

Credit Opinion

18 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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Taizhou Luqiao State-owned Assets Development Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Taizhou Luqiao State-owned Assets Development Group Co., Ltd., with stable outlook.

Summary

The BBB_g long-term credit rating of Taizhou Luqiao State-owned Assets Development Group Co., Ltd. (“LSAD” or the “Company”) reflects (1) Luqiao District Government’s strong capacity to provide support; and (2) the local government’s extremely high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of Luqiao District Government’s capacity to provide support reflects its relatively good comprehensive strength, ongoing economic growth, and good fiscal profile.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) most important position in the infrastructure construction and utility services of Luqiao District; (2) high sustainability of public policy businesses; (3) good track record of receiving government payments; and (4) good access to fundings.

However, the Company’s rating is constrained by its (1) medium exposure to diversified commercial activities, with manageable commercial risks; and (2) high debt leverage and moderate asset liquidity.

The stable outlook on LSAD’s rating reflects our expectation that the local government’s capacity to provide support will remain stable, and the Company will maintain its most important policy role in Luqiao District.

Rating Drivers

- Most important position in infrastructure construction and utility services of Luqiao District
- High sustainability of public policy businesses
- Good track record of receiving government payments
- Medium exposure to diversified commercial activities, with manageable commercial risks
- High debt leverage and weak asset liquidity
- Good access to fundings

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) local government's capacity to provide support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as materially decrease in its exposure to commercial activities.

What could downgrade the rating?

The rating could be downgraded if (1) local government's capacity to provide support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to provide support, such as decrease in its regional importance, materially decrease in government payments, or deteriorated debt management.

Key Indicators

	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	65.7	71.8	76.7	80.4
Total Equity (RMB billion)	24.7	26.1	26.0	26.2
Total Revenue (RMB billion)	1.2	1.4	1.5	0.3
Total Debt/Total Capital (%)	58.2	57.5	61.7	63.4

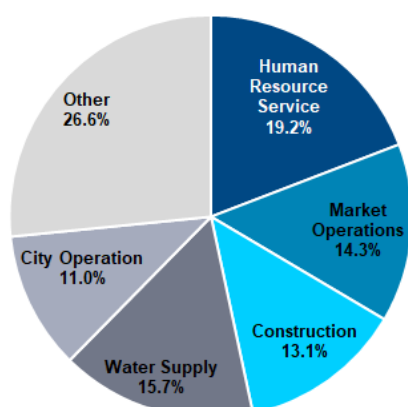
All ratios and figures are calculated using CCXAP's adjustments.

Source: CCXAP research

Corporate Profile

Founded in 2000, LSAD is the most important local infrastructure investment and financing company ("LIIFC") in Luqiao District, Taizhou City. In 2023, the Company integrated with Taizhou City Luqiao Public Asset Investment Management Group Co., Ltd., which has become its core subsidiary. The Company mainly engages in infrastructure construction, resettlement housing construction, water supply and sewage treatment businesses, as well as commercial businesses such as property development, property leasing, trading, and city operation in Luqiao District. The Company is wholly owned and directly controlled by Luqiao District State-owned Assets Work Center.

Exhibit 1. Revenue structure in 2022



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe Luqiao District Government has a strong capacity to provide support given its relatively good comprehensive strength, ongoing economic growth, and good fiscal profile.

Zhejiang Province is one of the most economically developed provinces in China, and its comprehensive economic strength and private economy leads in China. In 2022, the gross regional product ("GRP") of Zhejiang Province was RMB7.8 trillion, ranking 4th among all provinces in China, with a year-on-year ("YoY") increase of 3.1%. In 2022, its general budgetary revenue reached RMB0.8 trillion, ranking 3rd among all provinces in China.

Taizhou City, as one of the key cities in the Yangtze River Delta Economic Area, enjoys a leading position in terms of economic development among all cities in Zhejiang Province. Taizhou City has outstanding transportation infrastructure, making it an important transportation hub in central Zhejiang Province. Taizhou City has a well-developed manufacturing industry, and has formed six pillar industries, such as automobiles and motorcycle accessories, pharmaceutical chemicals, sewing equipment, marine equipment, household appliances, and plastic molds. Taizhou City has a well-developed private economy. At the end of 2022, there were 71 listed companies in Taizhou City, of which about 90% were private-owned enterprises, such as Tianshan Aluminum Group Co., Ltd and Shentong Express Co., Ltd., providing a good foundation for its economy and taxation. In 2022, Taizhou City's GRP increased by 3.7% YoY to RMB578.6 billion, ranking 6th among all prefecture-level cities in Zhejiang Province. Affected by the pandemic, the Taizhou Municipal Government's general budgetary revenue decreased from RMB45.5 billion in 2021 to RMB44.1 billion in 2022. Its fiscal balance ratio was moderate at 52.8%. However, Taizhou City's debt profile is modest. In 2022, its outstanding governmental debt amounted to RMB160.6 billion, equivalent to 26.6% of its GRP.

Exhibit 2. Key economic and fiscal indicators of Taizhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	526.3	578.6	604.1
GRP Growth (%)	3.4	8.3	2.7
General Budgetary Revenue (RMB billion)	40.1	45.5	44.1

General Budgetary Expenditure (RMB billion)	70.0	73.5	83.5
Local Government Debt (RMB billion)	119.8	139.7	160.6

Source: Statistics Bureau of Taizhou City, CCXAP research

Luqiao District is one of the three main urban areas of Taizhou City, with relatively good comprehensive strength. In 2022, it ranked 55th by comprehensive strength among top 100 districts in China. With developed private economy and regional characteristics, it has formed 4 pillar industries: commerce and trade, finance, automobiles, and metal resource recycling. Even affected by the disruptions of the pandemic, the economy of Luqiao District has continued to grow. From 2020 to 2022, the GRP of Luqiao District increased from RMB66.9 billion to RMB75.7 billion. With the ongoing economic growth, Luqiao District Government's general budgetary revenue also increased from RMB3.8 billion in 2020 to RMB5.0 billion in 2022. Besides, Luqiao District has fiscal profile, as reflected by its high fiscal stability and good fiscal self-sufficiency. In 2022, its tax income accounted for 83.1% of general budgetary revenue and its fiscal balance ratio remained high at 93.8%. Luqiao District Government reported outstanding governmental debt of RMB16.3 billion at end-2022, representing 21.6% of GRP.

Exhibit 3. Key economic and fiscal indicators of Luqiao District

	2020FY	2021FY	2022FY
GRP (RMB billion)	66.9	71.7	75.7
GRP Growth (%)	3.4	8.3	3.7
General Budgetary Revenue (RMB billion)	3.8	4.3	5.0
General Budgetary Expenditure (RMB billion)	4.0	4.8	5.4
Local Government Debt (RMB billion)	10.3	15.1	16.3

Source: Statistics Bureau of Luqiao District, CCXAP research

Government's Willingness to Provide Support

Most important position in infrastructure construction and utility services of Luqiao District

There are two primary LIIFCs in Luqiao District, LSAD and Taizhou Luqiao State-owned Assets Operations Co., Ltd. ("LSAO"), each with clear positioning in the development of the region. LSAO is mainly responsible for industrial investment and providing financial services in Luqiao District. LSAD is the largest infrastructure construction and state-owned assets operation entity by total assets in Luqiao District, mainly focusing on infrastructure construction and providing utility services in the area. Considering LSAD's dominant position in undertaking public policy projects and essential role in public utility services in Luqiao District, we believe that the Company will not be easily replaced by other state-owned enterprises in the foreseeable future.

High sustainability of public policy businesses

As the major infrastructure construction and state-owned assets operation entity in Luqiao District, LSAD has participated in infrastructure construction, water supply and sewage treatment, local resettlement, grains collection and storage through its subsidiaries. There are considerable construction projects in the pipeline from these public policy businesses, ensuring their sustainability, but exerting high capital expenditure pressure to the Company.

Entrusted by the local government, LSAD undertakes infrastructure construction projects by self-raised funds. The local government will compensate the Company every year in forms of subsidies, based on the investment in the construction projects. As of 31 March 2023, the Company had invested RMB19.5 billion into 9 major

infrastructure construction projects under construction, with an uninvested amount of RMB4.2 billion, and planned to invest RMB1.6 billion into 4 new projects. Given large uninvested amount on the projects under construction or planning, we believe the infrastructure construction business is highly sustainable, but exerting high capital expenditure pressure to the Company.

LSAD is the sole water supply and sewage treatment services provider in Luqiao District, with stable development momentum. As of 31 March 2023, the Company had one water supply plant and three pumping stations with a daily water supply capacity of 160,000 tons, and 2 sewage treatment plants with a daily sewage treatment capacity of 150,000 tons, serving around 190,000 households in the Luqiao District. Due to the public welfare nature of water services, the Company regularly receives subsidies from the local government to support its operations.

Pursuant to the local resettlement plan, LSAD has also undertaken a number of resettlement housing projects in Luqiao District, which will be sold to the relocation households after completion within the price range set by the local government. As of 31 March 2023, the Company had completed 10 resettlement housing projects, with total investment of RMB2.3 billion, and had 3 projects under construction, with total estimated investment of RMB2.9 billion and uninvested amount of RMB1.8 billion, indicating certain capital needs. As the projects under construction will be completed within two years and there is no project under planning at present, the sustainability of resettlement housing business is subject to uncertainty.

Approved by local government, LSAD also assumes the grains collection and storage functions in Luqiao District and plays an important role in ensuring food safety and maintaining market price. The Company will first purchase the grains through three main stores and then store those grains in third-party factories. Given the public welfare nature of the grain business, the Company regularly receives government subsidies, which amounted to RMB26 million in 2022.

Medium exposure to diversified commercial activities, with manageable commercial risks

LSAD's exposure to commercial activities is medium as its commercial assets accounted for less than 30% of total asset as of 31 December 2022. The commercial businesses include property development, property leasing, city operation, tourism service, hotel operation and building materials trading. We believe that the commercial risks are manageable as most of the commercial businesses provide stable income and reasonable profit to the Company.

LSAD has participated in the leasing of self-owned investment properties in Luqiao District, such as daily necessity shopping mall, farmer's markets, cultural and sports center, fitness center, and industrial plants. The property leasing business can provide stable rental income to the Company. In 2022, affected by the rent reduction policy during the pandemic, the revenue from property leasing decreased by 18.9% YoY to RMB190.0 million, with gross profit margin of 28.9%. We expect the rental income will recover this year given the ease of the pandemic.

LSAD provides city operation services in Luqiao District through its subsidiaries, mainly involving garbage disposal and public cemetery services. The Company is responsible for more than 90% of garbage disposal in Luqiao District, and is the sole social welfare cemetery company in the area, with strong regional advantage. The city operation services provide stable income to the Company, increasing by 8.5% YoY to RMB137.8 million in 2022.

LSAD also engages in building materials trading business, with diversified trading products such as cement and steel. The trading business is susceptible to the demand from downstream property development industry. In 2022, the Company's revenue from trading business decreased by 61% YoY to RMB31 million due to the slowdown of local property market. In addition, the gross profit margin of trading business is as low as 1% in 2022.

LSAD also engages in property development business. The Company will purchase the land through open bidding, and then conduct project construction by self-raised funds. As of 31 March 2023, the Company had completed one real estate project, with total investment of RMB80 million, and had invested RMB224.1 million into one real estate project under construction, with uninvested amount of RMB71.9 million. Given that there is no project under planning and the future capital needs is low, we believe that the property development business risk is manageable.

The Company is also engaged in diversified commercial businesses, such as labor dispatching, security service, hotel service, property management, passenger transport, and travel businesses. However, the income scale of these businesses is small and does not contribute much to the Company's revenue and profit. Given that the Company plans to further diversify its commercial businesses into wellness center, photovoltaic power generation, and civil air defense parking, we expect the Company's exposure to commercial activities will gradually increase in the next two to three years.

Exhibit 4. Construction Projects as of 31 March 2023

	Total Investment (RMB million)	Uninvested amount (RMB million)
Projects under construction		
Infrastructure Construction	23,705.0	4,247
Resettlement Housing	2,919.6	1,793.0
Property Development	296.0	71.9
Projects under planning		
Infrastructure Construction	1,585.2	1,585.2
Self-operating Projects	1,503.2	1,503.2
Total	30,009.0	9,200.3

Source: Company information, CCXAP Research

High debt leverage and weak asset liquidity

With the ongoing financing for the construction projects, LSAD's debt burden has continued to grow over the past three years, resulting in a high debt leverage. The Company's total debt increased from RMB34.3 billion at end-2020 to RMB45.4 billion at end-2023Q1, with a high total capitalization ratio of 63.4%. Nevertheless, the Company has a reasonable debt maturity structure. As of 31 March 2023, its short-term debt accounted for about 35.5% of total debt. With large number of construction projects, we expect the Company will continue to rely on external financing to meet its future capital expenditure needs, and that its debt leverage will remain relatively high in the next 12 to 18 months.

LSAD's asset liquidity is weak, which may undermine its financial flexibility. The Company's assets mainly consist of inventories, other receivables, and construction in progress, all with low liquidity. The inventories and constructions in progress are development costs from construction projects, while the other receivables mainly consist of uncollected payments from the local government and other state-owned enterprises, totally accounting for about 77% of total asset at end-2023Q1.

Good access to fundings

LSAD has good access to fundings, reflected by its sufficient stand-by liquidity and access to direct financing. The Company has good relationship with multiple commercial banks and policy banks in China, such as Agricultural Development Bank of China and Bank of China, and has obtained sufficient credit facilities. As of 31 March 2023, the Company's total credit facilities were RMB35.8 billion, of which the unutilized portion was RMB7.8 billion. The Company's subsidiaries have a track record of bond issuance in the onshore debt capital market. From 2022 to mid-2023, it had issued various bond products such as SCPs, MTNs, PPNs, and corporate bonds, raising about RMB7.3 billion, with average coupon rate of about 3%. It also plans to issue offshore bonds to further diversify its financing channels. However, LSAD has medium exposure to non-standard financing, which accounted for about 20% of its total debts at end-2023Q1.

Good track record of receiving government payments

LSAD has a good track record of receiving support from local government in forms of projects repayment, equity transfer, financial subsidiary, debt swap, and using government special-purpose bonds. From 2020 to 2023Q1, the Company received RMB2.0 billion through equity transfer from the local government. Besides, the Company also received debt swap of RMB1.8 billion and government special-purpose bonds of RMB3.0 billion from 2020 to 2023Q1. In May 2023, equity of Taizhou Luqiao Water Improvement Investment Co., Ltd. and Taizhou Luqiao District Civil Defense Investment Development Co., Ltd. were fully transferred to Taizhou Luqiao Fuxingda Industrial Development Co., Ltd, a subsidiary of the Company. Considering the important position of LSAD and its tight relationship with the local government, we expect that the support from the local government to support LSAD will continue over the next 12 to 18 months.

ESG Considerations

LSAD bears environmental risks through its infrastructure projects. Such risks could be moderated by conducting environmental studies and detailed planning before the commencement of projects and close supervision during the construction.

LSAD is also exposed to social risks as a public services provider in Luqiao District. Demographic changes, public awareness and social priorities shape government's target for LSAD, or affect the government's propensity to support the Company.

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

Structural Consideration

LSAD'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 important role in state-owned assets operation and infrastructure construction in Luqiao District, 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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