

Credit Opinion

7 July 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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Jiangsu Fushui Water Group Co., Ltd.

Initial credit rating report

CCXAP assigns long-term credit rating of BBB_g- to Jiangsu Fushui Water Group Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Jiangsu Fushui Water Group Co., Ltd. (“FSWG” or the “Company”) reflects Funing County Government’s relatively strong capacity to provide support and extremely high willingness to support based on our assessment of the Company’s characteristics.

Our assessment of Funing County Government’s capacity to support reflects Funing County’s ongoing economic growth along with improving industrial structure. However, its fiscal balance ratio was relatively weak.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) strong role in hydraulic infrastructure construction and public services in Funing County; and (2) solid track record of receiving government support.

However, the Company’s rating is strained by its (1) medium exposure to commercial activities; (2) increased debt level to support investment in public policy projects; and (3) relatively high reliance on non-standard financing.

The stable outlook on FSWG’s rating reflects our expectation that the local government’s capacity to support will remain stable, and the Company will maintain its important position in hydraulic infrastructure construction and public services in Funing County.

Rating Drivers

- Strong role in hydraulic infrastructure construction and public services in Funing County
- Medium exposure to commercial activities
- Increased debt level to support investment in public policy projects
- Solid track record of receiving government support
- Relatively high reliance on non-standard financing

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Funing County 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 reduced exposure to commercial activities and improved access to funding.

What could downgrade the rating?

The rating could be downgraded if (1) Funing County 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 reduced regional significance or deteriorate capital structure.

Key Indicators

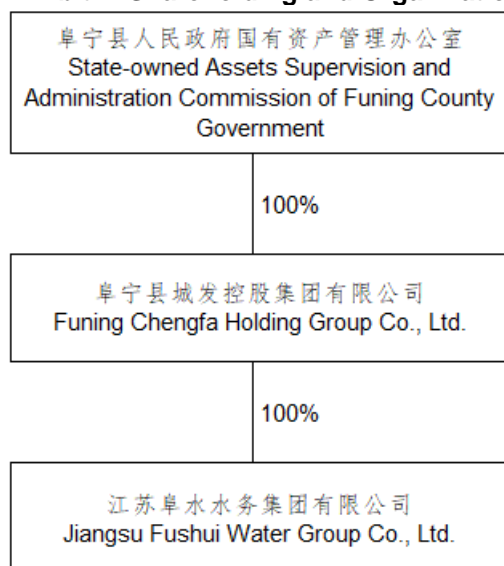
	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	10.0	10.8	13.3	13.2
Total Equity (RMB billion)	5.7	6.2	6.5	6.5
Total Revenue (RMB billion)	0.7	1.1	1.0	0.3
Total Debt/Total Capital (%)	40.2	39.6	49.5	48.5

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

Corporate Profile

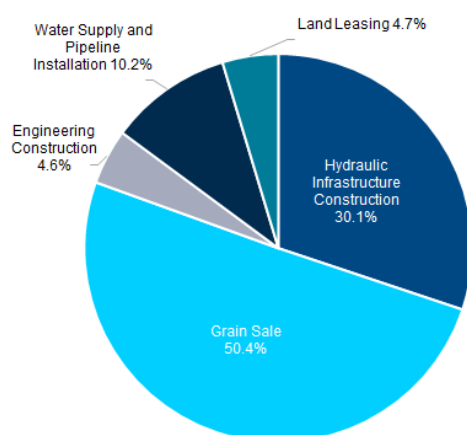
Established in 2009, FSWG is one of the major local infrastructure investment and financing companies ("LIIFCs") in Funing County. FSWG is primarily engaged in hydraulic infrastructure construction, water supply and pipeline installation in Funing County. It also conducts other businesses including grain sales and land leasing. As of 31 March 2023, Funing County Government ultimately controlled the Company and indirectly held 100% shares of the Company through Funing Chengfa Holding Group Co., Ltd. The total assets of the Company were RMB13.2 billion as of 31 March 2023.

Exhibit 1. Shareholding and Organization Chart as of 31 March 2023



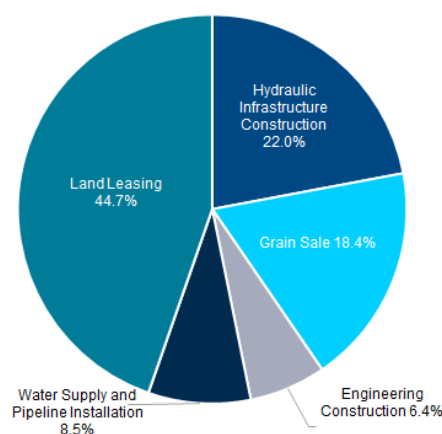
Source: Company information, CCXAP research

Exhibit 2. Revenue Structure in 2022



Source: Company information, CCXAP research

Exhibit 3. Gross Profit Structure in 2022



Rating Considerations

Government's Capacity to Provide Support

We believe the Funing County Government has a relatively strong capacity to provide support given its ongoing economic growth with improving industrial structure. However, its fiscal balance ratio was relatively weak.

Jiangsu Province is one of the leading and well-developed provinces in China. It is home to many of the world leading enterprises of electronic equipment, chemicals, and textiles. Jiangsu Province is the second largest province in China by GRP, after Guangdong Province. In 2022, its total gross regional product ("GRP") amounted to RMB12.3 trillion, growing by 2.8% year-over-year ("YoY"). The GRP per capital was RMB144,390 for the same period, which was the highest one among all provinces in China.

Yancheng City is a prefecture-level city in Jiangsu Province, with a good economic foundation. Its pillar industries include auto parts, machinery, textiles, and chemical industry. Yancheng City is undergoing an economic transition and is developing emerging industries such as high-tech electronic manufacturing, big data, new energy, and intelligent manufacturing, which help support sustainable economic growth in the long run. In

2022, Yancheng City recorded a GRP of RMB708.0 billion, ranking 8th among 13 municipals in Jiangsu Province. On the back of steady economic growth and optimized upgrading of the industrial structure, the general budgetary revenue increased year by year. In 2022, the Yancheng Municipal Government reported a general budgetary revenue of RMB45.3 billion, of which taxes income accounted for around 65.6%. Excluding the impact of tax rebates, the general budgetary revenue increased by 8.1%. However, the fiscal balance ratio (calculated by general budgetary revenue over general budgetary expenditure) was at a moderate level of 40.5%. As of the end of 2022, the local government's outstanding debt amounted to RMB153.5 billion, accounting for about 21.7% of GRP.

Exhibit 4. Key Economic and Fiscal Indicators of Yancheng City

	2020FY	2021FY	2022FY
GRP (RMB billion)	595.3	661.7	708.0
GRP Growth (%)	3.5	7.7	4.6
General Budgetary Revenue (RMB billion)	40.0	45.1	45.3
General Budgetary Expenditure (RMB billion)	97.4	105.3	111.8
Local Government Debt (RMB billion)	137.0	147.3	153.5

Source: Statistics Bureau of Yancheng City, CCXAP research

Funing County is a county-level city under the jurisdiction of Yancheng City. It is one of the strong counties in the food industry, the advanced counties in grain production, and one of the Top 100 counties in China in the new energy industry. Funing County has developed several core industries, including new energy, intelligent manufacturing, and environmentally friendly new material, food processing, and fiber textile, and continued to optimize the industrial structure. From 2020 to 2022, Funing County's economic strength improved steadily with GRP increasing from RMB57.4 billion to RMB70.0 billion. Funing County Government's general budgetary revenue also continued to increase and reached RMB3.1 billion in 2022. Tax revenue is a stable contribution to the general budgetary revenue, accounting for over 70% over the past three years. However, Funing County Government's fiscal balance is relatively low with fiscal balance ratios around 30% over the past three years. It relies highly on governmental fund income and payments from high-tier governments to balance its fiscal budget. The governmental fund income in 2022 decreased to RMB5.5 billion by 26.1% from the previous year as the land transfer income decreased. Its outstanding government debt amounted to RMB14.7 billion at end-2022, accounting for about 21.0% of GRP.

Exhibit 5. Key Economic and Fiscal Indicators of Funing County

	2020FY	2021FY	2022FY
GRP (RMB billion)	57.4	64.5	70.0
GRP Growth (%)	2.4	7.2	4.8
General Budgetary Revenue (RMB billion)	2.8	3.0	3.1
General Budgetary Expenditure (RMB billion)	9.1	9.4	11.0
Local Government Debt (RMB billion)	12.6	13.9	14.7

Source: Statistics Bureau of Funing County, CCXAP research

Government's Willingness to Provide Support

Strong role in the hydraulic infrastructure construction and public services in Funing County

FSWG is one of the key LIIFCs in Funing County and is responsible for infrastructure construction, particularly hydraulic infrastructure, water supply and grain reserves. FSWG undertakes hydraulic infrastructure construction in Funing County by signing construction agreements with the local government and carrying out

the construction work accordingly. The local government would make payments to the Company based on the actual cost plus a markup in return upon completion, generally around 18%. As of 31 March 2023, FSWG has completed a key construction project with a total investment of RMB75 million. The Company also had 8 projects under construction and one project under planning, including river remediation and high-standard farmland construction, with a total investment of RMB3.7 billion and an outstanding amount of RMB816 million. Such projects are essential to the agricultural development of Funing County and are beneficial to the local livelihood.

FSWG engages in water supply covering the entire area of Funing County with a quasi-monopoly position. The water is mainly supplied to residents in Funing County at prices set by the government. As of 31 March 2023, the Company owned three water supply plants with a total water supply capacity of 225,000 tons per day. FSWG also had one water supply plant under construction, with a total water supply capacity of 75,000 tons per day and a total investment of RMB80 million. In addition, the Company is responsible for water pipeline installation business. It mainly provides the installation of indoor and outdoor water supply and drainage facilities and systems for residential communities, enterprises, and institutions in Funing County. As of 31 March 2023, the Company had a total contract amount of RMB1.1 million for pipeline installation.

The Company also undertakes the function of policy grain storage. It is the sole entity responsible for the acquisition, storage, and conversion of county-level grain reserves in Funing County, and the scale of reserves is determined by the Funing County Government. FSWG can enjoy fiscal subsidies for loan interest, storage fees, and rotation fees for the policy grain reserve business.

Medium exposure to commercial activities

FSWG diversified into other business segments such as grain sales and land leasing. The Company has medium exposure to commercial activities, accounting for less than 30% of the Company's total assets, according to our assessment.

Apart from policy grain reserves, FSWG also engages in commodity grain sales business, which is a main component of its revenue. The Company purchases the grains directly from local farmers and sells to downstream customers at market prices through online or offline sales. The downstream customers are dispersed, including flour processing companies, wine-making companies, feed companies, and grain and oil management institutes. The Company conducts grain sales business with advantages as grain production is rich in Funing County and the storage capacity is as large as 121.5 thousand tons. However, the grain sales market is so competitive that the profit margin is relatively low.

FSWG's land leasing business provides additional recurring income to the Company. As of 31 March 2023, the Company has leased 290,962 square meters of land with a total book value of RMB2.5 billion to state-owned companies in Funing County at fixed rents for building sheds and stacking trading materials, and the lease term was two years. We expect the Company to generate a relatively stable operating cash flow, and the risk exposure arising from this business segment is considered to be low.

Solid track record of receiving government support

FSWG has a solid track record of receiving government support in various forms such as capital injection, operating subsidies, and government payment for construction projects. The Company received a capital injection from the government in the form of cash of RMB100 million in 2022, enhancing the capital strength of the Company. The Company had received a total of around RMB401.8 million in subsidies in the past three years. The Company also received a government special-purpose bond fund for the construction of the water

supply plant.

In addition, the Company is expected to receive ongoing government payments for its public policy activities as relevant repurchase agreements were signed with the government. As of 31 March 2023, the Company has received RMB648 million in project repayments from the government. However, these payment periods are long and the payments are close links with the government's fiscal position. The Company still needs to rely on external financing to meet its occasional funding gaps.

Overall, we expect FSWG to receive ongoing support from the government given its strong position in hydraulic infrastructure construction and public services in Funing County.

Increased debt level to support investment in public policy projects

FSWG shows rising debt burden owing to its expansion in the construction of public-policy projects over the past few years. As of 31 March 2023, the Company's total debt increased to RMB6.1 billion from RMB3.9 billion at end-2020. At the same time, the total capitalization ratio, as measured by total debt to total capital, also increased to 48.5% from 40.2% at end-2020. The ongoing increase in the total debt is mainly driven by the investment in policy support projects which are beneficial to local development. The debt structure of the Company continues to improve. As of 31 March 2023, the proportion of short-term debt to total debt decreased to 35.5% from 44.5% as of end-2021. Furthermore, the cash to short-term debt ratio increased to 0.8x from 0.3x as of end-2021. The Company plans to invest around RMB896 million in local infrastructure projects and the water plant construction. Considering the time lag in government payments, the outstanding investment in these projects may rely on external financing, we expect the Company's debt level will continue to increase in the next 12 to 18 months.

Relatively high reliance on non-standard financing

FSWG maintains good relationships with different banks and financial companies such as trust and financial leasing companies. FSWG financed its capital expenditure mainly through bank loans, most of which were guaranteed or mortgaged. As of 31 March 2023, it had total bank credit facilities of approximately RMB4.9 billion with an undrawn portion of RMB1.2 billion, mainly from policy banks, large state-owned banks, and joint-stock commercial banks. However, the Company had certain exposure to non-standard financing, accounting for around 30% of its total debt as of 31 March 2023. The overall cost of financing for non-standard products was high, which may exert a higher pressure on debt repayment. As the Company undertakes more projects encouraged by national policies, the percentages of bank loans may increase, which in turn, will improve the debt structure in the future.

ESG Considerations

FSWG is exposed to environmental risks because it has undertaken hydraulic infrastructure construction projects. Such risks could be moderated by conducting environmental studies and planning before the commencement of projects, and close monitoring during the construction phase.

FSWG bears social risks as it plays a crucial role in the social welfare of the residents in the Funing County. Demographic changes, public awareness and social priorities shape the Company's development targets and ultimately affect the local government's propensity to support the Company.

FSWG's governance considerations are also material as the Company is subject to oversight and reporting requirements to the Funing County Government and has to meet several reporting requirements, reflecting its public-policy role and status as a government-owned entity.

Structural Consideration

FSWG's senior unsecured debt rating is in line with its long-term credit rating. We believe that government support will flow through the Company given its key roles in hydraulic infrastructure construction and public services in Funing County, 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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