

Puyang Kaizhou Investment Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	1 March 2024

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

Summary

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

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

Rating Rationale

Puyang Government’s Ownership and Supervision: The Puyang government holds the majority ownership of PKIG through the Finance Bureau of Puyang County (“Puyang FB”). The Puyang 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 Puyang 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 Puyang and Strategic Alignment: PKIG, as the key LIDC in Puyang, is primarily responsible for the investment, development and operation of infrastructure projects within the city. Serving as the sole entity in charge of infrastructure projects throughout the region, PKIG is mainly engaged in construction projects encompassing urban and rural development, urban village renovations, shantytown transformations, resettlement housing initiatives, and ecological restoration projects with strong regional advantages. The company is also responsible for urban operations, real estate development, and the construction of municipal, bridge, and water conservancy projects. PKIG 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: PKIG received operational and financial support from the Puyang government. PKIG received a total subsidy amount of RMB272.4 million from 2020 to the first six months of 2023. The Puyang government continued to inject capital, project-related assets, equities of other companies and other kinds of assets into PKIG to expand its asset size and diversify its business. Besides, the Puyang government will repurchase some infrastructure projects and provide policy supports to PKIG to ensure its business

Key Figures of Puyang and PKIG

(RMB billion)	2021	2022
Puyang		
GDP	30.3	32.6
GDP growth rate (%)	9.5	5.8
Budgetary revenue	1.7	1.8
Government fund	2.3	1.2
Transfer payment	4.8	4.8
Budgetary expenditure	4.5	5.2
PKIG	2022	2023.6
Assets	32.2	33.6
Equity	15.8	15.8
Revenue	1.3	0.4

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

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Applicable Criteria

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

operation. Given that it is the sole entity for infrastructure construction in Puyang, PKIG has an advantage in acquiring related resources and major projects. We believe PKIG is likely going to receive government support to support its daily business operation.

PKIG's Financial Matrix and Liquidity Position: PKIG's total assets showed a continuous growth trend in the past few years and reached RMB33.6 billion at end-June 2023, largely attributed to the increase of inventories that related to the infrastructure construction business. The current assets of PKIG accounted for 89.5% of the total assets at end-June 2023, yet the overall asset liquidity was moderately weak due to large amount of inventories and receivables. These assets usually take a long time to monetize due to the protracted construction and payment collection period.

PKIG's financial leverage (total liabilities to total assets) increased to 52.9% and its adjusted debt increased to RMB10.0 billion at end-June 2023 from RMB6.0 billion at end-2020. PKIG's liquidity was sufficient. At end-June 2023, PKIG had a cash balance and unused credit facilities of RMB1.6 billion and RMB8.4 billion, respectively, compared with its debt due within one year of RMB557.9 million. Besides, PKIG 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 Strength of Puyang: Puyang is a county-level city under the jurisdiction of Puyang City, and located in the northeastern part of Henan Province. Puyang had maintained relatively stable economic growth in the past few years, with its GDP amount reaching RMB27.9 billion, RMB30.3 billion, RMB32.6 billion in 2020, 2021 and 2022, respectively. Its economic growth was mainly fueled by the tertiary industries in the past few years, which accounted for 54.0% in 2022.

Puyang's governmental fiscal revenues primarily stem from budgetary income and government fund income. In 2022, the budgetary revenue of the Puyang government increased to RMB 1.8 billion, up from RMB1.7 billion in 2021. The tax revenue accounted for 70.7% of the budgetary revenue in 2022, down from 76.7% in 2021. This reduction was a result of implementing tax reduction and fee reduction policies to support the development of the local real economy. Puyang's government fund income, mainly generated by land sales, declined to RMB1.2 billion in 2022 from RMB2.3 billion in 2021, mainly due to macroeconomic policy adjustments and a downturn in the real estate industry. Over the past three years, the fiscal liability ratio measured by the total government outstanding debt/total fiscal revenue increased from 87.1% in 2020 to 113.2% in 2021 and further to 158.6% in 2022. Despite this increase, the government debt remains manageable and under control.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Puyang

Puyang is a county directly under the jurisdiction of Puyang City, and located in the northeastern part of Henan Province. Puyang is a time-honored county, with abundant nature resources and cultural sites. Puyang has jurisdiction over 12 towns, 8 villages and 1 provincial economic development zone, with a total land area of 1,382 square kilometers. At end-2022, Puyang had a resident population of 0.9 million, with an urbanization rate of 45.5%.

Puyang had maintained relatively stable economic growth in the past few years, with its GDP amount reaching RMB27.9 billion, RMB30.3 billion, RMB32.6 billion in 2020, 2021 and 2022, respectively. Its economic growth was mainly fueled by the tertiary industries in the past few years, which accounted for 54.0% in 2022. Its economic development focused on equipment manufacturing, new materials, green food industry in recent years. Its fixed asset investment growth rate was on an upward trend in the past few years, recording at 7.7%, 10.8% and 18.5% in 2020, 2021 and 2022, respectively.

Puyang's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	27.9	30.3	32.6
-Primary industry (%)	20.0	17.4	18.7
-Secondary industry (%)	24.5	27.3	27.3
-Tertiary industry (%)	55.6	55.3	54.0
GDP growth rate (%)	5.5	9.5	5.8
Fixed asset investment	20.4	22.6	26.7
Fixed asset investment growth rate (%)	7.7	10.8	18.5
Population (million)	1.0	1.0	0.9

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Puyang

The Puyang government's budgetary revenue remained relatively stable in the past few years, with growth rates of 4.4%, 8.5% and 5.1% in 2020, 2021 and 2022, respectively. The tax revenue accounted for 70.7% of the budgetary revenue in 2022, down from 76.7% in 2021, mainly due to related tax-advantaged policies. As another substantial component of the local fiscal revenue, Puyang's government fund income, mainly generated by land sales, declined to RMB1.2 billion in 2022 from RMB2.3 billion in 2021, mainly owing to the weak property market. The budgetary expenditure remained at a high level in the past few years, thus its budget balance recorded at -362.9%, -165.8% and -190.1% in 2020, 2021 and 2022, respectively. Despite the narrowing trend in budget deficits, the fiscal self-sufficiency rate of the Puyang government was still low (c. 34.5% in 2022), hence it continuously received a certain number of subsidies from higher government authorities, which reached RMB5.5 billion, RMB4.8 billion and RMB4.8 billion in 2020, 2021 and 2022, respectively.

The outstanding debt of the Puyang government continued to grow. At end-2022, the Puyang government's outstanding debt was RMB12.4 billion, including RMB2.4 billion of general obligations and RMB9.9 billion of special debt. Given the Puyang 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 158.6% at end-2022 from 87.1% at end-2020.

Puyang's Fiscal Condition			
(RMB billion)	2020	2021	2022

Budgetary revenue	1.6	1.7	1.8
Budgetary revenue growth rate (%)	4.4	8.5	5.1
Tax revenue	1.2	1.3	1.3
Tax revenue (% of budgetary revenue)	76.9	76.7	70.7
Government fund income	2.3	2.3	1.2
Transfer payment	5.5	4.8	4.8
Aggregate revenue	9.3	8.8	7.8
Budgetary expenditure	7.3	4.5	5.2
Budget balance ¹ (%)	-362.9	-165.8	-190.1

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

PKIG was established in 2004 with an initial registered capital of RMB20.49 million, funded by Puyang FB and 6 natural persons. In 2016, the natural person shareholders transferred all their equity holdings to Puyang FB, and the registered capital of the company increased to RMB2.0 billion.

After a series of capital injections and equity transfers, at end-2022, PKIG's registered capital and paid-in capital were both RMB4.0 billion. PKIG had a shareholding structure in which the Puyang FB, as the controlling shareholder and actual controller of the company, held 51.0% of the company's equity, and the Puyang Investment Group Co., Ltd. ("PIG") held the remaining 49.0% equity. The Puyang Municipal Finance Bureau ultimately holds a 90% stake in PIG, with the remaining 10% held by the Henan Provincial Department of Finance.

Strategic Importance and Government Linkage

Strategic Importance of PKIG to Puyang

PKIG, as the key LIDC in Puyang, is primarily responsible for the investment, development and operation of infrastructure projects within the city. Serving as the sole entity in charge of infrastructure projects throughout the region, PKIG is mainly engaged in construction projects encompassing urban and rural development, urban village renovations, shantytown transformations, resettlement housing initiatives, and ecological restoration projects with strong regional advantages. The company is also responsible for urban operations, real estate development, and the construction of municipal, bridge, and water conservancy projects. PKIG 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

PKIG's linkage with the local government is strong as the Puyang government holds the majority ownership of PKIG through Puyang FB. The Puyang 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 Puyang 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

PKIG received operational and financial support from the Puyang government. PKIG received a total subsidy amount of RMB272.4 million from 2020 to the first six months of 2023. The Puyang government continued to inject capital, project-related assets, equities of other companies and other kinds of assets into PKIG to expand its asset size and diversify its business. Besides, the Puyang government will repurchase some infrastructure projects and provide policy supports to PKIG to ensure its business operation. Given that it is the key entity for infrastructure construction and affordable housing construction in Puyang, PKIG has an advantage in acquiring related resources and major projects. We believe PKIG is likely going to receive government support to support its daily business operation.

Business Profile

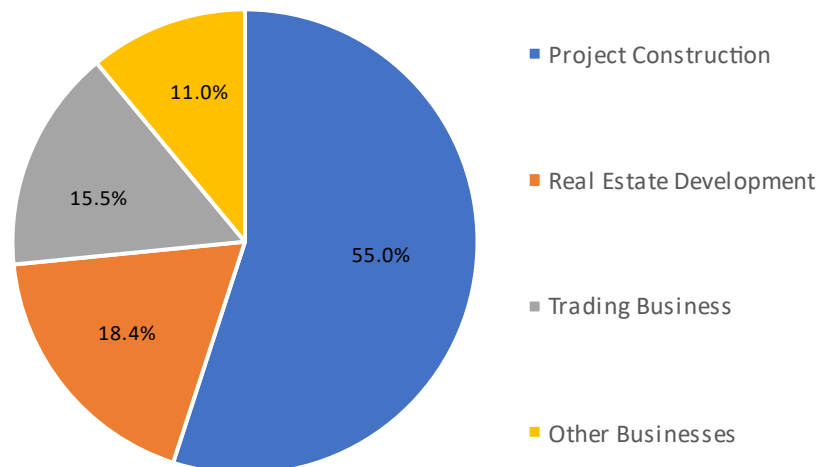
The Sole Entity Responsible for Infrastructure Construction in Puyang

PKIG, as an important LIDC in Puyang, is mainly responsible for the construction of municipal infrastructure projects, real estate development and utility operations within the region, with a strong regional advantage. As the major platform designated by the Puyang FB to undertake infrastructure construction projects within the region, the company has received strong support from the government in terms of capital injection, asset transfer and fiscal subsidies.

The primary sources of operating revenue for PKIG are project construction, real estate development and trading business, while it also engaged in photovoltaic power generation, water supply, leasing and property services, etc. The company's total revenue was on an upward trend in the past few years, recording at RMB0.9 billion, RMB1.0 billion, RMB1.3 billion in 2020, 2021 and 2022, respectively. The overall gross profit margin of PKIG fluctuated between 12.0% and 18.4% over the same period. In general, PKIG's business was well diversified, but it has regional advantages in its major businesses.

Revenue Breakdown

(Total revenue: RMB1.3 billion in 2022)



Source: The company and Lianhe Global's Calculation

Project Construction

PKIG and its subsidiaries undertake project construction business under both agent construction and self-operated models. Under the agent construction model, the company signs the agent construction agreements with the Puyang County government and is responsible for fundraising and construction of entrusted projects. The company settles construction costs plus a percentage (c.15%-20%) of management fees annually with the entrusting party according to the project's progress. Under the self-operated model, the company constructs the projects with internal and external funds, and operates them for rental income upon completion. The revenue derived from this segment reached c. RMB0.3 billion, RMB0.7 billion and RMB0.7 billion in 2020, 2021 and 2022, respectively. Its gross profit margin in this segment was on a downward trend, recording at 16.6%, 12.2% and 13.9% in 2020, 2021 and 2022, respectively. 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.

Real Estate Development

The company's head office and its subsidiaries, Puyang County Urban Construction Investment and Development Co., Ltd., Puyang County Construction Investment Co., Ltd. and Puyang Kaizhou Commercial Real Estate Development Co., Ltd., undertake real estate development business within the region. The revenue generated from this segment reached RMB0.4 billion, RMB0.2 billion and RMB0.2 billion in 2020, 2021 and 2022, respectively, with its gross profit margin fluctuating between 10.9% and 49.9% over the same period. Overall, the revenue of real estate development is susceptible to uncertainties arising from factors such as policy, planning and market.

Trading Business

The trading segment makes the company's business more diversified and plays a complementary role to its main business. The company's trading business is mainly engaged in the sales of steel, concrete, cement, etc., and mostly conducted in a "sales-driven" model, where it determines the amount of materials to be procured strictly based on the actual purchase orders placed by customers. The company makes a profit from the spread between buying and selling prices. The company's trading business has a high concentration of buyers, mainly consisting of small and medium-sized private enterprises, indicating a relatively high counterparty risk. The revenue generated from this segment reached c. RMB0.1 billion, RMB0.1 billion and RMB0.2 billion in 2020, 2021 and 2022, respectively, with its gross profit margin fluctuating between 3.7% and 8.6% over the same period.

Other Businesses

Other businesses of PKIG include photovoltaic power generation, water supply, leasing and property 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

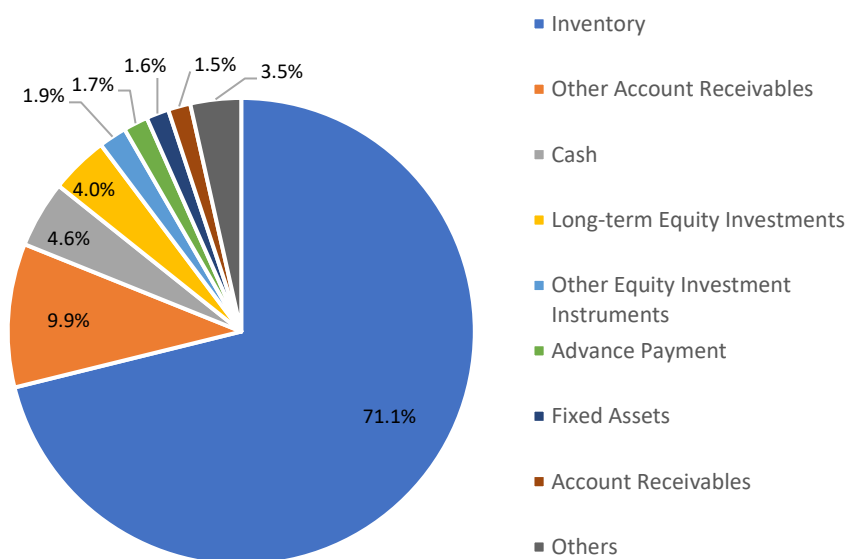
Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	June-2023
Total Asset	21,538	27,363	32,249	33,649
Equity	12,949	15,665	15,786	15,845
Debt	5,953	8,505	10,294	9,979
Debt / (Debt + Equity) (%)	31.5	35.2	39.5	38.6
LT Debt	5,578	7,762	9,679	9,421
LT Debt / (LT Debt + Equity) (%)	30.1	33.1	38.0	37.3

Source: Company information and Lianhe Global's calculations

PKIG's asset size grew rapidly to RMB33.6 billion at end-June 2023 from RMB21.5 billion at end-2020, largely attributed to the increase of inventory. The company's financial leverage, as measured by debt/capitalization increased to 52.9% at end-June 2023 from 39.9% at end-2020. Although its debt structure was improving, with long-term debt's proportion increased by 7.2 pp to 37.3% at end-June 2023 from 30.1% at end-2020, the company's short-term debt pressure still high.

Asset Breakdown

(Total Assets: RMB33.6 billion at end-June 2023)



Source: PKIG's 2023 unaudited interim report and Lianhe Global's calculation

PKIG's asset liquidity was moderately weak, as it has large part of inventories and other account receivables. The company's project construction activities accumulated sizeable inventories (mainly lands and construction costs) and fixed assets, total amounting to RMB24.5 billion, and representing 72.7% of total asset at end-June 2023. These assets usually take a long time to monetize due to the protracted construction and payment collection period. In addition, the company had a large number of account receivables and other account receivables, primarily due from government agencies. Their repayment schedules are highly subject to the fiscal conditions of the local government.

Debt Servicing Capability

PKIG's liquidity was sufficient. At end-June 2023, PKIG had a cash balance and unused credit facilities of RMB1.6 billion and RMB961.9 million, respectively, compared with its debt due within one year of RMB557.9 million. Besides, PKIG 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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