

Credit Opinion

21 February 2024

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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Lanzhou New District Modern Agriculture Investment Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Lanzhou New District Modern Agriculture Investment Group Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Lanzhou New District Modern Agriculture Investment Group Co., Ltd. (“LNAI” or the “Company”) reflects Lanzhou New District 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 Lanzhou New District Government’s capacity to provide support reflects Lanzhou New District’s status as the first national-level new district in the northwest region of China, with increasing fiscal strength, but rising debt burden.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) important role in the agricultural infrastructure construction of Lanzhou New District; and (2) solid track record of receiving government support.

However, the Company’s rating is constrained by its (1) fast debt growth and weak asset liquidity; (2) moderate exposure to commercial activities; and (3) moderate access to funding.

The stable outlook on LNAI’s rating reflects our expectation that the Lanzhou New District Government’s capacity to provide support will remain stable, and the Company will maintain its key role in the agricultural infrastructure construction of Lanzhou New District.

Rating Drivers

- Important role in the agricultural infrastructure construction of Lanzhou New District
- Moderate exposure to commercial activities
- Solid track record of receiving government support
- Fast debt growth and weak asset liquidity
- Moderate access to funding

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Lanzhou New District 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 support such as improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Lanzhou New District 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 weakened market position or material decrease in government support.

Key Indicators

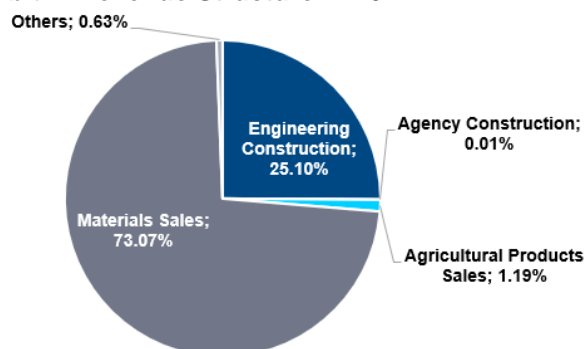
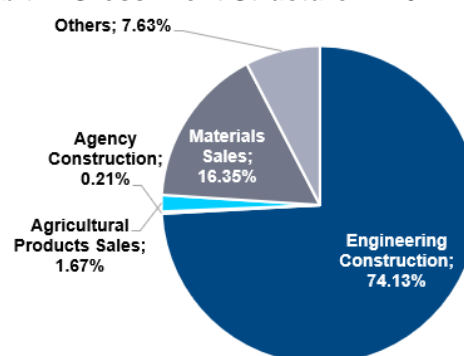
	2020FY	2021FY	2022FY	2023Q3
Total Asset (RMB billion)	19.5	23.5	25.8	27.2
Total Equity (RMB billion)	8.7	8.4	9.0	9.7
Total Revenue (RMB billion)	6.3	8.0	10.1	12.0
Total Debt/Total Capital (%)	38.1	46.9	47.6	48.9

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

Source: Company data, CCXAP research

Corporate Profile

Founded in 2017, LNAI is the key state-owned enterprise responsible for agricultural infrastructure construction in Lanzhou New District. Its business scope covers agricultural infrastructure construction, engineering construction, sale of agricultural product and materials. As of 30 September 2023, the Company was wholly owned and directly controlled by the Finance Bureau of Lanzhou New District.

Exhibit 1. Revenue Structure in 2022**Exhibit 2. Gross Profit Structure in 2022**

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe that the Lanzhou New District Government has a strong capacity to provide support, reflecting Lanzhou New District's status as the first national-level new district in the northwest region of China, with increasing fiscal strength, but rising debt burden.

Located in the Hexi Corridor Region, Gansu Province is an important node of the Belt and Road Initiative with close ties with Central Asia and West Asia. In 2022, Gansu Province recorded a gross regional product ("GRP") of RMB1.1 trillion, with a GRP growth rate of 4.5% year-on-year ("YoY"). Its general budgetary revenue increased to RMB90.8 billion, up by 4.9% YoY. In 2023, Gansu Province recorded a GRP of RMB1.2 trillion, with a GRP growth rate of 6.4% YoY.

Lanzhou City, the provincial capital and largest city of Gansu Province, is an important national petrochemical base, equipment manufacturing base and biopharmaceutical base. The pillar industries of Lanzhou are petrochemicals, equipment manufacturing, biomedicine, and metallurgy, with heavy industry as the main industry, and industrial transformation is under pressure. In 2022, Lanzhou City achieved a GRP of RMB334.4 billion, a YoY increase of 0.8%. In 2023, Lanzhou City recorded a GRP of RMB553.9 billion, an increase of 6.8% YoY. However, Lanzhou Municipal Government's general budgetary revenue declined from RMB24.7 billion in 2020 to RMB22.1 billion in 2022, which was due to tax refunds and weak economic fundamentals. Meanwhile, it has a relatively weak financial self-sufficiency ratio of 44.3% at the same time. In 2022, Lanzhou Municipal Government's outstanding debt amounted to RMB99.7 billion, accounting for 29.8% of its GRP.

Exhibit 3. Key Economic and Fiscal Indicators of Lanzhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	288.7	323.1	334.4
GRP Growth (%)	2.4	6.1	0.8
General Budgetary Revenue (RMB billion)	24.7	27.7	22.1
General Budgetary Expenditure (RMB billion)	48.6	48.5	49.9
Local Government Debt (RMB billion)	64.6	72.6	99.7

Source: Statistic Bureau of Lanzhou City, CCXAP research

Lanzhou New District is the first national-level new district in northwest China, with a high strategic positioning and a relatively complete transportation network in the region. Though the economic scale of Lanzhou New District is relatively small compared to other regions of Lanzhou City, the economy of Lanzhou New District is

expanding at a high speed. Compared with other regions of Lanzhou City, Lanzhou New Area has price advantages in terms of land resources and electricity costs, and has formed a unique industrial cluster focusing on equipment manufacturing, petrochemicals, new materials, and biomedicine. In 2022, Lanzhou New District's GRP amounted to RMB35.2 billion, representing a YoY growth of 13%. Meanwhile, its general budgetary revenue steadily increased from RMB2.0 billion in 2020 to RMB3.5 billion in 2022. Similar to Lanzhou City, Lanzhou New District also faces the problems of relatively low financial self-sufficiency and high debt burden. As of 2022, the financial self-sufficiency ratio of Lanzhou New District was 48.3% and the outstanding government debt/GRP amounted to 85.3%. In addition, the debt scale of local state-owned enterprises within Lanzhou New District is relatively large, implying a heavy debt burden in the region.

Exhibit 4. Key economic and fiscal indicators of Lanzhou New District

	2020FY	2021FY	2022FY
GRP (RMB billion)	23.6	30.0	35.2
GRP Growth (%)	16.7	20.0	13.0
General Budgetary Revenue (RMB billion)	19.8	32.4	35.2
General Budgetary Expenditure (RMB billion)	48.5	71.5	72.9
Local Government Debt (RMB billion)	19.4	22.4	30.0

Source: Management Committee of Lanzhou New District, CCXAP research

Government's Willingness to Provide Support

Important role in the agricultural infrastructure construction of Lanzhou New District

There are around 10 local infrastructure investment and financing companies ("LIIFC") in Lanzhou New District, each with clear positioning in the development of the region, such as municipal infrastructure construction, water supply, financial services, and tourism. LNAI is the key state-owned entity responsible for agricultural infrastructure construction in Lanzhou New District, undertaking construction projects, agricultural product sales, material sales in the region. Since establishment, the Company has invested about RMB23 billion into 92 construction projects, including modern agriculture demonstration park, rural revitalization industrial park, ecological restoration and farmland construction, modern agricultural park, afforestation and resettlement housing projects, laying a solid foundation for the development of modern agriculture, ecological restoration and management, and integrated industrial development in Lanzhou New District. We believe that the Company is unlikely to be replaced by other state-owned enterprises in the foreseeable future.

LNAI's agency construction business mainly involves construction of roads, and green projects. The Company enters into agreements with various government-related entities and collects corresponding management fee. As of 30 September 2023, the Company had completed 61 agency construction projects, with a total planned investment of about RMB3.7 billion. However, the Company has few agency construction projects under construction or planning, indicating that the business sustainability is subject to uncertainty. The current construction projects of the Company are mainly conducted by self-operated model.

Moderate exposure to commercial activities

In addition to public activities, LNAI is also involved in commercial activities, such as sale of materials and agricultural products. We estimate that the Company has moderate commercial exposure as the proportion of commercial business assets accounts for less than 30% of its total assets. Given the large number of projects in the pipeline, we expect the Company's exposure to commercial activities will increase in the next 12-18 months.

The commercial activities that the Company engaged in are mainly material sales, which covers washed-out sand, steel, precious metals, refined oil and cement, etc. The Company adopts two models to operate material sales business. The Company adopts procurement and sale model for steel, precious metals, refined oil and cement, under which it purchases the materials from upstream suppliers, and then selling them to downstream customers, thereby earning price differences. In terms of washed-out sand, the Company owns the mining right of a sand mine with daily sand production of 3,500 square meters, which will be directly sold to downstream customers. In 2022, this segment recorded a revenue of RMB7.4 billion, with a gross margin of 1.06%. Meanwhile, as of 2023Q3, the segment faces certain concentration risk as the Company's top 5 customers and top 5 suppliers accounted for 72.5% and 42.1% of total sales value and total procurement cost, respectively.

The Company also engages in sale of agricultural products, which includes white sugar, corn product and self-produced flowers and fruits, which provide a useful supplement to the Company's operating income. In 2022, this segment recorded revenue of RMB120 million with gross margin of 6.7%. The Company also adopts two models (procurement and sales, self-produce and sales) under this segment. For procurement and sales model, it purchases the agricultural products from upstream suppliers, and then selling them to downstream customers, thereby earning price differences. For self-produce and sales model, the Company realizes income through self-production and sale of flowers, fruits and vegetables. In 2022, the Company produced a total of 8 million fresh cut flowers, 2 million branches and potted flowers, and 1.1 million tons of fruits and vegetables in its 600,000 square meters of smart glass greenhouses and 357 solar greenhouses. The agricultural product sales segment faces moderate concentration risk, as top 5 suppliers and top 5 customers account for 24.2% and 34.2% of sales value and procurement cost, respectively. In addition, revenue from agricultural product sale may fluctuate due to market conditions and consumer demand.

The engineering construction is the largest contributor to the Company's gross profit. In 2022, the revenue from engineering construction amounted to RMB2.5 billion, with gross profit margin of 14%. The Company obtains projects through public bidding, and mainly undertakes construction projects such as land consolidation, ecological improvement, and rural construction within Lanzhou New District. As of 30 September 2023, the Company had 934 engineering construction contracts at hand, with a total contract value of RMB10.8 billion.

At present, the Company has large amount of self-operated projects under construction, mainly including agricultural industrial parks and green projects, causing high investment pressure. These projects can provide rental income and sale income for fund balance after completion of construction. As of 30 September 2023, the Company had 10 self-operated projects under construction, with total planned investment of RMB15.3 billion and uninvested amount of RMB10.7 billion. We expect the Company's exposure to commercial activities will increase after completion of project construction. Besides, we assess the Company's capital expenditure pressure is high and there is uncertainty regarding its future operating capabilities.

Solid track record of receiving government support

As the key entity in charge of infrastructure construction in the Lanzhou New District, the Company has a good track record of receiving support from the local government in the past few years. The support mainly includes asset transfer, special bond funds, and operating subsidies. From 2020 to 2022, the Company received asset transfer of about RMB2.0 billion, which are mainly lands and special funds, and operating subsidies of RMB50 million from local government. In 2021, the Company received special bond funds of RMB840 million to support the construction of its self-operated project, namely Agricultural Demonstration Park. The Company has also regularly received payments from the local government for its completed agency projects. In 2023, the Company received project payment of about RMB200 million. In light of LNAI's important regional position in the Lanzhou

New District, we expect the Company will continue to receive ongoing support from the local government over the coming 12-18 months.

Fast debt growth and weak asset liquidity

Project construction have caused the Company's total debt to rise in the past few years. The total debt of the Company has rose from RMB5.4 billion at end-2020 to RMB9.3 billion at end of September 2023, with total capitalization ratio of 48.9%. In addition, the Company has relatively high short-term debt servicing pressure. As 30 September 2023, the Company's short-term debt accounted for 35.8% of its total debt, and cash to short-term debt ratio was 0.6x.

The Company's exposure to external guarantee is low. As of 30 September 2023, the Company had outstanding external guarantees of RMB1.3 billion, representing 13.5% of its net assets. All of them are provided to local state-owned enterprises, which are likely to be supported by the local government when necessary, indicating controllable contingent risk.

Meanwhile, LNAI has weak asset liquidity. The Company's total asset mainly consists of other receivables, inventory, construction in progress and intangible asset, which accounted for 73.5% of its total assets as of 30 September 2023. Receivables are mainly unreceived payments from local state-owned enterprises and downstream customers, with uncertain payback time; inventories and construction in progress are mainly development costs and product for construction projects, and intangible assets are mainly land-use rights, all of which are considered low liquidity.

Moderate access to funding

LNAI's external financing mainly relies on bank loans. Nearly all of the debt was provided by bank loans as of 30 September 2023, with an average financing cost of around 5.2% to 5.5%. It has good relationship with large domestic commercial and policy banks. As of 30 September 2023, the Company possessed a total credit facility of RMB6.4 billion, of which the undrawn portion amounted to RMB1.2 billion. In addition, the scale of non-standard financing is very low, with outstanding amount of RMB89 million as of 30 September 2023. The Company plans to issue onshore and offshore bonds to broaden its financing channels as well as improve its debt structure.

ESG Considerations

LNAI 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.

LNAI bears social risks as it implements public policy initiatives by building public infrastructure in the Lanzhou New 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.

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

Structural Considerations

LNAI's senior unsecured debt rating is equivalent to its long-term credit rating. We believe that government support will flow through the Company given its key roles in agricultural infrastructure construction in Lanzhou New 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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