

Credit Opinion

6 March 2024

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

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Chongqing Nanzhou Water Group Co Ltd.

Surveillance credit rating report

CCXAP upgrades Chongqing Nanzhou Water Group Co Ltd.'s long-term credit rating to BBB_g-, with stable outlook.

Summary

CCXAP has upgraded the long-term credit rating of Chongqing Nanzhou Water Group Co Ltd. ("CNWG" or the "Company") to BBB_g- from BB_g+, with stable outlook.

The rating upgrade is based on the improving regional strength, which strengthens the local government's capacity to support the Company. It also reflects the important position of the Company, as the sole water conservancy constructor in Qijiang District.

The long-term credit rating of CNWG reflects Qijiang District Government's relatively strong capacity and extremely high willingness to provide support to the Company, based on our assessment of the Company's characteristics. Our assessment of Qijiang District Government's capacity to provide support reflects Qijiang District's steady economic growth, but is constrained by its modest fiscal profile.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) important role as the sole water conservancy construction entity in Qijiang District and water supply platform outside the main urban area; (2) large project reserves in water conservancy construction; and (3) solid track record of receiving government support, especially for the construction of water conservancy projects.

However, the rating is constrained by the Company's (1) moderate exposure to commercial activities; (2) weak asset liquidity; and (3) high short-term debt repayment pressure and relatively high financing cost.

The stable outlook on CNWG's rating reflects our expectation that the local government's capacity to support the Company will remain stable, and the Company will maintain its important role as the sole water conservancy construction entity in Qijiang District.

Rating Drivers

- Important role as the sole water conservancy construction entity in Qijiang District
- Large project reserves in water conservancy construction
- Moderate exposure to commercial activities
- Solid track record of receiving government support
- Stable debt growth and weak asset liquidity
- Diversified access to financing channels but relatively high financing cost

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's capacity to provide support strengthens; and (2) changes in the Company's characteristics enhance the local government's willingness to provide support, such as decreased exposure to commercial activities.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's capacity to provide support weakens; or (2) changes in the Company's characteristics decrease the local government's willingness to provide support, such as reduced regional significance.

Key Indicators

	2020FY	2021FY	2022FY	2023Q3
Total Asset (RMB billion)	21.0	21.4	23.7	24.7
Total Equity (RMB billion)	11.6	11.7	13.9	14.0
Total Revenue (RMB billion)	0.8	0.8	0.8	0.4
Total Debt/Total Capital (%)	32.8	33.8	31.7	33.0

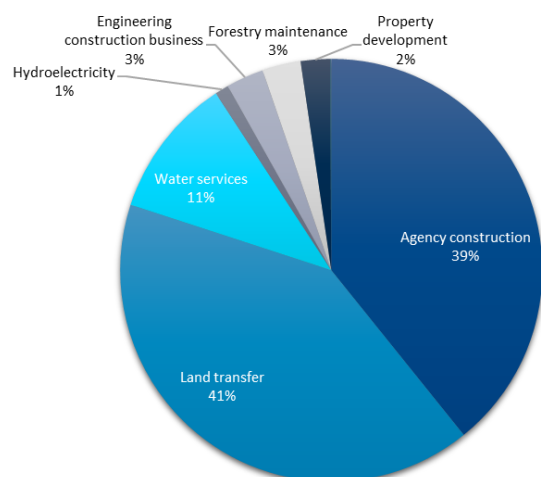
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company Data, CCXAP research

Corporate Profile

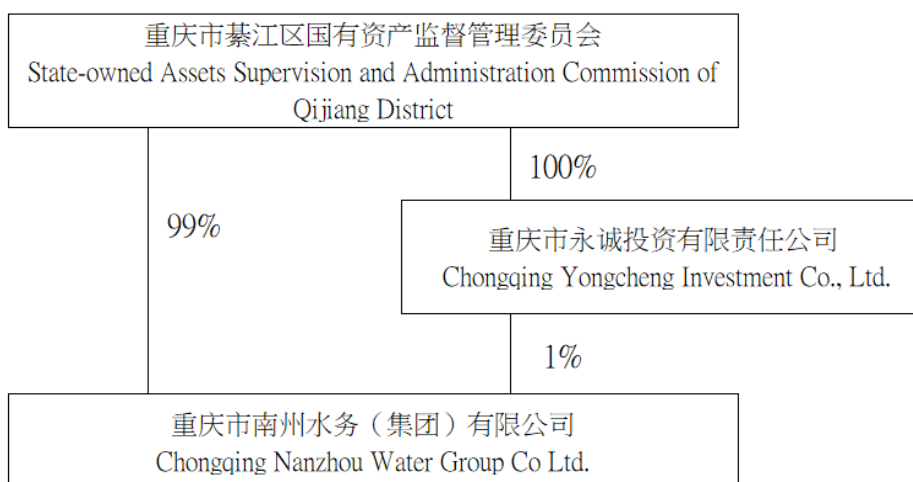
Formerly known as Qijiang County Yunan Water Conservancy and Hydropower Engineering Development Co., Ltd., CNWG was founded in 2002 and is one of the major local infrastructure investment and financing companies ("LIIFCs") in Qijiang District. It is the only platform engaged in the construction of water conservancy facilities. The Company is also responsible for public utility services in Qijiang District, including water supply and drainage, sewage treatment and hydroelectric power generation. On top of that, the Company also undertakes various commercial activities, such as property development, engineering construction, and forestry maintenance. As of 30 September 2023, the State-owned Assets Supervision and Administration Commission of Qijiang District ("Qijiang SASAC") was the ultimate controller of the Company by holding 99% of its shares, and the remaining 1% of shares was held by Chongqing Yongcheng Investment Co., Ltd.

Exhibit 1. Revenue Structure in 2022



Source: Company information, CCXAP research

Exhibit 2. Shareholding Structure as of 30 September 2023



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Qijiang District Government has a relatively strong capacity to provide support to the Company, given its steady economic growth, but constrained by its modest fiscal profile.

Chongqing City is one of the four municipalities in China and the only municipality in Western China. It has formed a pillar industry pattern represented by modern heavy machinery, electronics, chemical and pharmaceutical, as well as the energy industry. Chongqing City's economy has demonstrated a growth trend over the past years. In 2022, Chongqing City's gross regional product ("GRP") increased by 2.6% year-on-year ("YoY") to RMB2.9 trillion, ranking 4th among municipalities and prefecture-level cities in China. In 2023, Chongqing City recorded a GRP of RMB3.0 trillion with a GRP growth rate of 6.1% YoY, becoming the first city in western China and one of the five cities in China with a GRP surpassing RMB3.0 trillion. However, mainly

due to the tax refund policies, key financial indicators of the Chongqing City were negatively affected in 2022. Chongqing City's tax revenue has decreased from RMB154.4 billion in 2021 to RMB127.09 billion in 2022, resulting in a decline in the public budget revenue from RMB228.5 billion in 2021 to RMB210.3 billion in 2022. As of the end of 2022, the outstanding direct government debt balance of Chongqing City amounted to RMB1.0 trillion, accounting for 34.6% of its GRP for that year.

Exhibit 3. Key Economic and Fiscal Indicators of Chongqing City

	2020FY	2021FY	2022FY
GRP (RMB billion)	2,500.3	2,789.4	2,912.9
GRP Growth (%)	3.9	8.3	2.6
General Budgetary Revenue (RMB billion)	209.5	228.5	210.3
General Budgetary Expenditure (RMB billion)	489.4	483.5	489.3
Local Government Debt (RMB billion)	679.9	861.0	1,007.1

Source: Statistic Bureau of Chongqing City, CCXAP research

Qijiang District is located in the south of Chongqing City, with a total area of 2,747 square kilometers. It is an important node on the new western land-sea corridor, and an important material distribution center in southern Chongqing and northern Guizhou, with a prominent position as a transportation hub. As the only district and county mentioned in the *"Planning Outline for the Construction of the Chengdu-Chongqing Economic Circle"*, Qijiang District has undertaken key infrastructure construction in the region. For example, Zaodu Reservoir in Qijiang District has been included in the list of 150 major water conservancy projects in the country's *"14th Five-Year Plan"*. We expect the advantageous location of Qijiang District reinforce its policy importance to southwest China, and therefore, is likely to warrant continuous support from the Chongqing Municipal Government given national development strategy.

In recent years, Qijiang District's economy has continued to grow and develop, relying on pillar industries such as energy, metallurgy, coal chemical industry, equipment manufacturing, new materials, and food processing. With good location advantages and natural resources, Qijiang District's economic scale improved steadily. In 2022, the GRP of Qijiang District increased by 3.0% YoY to RMB77.1 billion, ranking 17th among the 38 districts and counties in Chongqing City, accounting for 2.6% of Chongqing's GRP for that year. In the first three quarters of 2023, Qijiang District reported a GRP of RMB58.4 billion, representing a YoY increase of 4.9%. In 2022, the general budgetary revenue of Qijiang District was RMB2.1 billion, of which tax revenue accounted for 47.2%. However, Qijiang District's fiscal self-sufficiency is relatively weak, and its debt burden is heavy. In 2022, its fiscal balance ratio was 29.9%. The fiscal gap mainly depends on the balance of government fund income and transfer income from the higher-tier government. The outstanding debt of Qijiang District in 2022 was RMB18.5 billion, accounting for 24.0% of its GRP.

Exhibit 4. Key Economic and Fiscal Indicators of Qijiang District

	2020FY	2021FY	2022FY
GRP (RMB billion)	71.4	74.2	77.1
GRP Growth (%)	2.8	4.8	3.0
General Budgetary Revenue (RMB billion)	2.0	2.1	2.1
General Budgetary Expenditure (RMB billion)	8.1	7.1	7.1
Local Government Debt (RMB billion)	8.4	16.1	18.5

Source: Statistic Bureau of Qijiang District, CCXAP research

Government's Willingness to Provide Support

Important role as the sole water conservancy construction entity in Qijiang District

There are five major LIIFCs in Qijiang District, but CNWG is the only platform to undertake water conservancy construction and operation in Qijiang District, and is responsible for water supply within Qijiang District outside the main urban area. The other LIIFCs mainly undertake urban infrastructure construction, land development and cultural tourism in the region. The Company is also mandated by the local government to undertake local public activities, such as infrastructure construction, land transfer, sewage treatment and hydroelectric power generation. Considering the Company's important strategic role in the development of Qijiang District, we believe the Company will not be easily replaced by other local state-owned enterprises in the foreseeable future.

Large project reserves in water conservancy construction

As the sole water conservancy construction entity, the Company has a regional monopoly position in the investment, financing, and construction of water conservancy construction in Qijiang District. The Company continues to carry out water conservancy construction projects by signing agency construction agreements with the entrusting parties. The initial construction cost of the Company's water conservancy projects was partly supported by the government's special funds, which can ease the Company's investment pressure. From the perspective of project reserves, as of 30 September 2023, the Company had 8 infrastructure construction projects under construction, mainly water conservancy projects and infrastructure construction projects, with a total planned investment of RMB3.0 billion and an outstanding amount of RMB1.3 billion. Furthermore, the Company had 4 reservoir projects under planning with a total planned investment of around RMB1.6 billion, which is supported by a national project special fund covering 80% of capital expenditure. These projects are expected to be finished before 2028. The sufficient project reserves demonstrated the high sustainability of the Company's public-policy businesses.

In addition, CNWG undertakes a water supply business outside the main urban area of Qijiang District with regional monopoly advantages, providing water sourcing, water supply, sewage treatment and hydroelectric power generation business. The Company owns most of the water supply plants outside the main urban area of Qijiang District through government allocation and asset acquisition itself. As of 30 September 2023, the Company had 27 water supply plants with a daily water supply capacity of 98,600 tons. The Company runs a sewage treatment business through 7 sewage treatment plants, including 3 park sewage treatment plants and 4 township sewage treatment plants, with a daily sewage treatment capacity of 24,800 tons. Moreover, the hydroelectric power generation business was carried out through 4 hydroelectric power plants with a total installed capacity of 2.6 million kilowatts. However, the profitability of the Company's water supply business is affected by the water sourcing service and hydroelectric power generation business, as the water sourcing service business continues to lose due to the relatively high depreciation of reservoir assets. Overall, we believe that as these public services are vital to local populations, the replacement costs of the Company's role will be relatively high.

CNWG is entrusted by the local government to undertake land development projects in Qijiang District. The business model remained unchanged as last year. This business is one of the Company's major sources of income, which accounted for 35.5% of the total revenue as of 30 September 2023. However, the payback from land transfer is subject to the prosperity of the land market and the planning of the Qijiang District Government. From 2020 to 2023Q3, the government had taken back 1,154.9 mu of land with compensation, and the Company had recognized revenue of RMB1.1 billion and received payments of RMB733.5 million with a total invested amount of RMB282.6 million. The Company also owns a relatively large amount of consolidated land of around

3,228.3 mu, indicating that its land transfer business has strong sustainability. However, the income from land development is subject to the land market and government policies.

Moderate exposure to commercial activities

In addition to public activities, CNWG is also involved in various commercial activities such as property development, engineering construction, and forestry maintenance. We consider CNWG's commercial business exposure to be moderate, as its market-driven businesses account for only around 20% of its total assets.

The Company undertakes engineering construction projects in Qijiang District through the public market. As of 30 September 2023, the Company had 8 construction projects under construction. Although engineering construction projects have brought supplement income to the Company, their small scale of operations limits their contributions to the Company's overall revenue.

CNWG also engages in property development business by acquiring land parcels through the open market and entrusts construction companies to implement the construction of commercial property development. The business is susceptible to the volatility of the local real estate market, which may lead to fluctuations in its property sales. As of 30 September 2023, all the Company's completed real estate projects had been sold, but due to high costs and low sales prices, the property sale business has continued to record losses in the past three years. The Company had one real estate development project under construction, which is the Sunshine Business Office Building project, with a total investment of RMB220.0 million and an outstanding amount of RMB113.2 million at end-2022. This project is planned to be sold to the Meteorological Bureau, Water Conservancy Bureau, and Forestry Bureau with an estimated selling price of RMB5,200 per square meter, and the remaining part will be leased to state-owned enterprises in Qijiang District.

In addition, CNWG carries out forestry maintenance business by signing an agreement for 20 years with Chongqing Nanzhou Tourism Development Construction Investment (Group) Co., Ltd. ("NZTC"), which is a state-owned enterprise in Qijiang District. CNWG is responsible for maintenance and upkeep work for scenic spots, forest farms, and forest barriers in Qijiang District and receives payments based on maintenance costs plus a certain markup. The income of the forestry maintenance business has remained stable in the past few years; however, the gross profit margin of the business is as low as 3.6% in 2023Q3.

Solid track record of receiving government support

As the only water conservancy construction entity in Qijiang District, CNWG has a good track record of receiving payments from the Qijiang District Government. These payments take various forms, such as government subsidies and capital injections. The Company also regularly receives repurchase payments for its water conservancy construction projects, infrastructure construction projects, and land transfer projects.

In 2022, the local government transferred operation rights of river sand resources in the section of the river from Sanjiang to Qianshui, with a book value of RMB2.0 billion, to the Company without compensation, enhancing its asset scale. From 2020 to 2022, the Company had received a total operating subsidies from the government of RMB666.0 million. Benefiting from undertaking water conservancy construction mandates, the Company has obtained a series of project subsidies based on the policy issued by the Chongqing Municipal Water Conservancy Bureau. For reservoirs included in the central government's investment plan, 70%-80% of the total investment of the project will be subsidized by the municipal or higher-tier government, while for reservoirs that are not included in the central government's investment plan, the Chongqing Municipal Finance Bureau will provide a fixed subsidy of RMB50 million per medium-sized reservoir. However, the amount of support may

fluctuate with the Company's project pipeline and the government's fiscal budget. Considering the Company's policy role as the sole water conservancy construction entity and the important water supplier in Qijiang District, we expect government support for CNWG to continue in the next 12 to 18 months.

Exhibit 5. Government Support from 2020 to 2022

(RMB million)	2020FY	2021FY	2022FY
Government Subsidies	220	226	220
Capital Injections	-	1	1,974
Repurchase Payments			
- Land Transfer	430	114	170
- Infrastructure Construction	281	72	91
Total	931	413	2,455

Source: Company information, CCXAP research

Stable debt growth and weak asset liquidity

As of 30 September 2023, CNWG's total debt had increased to RMB6.9 billion from RMB5.6 billion at end-2020. The increase in debt was mainly attributable to the expansion of construction of infrastructure projects. The Company has maintained a reasonable debt leverage, with a capitalization ratio of 33.0% as of 30 September 2023. However, the Company is exposed to certain short-term debt repayment pressure, with a cash/short-term debt ratio of 0.4x as of 30 September 2023. Given that the Company's future capital expenditure for its water conservancy construction projects was mostly supported by government special funds, we expect the Company's debt growth will be stable for the next 12-18 months.

In addition, CNWG asset liquidity is relatively weak. The Company's total asset mainly consists of inventories receivables, contract assets and construction in progress, which accounted for 71.7% of its total assets as of 30 September 2023. Inventories were mainly land and investment costs for infrastructure construction projects, while receivables were mainly unreceived payments from government agencies or other state-owned companies, all of which are considered low liquidity. Since 2022, the Company has increased intangible assets which are operation rights of river sand resources in the section of the river from Sanjiang to Qianshui of RMB2.0 billion, accounting for 8.1% of the total assets at end-2023Q3.

As of 30 September 2023, the Company's external guarantees amounted to RMB2.3 billion, accounting for 16.5% of its net assets. All the external guarantees were provided to local state-owned enterprises in Qijiang District such as NZTC and Chongqing Qijiang District Urban Construction Investment Co., Ltd. As a result, we consider that the Company's contingent liability risk is relatively controllable.

Diversified access to financing channels, but relatively high financing cost

CNWG has access to various sources of funding, including bank loans, onshore bond financing and non-standard financing. As of 30 September 2023, about 48.0% of the Company's debt financing was provided by domestic banks. It held total credit facilities of RMB8.1 billion and available credit facilities of RMB1.5 billion. The onshore debt capital market provides around 44.2% of the Company's debt financing. From 2019 to 2023Q3, the Company had raised over RMB3.0 billion from the onshore bond market via the issuance of PPNs and corporate bonds, with coupon rates ranging from 5.2% to 7.7%. In addition, the Company has a low exposure to non-standard financing, including financial leasing, which accounted for about 7.7% of total debt financing at end-2023Q3. However, the average cost of non-standard financing was relatively high at 7.0% to 7.5% as of 30 September 2023.

Given the limited credit facilities available to the Company, and the relatively high financing costs of LIIFCs in Qijiang District in the onshore debt capital market, we believe additional funding channels, such as increasing credit facilities, are needed to satisfy the Company's large capital expenditure needs.

ESG Considerations

The Company is subject to environmental laws and regulations governing air pollution, noise emissions, hazardous substances, water and waste discharge and other environmental matters issued by the national governmental authorities. CNWG assumes environmental risks for its infrastructure projects. Such risks could be mitigated by conducting environmental studies and detailed planning prior to the commencement of projects and close supervision during construction.

CNWG is also exposed to social risks as it implements public-policy initiatives by building public infrastructure in Qijiang District. Demographic changes, public awareness and social priorities shape government's development strategies and will affect the government's propensity to support the Company.

The Company's governance considerations are also material as it is subject to oversight and reporting requirements to the local government, reflecting its public policy role and status as a government-owned entity. CNWG believes that it is in compliance in all material respects with the applicable governmental regulations, rules and executive orders in each jurisdiction in which it operates. The Company maintains regular communication with local governments and regulatory authorities through its management team or representatives, ensuring compliance with the requirements and conditions for obtaining and maintaining the licenses, concessions, permits, or certificates.

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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