

Wuhan Optics Valley Financial Holding Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	A
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	22 August 2024

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘A’ global scale Long-term Issuer Credit Rating with Stable Outlook to Wuhan Optics Valley Financial Holding Group Co., Ltd. (“WOVFH” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the Management Committee of Wuhan Donghu New Technology Development Zone (“the Management Committee”), the de facto local government of Wuhan Donghu New Technology Development Zone (“Donghu NTZ”), would provide very strong support to WOVFH if needed, in light of its indirect majority ownership of WOVFH, WOVFH’s strategic importance as a key investment platform in Donghu NTZ, and the linkage between the local government and WOVFH, including appointment of the senior management, strategic alignment, supervision of major investment and financing decisions and ongoing operational and financial support. In addition, the local government may face significant negative impact on its reputation and financing activities if WOVFH encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The management committee indirectly owns 99.61% shares of WOVFH, and is the company’s actual controller. The local government has strong control and supervision over the company, including management appointment, decision on its strategic development, and supervision of its major investment and funding plans. In addition, the local government has assessment mechanism over the company and appoints auditors to supervise its operating performance and financials on a periodic basis.

Strategic Importance and Alignment: WOVFH is a key investment platform in Donghu NTZ. The company is responsible for the investment in funds such as Hubei Integrated Circuit Fund, National Integrated Circuit Industry Investment Fund (Phase II), and Yangtze Memory Phase II projects to support the development of the state-of-the-art technologies, and in high technology companies within the region. It plays an important role in promoting high and new technology industries’ development in Donghu NTZ. Its development strategy has been aligned with the local government’s economic and social development plans.

Strong Government Support: The local government provides strong support to WOVFH. Between 2021 and 2023, the local government injected cash capital amounting to approximately RMB10 billion into WOVFH through its shareholders to support its investment. The company also received ongoing operational subsidies from the local government. We expect the support from the local government to remain intact given WOVFH’s strategic importance in Donghu NTZ.

Economy and Fiscal Condition of Local: Donghu NTZ, also known as the Optics Valley of China, was established in 1988 in Wuhan, the capital city of Hubei Province. It is one of the first batch National High-tech Zones of China and is famous for being a National Optoelectronic Information Industrial Base. In recent years, Donghu NTZ is constructing two

Key Figures of WOVFH and Donghu High-tech Zone (RMB billion)

Donghu High-tech Zone	2022	2023
GDP	264.4	276.8
GDP growth rate (%)	6.0	4.7
Budgetary revenue	19.0	20.6
Government fund	20.2	17.8
Transfer payment	9.3	0.9
Budgetary expenditure	23.2	20.7
WOVFH	2023	2024.3
Asset	76.3	77.7
Equity	45.1	45.2
Revenue (million)	147	12

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

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Applicable Criteria

China Local Investment and Development Companies Criteria
(31 July 2024)

world-class trillion-yuan-level industry clusters, namely the “Optics, IC, Displays, Terminals and Internet” cluster and the biomedicines cluster. Donghu NTZ recorded GDP of RMB276.8 billion in 2023, representing an annual growth of 4.7%. Its GDP scale was ranked first among all Wuhan’s jurisdictions.

The budgetary revenue of the Donghu NTZ increased from RMB19.5 billion in 2021 to RMB20.6 billion in 2023. The financial self-sufficiency rate of Donghu High-tech Zone was improving, with the budget deficit narrowing to 0.6% in 2023 from 9.0% in 2021. However, the government fund income, as another important part of aggregate revenue, declined from RMB26.4 billion in 2021 to RMB17.8 billion in 2023, owing to the weak property market.

The outstanding amount of the Donghu High-tech Zone government’s debt continued to grow in the past few years. By the end of 2023, the Donghu NTZ’s outstanding debt was RMB48.9 billion, up from RMB37.5 billion at end-2021. Its government debt ratio, as measured by total government debt outstanding/aggregate revenue, was elevated to 101.6% at end-2023 from 72.3% at end-2021, mainly due to the increase in special debt to support public projects and investments.

WOVFH’s Financial and Liquidity Position: WOVFH’s total asset grew significantly by 150% to RMB77.7 billion at end-March 2024 from RMB31.1 billion at end-2021, as the company actively invested in funds and technology companies in Donghu NTZ. The company relied on both borrowings and equity injections to fund its investments. Its total debts increased by 358% to RMB19.7 billion from RMB4.3 billion over the same period. Yet the company’s financial leverage, as measured by total debts to capitalization, stayed at a manageable level of 30% at end-March 2024, owing to multiple capital injections from the government.

The short-term debt servicing pressure of WOVFH was moderate. At end-March 2024, the company had cash balance of RMB6.7 billion as compared to short-term debts due within one year of RMB2.2 billion. In addition, the company has access to various financing channels, including bank borrowings, bond issuance and other non-traditional financings, to support its operations and debt repayments. At-end March 2024, WOVFH has unused credit lines amounting to RMB5 billion.

Rating Sensitivities

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

We would consider upgrading WOVFH’s rating if there is strengthened support from the local government.

Operating Environment

Economic Condition of Donghu NTZ

Donghu NTZ, also known as the Optics Valley of China, was established in 1988 in Wuhan, the capital city of Hubei Province. It is one of the first batch National High-tech Zones of China and is famous for being a National Optoelectronic Information Industrial Base. There are 42 higher education institutions located in Donghu NTZ, including Wuhan University and

Huazhong University of Science and Technology, supporting its new technology industries' development.

In recent years, Donghu NTZ is constructing two world-class trillion-yuan-level industry clusters, namely the "Optics, IC, Displays, Terminals and Internet" cluster and the biomedicines cluster. Donghu NTZ recorded GDP of RMB276.8 billion in 2023, representing an annual growth of 4.7%. Its GDP scale was ranked first among all Wuhan's jurisdictions.

Donghu High-tech Zone's GDP and Fixed Asset Investment

(RMB billion)	2021	2022	2023
GDP	240.1	264.4	276.8
-Primary industry (%)	0.2	0.0	-
-Secondary industry (%)	44.1	46.1	-
-Tertiary industry (%)	55.7	53.9	-
GDP growth rate (%)	16.8	6.0	4.7
Fixed asset investment growth rate (%)	20.1	11.5	-
Population (million)	1.2	1.2	1.2

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Donghu NTZ

The aggregate fiscal revenue of the Donghu High-tech Zone government was mainly derived from budgetary revenue and government fund income. The budgetary revenue of the Donghu NTZ increased from RMB19.5 billion in 2021 to RMB20.6 billion in 2023, while the contribution of tax revenue stayed above 90%. The financial self-sufficiency rate of Donghu High-tech Zone was improving, with the budget deficit narrowing to 0.6% in 2023 from 9.0% in 2021. However, the government fund income, as another important part of aggregate revenue, declined from RMB26.4 billion in 2021 to RMB17.8 billion in 2023, owing to the weak property market.

The outstanding amount of the Donghu High-tech Zone government's debt continued to grow in the past few years. By the end of 2023, the Donghu NTZ's outstanding debt was RMB48.9 billion, including RMB10.0 billion of general obligations and RMB38.9 billion of special debts, up from RMB37.5 billion. Its government debt ratio, as measured by total government debt outstanding/aggregate revenue, was elevated to 101.6% at end-2023 from 72.3% at end-2021, mainly due to the increase in special debt to support public projects.

Donghu NTZ's Fiscal Condition

(RMB billion)	2021	2022	2023
Budgetary revenue	19.5	19.0	20.6
Budgetary revenue growth rate (%)	41.3	6.6*	8.3
Tax revenue	17.9	17.3	18.5
Tax revenue (% of budgetary revenue)	91.9	90.9	90.1
Government fund income	26.4	20.2	17.8
Transfer payment	6.0	9.3	9.5
Aggregate revenue	52.0	48.6	48.1
Budgetary expenditure	21.2	23.2	20.7
Budget balance ¹ (%)	-9.0	-22.0	-0.6

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

*Excluding the influence of value-added tax credit refund

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

WOFH was established in June 2015 with an initial registered capital of RMB50million, funded by the Management Committee. After an array of capital replenishment and equity transfers, the company's registered and paid-in capital was RMB20.0 billion and RMB17.8 billion at end-March 2024, respectively. The Management Committee, as the actual controller, holds 99.61% shares of the company through three local SOEs.

Strategic Importance and Government Linkage

Strategic Importance of WOFH to Local

WOFH is a key investment platform in Donghu NTZ. The company is responsible for the investment in funds such as Hubei Integrated Circuit Fund, National Integrated Circuit Industry Investment Fund (Phase II), and Yangtze Memory Phase II projects to support the development of the state-of-the-art technologies, and in high technology companies within the region. It plays an important role in promoting high and new technology industries' development in Donghu NTZ. Its development strategy has been aligned with the local government's economic and social development plans.

Strong Linkage with the Local Government

WOFH's linkage with the local government is strong. The management committee owns 99.61% shares of the company, and is the company's actual controller. The local government has strong control and supervision over the company, including management appointment, decision on its strategic development, and supervision of its major investment and funding plans. In addition, the local government has assessment mechanism over the company and appoints auditors to supervise its operating performance and financials on a periodic basis.

Strong Government Support

The local government provides strong support to WOFH. Between 2021 and 2023, the local government injected cash capital amounting to approximately RMB10 billion into WOFH through its shareholders to support its investment. The company also received ongoing operational subsidies from the local government. We expect the support from the local government to remain intact given WOFH's strategic importance in Donghu NTZ.

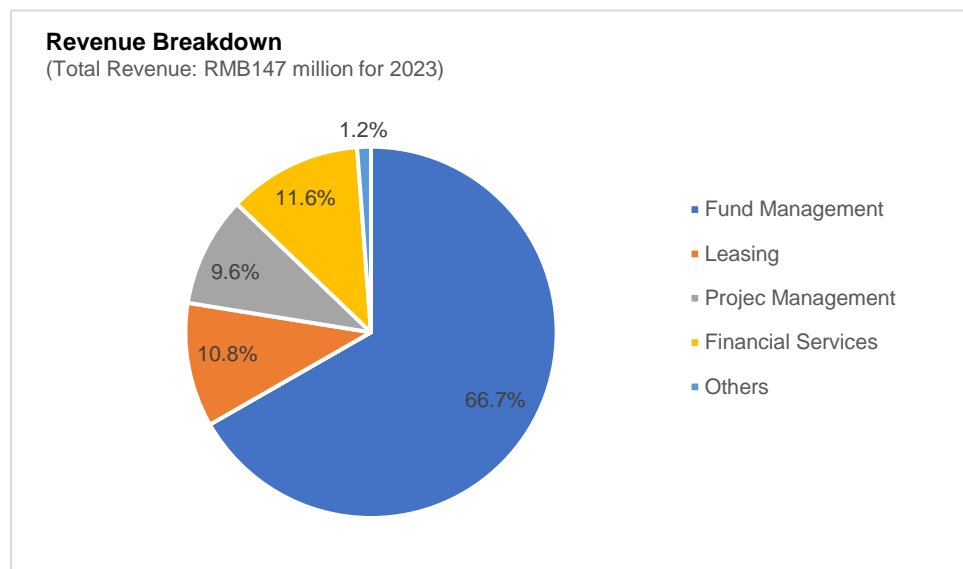
Business Profile

The Key Investment Platform to Promote National Strategy and Local Industrial Development in Donghu NTZ

WOFH, as a key investment platform in Donghu NTZ, is mainly responsible for investment in technology companies within the region. The company has invested over 1,000 companies in Donghu NTZ with total investment amount of RMB60 billion. Especially, the company has participated in the investment of Hubei Integrated Circuit Fund, National Integrated Circuit Industry Investment Fund (Phase II), and Yangtze Memory Phase II projects, to support important national science and technology projects.

The primary source of revenue for the WOVFH are fund management fees, while it also engages in leasing, project management and financial services businesses. The company realized revenue of RMB116 million, 131 million, 147 million, respectively. Its gross margin stayed at a relatively high level of 90.8%, 65.1% and 68.2% over the same period.

Source: Company and Lianhe Global's calculations



Investment and Fund Management

WOVFH mainly invests in technology companies in Donghu NTZ through strategy investments and fund investments and direct investments. The source of funds includes the company's borrowings, governments' fiscal budget and special debts.

For strategy investment, the company invests in Hubei Integrated Circuit Fund, National Integrated Circuit Industry Investment Fund (Phase II), and Yangtze Memory Phase II projects as a limited partner, to promote the development of state-of-the-art technologies. The company has completed strategy investments of RMB58 billion by end-2023. In addition, WOVFH sets up and manages seed funds and private equity investment funds, which target to invest in "Optics, IC, Displays, Terminals and Internet" and the biomedicines industries and earn management fees. The company also direct invests in target companies.

WOVFH recorded investment incomes of RMB151 million, 439 million and 474 million in 2021, 2022 and 2023, respectively, and the company has a strong investment pipeline in next three to five years.

Leasing, Project management and Others

In addition to investment, WOVFH develops and operates industrial parks to provide operational space for technology companies in Donghu NTZ. By end-2023, the company has five projects under construction and one scheduled to be developed with total planned investment of RMB9.6 billion. In 2023, the company recorded rental incomes of RMB16 million by leasing its self-owned properties. We expect the leasing incomes to increase in the next one to two years as more projects will be put into operation.

WOVFH also provides project management services, such as holding of exhibitions and competitions in Donghu NTZ, financial services (e.g. financial guarantees) to local SMEs.

These activities are mainly to provide comprehensive services for companies within the region and to diversify the company's source of incomes.

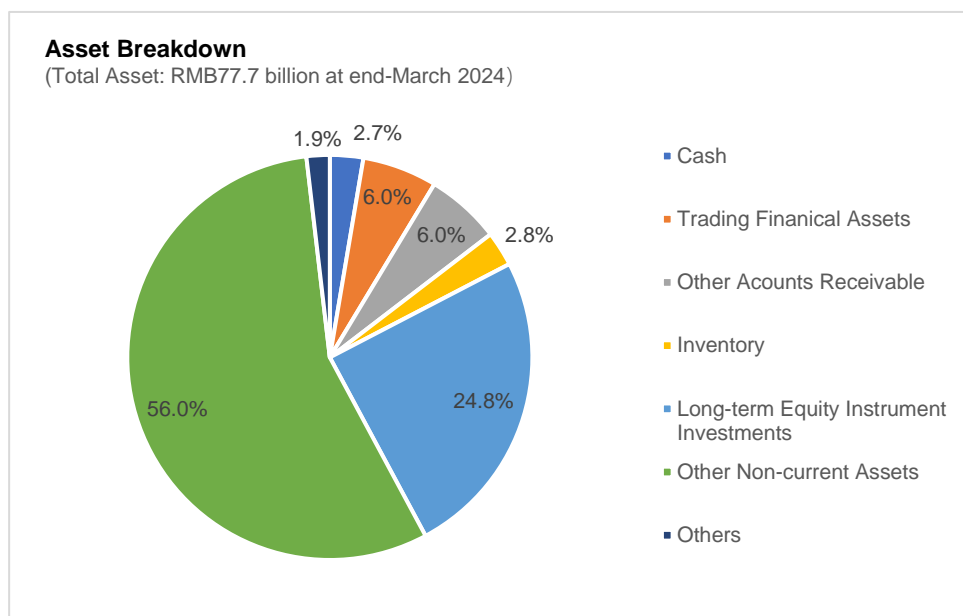
Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality					
(RMB million)	2021	2022	2023	2024.3	2024.3* (adjusted)
Total Asset	31,050	59,323	76,262	77,659	77,659
Equity	19,284	39,665	45,121	45,233	44,303
Debt	4,308	9,426	19,526	19,718	20,648
Debt / (Debt + Equity) (%)	18.3	19.2	30.2	30.4	31.8
LT Debts	3,527	7,019	16,854	17,526	18,456
LT Debt / (LT Debt + Equity) (%)	15.5	15.0	27.2	27.9	29.4

Note Adjusted numbers and ratios reflect the perpetual debts reallocating to long-term debts and total debts from equity*
Source: WOVFH and Lianhe Global's calculations

WOVFH's total asset grew significantly by 150% to RMB77.7 billion at end-March 2024 from RMB31.1 billion at end-2021, as the company actively invested in technology companies in Donghu NTZ. The company relied on both borrowings and equity injections to fund its investments. Its total debts increased by 358% to RMB19.7 billion from RMB4.3 billion over the same period. Yet the local government injected cash capital amounting to approximately RMB10 billion into WOVFH between 2021 and 2023. As a result, the company's financial leverage, as measured by total debts to capitalization, stayed at a manageable level of 30% at end-March 2024.



Source: Company and Lianhe Global's calculations

WOVFH's asset liquidity is weak. Long-term equity instruments investment (mainly investment in technology companies) and Other non-current assets (mainly strategy investment in Yangtze Memory Phase II projects) contributed to majority of the company's total asset. These investments are long-term in nature.

Debt Servicing Capability

The short-term debt servicing pressure of WOVFH was moderate. At end-March 2024, the company had cash balance of RMB6.7 billion as compared to short-term debts due within one year of RMB2.2 billion. In addition, the company has access to various financing channels, including bank borrowings, bond issuance and other non-traditional financings, to support its operations and debt repayments. At-end March 2024, WOVFH has unused credit lines amounting to RMB5 billion.

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