

Credit Opinion

22 September 2023

Hunan Miluo River Holding Group Co., Ltd

Initial credit rating report

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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CCXAP assigns first-time long-term credit rating of BBB_g- to Hunan Miluo River Holding Group Co., Ltd, with stable outlook

Summary

The BBB_g- long-term credit rating of Hunan Miluo River Holding Group Co., Ltd (“MRHG” or the “Company”) reflects Miluo City Government’s (1) relatively strong capacity to provide support; and (2) extremely high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of the local government’s capacity to provide support reflects Miluo City’s economic importance in Yueyang City with ongoing economic growth, but constrained by its relatively weak fiscal profile.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) strong position in public-related services of Miluo City; and (2) good track record of receiving government support.

However, the rating is constrained by the Company’s (1) increasing investment on self-operated commercial projects, exerting high capital expenditure pressure; and (2) fast debt growth and modest asset liquidity.

The stable outlook on MRHG’s rating reflects our expectation that the local government’s capacity to provide support will remain stable, and the Company will maintain its strong position in infrastructure construction of Miluo City.

Rating Drivers

- Strong position in public-related services of Miluo City
- Increasing investment on self-operated commercial projects, exerting high capital expenditure pressure
- Good track record of receiving government support
- Fast debt growth and modest asset liquidity
- Moderate exposure to external guarantees

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's ability to provide support strengthens; and (2) the Company's characteristics change in a way that strengthens local government's willingness to provide support, such as improved debt management or decrease in exposure to external guarantee.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's ability to provide support weakens; or (2) the Company's characteristics change in a way that decreases the local government's willingness to provide support, such as reduced regional significance or material increase in exposure to external guarantee.

Key Indicators

	2020FY	2021FY	2022FY
Total Asset (RMB billion)	25.9	28.2	31.7
Total Equity (RMB billion)	14.7	15.1	17.8
Total Revenue (RMB billion)	2.4	2.8	3.1
Total Debt/Total Capital (%)	34.5	40.4	39.8

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

Source: CCXAP research

Corporate Profile

Founded in November 2017, MRHG is the most important local infrastructure investment and financing companies ("LIIFC") in Miluo City. The Company is mainly engaged in the local infrastructure construction, land consolidation, and state-owned asset management in Miluo City. It has also participated in other commercial activities such as engineering construction, sandstone mining and sale, logistics, building materials trading, and modern service business. As of 31 December 2022, the Company was wholly owned and ultimately controlled by Miluo State-owned Assets Service Center.

Rating Considerations

Government's Capacity to Provide Support

We believe that the Miluo City Government has a relatively strong capacity to provide support, given its economic importance in Yueyang City with ongoing economic growth, but constrained by its relatively weak fiscal profile.

Located in the central part of China, Hunan Province is one of the important cradles of Chinese civilization and it is also an important grain production base. In 2022, the gross regional product ("GRP") of Hunan Province was RMB4.9 trillion, ranking 9th among all provinces in China. Affected by the COVID-19 pandemic and tax refund factors, its general public budget revenue decreased to RMB310.2 billion in 2022 from RMB325.1 billion in 2021, with tax revenue accounting for 64.6% of its general public budget revenue.

Located in the northeastern part of Hunan Province, Yueyang City is a node city in the national Yangtze River Economic Belt and the urban agglomeration in the middle reaches of the Yangtze River. It has superior location advantages and convenient transportation. It is also the international shipping center and the largest international container port and direct shipping port in Hunan Province. Yueyang City is an important petrochemical, papermaking, and electric power energy base. Benefiting from its good location advantages and optimized industrial structure, Yueyang City's GRP increased from RMB400.2 billion in 2020 to RMB471.1 billion in 2022, ranking second after Changsha City among all prefecture-level cities in Hunan Province. In the first half of 2023, its GRP continued to increase by 4.4% year-on-year to RMB223.1 billion. With ongoing economic growth, the general budgetary revenue of Yueyang City also increased from RMB15.3 billion in 2020 to RMB18.5 billion in 2022. However, Yueyang City has weak fiscal self-sufficiency, as reflected by its average fiscal balance ratio of around 30% over the past three years. Accordingly, it has high reliance on higher-tier government transfer payments and local land sales. At the end of 2022, Yueyang City's local government debt balance was RMB92.3 billion, accounting for 19.6% of GRP.

Exhibit 1. Key Economic and Fiscal Indicators of Yueyang City

	2020FY	2021FY	2022FY
GRP (RMB billion)	400.2	440.3	471.1
GRP Growth (%)	4.2	8.1	5.4
General Budgetary Revenue (RMB billion)	15.3	17.1	18.5
General Budgetary Expenditure (RMB billion)	53.9	54.8	55.7
Local Government Debt (RMB billion)	67.7	79.5	92.3

Source: Statistics Bureau of Yueyang City, CCXAP research

Located in the northeast of Hunan Province, Miluo City is a county-level city under the jurisdiction of Yueyang City, covering a total area of 1,562 square kilometers. Miluo City is a famous dragon boat city in China. It has demonstrated ongoing economic growth over the past three years. Its GRP increased from RMB42.7 billion in 2020 to RMB49.1 billion in 2022, ranking second among the districts/counties in Yueyang City. Its general budgetary revenue also increased from RMB1.1 billion in 2020 to RMB1.5 billion in 2022. It has moderate fiscal stability, with tax revenue accounting for 76% of its general public budget revenue on average over the past three years. In addition, the Miluo City Government has outstanding government debt of RMB8.2 billion at end-2022, accounting for 16.7% of its GRP.

Exhibit 2. Key Economic and Fiscal Indicators of Miluo City

	2020FY	2021FY	2022FY
GRP (RMB billion)	42.7	46.4	49.1
GRP Growth (%)	5.1	8.1	6.0
General Budgetary Revenue (RMB billion)	1.1	1.2	1.5
General Budgetary Expenditure (RMB billion)	5.1	4.4	4.4
Local Government Debt (RMB billion)	5.3	6.7	8.2

Source: Statistics Bureau of Miluo City, CCXAP research

Government's Willingness to Provide Support Strong position in public-related services of Miluo City

There are two key LIIFCs in Miluo City, MRHG and Miluo City Cultural Tourism Group Co., Ltd ("MCTG"), each with clear positioning in the regional development. MCTG is mainly responsible for cultural tourism development in Miluo City. The Company is the most important LIIFC with the largest assets size in Miluo City, mainly responsible for local infrastructure construction, land consolidation, and state-owned assets management. The Company has undertaken about 80% of infrastructure projects in Miluo City, making great contribution to local economic and social development. Given its strong position to the urban construction of Miluo City, we believe that the Company is unlikely to be replaced by other local state-owned enterprises in the foreseeable future.

The infrastructure construction projects of the Company are mainly conducted by its subsidiary Hunan Chuzhisheng Holding Industrial Group Co., Ltd ("CHIG"). Entrusted by the local government, CHIG undertakes major construction projects. As of 31 December 2022, the Company has 10 infrastructure construction projects under construction, with total estimated investment of RMB5.1 billion and uninvested amount of around RMB1.8 billion; the Company had 3 infrastructure construction project under planning, with a total investment of RMB756 million. These projects mainly include construction of roads, hospital, and environment improvement projects.

Entrusted by the local government, MRHG is also engaged in the land consolidation in Miluo City. As of 31 December 2022, MRHG has 5 land consolidation projects under construction, with a total estimated investment of RMB1.3 billion and uninvested amount of RMB533 million; the Company had 2 land consolidation project under planning, with a total investment of RMB832 million. However, the land consolidation business is susceptible to local land market and land policies.

MRHG is the major water service provider in urban area and most rural area of Miluo City, with strong regional position. The Company provides water to around 61,000 households via one water supply plant with daily water supply capacity of 38,800 cubic meters and water pipe network of 3,480 kilometers.

Increasing investment on self-operated commercial projects, exerting high capital expenditure pressure

In addition to public activities, MRHG is also engaged in diversified commercial businesses, mainly including engineering construction, sandstone mining and sale, logistics, building materials trading, charging pile, parking lots, and cemetery businesses. We consider the Company's exposure to commercial businesses to be moderate, accounting for less than 20% of its total assets. As most of the commercial businesses have franchise advantage, we believe that the commercial business risk is manageable. However, given that the Company currently focuses on the construction of self-operated projects, we expect its exposure to commercial businesses will gradually increase. As of 31 December 2022, the Company had 12 commercial projects under construction or planning, with total estimated investment of RMB3.7 billion and uninvested amount of RMB3.3 billion, exerting

high capital expenditure pressure to the Company.

Good track record of receiving government support

MRHG has regularly received support from the local government in the form of operating subsidies, project payments, capital injection, and asset transfers. The Company has received ongoing asset transfer, such as pipeline assets, significantly enhancing its capital strength. From 2020 to 2022, the local government had transferred assets of RMB4.1 billion into the Company. Besides, the local government has regularly made project payments to the Company. From 2020 to 2022, The Company had received government payments of RMB2.4 billion for the completed agency projects. The local government also regularly provided subsidies to support the Company's general operations during the same period. Besides, the Company has received capital injection of RMB176 million from the local government in 2021. Given its important role in undertaking infrastructure construction projects and providing public services in Miluo City, we believe that the local government will continue to provide strong support to the Company.

Fast debt growth and modest asset liquidity

MRHG has a fast debt growth over the past three years. The Company's total debt had increased from RMB7.8 billion at end-2020 to RMB11.8 billion at end-2022. The increase in debt is mainly attributable to the ongoing financing for the construction projects. Nonetheless, the Company has reasonable debt leverage and debt structure. As of 31 December 2022, its total capitalization ratio was 39.8% and its short-term debt accounted for about 19.4% of total debt. Given its capital expenditure pressure, we expect the Company's debt burden will continue to grow in the next 12 to 18 months.

MRHG has modest asset liquidity, which may undermine its financing flexibility. The Company's total assets mainly consist of inventories, account receivables, and advance payments, accounting for 66% of its total asset at end-2022. Inventories are mainly investment costs for construction projects and land assets, while account receivables and advance payments are mainly unreceived project payments from the local government and advance project payments to construction companies, respectively. Furthermore, as of 31 December 2022, the Company had pledged assets of RMB4.9 billion for loans, accounting for 15.4% of total assets.

Access to funding from banks and onshore bond market

MRHG has good access to funding, as reflected by its good relationship with banks and track record of bond issuance. The Company has an approved line of credit from diversified commercial and policy banks, such as Industrial and Commercial Bank of China and Agricultural Development Bank. As of 31 December 2022, it had obtained total credit facilities of RMB6.6 billion, with available credit facilities of RMB890 million. The Company also has access to onshore bond market. From 2020 to 2022, the Company's subsidiary CHIG had raised RMB900 million via issuance of 3 domestic bonds. In addition, the Company has low reliance on non-standard financing, accounting for less than 5% of total debt. The Company also plans to issue offshore bonds to broaden its financing channels.

Moderate exposure to external guarantees

MRHG has moderate exposure to external guarantees, which has constrained its credit rating. As of 31 December 2022, the Company had outstanding external guarantees of RMB5 billion, accounting for 28.1% of its net assets. However, we consider the Company's contingent liability risks to be manageable, as all of the external guarantees are provided to local state-owned enterprises with counter-guarantee measures.

ESG Considerations

MRHG faces environmental risks because it has undertaken infrastructure construction and land consolidation projects. Such risks could be moderated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

MRHG bears social risks as it implements public policy initiatives by undertaking infrastructure construction and water supply projects in Miluo City. 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.

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

Structural considerations

We did not notch MRHG's senior unsecured debts rating for structural subordination, reflecting our expectation that in the event of financial distress, the local government will likely provide support to the Company, thereby increasing the recovery prospects for its creditors. We also see that the structural subordination risk is mitigated by the strong position of MRHG's infrastructure and public utility assets, thus we expect that government support will be provided to the Company to preserve its ownership of such assets.

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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