

Credit Opinion

11 May 2023

Ratings	
Senior Unsecured Debt Rating	BBB _g -
Long-Term Credit Rating	BBB _g -
Outlook	Stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

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Zhejiang Huzhou Nanxun Economic Construction Development Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Zhejiang Huzhou Nanxun Economic Construction Development Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Zhejiang Huzhou Nanxun Economic Construction Development Co., Ltd. (“NECD” or the “Company”) reflects Nanxun District Government’s relatively strong capacity to provide support, and its extremely high willingness to provide support to the Company based on our assessment of the Company’s characteristics.

Our assessment of Nanxun District Government’s capacity to provide support reflects its good geographic advantage and improving economic fundamentals, but constrained by modest fiscal profile.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) important role in infrastructure construction in Nanxun Economic and Technological Development Zone (“Nanxun ETDZ”); (2) good access to diversified funding channels; and (3) good track record of receiving ongoing government payments.

However, the rating is constrained by the Company’s increasing debt burden and moderate asset liquidity.

The stable outlook on NECD’s rating reflects our expectation that the local government’s capacity to support the Company will remain stable, and that the Company will maintain its important roles in the infrastructure construction in Nanxun ETDZ.

Rating Drivers

- Important platform for infrastructure construction in Nanxun ETDZ
- Sufficient public policy project reserves
- Good track record of receiving ongoing government payments
- Increasing debt burden and moderate asset liquidity
- Good access to diversified funding channels

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as improvement in debt management.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to support, such as decrease in its strategic significance; decrease in government payments; or increase in exposure to commercial activities.

Key Indicators

	2019FY	2020FY	2021FY	2022Q3
Total Asset (RMB billion)	12.1	21.6	30.1	32.2
Total Equity (RMB billion)	6.0	11.5	15.7	16.2
Total Revenue (RMB billion)	0.8	1.3	1.7	1.1
Total Debt/Total Capital (%)	46.4	44.5	45.4	47.2

All ratios and figures are calculated using CCXAP's adjustments.

Source: CCXAP research

Corporate Profile

Established in 1997, NECD is designated to carry out the directions and policies of Nanxun ETD Management Committee. It is an important local infrastructure construction entity in Nanxun District. The Company is mainly engaged in infrastructure construction in Nanxun ETDZ. In addition, the Company also conducts commercial businesses such as trading, land leasing and surveying and mapping services. As of 30 September 2022, NECD was 100% owned by Huzhou Nanxun Xinkai Construction Group Co., Ltd ("Nanxun Xinkai"). NECD is ultimately controlled by the Finance Bureau of Nanxun District, with a registered and paid-in capital of RMB2.0 billion.

Exhibit 1. Revenue structure in 2021

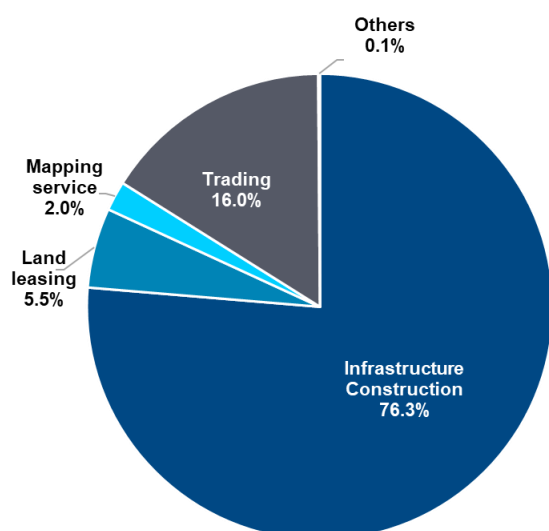
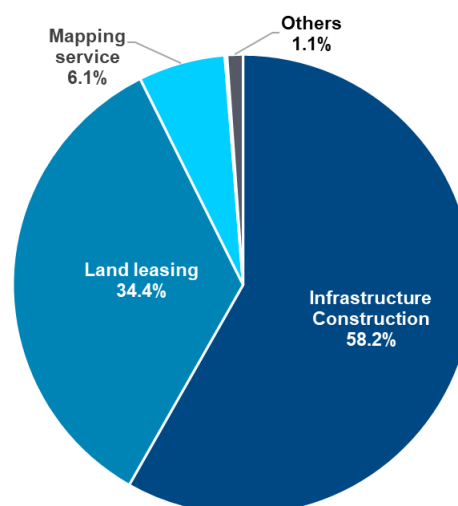
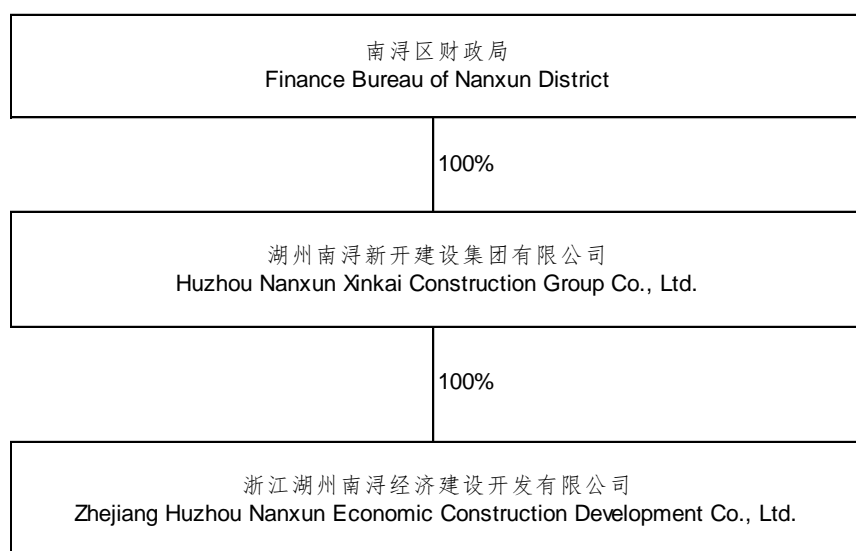


Exhibit 2. Gross profit structure in 2021



Source: Company information, CCXAP research

Exhibit 3. Shareholding Chart as of 30 September 2022



Source: Company information, CCXAP research

Rating Considerations

Government Capacity to Provide Support

We believe that Nanxun District Government has a relatively strong capacity to provide support as reflected by its good geographic advantage and improving economic fundamentals, but constrained by its modest fiscal profile.

Located in the northern part of Zhejiang Province, Huzhou City is the node city connecting the north and south areas of the Yangtze River Delta region. In 2022, Huzhou City recorded a gross regional product (“GRP”) of

RMB385.0 billion, increasing by 3.3% year-over-year (“YoY”). Due to the COVID-19 pandemic and tax refund factor, Huzhou Municipal Government’s general budgetary revenue decreased from RMB41.4 billion in 2021 to RMB38.7 billion. Its fiscal balance remained at a moderate level, with general budgetary revenue to general budgetary expenditure ratio of 64.3% in 2022. However, Huzhou Municipal Government’s debt burden was large with an outstanding direct government debt of RMB118.9 billion at end-2022, accounting for 30.9% of its GRP and 85.7% of its total fiscal revenue.

Exhibit 4. Key Economic and Fiscal Indicators of Huzhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	320.1	364.5	385.0
GRP Growth (%)	3.3	9.5	3.3
General Budgetary Revenue (RMB billion)	33.7	41.4	38.7
General Budgetary Expenditure (RMB billion)	48.4	52.4	60.2
Local Government Debt (RMB billion)	83.7	102.3	118.9

Source: Statistics Bureau of Huzhou City, CCXAP research

Located in the east part of Huzhou City, Nanxun District is at the junction of Jiangsu and Zhejiang Province and is 100 kilometers away from Shanghai and Hangzhou City. It benefits from the industrial transfer and overflow of technical funds in Hangzhou Bay Industrial Belt and Yangtze River Delta Economic Circle, and develops its industrial system forming by two key industries, which are high-end equipment and information economy, and three traditional industries, including new metal material, green home and modern textile, respectively. It is also rich in cultural and natural resources including one national “5A” scenic area and one national “4A” scenic area. In 2022, Nanxun District recorded a GRP of RMB55.9 billion, increasing by 3.5% YoY. However, Nanxun District’s fiscal revenue is highly dependent on transfer payments from the high-tier government, and its general budgetary revenue was RMB4.0 billion in 2022. The fiscal balance of Nanxun District is moderate, with a general budgetary revenue to general budgetary expenditure ratio of 57.4% in 2022. In addition, Nanxun District’s debt profile is weak. Nanxun District’s governmental debt amounted to RMB12.4 billion at end-2022, representing 22.1% of GRP and 118.9% of total fiscal revenue.

Exhibit 5. Key Economic and Fiscal Indicators of Nanxun District

	2020FY	2021FY	2022FY
GRP (RMB billion)	46.8	52.9	55.9
GRP Growth (%)	3.3	8.5	3.5
General Budgetary Revenue (RMB billion)	4.0	4.3	4.0
General Budgetary Expenditure (RMB billion)	5.5	6.6	6.9
Local Government Debt (RMB billion)	7.6	9.2	12.4

Source: Statistics Bureau of Nanxun District, CCXAP research

Established in August 1992 and approved by the Zhejiang Government in December 1993, Nanxun ETDZ is one of the first provincial-level development zones in Zhejiang province. Relying on its excellent location, the surrounding Shanghai Port, Zhapu Port, Ningbo Beilun Port and Zhangjiagang, it can facilitate the import and export trade. Nanxun ETDZ has formed four characteristic leading industries including photoelectric communication, elevator, motor, and wood processing. Nanxun ETDZ also receives continuous support from the Jiangsu Provincial Government and the Huzhou Municipal Government, such as the development of high-tech industries, providing support for the long-term sustainable development of NECD.

Government Willingness to Provide Support

Important platform for infrastructure construction in Nanxun ETDZ

There are four major local infrastructure investment finance groups in Nanxun District to support local economic and industrial development. Each has a clear position under the local government's planning, they are responsible for developing in infrastructure investment and construction, transportation, tourism and Nanxun ETDZ, respectively.

There are three platforms in Nanxun ETDZ, including Nanxun Xinkai, Huzhou Nanxun New City Investment Development Group Co., Ltd ("Nanxun New City") and NECD, Nanxun New City and NECD are Nanxun Xinkai's subsidiaries. New City is mainly responsible for industrial park operation, NECD is an important platform responsible for infrastructure construction in Nanxun ETDZ. The Company's infrastructure construction projects adopt the agency model. The Company signed the entrustment agreement with the entrusted party, and received the construction cost plus 10% for project payment. Such projects were mainly relevant to the construction of roads, bridges and demolition projects. As of 30 September 2022, the Company has completed 8 key infrastructure construction projects with a total investment of around RMB2.0 billion, and there were 17 infrastructure construction projects under construction or planning, with a total outstanding amount of around RMB19.8 billion. Overall, the infrastructure construction business is sustainable given the considerable construction projects in the pipeline. However, they also exert great pressure on the Company's capital expenditure. We expect that the leading position of the Company will be maintained in the foreseeable future given its sufficient project reserves.

Low commercial business risk

NECD also participated in commercial activities such as commercial trading, land leasing, trading and mapping service business. We estimate that the Company had low commercial exposure with the proportion of commercial business assets being less than 10% of its total assets.

NECD started its commercial trading business since 2020, and conducted this business through its subsidiary. The trading business segment mainly includes the sales of ethylene glycol, white granulated sugar, tomato sauce, angle steel and steel billet. In 2021, the Company's trading business revenue has largely increased by 67.7% compared to 2020, but the gross profit margin has remained low, less than 1%. NECD also involves in the land leasing business. In 2020, the Management Committee of Nanxun ETD transferred the land circulation management rights to the Company, and it has generated revenue from leasing land for ecological agricultural production and operation. The leased land is mainly used for fish ponds, fruit and vegetable cultivation, and the lessees are all state-owned enterprises, providing a stable income for the Company. The Company adopts various methods for mapping service business, including bidding and business negotiation. For municipal engineering projects, the Company adopts the bidding method and signs contracts. For construction engineering and real estate projects, the Company adopts a business negotiation method.

In addition, As of 30 September 2022, the Company had 3 self-operated projects under construction, with an estimated investment of RMB2.1 billion, including South Taihu Lake Elite Plan Industrial Park Project and Energy Electronics Industrial Park Project. After the self-operated project is completed, NECD will generate rental or sales income by attracting high-quality enterprises and talents to move in, so as to achieve capital balance. However, we expect that the large initial investment and long payback period of self-operated products will bring large financial pressure on the Company.

Good track record of receiving ongoing government payments

NECD has a proven track record of receiving government support in the form of capital injection, asset transfers, and financial subsidies. In 2021, The Management Committee of Nanxun ETDZ injected various assets including scenic spot franchise rights and parking space into the Company, increasing the Company's total capital reserve by RMB2.5 billion; its controlling shareholder Nanxun Xinkai has injected RMB1.5 billion into the Company. From 2020 to 2022Q3, the Company received RMB600.3 million in government subsidies to support its operation. Given its key role in infrastructure construction projects, we expect the local government will continue to support the Company in the future.

Exhibit 6. Government supports from 2020 to 2022Q3

(RMB million)	2020FY	2021FY	2022Q3
Government Subsidies	232.0	274.0	94.4
Capital Injections			
- Cash	-	1,500	-
- Assets	4,700.0	2,508.6	-
Total	4932.0	4282.6	94.4

Source: Company information, CCXAP research

Increasing debt burden and moderate asset liquidity

NECD's total debt continued to increase in the past three years as ongoing investment needs. From 2019 to 2022Q3, the Company's total debt increased from RMB5.2 billion to RMB15.0 billion, and its total capitalization ratio maintained at a relatively high level of around 47.2% in 2022Q3.

NECD's asset liquidity was moderate as they were mainly inventories with weak liquidity. As of 30 September 2022, the inventories amounted to RMB19.9 billion, accounting for 61.7% of total assets, and mainly consisted of the lands and construction cost caused by infrastructure construction projects. Furthermore, as of 30 September 2022, the Company had pledged assets of RMB1.6 billion for loans, accounting for 10.1% of net assets. The moderate liquidity asset may undermine the Company's financing flexibility, which is credit negative.

Good access to diversified funding channels

NECD has diversified sources of funding including bank loans, onshore and offshore bond issuances. The Company maintains a good relationship with policy banks and large domestic banks such as Agricultural Development Bank of China and Bank of China Limited. As of 30 September 2022, the Company's total credit facilities were RMB16.3 billion, of which the unutilized amount was about RMB4.0 billion. The Company also has access to debt capital markets. As of 30 September 2022, the Company and its subsidiary had 12 onshore and 2 offshore outstanding bonds, with a total outstanding amount of RMB5.4 billion and USD76.5 million, respectively.

Manageable contingent risks resulting from external guarantees

NECD has some exposure to contingent liabilities. As of 30 September 2022, The Company's external guarantees amounted to RMB1.8 billion, accounting for 10.9% of its net assets, all of which were provided to local state-owned enterprises. We believe there are regional cross-guarantees, but the overall risk of contingent liabilities is manageable.

ESG Considerations

NECD assumes environmental risks through its infrastructure construction projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

In terms of social awareness, NECD has played a crucial role in the social welfare of Nanxun ETDZ by involving the construction of roads, bridges and demolition projects.

In terms of corporate governance, NECD's governance considerations are also material as the Company is subject to local government oversight and reporting requirements, reflecting its public-policy role and status as a government-owned entity.

Structural Considerations

NECD's senior unsecured debt rating is equal to its long-term credit rating. We believe that government support will be strong for the Company given its important role in infrastructure construction in Nanxun ETDZ, thereby mitigating any differences in an expected loss that could result from structural subordination.

Rating Methodology

The methodology used in this rating is the Rating Methodology for [China's Local Infrastructure Investment and Financing Companies \(July 2022\)](#).

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