

Xuchang Investment Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	A-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	12 April 2024

Key Figures of Xuchang and XIG

(RMB billion)	2021	2022
Xuchang		
GDP	365.5	374.7
GDP growth rate (%)	5.5	1.8
Budgetary revenue	18.9	20.4
Government fund	11.9	8.2
Transfer payment	15.9	16.9
Budgetary expenditure	32.6	34.7
XIG	2022	2023.9
Assets	106.6	106.3
Equity	57.1	56.2
Revenue	6.6	3.6

Source: Public information, XIG and Lianhe Global's calculations

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

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Xuchang City (“Xuchang government”) would provide very strong support to XIG if needed, in light of its full ownership of XIG, XIG’s strategic importance as the most important local investment and development company (“LIDC”) that is responsible for infrastructure construction, industrial development and state-owned capital and asset operation in Xuchang, and the linkage between the Xuchang government and XIG, 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 Xuchang government may face significant negative impact on its reputation and financing activities if XIG encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Xuchang government holds 100% ownership of XIG via the Xuchang Finance Bureau (“Xuchang FB”), and is the actual controller of the company. The Xuchang 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, etc. In addition, the Xuchang government has formulated a performance assessment mechanism for the company and appoints auditors to review the company’s operating performance and financial position on a periodic basis.

Strategic Importance to Xuchang and Strategic Alignment: XIG is the most important LIDC in Xuchang that is responsible for the infrastructure construction, industrial development and state-owned capital and asset operation in Xuchang. The company is engaged in the investment, construction and operation of infrastructure facilities, together with land development and affordable housing sales in the region. The company is also engaged in entrusted loans, guarantee, commodity sales, rental and leasing, etc. It plays an important role in promoting the economic and social development of the region. Its business operation and strategic planning have been aligned with the government’s development plans.

Ongoing Government Support: XIG continued to receive financial subsidies and asset/capital injections from the local government to support its business operations. We believe the government support will remain intact given the company’s strategic importance in Xuchang. Between 2020 and the first nine months of 2023, the local government injected cash capital of RMB187.0 million into XIG, enlarging its paid-in capital to RMB1.6 billion at end-September 2023 from RMB1.4 billion at end-2020. During the same period, XIG received financial subsidies totaling around RMB1.89 billion from the local government. Meanwhile, the company received asset injections from the local government in the form of

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Applicable Criteria

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

properties, sand and stone management rights, equity transfers and other assets, which reached about RMB10.1 billion.

XIG's Financial and Liquidity Position: XIG's total assets increased to RMB106.3 billion at end-September 2023 from RMB92.2 billion at end-2020, as the company actively participated in the infrastructure construction and land development projects in Xuchang. Its total debt also increased to RMB31.2 billion at end-September 2023 from RMB26.5 billion at end-2020. At end-September 2023, the short-term debt and long-term debt accounted for 31.7% and 68.3% of the total debt, respectively. The company's financial leverage, as measured by debt/capitalization, was in the range of 35%-38% over the same period.

XIG's short-term debts repayment pressure was moderate. At end-September 2023, XIG had cash assets of RMB2,521 million (including RMB20 million of restricted cash), compared with its non-current debt due within one year of RMB9,888 million. Nevertheless, XIG has accessed to various financing channels, including bank borrowings, bond issuance and non-traditional financing (such as financial lease) to support its debt repayments and business operations. Its short-term bank borrowing (RMB1,270 million) was expected to be rolled over, and it had unused credit lines and available bond issuance quota of RMB14.6 billion and RMB6,700 million, respectively.

Economy and Fiscal Condition of Xuchang: Xuchang is a prefecture-level city of Henan Province ("Henan") and is located in the center of Henan, bordering Zhengzhou on the north. Xuchang maintained moderate economic growth during the past few years, with the GDP growth rate of 2.7%, 5.5% and 1.8% in 2020, 2021 and 2022, respectively. Xuchang's GDP reached RMB374.7 billion in 2022, which was ranked 4th among 18 prefecture-level cities of Henan.

The aggregate fiscal revenue of the Xuchang government was mainly derived from the budgetary revenue and transfer payment from the higher government. In 2020-2022, the budgetary revenue of the Xuchang government increased from RMB18.2 billion to RMB20.4 billion, with the contribution of tax revenue fluctuating between 64.9% and 67.1% over the same period. The financial self-sufficiency rate of Xuchang was weak but improving, with the budget deficit narrowing to 70.1% in 2022 from 100.3% in 2020. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, surged to 148.1% at end-2022 from 91.3% at end-2020.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Xuchang

Xuchang is a prefecture-level city of Henan Province ("Henan") and is located in the center of Henan, bordering Zhengzhou on the north. Xuchang is renowned for its abundant tourism resources and rich cultural heritage. The city is ranked as one of the National Ecological

Park Cities, National Forest Cities and China's Best Tourism Cities. Xuchang has jurisdiction over 2 districts, 2 county-level cities, 2 counties and 3 functional areas with a total land area of 4,979 square kilometers. At end-2022, Xuchang had a residential population of 4.4 million with an urbanization rate of 55.2%.

Xuchang maintained moderate economic growth during the past few years, with the GDP growth rate of 2.7%, 5.5% and 1.8% in 2020, 2021 and 2022, respectively. Xuchang's GDP reached RMB374.7 billion in 2022, which was ranked 4th among 18 prefecture-level cities of Henan. The economic structure of Xuchang was mainly driven by the secondary and tertiary industries, which accounted for 52.0% and 42.9% of its GDP in 2022, respectively.

Xuchang's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	344.9	365.5	374.7
-Primary industry (%)	5.3	5.0	5.2
-Secondary industry (%)	52.7	52.3	52.0
-Tertiary industry (%)	42.0	42.7	42.9
GDP growth rate (%)	2.7	5.5	1.8
Fixed asset investment	298.5	319.7	331.8
Fixed asset investment growth rate (%)	1.7	7.1	3.8
Population (million)	4.4	4.4	4.4

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Xuchang

The aggregate fiscal revenue of the Xuchang government was mainly derived from the budgetary revenue and transfer payment from the higher government. In 2020-2022, the budgetary revenue of the Xuchang government increased from RMB18.2 billion to RMB20.4 billion, with the contribution of tax revenue fluctuating between 64.9% and 67.1% over the same period. The financial self-sufficiency rate of Xuchang was weak but improving, with the budget deficit narrowing to 70.1% in 2022 from 100.3% in 2020. The transfer payment from the higher government is another important part of the aggregate revenue, though it decreased from RMB17.9 billion in 2020 to RMB16.9 billion in 2022.

The outstanding amount of the Xuchang government's debt rose considerably in 2020-2022, as both the general obligations and special debts were on an upward trend. At end-2022, the Xuchang government's outstanding debt was RMB67.7 billion, including RMB16.4 billion of general obligations and RMB51.3 billion of special debt. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, surged to 148.1% at end-2022 from 91.3% at end-2020.

Xuchang's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	18.2	18.9	20.4
Budgetary revenue growth rate (%)	1.1	4.0	7.8
Tax revenue	11.8	12.7	13.6
Tax revenue (% of budgetary revenue)	64.9	67.1	66.7
Government fund income	14.6	11.9	8.2
Transfer payment	17.9	15.9	16.9
Aggregate revenue	51.1	47.1	45.7
Budgetary expenditure	36.4	32.6	34.7
Budget balance ¹ (%)	-100.3	-72.2	-70.1

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

XIG was established in August 1988 with an initial registered capital of RMB5.0 million, and it was funded by the Xuchang FB. After an array of capital injections, the company's registered and paid-in capital increased to RMB5.0 billion and RMB1.6 billion at end-September 2023, respectively. At end-September 2023, the Xuchang FB was the sole controlling shareholder, holding 100% shares of the company, and the Xuchang government was the actual controller of XIG.

Strategic Importance and Government Linkage

Strategic Importance of XIG to Xuchang

XIG is the most important LIDC in Xuchang that is responsible for the infrastructure construction, industrial development and state-owned capital and asset operation in Xuchang. The company is engaged in the investment, construction and operation of infrastructure facilities, together with land development and affordable housing sales in the region. The company is also engaged in entrusted loans, guarantee, commodity sales, rental and leasing, etc. It plays an important role in promoting the economic and social development of the region. Its business operation and strategic planning have been aligned with the government's development plans.

Strong Linkage with the Local Government

XIG's linkage with the local government is strong as the Xuchang government holds 100% ownership of XIG via the Xuchang FB, and is the actual controller of the company. The Xuchang 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, etc. In addition, the Xuchang government has formulated a performance assessment mechanism for the company and appoints auditors to review the company's operating performance and financial position on a periodic basis.

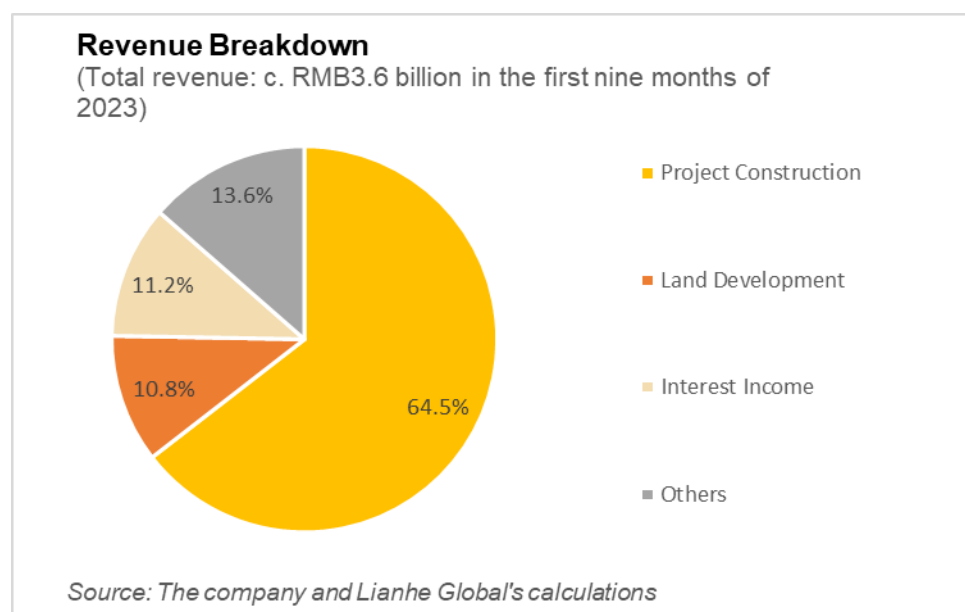
Government Support

XIG continued to receive financial subsidies and asset/capital injections from the local government to support its business operations. We believe the government support will remain intact given the company's strategic importance in Xuchang. Between 2020 and the first nine months of 2023, the local government injected cash capital of RMB187.0 million into XIG, enlarging its paid-in capital to RMB1.6 billion at end-September 2023 from RMB1.4 billion at end-2020. During the same period, XIG received financial subsidies totaling around RMB1.89 billion from the local government. Meanwhile, the company received asset injections from the local government in the form of properties, sand-mining right, equity transfers and other assets, which reached about RMB10.1 billion.

Business Profile

The Most Important Entity Responsible for Infrastructure Construction, Industrial Development and Stated-owned Capital and Asset Operation in Xuchang

XIG is the most important LIDC in Xuchang that is responsible for the investment, construction and operation of infrastructure facilities within the region. The primary sources of the company's operating revenue are project construction, land development and affordable housing sales. The company is also engaged in entrusted loans, guarantee, commodity sales, rental and leasing, etc. The total operating revenue of XIG was RMB6.3 billion, RMB6.6 billion, and RMB3.6 billion in 2021, 2022 and the first nine months of 2023, respectively. The gross profit margin stayed at c. 22.0% over the same period.



Project Construction

The company's project construction business mainly includes infrastructure construction and affordable housing construction. The infrastructure construction business is mainly operated under the entrusted construction mode. Having said that, the company is involving in self-operated infrastructure construction projects as well. XIG is mainly engaged in the construction in roads, bridges, industrial parks and shantytown redevelopment, etc. The income derived from this segment was RMB3,113 million, RMB3,652 million and RMB2,321 million in 2021, 2022 and the first nine months of 2023, respectively. The gross profit margin of this segment ranged between 11.1% and 13.4% over the same period.

Land Development

Authorized by the government of the Dongcheng district in Xuchang, the company is responsible for the land development and consolidation within the region. The revenue recognition for this segment hinges on the progress of the land transfer and land sales transaction. Therefore, the segment income may fluctuate over the years. The income derived from this segment was RMB1,011 million, RMB821 million and RMB388 million in 2021, 2022 and the first nine months of 2023, respectively. The gross profit margin of this segment fluctuated between 8.6% and 25.2% over the same period.

Interest Income

In order to support the operation and development of key local enterprises in Xuchang, XIG carries out the entrusted loan business which employs its own financial resources in

supporting the financing needs of these local enterprises. The income derived from this segment was RMB212 million, RMB575 million and RMB401 million in 2021, 2022 and the first nine months of 2023, respectively. The gross profit margin of this segment was high, staying at 100% over the same period.

Other Businesses

Other businesses of XIG include guarantee, commodity sales, rental, leasing and management fee, etc., with each segment accounted for a small proportion of the company's total revenue. Other businesses mainly play the role of supplementing the revenue of the main businesses and further diversify XIG's revenue structure.

Financial Profile

Balance Sheet Structure and Quality

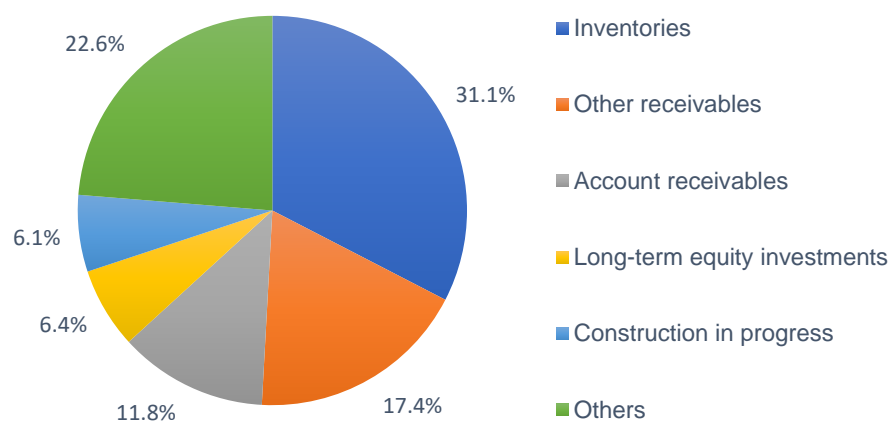
Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	Sep 2023
Total Asset	92,231	108,679	106,570	106,274
Equity	44,217	51,722	57,091	56,214
Debt	26,519	31,180	31,920	31,157
Debt / (Debt + Equity) (%)	37.5	37.6	35.9	35.7
LT Debts	20,657	22,224	19,631	21,269
LT Debt / (LT Debt + Equity) (%)	31.8	30.1	25.6	27.4

Source: Company information and Lianhe Global's calculations

XIG's total assets increased to RMB106.3 billion at end-September 2023 from RMB92.2 billion at end-2020, as the company actively participated in the infrastructure construction and land development projects in Xuchang. Its total debt also increased to RMB31.2 billion at end-September 2023 from RMB26.5 billion at end-2020. At end-September 2023, the short-term debt and long-term debt accounted for 31.7% and 68.3% of the total debt, respectively. The company's financial leverage, as measured by debt/capitalization, was in the range of 35%-38% over the same period.

Asset Breakdown

(Total assets: RMB106.3 billion at end-September 2023)



Source: The company and Lianhe Global's calculation

XIG's asset liquidity was moderate, with the current asset accounting for 71.3% of the total assets at end-September 2023. The company had a large size of inventories (mainly construction cost, land to be developed and land use rights), which accounted for 31.1% of the total assets at end-September 2023. These inventories usually take a long time to monetize due to protracted construction, recognition and cash collection periods. Moreover, the company had a large amount of account receivables and other receivables (mainly due from government agencies), together representing 29% of the total assets.

Debt Servicing Capability

XIG's short-term debts repayment pressure was moderate. At end-September 2023, XIG had cash assets of RMB2,521 million (including RMB20 million of restricted cash), compared with its non-current debt due within one year of RMB9,888 million. Nevertheless, XIG has accessed to various financing channels, including bank borrowings, bond issuance and non-traditional financing (such as financial lease) to support its debt repayments and business operations. Its short-term bank borrowing (RMB1,270 million) was expected to be rolled over, and it had unused credit lines and available bond issuance quota of RMB14.6 billion and RMB6,700 million, respectively.



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