Credit Opinion

28 May 2024

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

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Huzhou Wuxing Economic Development and Investment Group Co., Ltd.

Surveillance credit rating report

CCXAP upgrades Huzhou Wuxing Economic Development and Investment Group Co., Ltd.'s long-term credit rating to BBB_g, with stable outlook.

Summary

CCXAP has upgraded the long-term credit rating of Huzhou Wuxing Economic Development and Investment Group Co., Ltd. ("WEDG" or the "Company") to BBB_g from BBB_g-, with stable outlook. The rating upgrade is based on the robust economic development of Wuxing District, which strengthens the local government's capacity to support the Company. It also reflects the Company's strategic importance in the regional development of Wuxing Economic Development Zone ("Wuxing EDZ").

The BBB_g long-term credit rating of WEDG reflects Wuxing District Government's strong capacity to support and its very high willingness to support, based on our assessment of the Company's characteristics. Our assessment of Wuxing District Government's capacity to provide support reflects its leadership as the first ranking by gross regional product ("GRP") in Huzhou City and the local government's moderate fiscal metrics.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) strategic importance in the infrastructure construction in Wuxing EDZ; and (2) track record of receiving government payments.

However, the Company's rating is constrained by its (1) increasing commercial business risk driven by self-operated projects; (2) increasing debt burden and moderate asset liquidity; and (3) high dependence on non-standard financing.

The stable outlook on WEDG's rating reflects our expectation that the Wuxing District Government's capacity to provide support will be stable, and that the Company will maintain its important role in local infrastructure construction in Wuxing EDZ over the next 12 to 18 months.

Rating Drivers

- Strategic importance in the infrastructure construction in Wuxing EDZ
- Increasing exposure to commercial activities
- Large capital expenditure pressure caused by self-operated projects
- Track record of receiving government payments
- Increasing debt burden and moderate asset liquidity
- Diversified financing channels but high dependence on non-standard financing
- Moderate contingent liability risk from external guarantees with exposure to related parties

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Wuxing District Government's capacity to provide support strengthens; or (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as decreased debt burden and improved asset liquidity.

What could downgrade the rating?

The rating could be downgraded if (1) Wuxing 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 reduced strategic significance, decreased government payments, or weakened funding capabilities.

Key Indicators

	2021FY	2022FY	2023FY
Total Asset (RMB billion)	7.3	15.5	19.0
Total Equity (RMB billion)	4.0	7.5	7.6
Total Revenue (RMB billion)	0.9	0.9	0.8
Total Debt/Total Capital (%)	41.9	47.4	57.9

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

Source: Company data, CCXAP research

Corporate Profile

Established in December 2004, formerly known as Huzhou Daixi Urban Development Co., Ltd. As an important investment and construction entity in the Wuxing District of Huzhou City, WEDG is primarily engaged in infrastructure construction and self-operated projects in Wuxing EDZ. It is also involved in commercial businesses including property leasing, merchandise trading, and ore trading. As of 31 December 2023, the Company was 60% owned by Huzhou Wuxing Development of State-owned Capital Investment Co., Ltd. ("WSCI") and 40% owned by Huzhou Wuxing Transportation and Tourism Investment Development Group Ltd ("WTTI"). The Company was ultimately wholly owned by Wuxing District State-owned Assets Supervision and Administration Service Centre ("Wuxing Service Centre"), and the People's Government of Wuxing District of Huzhou City ("Wuxing District Government ") was its ultimate controlling shareholder.

Exhibit 1. Revenue structure in 2023

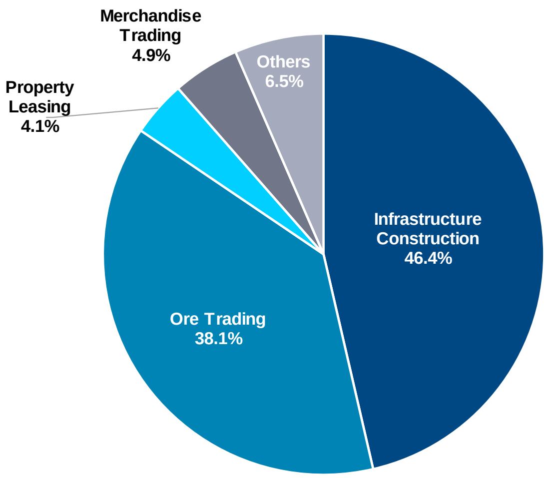
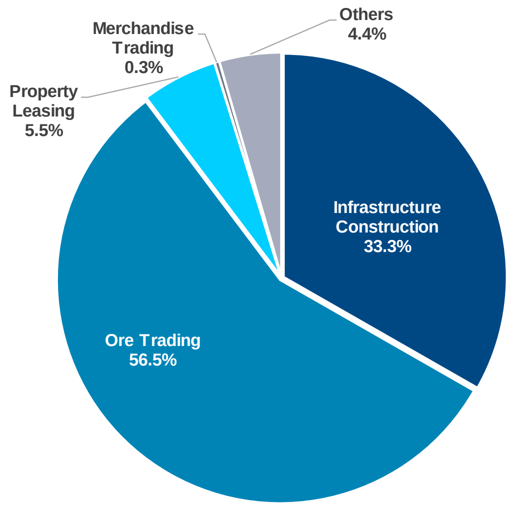
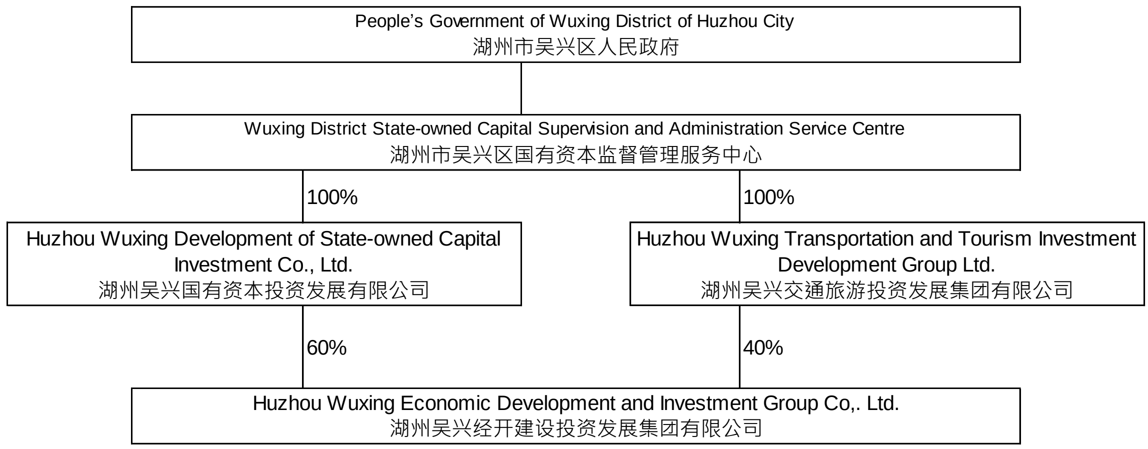


Exhibit 2. Profit structure in 2023



Source: Company information, CCXAP research

Exhibit 3. Shareholding chart as of end-2023



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

Wuxing District is under Huzhou City, a prefecture-level city in Zhejiang Province. We believe the local government of Wuxing District has a strong capacity to provide support given its leadership as the first ranking in GRP in Huzhou City and the local government's moderate fiscal metrics.

Located in the northern part of Zhejiang Province, Huzhou City is the node city connecting the north and south areas of the Yangtze River Delta region. Huzhou City has four leading industries including information technology, high-end equipment, health and tourism. It has achieved a significant increase in GRP over the past three years. In 2023, Huzhou City recorded a GRP of RMB401.5 billion, increasing by 5.8% year-over-year ("YoY"). Due to the economic recovery and industry growth, Huzhou Municipal Government's general budgetary revenue increased from RMB38.7 billion in 2022 to RMB41.1 billion in 2023. It also has good fiscal stability, with tax income accounting for around 90% of general budgetary revenue for the past three years. Its fiscal balance remained at a moderate level, with general budgetary revenue to general budgetary expenditure ratio of 67.6%

in 2023. However, Huzhou Municipal Government's debt burden was large with an outstanding direct government debt of RMB136.4 billion at end-2023, accounting for 34.0% of its GRP and 98.6% of its total fiscal revenue.

Exhibit 4. Key Economic and Fiscal Indicators of Huzhou City

	2021FY	2022FY	2023FY
GRP (RMB billion)	364.5	385.0	401.5
GRP Growth (%)	9.5	3.3	5.8
General Budgetary Revenue (RMB billion)	41.4	38.7	41.1
General Budgetary Expenditure (RMB billion)	52.4	60.2	60.7
Local Government Debt (RMB billion)	102.3	118.9	136.4

Source: Statistics Bureau of Huzhou City, CCXAP research

As the central municipal district of Huzhou City, Wuxing District is located at the intersection of Shanghai Metropolitan Circle, Hangzhou Metropolitan Circle and Taihu Lake Economic Circle. A large number of large-scale headquarters gather in Wuxing District. In addition, Huzhou South Taihu High-tech Industrial Zone and Huzhou Economic and Technological Development Zone are also located in Wuxing District. The textile and garment industries are traditional pillar industries in Wuxing District, and five characteristic industrial clusters have been formed, including children's clothing, cashmere products, functional fibers, home textiles, and silk weaving. The intelligent equipment industry is one of the equipment manufacturing industries supported by Wuxing District Government, forming a complete industrial chain including equipment manufacturing, R&D and design, intelligent support, and integrated services. In 2023, Wuxing District ranks 42nd among the top 100 nationwide technology and innovation districts. At the same time, the GRP of the Wuxing District increased by 5.3% YoY to RMB92.5 billion, representing around 23.0% of Huzhou City's GRP. Wuxing District Government's general budgetary revenue increased from RMB6.2 billion in 2022 to RMB6.7 billion in 2023. Wuxing District has a strong fiscal balance but a weak debt profile, with high general budgetary revenue to the general budgetary expenditure of 94.8% in 2023 and a government debt to total fiscal revenue ratio of 114.1% as of 31 December 2023.

Exhibit 5. Key economic and fiscal indicators of Wuxing District

	2021FY	2022FY	2023FY
GRP (RMB billion)	85.3	89.7	92.5
GRP Growth (%)	9.7	3.5	5.3
General Budgetary Revenue (RMB billion)	6.3	6.2	6.7
General Budgetary Expenditure (RMB billion)	5.8	6.9	7.0
Local Government Debt (RMB billion)	14.8	17.1	18.6

Source: Statistics Bureau of Wuxing District, CCXAP research

Wuxing EDZ was established in 2015 with the approval of the Zhejiang Provincial Government. It has formed three leading industries including smart equipment, cosmetics, and children's clothing. In 2020, Wuxing EDZ was listed as a national green industry demonstration base. The total development area of the Economic Development Zone is 42.78 square kilometers, including Donglin subdivision, Daixi subdivision, Daochang subdivision and Zhili subdivision. As an important entity of infrastructure construction in Wuxing EDZ, the development of Wuxing EDZ will provide opportunities for the Company.

Government’s Willingness to Provide Support

Strategic importance in the infrastructure construction in Wuxing EDZ

There are four major local infrastructure investment finance companies (“LIIFCs”) supporting the development of Wuxing District, each having a clear position. As one of the four major LIIFCs, WSCI is primarily responsible for the construction and development of major infrastructure in Wuxing District, holding 60% of the Company's shares. Besides, WTTI, responsible for undertaking transportation and tourism-related construction projects in Wuxing District, holds the remaining 40% share of the Company.

As an important infrastructure construction entity in Wuxing District of Huzhou City, WEDG is primarily engaged in construction projects including road and bridge construction, comprehensive environmental improvement, sewage treatment and relocation housing construction. The Company adopts an agency model for its infrastructure construction projects. As of 31 December 2023, the Company has completed 6 key infrastructure construction projects with a total investment of around RMB2.8 billion, and a payback amount of RMB896.8 million. The payback amount was much lower than the total investment amount due to settlement periods and government planning. There were 8 infrastructure construction projects under construction or planning, with a total investment amount of around RMB3.3 billion and an outstanding amount of RMB674.0 million. Overall, the Company’s projects in the pipelines can ensure the sustainability of the business, but cause large capital expenditure pressure on the Company.

Increasing exposure to commercial activities

WEDG's commercial businesses mainly include merchandise trading, ore trading and property leasing. In addition, the Company is also carrying out self-operated projects in the region. We consider the Company’s exposure to commercial businesses to be medium, accounting for around 35% of its total assets.

The Company has conducted its merchandise trading business since 2021, primarily through its minority-owned consolidated subsidiary, Huzhou Wuxing Xuge Supply Chain Management Co., Ltd (‘Xuge Supply Chain’’). Xuge Supply Chain primarily trades building materials such as steel The Company adopts a demand-driven business model for its trading business and does not keep inventory. The merchandise trading business contributes supplementary income for the total revenue of the Company, accounting for 4.9% of its total revenue in 2023, with a very low gross profit margin of 1.4%. In addition, the Company’s high reliance on its top 1 customers and top 5 suppliers increased uncertainties in this business.

WEDG also conducts ore trading business, with revenue growing from RMB79.8 million in 2022 to RMB316.6 million in 2023. The Company owns the mining rights to a tuff mine located in Beauty Town of Daixi Town in Wuxing District. As of 31 December 2023, approximately 3.41 million tons of tuff had been mined, with 6.16 million tons of tuff reserves. Nuclear Industry Shaft Construction Group Co., Ltd. (‘‘NISC’’) has been contracted as the general contractor and is responsible for the mining, transportation and processing services. In terms of sales, the Company signed a corresponding long-term sales agency agreement with Hangzhou Haoxiang Cargo Transfer Co., Ltd. (“HHCT”), HHCT carried out customer search and price negotiation. Ore prices are determined based on the appraisal report issued by the asset appraisal company at the beginning of each month. However, the top 5 downstream customers for the ore trading business accounted for 100% of total sales, indicating a high risk of customer concentration.

The Company has developed its property management and property leasing businesses since 2021. It receives service fees by providing property management services for agricultural product trading centers through its subsidiary. The Company also leases its commercial properties for rental revenue. The Company has a rental area of 56,743 square meters and an average rental rate of 67.8% as of the end of 2023. Furthermore, the leasing business grows very fast from RMB9.8 million in 2022 to RMB33.9 million in 2023, with a profit margin rate of 28.6% in 2023.

In addition, the Company has some self-operated projects under construction, such as industrial parks in Wuxing EDZ, with a total investment amount of around RMB8.2 billion and an outstanding amount of RMB7.6 billion. The Company plans to achieve a funding balance for self-operated projects through leasing. We expect that these projects exert large capital expenditure pressure on the Company. Due to the economic downturn, the future revenue generated from this business is also uncertain, depending on regional development and the operating conditions of attracted companies. At the same time, along with the development of self-operated projects, the proportion of the Company's commercial business will increase in the future.

Track record of receiving government payments

WEDG has a proven track record of receiving government support in the form of capital injection, asset transfers, tax incentives and financial subsidies. In 2020, the Company received asset transfers from the government including forest rights, sand mining rights, and the equity shares of Huzhou Wuxing Shangqiang Industry and Trade Co., Ltd. and Huzhou Wuxing Beauty Town Construction Management Co., Ltd., increasing the Company's capital strength and broadening its business scope. In 2022, the Company received mining rights and advertising space management rights, increasing its capital reserve by RMB3.4 billion. From 2021 to 2023, the Company received government subsidies of approximately RMB182.0 million. We expect the local government will continue to provide ongoing support to the Company, given WEDG's important role in the infrastructure construction of Wuxing District, especially Wuxing EDZ.

Increasing debt burden and moderate asset liquidity

WEDG's debt burden is increasing, which is driven by the large capital expenditure. Its total debt has increased from RMB6.8 billion at end-2022 to RMB10.4 billion at end-2023, with a total capitalization ratio of 57.9% as of 31 December 2023. The Company has relatively high short-term debt repayment pressure since its short-term debt accounted for about 47.5% of total debt as of 31 December 2023, and the liquidity profile was weak with a cash-to-short-term debt ratio of around 0.3x at the same time, indicating that its cash balance was insufficient to cover its short-term debt. Considering the capital expenditure pressure caused by the Company's large number of self-operated projects, we expect that the Company will continue to raise funds through external financing. Therefore, the Company's total debt will keep growing over the next 12-18 months.

WEDG's asset liquidity is moderate as they are mainly inventories and other receivables with weak liquidity. As of 31 December 2023, the inventories and receivables amounted to RMB8.8 billion, accounting for 46.3% of its total assets. The inventories mainly consisted of construction costs caused by infrastructure construction projects and the receivables mainly consisted of uncollected payments from the local government and other state-owned enterprises. The moderate liquidity asset may undermine the Company's financing flexibility, which is credit-negative.

Diversified financing channels but high dependence on non-standard financing

WEDG has relatively good access to various sources of funding, including bank loans and offshore bond financing. As of 31 December 2023, the Company has obtained a total of RMB7.8 billion in bank credit facilities, with an available credit of RMB3.2 billion. In terms of direct financing, the Company had issued 2 USD bonds in the offshore debt market, with an outstanding amount of USD180.0 million as of 31 December 2023, with coupon rates of 3.1% and 5.2%, respectively.

However, the Company is highly dependent on non-standard financing, accounting for 47.5% of the total debt at end-2023, with a relatively high interest rate of around 7.3%. Besides, the non-standard financing channels are unstable, which may affect the Company's financing ability.

Moderate contingent liability risk from external guarantees with exposure to related parties

WEDG has moderate exposure to contingent liabilities. As of 31 December 2023, the Company's external guarantee amount was RMB2.2 billion, accounting for 29.3% of its net assets. Most of the external guarantees are provided to Huzhou New City Investment Development Group Co., Ltd, a subsidiary of Huzhou Wuxing Development of State-owned Capital Investment Co., Ltd. We expect that the contingent risk of the external guarantee is controllable, considering that these guarantees are all related parties. Nevertheless, if a credit event occurs in Wuxing District, it may lead to large-scale cross-default and increasing repayment obligations of the Company.

ESG Considerations

WEDG assumes environmental risks through its infrastructure construction projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

In terms of social awareness, WEDG has played a crucial role in the social welfare of Wuxing District by involving the construction of road and bridge construction, comprehensive environmental improvement, sewage treatment and relocation housing construction projects.

In terms of corporate governance, WEDG's governance considerations are also material as the Company is subject to local government oversight and 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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