

Credit Opinion

13 October 2023

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

Analyst Contacts

Olivia Feng +852-2860 7133

Senior Credit Analyst

olivia_feng@ccxap.com

Waldo Li +852-2860 7137

Assistant Credit Analyst

waldo_li@ccxap.com

Elle Hu +852-2860 7120

Executive Director of Credit Ratings

elle_hu@ccxap.com

**The first name above is the lead analyst for this rating and the last name above is the person primarily responsible for approving this rating.*

Client Services

Hong Kong +852-2860 7111

Luzhou High-tech Investment Group Co., Ltd.

Initial credit rating report

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

Summary

The BBB_g- long-term credit rating of Luzhou High-tech Investment Group Co., Ltd. (“LHIG” or the “Company”) reflects Luzhou Municipal Government’s (1) strong capacity to provide support, and (2) high willingness to provide support based on our assessment of the Company’s characteristics.

Our assessment of Luzhou Municipal Government’s capacity to support reflects Luzhou City’s status as an important trade and logistics center in the Chengdu-Chongqing Economic Circle and a well-known domestic alcohol industry base, with growing economic and fiscal strengths.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) key role in the infrastructure construction and high-tech industry investment in Luzhou High-Tech Industrial Development Zone (“Luzhou High-Tech Zone”); (2) solid track record of receiving government support; and (3) access to funding from banks and bond markets.

However, the Company’s rating is constrained by its (1) relatively low sustainability of public projects; (2) medium exposure to commercial activities; (3) high debt leverage with certain liquidity pressure; and (4) high contingent risk arising from external guarantees.

The stable outlook on LHIG’s rating reflects our expectation that the Luzhou Municipal Government’s capacity to provide support will remain stable, and the Company’s characteristics such as its key role in infrastructure construction in the High-Tech Zone will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Key role in the infrastructure construction and high-tech industry investment in Luzhou High-Tech Zone
- Solid track record of receiving government support
- Good access to funding from banks and bond markets
- Relatively low sustainability of public projects
- Medium exposure to commercial activities
- High debt leverage with certain liquidity pressure
- High contingent risk arising from external guarantees

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Luzhou Municipal 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 materially reduced exposure to risky commercial activities and improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Luzhou Municipal Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to provide support, such as weakened market position, deteriorated access to fundings, or material decreased government support.

Key Indicators

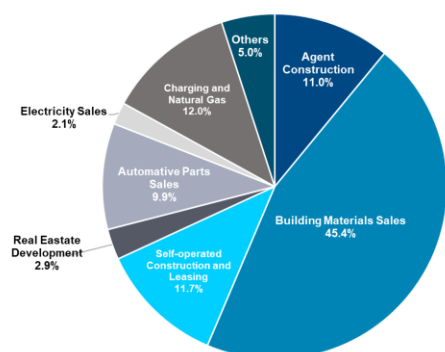
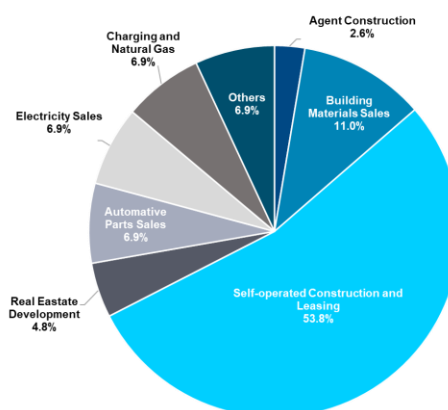
	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	17.5	20.4	21.4	21.5
Total Equity (RMB billion)	5.3	6.3	6.5	6.5
Total Revenue (RMB billion)	1.6	1.9	2.5	0.4
Total Debt/Total Capital (%)	67.5	66.9	67.6	68.9

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

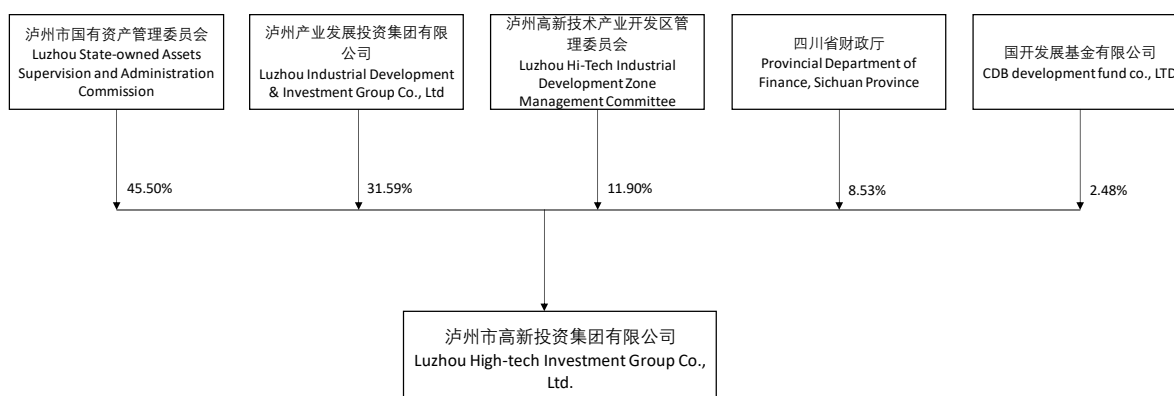
Source: CCXAP research

Corporate Profile

Established in December 2013, LHIG is the sole entity responsible for local infrastructure construction in the Luzhou High-Tech Zone and the sole state-owned high-tech industry investment entity in Luzhou City. The Company is also engaged in businesses such as self-operated project construction and leasing, real estate development, and sales of building materials. As of 31 March 2023, the largest shareholder and the actual controller of the Company was the Luzhou State-owned Assets Supervision and Administration Commission ("Luzhou SASAC"), holding 45.5% of the shares of the Company.

Exhibit 1. Revenue Structure in 2023Q1**Exhibit 2. Gross Profit Structure in 2023Q1**

Source: Company information, CCXAP research

Exhibit 3. Shareholding chart as of 31 March 2023

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe that the Luzhou Municipal Government has a strong capacity to provide support, reflecting Luzhou City's status as an important trade and logistics center in the Chengdu-Chongqing Economic Circle and a well-known domestic alcohol industry base, with growing economic and fiscal strengths.

Sichuan Province is a leading economic province and is recognized as one of the most developed provinces in China. In 2022, Sichuan recorded a gross regional product ("GRP") of RMB5.6 trillion, with a GRP growth rate of 2.9% year on year ("YoY"), ranking 6th in terms of GRP among all provinces in China. Its general budgetary revenue increased to RMB488.2 billion, up by 2.3% YoY. In 2023H1, Sichuan recorded a GRP of RMB2.8 trillion.

Luzhou City is a prefecture-level city of Sichuan Province. With the solid development of industries including liquor, electronic information, energy, and chemicals, Luzhou City's economic and fiscal strength ranks in the upper reaches of Sichuan Province. In 2022, Luzhou City's GRP was RMB260.2 billion, ranking 6th among all prefecture-level cities in Sichuan Province, representing an increase of 4.1% over the previous year. Its general budgetary revenue amounted to RMB19.3 billion in 2022, ranking 3rd among all cities in Sichuan Province, a YoY increase of 1.6%. However, affected by the pandemic and tax refund, the ratio of tax revenue to general budgetary revenue of Luzhou City decreased from 63.8% in 2020 to 42.4% in 2022. Meanwhile, its fiscal balance ratio was around 42.2% in 2022, which was at a moderate level. The government debt was RMB86.8 billion in

2022, representing 33.4% of its GRP and 134.2% of its total fiscal revenue, implying that the regional debt pressure shall be closely monitored.

Exhibit 4. Key economic and fiscal indicators of Luzhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	215.7	240.6	260.2
GRP Growth (%)	4.2%	8.5%	4.1%
General Budgetary Revenue (RMB billion)	17.0	19.0	19.3
General Budgetary Expenditure (RMB billion)	45.0	44.5	45.6
Local Government Debt (RMB billion)	61.1	72.7	86.8

Source: Statistic Bureau of Luzhou City, CCXAP research

Luzhou High-tech Zone was established in 2013 and was upgraded to a national high-tech industrial development zone with the approval of the State Council in February 2015. It is one of the three national high-tech industrial development zones in the upper reaches of the Yangtze River Economic Belt, with a total planned area of 202 square kilometers and a core area of 36 square kilometers. Luzhou High-tech Zone has several parks including the Modern Pharmaceutical Industrial Park, the High-end Equipment Manufacturing Industrial Park, the New Energy and New Materials Industrial Park, the Big Data Industrial Park as well and the Smart Grid Industrial Park. In 2022, enterprises in Luzhou High-tech Zone achieved an aggregate operating income of RMB120 billion, a YoY increase of 6.6%. Luzhou Municipal Government has provided various supports to the High-tech Zone. The land quota will be given priority to the High-Tech Zone, which enjoys preferential prices. Several banks and financial institutions have provided total credit facilities of RMB30 billion to the High-Tech Zone. The development of the high-tech zone provides support for the long-term sustainable development of the Company.

Government's Willingness to Provide Support

Key role in the infrastructure construction and high-tech industry investment in Luzhou High-Tech Industrial Development Zone

LHIG is the only entity responsible for local infrastructure construction in Luzhou High-Tech Zone, providing a range of services including land consolidation and pipeline construction. The infrastructure construction projects undertaken by the Company are mainly carried out through an agency construction model. The Company signs entrusting construction agreements with the entrusting parties, who would repurchase the construction upon project completion. The entrusting party is usually the government department and other state-owned companies. The repurchase payment is calculated based on the construction cost plus an agreed return, typically 10% for land development projects or 15% for engineering construction projects. The Company has successfully completed a series of large-scale infrastructure projects and public welfare facilities, such as schools, landscape and greening projects.

However, the large-scale construction of infrastructure projects in the High-Tech Zone has almost ended, and there are currently no infrastructure projects under construction or planning, the Company's business sustainability of public policy projects is relatively low. In addition, as of 31 March 2023, the Company's total investment amount of infrastructure construction projects was RMB4.0 billion, of which RMB2.5 billion has been collected from government payments.

The Company still plays a crucial role in the Luzhou High-Tech Zone. In order to attract high-quality enterprises to settle in the Luzhou High-Tech Zone, the Company's business has gradually shifted from land development

and infrastructure construction to the construction of factories, office buildings and other facilities. Considering the Company's high strategic significance to the development of Luzhou High-tech Zone, we believe the Company will not be easily replaced by other local state-owned enterprises in the foreseeable future.

Medium exposure to commercial activities

LHIG is also engaged in commercial activities such as self-operated construction and leasing, real estate development, sales of building materials, sales of automotive parts, and charging and natural gas business. Although the Company's commercial activities accounted for about 40% of its total assets in 2022, we consider the business risk in these commercial activities to be manageable, because some businesses are closely related to its strategic role in the industrial development of Luzhou High-tech Zone.

The Company's self-operated construction and leasing business mainly facilitates the investment attraction of Luzhou High-Tech Zone. The Company is responsible for building plants, data centers or office buildings based on the needs of the incoming enterprises. As of the end of March 2023, the Company had a total estimated investment amount of RMB432 million and an outstanding amount of RMB143 million. Currently, the Company has no self-operated projects under planning. As of 31 March 2023, the Company had a total leasing area of 1.1 million square meters, providing supplementary rental income to the Company. In 2022, the revenue from asset leasing was RMB218 million, with a relatively high gross profit margin of 94.5%. However, given the moderating macroeconomic growth, this business segment may face uncertainty in terms of its future cash inflow.

LHIG is engaged in real estate projects through the self-construction model, including residential and commercial property development projects. As of 31 March 2023, the Company had 4 major property development projects under construction, with a total estimated investment amount of RMB4.0 billion and an outstanding amount of RMB1.8 billion. Currently, most real estate projects are in the early development stage. As the sales of real estate projects are subject to the industry downturn, the debts formed by the property development may bring certain debt repayment pressure to the Company.

LHIG's sales of building materials business mainly consist of concrete, sand and stone. The Company mainly establishes cooperation with large central enterprises and supplies concrete, steel and other products to their engineering projects. In 2022, the Company achieved building materials sales revenue of RMB 1.1 billion yuan, an increase of 203.5% from the previous year, which was mainly due to the Company's successful launch of bulk trading (e.g., ethylene glycol, wood). In addition, The Company's auto parts sales business is mainly produced and sold by its subsidiary, Luzhou Hi-Tech AVIC Transmission Steering System Co., Ltd., ("AVIC Transmission"), which mainly produces gears, input shafts, assemblies, internal and external planetary wheels and other automotive transmission system components. However, this business has a relatively high customer concentration risk, since the top 5 customers account for 58.3% of total revenue.

The Company is also engaged in the energy sales business, including smart charging station services, electricity sales, natural gas transfer, and refined oil sales. The Company provides charging services to new energy vehicles through self-constructed charging facilities. As of 31 March 2023, the Company had 3 major charging projects under construction, with a total investment amount of RMB980 million and an outstanding amount of RMB630 million.

Solid track record of receiving government support

The Company has a good track record of receiving support from the local government in the past few years. These supports take various forms, such as government subsidies and capital injections. In 2020, the Luzhou High-Tech Zone Management Committee injected RMB787.0 million into the Company as the operating rights and income rights from parking spaces and advertising spaces, as well as funds for Gaolin Poverty Alleviation Industrial Park. In 2021, the local government injected RMB483.0 million into the Company as a 7% stake in Luzhou Lingang Investment Group Co., Ltd. From 2020 to 2023Q1, LHIG has received government subsidies of RMB157.1 million. In 2023, the Luzhou Municipal Government plans to transfer 20% of the equity interest of Gulin County State-Owned Assets Management Co., Ltd. to the Company. In light of LHIG's important regional position in infrastructure construction and investment attraction of Luzhou High-Tech Zone, we expect the Company to receive ongoing support from the local government over the coming 12-18 months.

Exhibit 5. Government Support from 2020 to 2023Q1

(RMB million)	2020FY	2021FY	2022FY	2023Q1
Government Subsidies	105.9	38.9	12.3	-
Capital Injections	787.0	483.0	-	-
Interest Subsidies	169.7	330.0	579.8	1.0
Total	1,062.6	851.9	592.1	1.0

Source: Company information, CCXAP research

High debt leverage with certain liquidity pressure

With ongoing financing for its construction projects in recent years, LHIG has a high debt leverage. The Company's total debt had increased from RMB11.0 billion at end-2020 to RMB14.4 billion as of 31 March 2023, and its total capitalization amounted to 68.9%. The Company faced certain short-term debt pressure as its short-term debt accounted for around 29.9% of its total debt and its cash/short-term debt remained at 0.2x as of 31 March 2023.

Furthermore, LHIG has moderate asset liquidity. The Company's liquid asset mainly consists of receivables and inventories, which accounted for 88.9% of its liquid asset as of 31 March 2023. Receivables are mainly unreceived payments from the agencies of the government or other state-owned companies. Inventories are mainly investment costs for its construction projects, all of which are considered low liquidity. Moreover, as of the end of March 2023, the total restricted assets were RMB5.3 billion which accounted for 24.5% of total assets and was mainly used for bank financing.

Access to funding from banks and bond markets

LHIG has good access to diversified funding such as bank loans and onshore bond financing, with bank loans accounting for about 47% and bonds accounting for about 31% of its total debts as of 31 March 2023. The Company has issued various types of bonds, such as PPNs, MTNs, and corporate bonds, with an average coupon rate of 6.5%. The Company maintains long-term close relationships with policy banks, state-owned commercial banks, and joint-stock commercial banks, such as the Agricultural Development Bank of China and the Industrial and Commercial Bank of China. The Company held total credit facilities of RMB19.9 billion, with an unutilized amount of RMB2.8 billion as of 5 September 2023. However, as of 31 March 2023, around 21.7% of the Company's total debt was non-standard financing, with an average financing cost of 8.6%.

High contingent risk arising from external guarantees

LHIG's credit profile is constrained by its external non-operating guarantees, which could potentially increase its repayment obligations. As of 31 March 2023, the Company had outstanding external guarantees of RMB8.0 billion, representing 122.9% of its net assets. All of them were provided to local state-owned enterprises ("SOEs"). The Company's contingent liabilities are subject to regional risks due to the mutual guarantee situation. Besides, the Company has lots of mutual payments with other SOEs in this region. In case a credit event occurs, the Company may face certain contingent liability risks, which could negatively impact its credit quality. However, we estimate most of these local SOEs are likely to be supported by the local government when necessary, and therefore contingent risk would be controllable.

ESG Considerations

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

LHIG bears social risks as it implements public policy initiatives by building public infrastructure in the Luzhou High-tech Zone. 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.

LHIG's governance considerations are also material as the Company is subject to oversight by Luzhou Municipal Government and has to meet several 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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China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 1904-1909, 19/F, Jardine House,
1 Connaught Place, Central, Hong Kong

Website: www.ccxap.com

Email: info@ccxap.com

Tel: +852-2860 7111

Fax: +852-2868 0656