

Credit Opinion

29 January 2024

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

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Luoyang Shengshi City Construction Investment Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Luoyang Shengshi City Construction Investment Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Luoyang Shengshi City Construction Investment Co., Ltd. (“LYSS” or the “Company”) reflects Luoyang Municipal Government’s (1) very strong capacity to provide support, and (2) moderate willingness to provide support based on our assessment of the Company’s characteristics.

Our assessment of Luoyang Municipal Government’s capacity to support reflects Luoyang City’s status as the second largest city for years by GRP in Henan Province, with growing economy. Moreover, Mengjin District’s GRP ranks top among all the districts or counties in Luoyang City for years.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) strategic position in infrastructure construction of Mengjin District; and (2) good track record of receiving government support.

However, the rating is constrained by the Company’s (1) large exposure to commercial activities; (2) increasing debt burden and moderate asset liquidity; and (3) moderate level of contingent risk.

The stable outlook on LYSS’s rating reflects our expectation that the Luoyang Municipal Government’s capacity to provide support will be stable, and the Company’s characteristics such as its strategic position in social and economic development of Mengjin District will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Strategic position in infrastructure construction of Mengjin District
- Good track record of receiving government support
- Large exposure to commercial activities
- Increasing debt burden and moderate asset liquidity
- Access to diversified funding channels
- Moderate level of contingent risk

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Luoyang Municipal Government's capacity to support strengthens; or (2) the Company's characteristics change in a way that strengthens the local government's willingness to support such as increased regional significance or improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Luoyang 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 deteriorated debt management or increased exposure to contingent liabilities.

Key Indicators

	2020FY	2021FY	2022FY	2023Q3
Total Asset (RMB billion)	14.8	17.3	18.3	20.9
Total Equity (RMB billion)	8.1	9.3	9.4	9.5
Total Revenue (RMB billion)	0.9	1.0	1.1	0.6
Total Debt/Total Capital (%)	43.8	39.5	43.5	48.6

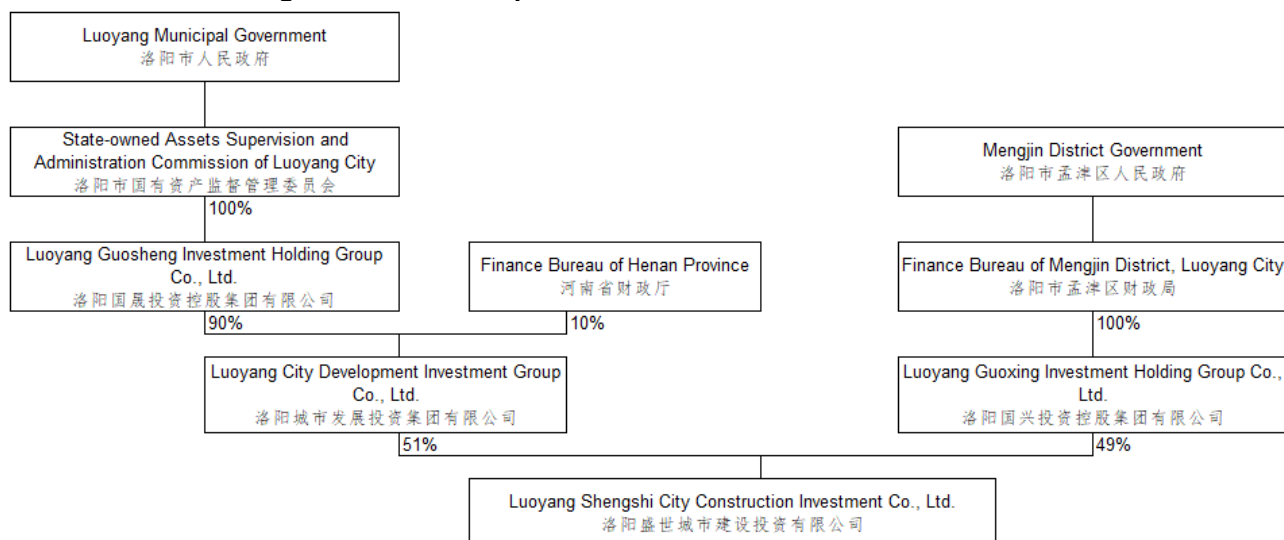
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

Corporate Profile

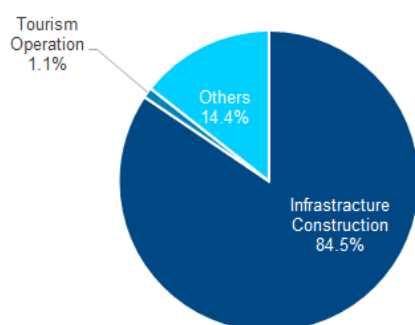
Established in 2010, LYSS is one of state-owned enterprises in Luoyang City and is responsible for infrastructure construction in Mengjin District of Luoyang City. The Company has also diversified into other commercial business, including self-operated construction and tourism operation. As of end-2023, the Company was 51% owned by the Luoyang Municipal Government through Luoyang City Development Investment Group Co., Ltd. ("LYCD") and 49% owned by the Mengjin District Government through Luoyang Guoxing Investment Holding Group Co., Ltd. ("Guoxing Investment"). LYCD is one of the key subsidiaries of Luoyang Guosheng Investment Holding Group Co., Ltd, which is the largest local infrastructure investment and financing company ("LIIFC") by total assets in Luoyang City.

Exhibit 1. Shareholding chart as of 30 September 2023



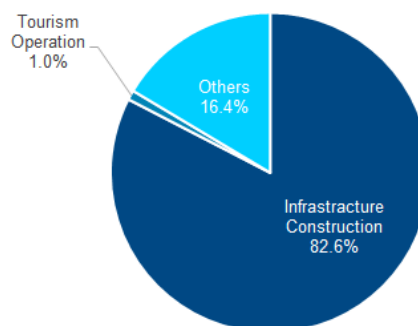
Source: Company information, CCXAP research

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 that the Luoyang Municipal Government has a strong capacity to provide support, reflects Luoyang City's status as the second largest city by GRP in Henan Province for years with growing economy.

Henan Province is located at the junction of the three major regions in China, including eastern, central and western regions. It has a strategic position as an important transportation and communication hub, and a material distribution center in China. With the good transportation and location advantages, Henan Province's GRP ranked 5th among all provinces in China in 2022.

Luoyang City is located in the west of Henan Province, which is the sub-central city in the Central Plains Urban Agglomeration. It is one of the first batch of historical and cultural cities announced by the State Council, and is also an important industrial city in the central region in China. Luoyang City is also an important transportation hub in the central and western regions of my country with several rail networks. Supported by its location advantages, Luoyang City has developed five pillar industries, namely advanced equipment manufacturing, new materials, high-end petrochemicals, electronic information, as well as tourism industries. Luoyang City demonstrated ongoing economic growth over the past three years. In 2022, it reported a GRP of RMB567.5

billion, representing 3.0% year-over-year (“YoY”) growth. The Luoyang Municipal Government’s general budget revenue increased to RMB39.8 billion from RMB38.4 billion in 2020, and tax accounted for more than 60% of its general budget revenue over the past three years. However, Luoyang Municipal Government has relatively low fiscal balance ratio (general budgetary revenue/general budgetary expenditure), averaging at 60.4% over the past three years, indicating its high reliance on fiscal support from higher-tier government. As of end-2022, its government debt balance amounted to RMB77.5 billion, accounting for 13.7% of GRP.

Exhibit 4. Key economic and fiscal indicators of Luoyang City

	2020FY	2021FY	2022FY
GRP (RMB billion)	512.8	544.7	567.5
GRP Growth (%)	3.0	4.8	3.0
General Budgetary Revenue (RMB billion)	38.4	39.8	39.8
General Budgetary Expenditure (RMB billion)	68.9	64.2	62.9
Local Government Debt (RMB billion)	52.9	63.0	77.5

Source: Luoyang Municipal Government, CCXAP research

Mengjin District is located in the northwest region of Henan Province, which is under the jurisdiction of Luoyang City. After years of development, Mengjin District has formed three pillar industries, including high-end petrochemicals, advanced equipment manufacturing, and special new materials. It also developed four major industrial parks, namely Luoyang Circular Economic Park, Luobei Modern Service Industry Cluster, Xincheng Science and Technology Park, and Dry Port Modern Logistics Park. In 2022, Mengjin District’s GRP increased to RMB54.2 billion from RMB33.9 billion in 2020, ranking top among all the districts or counties in Luoyang City for years. In 2022, Luoyang Municipal Government’s general budgetary revenue increased to RMB4.2 billion from RMB2.0 billion in 2020. As of 31 December 2022, the outstanding debt of Luoyang Municipal Government was RMB4.3 billion, accounting for 8.0% of its GRP.

Government’s Willingness to Provide Support

Strategic position in infrastructure construction of Mengjin District

LYSS is one of the most important LIIFC in Mengjin District in local infrastructure construction projects, which are crucial to local social and economic development that benefits the general public and local employment. In November 2023, the Finance Bureau of Mengjin District transferred all its shareholding of the Company to Guoxing Investment, which was a newly-established LIIFC in Mengjin District. Guoxing Investment is expected to become an urban investor and operator in Mengjin District. After the shareholding transfer, the Company is still the key LIIFC in Mengjin District, responsible for local infrastructure construction projects. We believe that the Company will maintain an important position in the public policy projects in Mengjin District and will not be easily replaced by other local state-owned enterprises in the foreseeable future.

The Company undertakes infrastructure construction through agency construction model. LYSS signed construction agreements with the entrusting parties and will receive payments based on the total cost plus a certain markup in return during the construction progress or after the project is completed. As of 30 September 2023, the Company had completed 4 infrastructure construction projects, with a total investment of RMB2.3 billion, such as provincial-level highway construction and sewage treatment projects. There were also 5 projects under construction, with a total investment amount of RMB3.9 billion and uninvested amount of RMB480 million. The sustainability of the Company’s business is affected by the relatively small project reserve.

Good track record of receiving government support

LYSS has a good track record of receiving support from the local government in the form of project payments, equity transfer, and operating subsidies to support its investments and the operation of its businesses. From 2020 to 2022, the local government transferred shares of some state-owned enterprises in Mengjin District to the Company, such as Luoyang Shengyang Thermal Power Co., Ltd., and Luoyang Lulian Road Construction Engineering Co., Ltd., increasing its capital reserve by RMB1.6 billion and further strengthened its capital base. LYSS also has a track record of receiving government payments. From 2020 to 2023Q3, the local government provided subsidies of RMB970 million to the Company to support its operation and development. As of 30 September 2023, LYSS has received total project repayments of RMB2.6 billion from the local government for its infrastructure construction. Apart from that, the Company also received support from its controlling shareholder LYCD, such as providing guarantees for its financing activities. Considering its strategic role in social and economic development of Mengjin District, we expect the local government will continue to provide support to the Company.

Large exposure to commercial activities

LYSS participates in different commercial activities, mainly including self-operated construction. While the commercial activities generate supplemental income, they may also pose higher operational and business risks than its public-policy businesses. The Company had large-scale of self-operated projects under construction and planning, which may increase its future investment pressure. We estimate the Company's risk exposure to commercial business is relatively large.

Apart from public policy projects, LYSS also has some self-operated construction projects. The Company achieves fund balance through operation revenue of the projects, such as rental income, parking fees, and hospitalization revenue. However, self-operated construction projects may undertake higher business risk. As of 30 September 2023, there were 9 key projects under construction, with a total investment amount of RMB6.8 billion and uninvested amount of RMB4.5 billion. The largest project in terms of the investment size was petrochemical ethylene project, which is crucial to the development of high-end petrochemical industry in Luoyang City. The Company is expected to balance the investment through operating revenues, such as energy supply income. However, the investment recovery cycle is long, making it more difficult to achieve fund balancing in short period of time. LYSS also had 2 projects under planning, with a total investment of RMB2.3 billion. The relatively large scale of investment will bring more pressure on the capital expenditure of the Company.

Moreover, LYSS participates in tourism operation in Mengjin District. In November 2023, the Company transferred some equity shares and all the scenic spots of Mengjin Hanwei Tourism Resources Development Group Co., Ltd. ("MJHW") to Guoxing Investment. MJHW was LYSS's subsidiary and is responsible for tourism operation in Mengjin District. After the share transfer, the Company now only has one scenic spot, namely Longma Futu Temple, which was newly transferred into the Company by the local government. However, the profitability of this scenic spots is relatively weak because of the pandemic situation over the past years.

Increasing debt burden and moderate asset liquidity

Due to the continuous investment in infrastructure construction projects, LYSS's total debt has been growing over the past three years. As of 30 September 2023, LYSS's total debt increased to RMB9.0 billion from RMB6.3 billion as of end-2020. The Company has maintained moderate debt leverage. Its total capitalization ratio, as measured by total debt to total capital, was recorded at 48.6% as of the same date. As of 30 September 2023, its short-term debt was RMB2.2 billion, accounting for 24.4% of total debt. Meanwhile, the cash to short-term debt ratio was only 0.1x, which could not fully cover the short-term debt. As of 30 September 2023, the Company

was planning to invest around RMB5.0 billion in 2023Q4 and 2024. Considering the large number of uninvested amounts of construction projects, we estimate the Company would continue to rely on external financing such as bank loans and bonds issuance to support its business, and its total debt would further increase over the next 12-18 months.

LYSS's asset liquidity was moderate. As of 30 September 2023, the Company's inventories, receivables account, construction in progress, and other non-current assets accounted for around 70% of the total assets. The Company's inventories and construction in progress mainly include the cost of construction works, while other receivables are mainly receivables from the local government, which are considered low liquidity. Furthermore, there's a risk of recovery from private-owned enterprises. The Company's other receivables account contains loans provided to a private-owned enterprise, namely Wuhan Tongxin Real Estate Co., Ltd. ("Wuhan Tongxin"), which has been listed as dishonest judgment debtor. The Company had loan receivables of around RMB192.4 million from Wuhan Tongxin as of 30 September 2023. The Company has obtained two pieces of land from Wuhan Tongxin as collateral.

Access to diversified funding channels

LYSS has access to funding channels such as bank loans, onshore bonds, and non-standard financing. The Company maintains long-term and close relationships with state-owned commercial banks and regional commercial banks, such as Agricultural Development Bank of China, Industrial and Commercial Bank of China Limited, and Zhongyuan Bank Co., Ltd. As of 30 September 2023, the Company had total bank facilities of RMB6.9 billion, with an unutilized portion of RMB2.5 billion.

The Company also has a track record for fund-raising activities in capital market. In 2023, the Company issues 2 tranches of domestic bonds, raising RMB1.0 billion. Meanwhile, the Company had a medium exposure to non-standard financing, mainly from trust companies, accounting for around 20% of total debt. These types of financing generally have high financing cost and short-term borrowing period, which may enlarge LYSS' refinancing pressure.

Moderate level of contingent risk

The credit profile of LYSS is constrained by its external guarantees, which could potentially increase its repayment obligations. As of 30 September 2023, the Company's external guarantees amounted to RMB1.8 billion, accounting for 13.2% of its net assets, most of which were provided to local SOEs. We believe that the credit risk of the guarantee is moderately controllable, considering the government's support to local SOEs. However, the Company has provided external guarantees to two private-owned enterprises, with a total amount of RMB173 million, accounting for 9.4% of the total external guarantees, which may expose the Company to higher contingent risks.

ESG Considerations

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

LYSS bears social risks as it implements public policy initiatives by building public infrastructure in Mengjin District. 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.

LYSS's governance considerations are also material as the Company is subject to oversight by Luoyang 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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