Given the regional advantage in infrastructure construction and affordable housing construction in Jianxi, LGIH has advantages to obtain land resources and major projects. We believe LGIH is likely going to receive government support in the form of operational or financial subsidies to support its daily business operation.

Business Profile

The Key Entity Responsible for Infrastructure Construction, and State-owned Asset Operation in Jianxi

LGIH, as an important LIDC in Jianxi, is mainly responsible for infrastructure and affordable housing construction, as well as the operation of state-owned assets within the region. The company's strong regional advantage enables it to undertake important infrastructure construction projects, urban renewal, cultural tourism, industrial investment and operation, all under the coordination plan of the Jianxi government. Moreover, the Jianxi government also entrusts the company with functions related to housing construction and public management services.

The primary sources of operating revenue for LGIH include its agent construction, affordable housing construction and merchandise sales. The company experienced steady revenue growth over the past three years, with revenue reaching of RMB1.6 billion, RMB2.1 billion and RMB2.4 billion for 2020, 2021 and 2022, respectively. In the first nine months of 2023, it recorded revenue of RMB2.3 billion. The overall gross profit margin of LGIH remained relatively stable at 8.2%-11.8% for 2020, 2021 and 2022. Having said that, the gross profit margin of the company declined to 6.6% in the first nine months of 2023, which was mainly due to the lower portion of the revenue from agent construction segment. In general, LGIH's business was diversified, and it has regional advantages in its major businesses.



Agent Construction

LGIH carries out municipal and other infrastructure projects in the region through agent construction mode, where LHZMC is the main entrusting party. LHZMC settles with LGIH by paying the actual costs plus an additional margin of 10%. Its revenue in this segment was relatively stable over the past years, with RMB674 million, RMB682 million, and RMB690 million generated in 2020, 2021 and 2022, respectively. The gross profit margin remained stable at around 9% over the same period. In addition, LGIH did not generate any income in the first nine months of 2023 due to the settlement practice, as most of the company's construction revenue are recognized towards the end of the year.

LGIH has completed various construction projects. Currently, the company is working on several large-scale projects, with total planned investment amounting to RMB8.7 billion at end-September 2023, of which RMB3.2 billion is scheduled to be invested in the coming years. These projects may bring a high capital expenditure pressure on the company.

Affordable Housing Construction

The Jianxi government has entrusted the construction of affordable housing and related supporting infrastructure projects in the district to LGIH. The company is responsible for engineering design, financing, project management, and construction, while the government pays for the project costs and a certain percentage of additional margin as the project revenue. The segment revenue reached RMB660 million, RMB630 million, RMB690 million and RMB377 million in 2020, 2021, 2022 and the first nine months of 2023, respectively, with a stable gross profit margin of 20%. The company operates affordable housing business under two models: entrusted construction and self-operated. Per management, LGIH plans to focus mainly on the latter mode in the future. This means that the company will sell the housing units through direct sales and earn additional income through rental income (e.g., ground floor rents and parking spaces rents) at a later stage. At end-September 2023, the company still had ongoing housing construction project, with total planned investment amounting to RMB4.8 billion at end-September 2023, of which RMB3.3 billion is scheduled to be invested in the coming years. Therefore, LGIH may face a high capital expenditure pressure in the future.

Merchandise Trading

LGIH diversified its business operations in 2021 by adding the merchandise trading business to complement its main operations. The company's primary trading commodities are aluminum ingots and alumina, with a high concentration of both suppliers and customers. While this segment generated revenues of RMB454 million, RMB717 million and RMB354 million in 2021, 2022 and the first nine months of 2023, respectively, its gross margin remained relatively low at below 1%, and had a small contribution to the company's overall profits.

Per management, the company's current merchandising approach remains supply chain-oriented. Having said that, given more investment and cooperation with companies located in the Jianxi, the company's management expects a significant improvement in the gross margin of the merchandise trading segment.

Other Businesses

Other businesses of LGIH include public management services, heating business, engineering construction and housing leasing, etc. Other businesses mainly play the role of supplementing the revenue of the main business. In addition, public management services,

heating and labor services are more in line with the development direction of LGIH as a regional integrated urban service provider, which improves the efficiency of urban operation in Jianxi and enhance the level of basic public services.

Financial Profile

Balance Sheet Structure and Quality

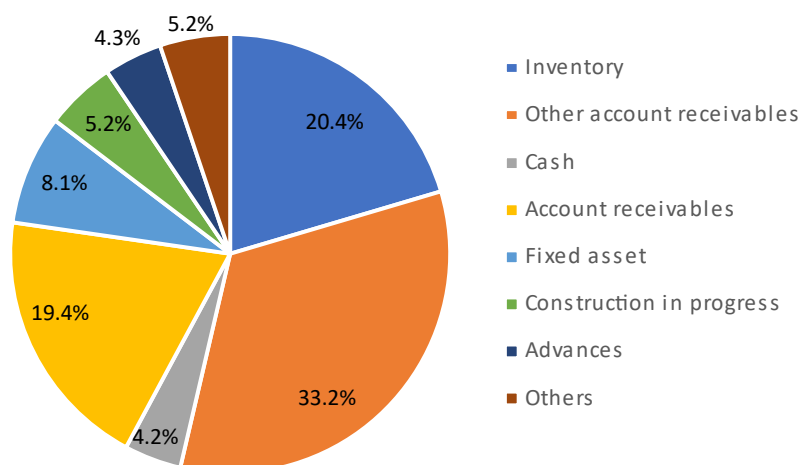
Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	End-September 2023
Total Asset	27,555	35,065	36,297	39,863
Equity	10,385	16,160	16,590	17,750
Debt	11,957	14,192	13,972	16,048
Debt/(Debt+Equity) (%)	53.5	46.8	45.7	47.5
LT Debt	10,457	10,125	8,741	10,393
LT Debt/(LT Debt+Equity) (%)	50.2	38.5	34.5	36.9

Source: LGIH and Lianhe Global's calculations

LGIH's total assets increased to RMB39.9 billion end-September 2023 from RMB36.3 billion at end-2022, mainly due to the large increase in inventories and other account receivables. At end-September 2023, current assets constituted the major proportion of the company's asset structure, accounting for 81.9% of its total assets. LGIH's current assets mainly consisted of other receivables, inventories, accounts receivable, and cash at bank and on hand. Other receivables primarily comprised transactions with related parties in Jianxi, with controllable counterparty risk and low bad debt provision. Inventories included development costs associated with LGIH's core business operations, such as engineering construction costs, which increased in parallel with the growth of the relevant projects. Accounts receivable was mainly aroused from the Jianxi FB and the LHZMC for construction projects. Though LGIH had considerable current assets, its assets were relatively illiquid, primarily due to the significant proportion of costs associated with construction projects and the receivables. Having said that, as the company's fixed assets, such as industrial parks and affordable houses, increase in the future, the percentage of its non-current assets will likewise increase.

Asset Breakdown

(Total Assets: RMB39.9 billion at end -September 2023)



Source: The company and Lianhe Global's calculation

LGIH's financial leverage (total liabilities to assets) had remained stable at 55% since 2022. LGIH's adjusted total debt increased steadily from RMB14.2 billion at end-2022 to RMB16.0 billion at end-September 2023, with short-term debt accounting for 35.2% of the total debt. LGIH mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure and affordable housing related projects under construction and to be constructed in the future.

Debt Servicing Capability

The liquidity of LGIH was tight. LGIH had a cash balance of approximately RMB1.7 billion and unused credit facilities of RMB0.3 billion at end-September 2023, compared with debt within one year of RMB5.7 billion at the same time. However, LGIH has established cooperative relationship with banks to obtain a certain amount of liquidity support and medium- and long-term loans, and it has maintained a normal bank loan financing ability. LGIH has financing channels including bank loans, bond issuance and non-traditional financing etc. to support its debt repayment and business operation.

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