

Credit Opinion

27 June 2023

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

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Huzhou Moganshan High-tech Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g to Huzhou Moganshan High-tech Group Co., Ltd., with stable outlook.

Summary

The BBB_g long-term credit rating of Huzhou Moganshan High-tech Group Co., Ltd. (“HMHG” or the “Company”) reflects Deqing County Government’s 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 Deqing County Government’s capacity to provide support reflects its good geographic advantage, with good economic development and fiscal balance.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) most important market position in infrastructure construction and industrial park development in the Mogan Mountain of Huzhou High-tech Industry Development Zone (“MHTZ”); (2) good track record of receiving government payments; and (3) diversified financing channels.

However, the rating is constrained by the Company’s (1) moderate exposure to commercial activities; (2) increasing debt burden and moderate asset liquidity; and (3) moderate contingent risks resulting from external guarantees.

The stable outlook on HMHG’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 market position in the infrastructure construction and industrial park development in the MHTZ.

Rating Drivers

- Most important market position in infrastructure construction and industrial park development in the MHTZ
- Moderate exposure to commercial activities
- Good track record of receiving government payments
- Increasing debt burden and moderate asset liquidity
- Diversified financing channels
- Moderate contingent risks resulting from external guarantees

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 and asset quality.

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 decreased in its strategic significance; government payments; or increase in exposure to commercial activities.

Key Indicators

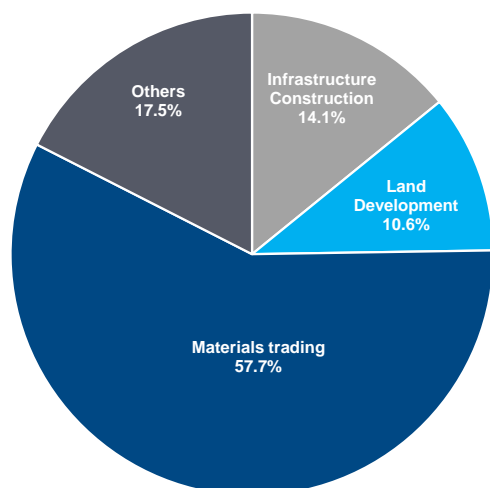
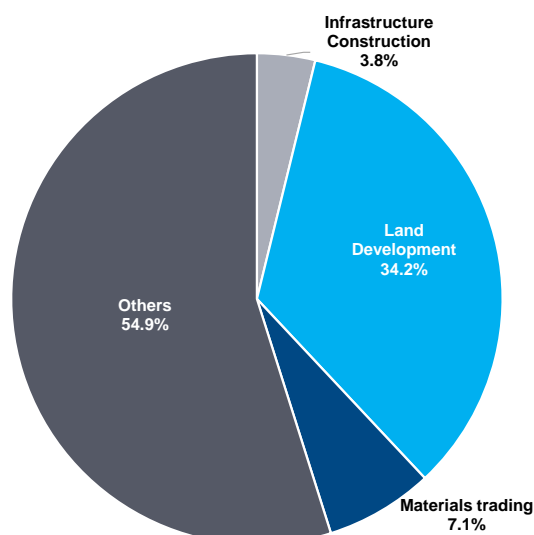
	2020FY	2021FY	2022FY
Total Asset (RMB billion)	57.0	72.3	90.5
Total Equity (RMB billion)	20.9	27.7	36.1
Total Revenue (RMB billion)	2.0	2.1	2.3
Total Debt/Total Capital (%)	60.9	59.9	58.1

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

Source: CCXAP research

Corporate Profile

Established in 2018, HMMG is the most important infrastructure construction and state-owned capital operation platform in the MHTZ and primarily undertakes land development and infrastructure construction projects within the MHTZ. The Company has played an important role in furthering the social and economic development of MHTZ. The Company is also engaged in commercial activities including materials trading and industrial park development businesses. On 31 March 2023, the Company's shareholder was adjusted, it was wholly owned by Huzhou Moganshan State-owned Capital Holding Group Co., Ltd. ("HMSC"), and the MHTZ Management Committee remains as the actual controller, which is a government organ of the Huzhou Municipal People's Government and share the same management team with the Deqing County Government.

Exhibit 1. Revenue structure in 2022**Exhibit 2. Gross profit structure in 2022**

Source: Company information, CCXAP research

Exhibit 3. Shareholding Chart as of 31 March 2023

Source: Company information, CCXAP research

Rating Considerations

Government Capacity to Provide Support

We believe that Deqing County Government has a relatively strong capacity to provide support as reflected by its good geographic advantage, with good economic development and fiscal balance.

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 in 2022. 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 relatively 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 south part of Huzhou City, Deqing County is an important node county in the Hangzhou metropolitan area. It ranked 35th by comprehensive strength in China's top 100 counties in 2022. Deqing County has a balanced development in its primary, secondary and tertiary industries. It has attracted a large number of modern industries, including advanced equipment manufacturing, biopharmaceutical, geographic information, general aviation, artificial intelligence and big data. Benefiting from the superior natural geographical environment, Deqing County has a national tourist resort Moganshan International Tourism Resort. In 2022, Deqing County recorded a GRP of RMB65.8 billion, increasing by 3.8% YoY, representing around 17.1% of Huzhou City's GRP. Its general budgetary revenue was RMB8.0 billion in 2022. Deqing County has a good fiscal balance and moderate debt profile, with a general budgetary revenue to general budgetary expenditure ratio of 78.4% in 2022. It has outstanding government debt amounting to RMB14.7 billion at end-2022, representing 22.2% of GRP and 58.8% of total fiscal revenue.

Exhibit 5. Key Economic and Fiscal Indicators of Deqing County

	2020FY	2021FY	2022FY
GRP (RMB billion)	54.4	61.6	65.8
GRP Growth (%)	2.6	8.7	3.8
General Budgetary Revenue (RMB billion)	6.7	8.3	8.0
General Budgetary Expenditure (RMB billion)	7.8	8.0	10.2
Local Government Debt (RMB billion)	9.8	10.9	14.7

Source: Statistics Bureau of Deqing County, CCXAP research

Formerly known as Deqing Economic Development Zone, MHTZ has been approved as a national-level high-tech industry development zone in Deqing County by the State Council in September 2015. MHTZ has risen by 10 places to 54th in the ranking of national high-tech zones in 2022. MHTZ focuses on the cultivation of high-tech enterprises and new industries, and aims to build a leading innovative development zone in the country. With a friendly environment for technology and innovation businesses, the MHTZ has attracted a large number of enterprises to set up facilities, branches or offices. The Deqing County and the MHTZ have achieved rapid economic and societal growth in recent years, which has provided opportunities and needs for the development of infrastructure and supporting facilities in MHTZ and in turn driving the growth of HMG's business.

Government Willingness to Provide Support

Most important market position in infrastructure construction in the MHTZ

As the most important infrastructure construction and state-owned capital operation platform in the MHTZ, the Company has undertaken a number of infrastructure construction projects within Deqing County. The Company's infrastructure construction projects adopt an agent construction model. The Company signs the entrustment agreement with the government agency, and conducts infrastructure construction work in accordance with such agreement. The Company bears the construction costs for the infrastructure projects with its own financial resources and receives the construction cost plus a certain amount for project payment. As of 31 December 2022, the Company has 38 infrastructure construction projects under construction or planning, with a total investment amount of around RMB4.5 billion and an outstanding amount of around RMB2.6 billion.

The Company conducts its land development business mainly through its subsidiaries. The Company signed land development agreements with the Deqing County Government and Deqing County Natural Resources and Planning Bureau. The Company is mainly responsible for land leveling and construction of supporting facilities and other necessary services after the expropriation of the land. The Company charged land development fees for its land development services rendered, and received the development costs incurred plus a fixed percentage of profits after the completion of land development projects. From 2020 to 2022, the Company had developed and transferred 30 parcels of land with 1.3 million square meters and received payments of RMB947.8 million. As of 31 December 2022, the Company had five land development projects with a total area of about 200,000 mu and a total investment amount of RMB44.4 billion, and an uninvested amount of RMB17.5 billion.

The Company involves in the resettlement housing business through its subsidiaries. The Company is entrusted by government agencies to undertake resettlement housing construction projects. As of 31 December 2022, there were 5 resettlement housing projects under construction or planning, with a total outstanding amount of around RMB4.5 billion. Overall, the Company's public policy business is sustainable given the considerable construction projects in the pipeline. However, this business also exerts great pressure on the Company's capital expenditure.

Moderate exposure to commercial activities

HMHG also participated in commercial activities such as industrial park development and materials trading businesses. We estimate that the Company had moderate commercial exposure with the proportion of commercial business assets being around 15% of its total assets.

The Company participated in the industrial park development business in MHTZ. The Company conducts sales of factories and commercial properties in accordance with the development plans of the local governments, attracting enterprises and investments for the development of MHTZ. As of 31 December 2022, the Company has 16 completed industrial park development projects, with a total invested amount of around RMB5.4 billion, and there were 31 industrial park development projects under construction or planning, with a total outstanding amount of around RMB14.6 billion, indicating great pressure on the Company's capital expenditure.

The Company started its materials trading business in 2018. The materials trading business products mainly include steal, cosmetics and construction materials. The Company adopts a demand-driven business model for its trading business, and does not keep its own inventory. This business contributes a large portion of income for the total revenue of the Company, accounting for 57.7% of its total revenue in 2022, but recording a low gross profit margin of lower than 1%. The Company's high reliance on its top 5 customers and suppliers

increased uncertainties in this business. Besides, the customers are mainly private enterprises, which increased certain risks to the trading business.

Good track record of receiving government payments

HMHG has a proven track record of receiving government support in the form of capital injection, asset transfers, and financial subsidies. From 2020 to 2022, the Company has received asset transfers from the government including greening projects, pipe network and advertising space right, increasing the Company's total capital reserve by RMB18.2 billion. During the same period, the Company received RMB1.6 billion in government subsidies to support its operation. In addition, the Company has a large number of infrastructure construction and land development projects, and will receive the project payments from the government agencies. Given its important position in MHTZ, we expect the local government will continue to support the Company in the future.

Increasing debt burden and moderate asset liquidity

HMHG's total debt continued to increase in the past three years as ongoing investment needs. From 2020 to 2022, the Company's total debt increased from RMB32.7 billion to RMB50.1 billion, and its total capitalization ratio was at a relatively high level of around 58.1% at end-2022. Also, the short-term debt accounts for about 30.4% of total debt. Given its large capital expenditure and slow operating repayment, we expect the Company's debt burden will remain at a relatively high level.

HMHG's asset liquidity was moderate as they were mainly inventories with weak liquidity. As of 31 December 2022, the inventories amounted to RMB47.8 billion, accounting for 52.8% of total assets, which mainly consisted of construction costs caused by infrastructure construction projects. Furthermore, as of 31 December 2022, the Company had pledged assets of RMB7.4 billion for loans, accounting for 20.4% of net assets. The moderate liquidity asset may undermine the Company's financing flexibility, which is credit negative.

Diversified financing channels

HMHG has relatively good access to various sources of funding, including bank loans, onshore and offshore debt financing. As of 31 December 2022, it had obtained a total bank credit facility of RMB36.1 billion, with an unutilized portion of RMB9.2 billion, indicating sufficient standby liquidity. The Company is also a frequent issuer in the bond market. From 2020 to June 2023, the Company issued various bond products, including CPs, MTNs, corporate bonds, and USD bonds, raising RMB26.3 billion and USD420 million. In addition, the Company's exposure to non-standard financing is manageable, accounting for about 14.2% of total debt as of end-2022.

Moderate contingent risks resulting from external guarantees

HMHG has a moderate exposure to contingent liabilities. As of 31 December 2022, The Company's external guarantees amounted to RMB5.5 billion, accounting for 15.3% of its net assets, all of which were provided to local state-owned enterprises. In case a credit event occurs, the Company may face certain contingent liability risks and cross-default risks.

ESG Considerations

HMHG 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, HMHG has played a crucial role in the social welfare of MHTZ by involving the construction of environmental improvement, resettlement housing and road reconstruction projects in MHTZ of Deqing County.

In terms of corporate governance, HMHG'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.

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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