

Credit Opinion

6 September 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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Zhaoqing Gaoyao District Gaohong Industrial Investment Development Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Zhaoqing Gaoyao District Gaohong Industrial Investment Development Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Zhaoqing Gaoyao District Gaohong Industrial Investment Development Co., Ltd. (“GIID”) is underpinned by the Company’s (1) status as the most important industrial investment platform in Gaoyao District; (2) good market position and competitiveness in engineering construction and product sales in Gaoyao District; and (3) diversified sources of revenue.

However, the rating is constrained by the Company’s (1) relatively weak profitability with a relatively high reliance on non-recurring gains; (2) relatively fast debt growth and certain short-term debt repayment pressure; and (3) modest long-term debt servicing capability with moderate access to funding.

The rating also reflects a high likelihood of government support from the Gaoyao District Government when needed, which is based on the Company’s (1) direct ownership and ultimate control by the Gaoyao District Government; (2) significance in promoting the industrial development and integration of state-owned assets in Gaoyao District; and (3) solid track record of receiving support from the local government including subsidies, capital injections and asset transfers.

The stable outlook on GIID’s rating reflects our expectation that the Company will continue to receive solid support from the Gaoyao District Government. We also expect the Company to maintain its strategic role as the important industrial development platform in Gaoyao District over the next 12 to 18 months.

Rating Drivers

- Most important industrial investment platform in Gaoyao District, but with relatively high capital pressure
- Good market position in engineering construction and product sales in Gaoyao District
- Strong regional competitiveness in product sales business
- Diversified sources of revenue
- Relatively weak profitability with a relatively high reliance on non-recurring gains
- Relatively fast debt growth and certain short-term debt repayment pressure
- Modest long-term debt servicing capability with moderate access to funding
- High likelihood of support from the Gaoyao District Government

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the likelihood of support from the Gaoyao District Government increases; (2) the quality of the Company's investment portfolio materially improves, such as having a higher level of asset liquidity and generating better recurring cash flow from investees; or (3) the Company's stand-alone credit profile improves significantly, such as stronger market position and improvement in profitability.

What could downgrade the rating?

The rating could be downgraded if (1) the likelihood of support from the Gaoyao District Government decreases; (2) the performance of the Company's investment portfolio deteriorates; or (3) the Company shows weakened access to funding and eroded liquidity profile.

Key Indicators

	2021FY	2022FY	2023FY	2024H1
Total Assets (RMB billion)	5.0	8.7	9.3	9.2
Total Equity (RMB billion)	3.0	5.3	6.3	6.3
Total Revenue (RMB billion)	0.4	0.5	0.8	0.5
Net Profits (RMB billion)	0.1	0.1	0.1	0.0
EBIT Margin (%)	21.8	50.1	13.0	7.9
Return on Assets (%)	1.2	1.7	0.6	0.2
Total Debt/Total Capital (%)	30.6	29.4	21.6	25.1
Total Debt/EBITDA (x)	14.6	9.1	13.3	41.0
EBITDA/Interest (x)	7.0	12.4	3.6	9.9
FFO/Total debt (%)	8.2	3.2	0.7	1.0

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

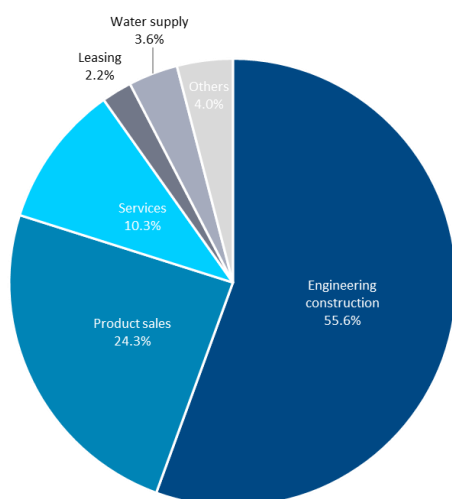
Source: Company data, CCXAP research

Corporate Profile

Established in 2000, formerly known as Gaoyao Gaojian State-owned Assets Management Co., Ltd., GIID is positioned as an important industrial investment and state-owned assets operation platform in Gaoyao District and mainly engages in industrial investment, engineering construction, product sales and human services

businesses. As of 30 June 2024, GIID was wholly owned by the Zhaoqing Gaoyao District State-owned Assets Supervision and Administration Bureau (“Gaoyao SASAB”), with a registered capital of RMB300 million.

Exhibit 1. Revenue structure in 2023



Source: Company information, CCXAP research

Rating Considerations

Business Profile

Most important industrial investment platform in Gaoyao District, but with relatively high capital pressure

As the most important industrial investment platform in Gaoyao District, GIID is of great significance in promoting the development of strategic emerging industries in Gaoyao District. The Company engages in industrial investment business by ways of equity investment and project investment and its investment portfolio is aligned with the government policies and economic development, focusing local advantageous industries such as new materials and metal processing and cultivating emerging industries including advanced equipment manufacturing, modern agriculture and electronic information, thereby improving regional industrial upgrading. The Company also revitalizes local high-quality resources such as mines. However, the large scale of project investment exerts relatively high capital pressure and puts certain pressure on the financing activities of the Company.

Positioned as an important industrial investment entity to promote the development of pillar industries in Gaoyao District, the Company engages in industrial investment business by ways of equity investment and projects construction. As of 30 June 2024, the Company had a diversified industrial portfolio as it had invested in the equity shares in 12 enterprises, with a total equity book value of RMB2.1 billion, focusing on auto parts production, engineering construction, new energy, civil explosives product sales, tobacco production and sales, gold mining and production and agricultural products industries. Benefiting from the diversification of investment targets, the Company achieved stable investment return in recent years, which amounted to RMB46.0 million, RMB65.9 million, RMB62.5 million and RMB23.7 million from 2021 to 2024H1, respectively.

In accordance with the development plans of the local government, attracting enterprises and investments for the development of Gaoyao District, the Company also participates in the industrial project development in Gaoyao District under the self-operated model with its own funds and self-raised funds. As of 30 June 2024, the

Company had 2 industrial development projects under planning, which are mainly photovoltaic projects and Gaogui duck industry chain projects, with an estimated investment of RMB5.4 billion, exerting high capital expenditure pressure. Moreover, the Company establishes joint venture companies with industry-leading companies to operate these projects and makes profits by leasing of factories and photovoltaic equipment, and collection of investment dividends. The income of the Company's industrial development business mainly comes from leasing of factories and photovoltaic equipment, and collection of investment dividends. However, the large amount of future investment of industrial development projects would bring large capital expenditure pressure to the Company.

Good market position in engineering construction in Gaoyao District

GIID is a leading local E&C company in Gaoyao District, mainly in the area of water conservancy and municipal construction. The Company maintains high market recognition as it participates in most infrastructure construction projects in Gaoyao District.

GIID possesses good technical advantages in local engineering construction, and is equipped with sufficient industry qualifications, which enable it to be more competitive in the tendering market and access to quality projects. GIID demonstrates good project reserves with good project quality that help support its future business growth. As of 30 June 2024, the Company's unfinished contract value amounted to RMB2.5 billion. The total contract value of projects under construction amounted to RMB1.8 billion with a recognized revenue of RMB640.0 million and a received repayment of RMB433.0 million. In addition, GIID's project quality is considered high given most of the Company's clients are the local government, SOEs and local large-sized enterprises that have lesser payment risk. However, the development of engineering construction business is constrained by its geographically concentrated operation in Gaoyao District as its growth is highly associated with the local construction needs in the district and its investment planning. The Company's amount of newly signed contracts fluctuated in recent years, which recorded RMB1.5 billion, RMB756.0 million and RMB361.0 million from 2022 to 2024H1.

Strong regional competitiveness in product sales business

GIID also has maintained strong regional competitiveness in the sales business sector in Gaoyao District, supported by its regional advantages. GIID carries out sales businesses with a multiple product portfolio including gas cylinders, civil explosives, hardware products, grain and chemical reagents. We believe that the Company has good market position in the region underpinned by its high market share benefited from franchise rights by the local government.

The Company undertakes the function of guiding foreign trade exports under the planning of local government. It conducts foreign trade sales and generates profits by purchasing products from small hardware manufacturers in Jinli Town and applying for tax refunds, and recognizes about 1% of the export sales revenue as the company's profit income.

As the sole grain and oil reserve operator in Gaoyao District, the Company is responsible for the purchase, storage, custody, rotation sales of grain in Gaoyao District. The grain is purchased by funds provided by policy loans from the Agricultural Development Bank of China, and the loan interest is subsidized by the Gaoyao District Government. Given the business's strategic functions of stabilizing grain prices by balancing the supply and demand, and responding to major natural disasters or emergencies, the Gaoyao District Government provides continuous subsidies and loan interests to the Company. However, the profitability of the business is susceptible to the fluctuating grain prices.

The Company also engages in sales of civil explosives, including explosives, detonators, and fuses, to specific groups at prices under government guidance. The gross profit margin of this business sector is relatively high at around 30%, providing supplementary revenue and cash flow to the Company but subject to its relatively small operating scale.

Exhibit 2. Revenue of product sales business by products from 2022 to 2024H1

(RMB million, %)	2022FY		2023FY		2024H1	
	amount	percentage	amount	percentage	amount	percentage
Gas and cylinder	21.7	10.3	21.6	10.6	15.4	15.3
Civil explosives	25.2	12.0	37.2	18.2	15.4	15.3
Foreign trade sales	66.9	31.8	70.2	34.3	27.1	26.9
Grain	70.1	33.3	33.6	16.4	20.8	20.7
Meat and vegetables	14.5	6.9	23.1	11.3	13.1	14.1
Chemical reagents	9.4	4.5	13.5	6.6	5.6	5.6
Others	2.8	1.3	5.5	2.7	2.2	2.1
Total	210.5	100.0	204.7	100.0	100.5	100.0

Source: Company information, CCXAP research

Diversified sources of revenue

In addition to engineering construction and product sales businesses, the Company has also diversified into different business segments, mainly including leasing, services, and water supply, forming a well-diversified business portfolio. We believe that the Company can diversify its business risks and mitigate revenue volatility through the synergistic operation of its multiple business segments, which is credit-positive.

The Company conducts service business through its subsidiaries, providing security, human resources, cleaning, slaughtering, garbage removal, motor vehicle training, sightseeing car services, freight services, which accounted for 10.3% of the total revenue in 2023. Moreover, the Company is also responsible for operating other businesses such as water supply and leasing services, each accounting for less than 5% of the Company's total revenue in 2023. As of 31 December 2023, the Company provided water services to 552,800 households with a daily water supply capacity of 225 thousand tons. The Company also owns leasable properties including factories of around 450 thousand sqm and 56 vehicles, providing supplementary income to the Company. Overall, these businesses have small contribution to the Company's overall revenue but are relatively stable.

Financial Profile

Relatively weak profitability with a relatively high reliance on non-recurring gains

Benefited from the expansion of engineering construction business, GIID's total revenue increased from RMB394.9 million in 2021 to RMB842.3 million in 2023, representing a CAGR of 28.7%. The engineering construction business is the main contributor, accounting for 55.6% of total revenue in 2023, followed by product sales (24.3%), and services (10.3%). However, the Company's period expense ratio (mainly including marketing fee, management fee and finance cost) is relatively high, amounting to 14.6% on average from 2021 to 2023.

GIID's profitability is relatively weak as reflected by the weak return on assets and EBIT margin. In 2023, the Company's EBIT margin was 13.0%, while the return on assets was 0.6%. Meanwhile, there is certain uncertainties to stability of the Company's profitability as investment income and gains from fair value change made great contribution to its total profit over the past years, accounting for 64.6% and 34.6% of its total profit on average from 2021 to 2024H1. The investment income came from long-term equity investment in the

Company's joint venture company, Guangdong Hongtu Technology Co., Ltd., while gains from fair value change were generated by investment properties and other non-current financial assets.

Relatively fast debt growth and certain short-term debt repayment pressure

Due to relatively large capital expenditure on its construction development projects, GIID's total debt has been growing rapidly over past few years. As of 30 June 2024, the Company's total debt increased to RMB2.1 billion from RMB1.3 billion at end-2021. Due to the increase in capital reserves benefiting from equity assets injected from local government, the scale of the Company's total equity further increased, keeping its debt leverage at a reasonable level in recent years, which was 25.1% at mid-2024. The Company is exposed to certain short-term debt repayment pressure as its short-term debt accounted for 44.9% (end-2021: 4.1%) of its total debt as of 30 June 2024. Meanwhile, after excluding restricted cash, the cash to short-term debt ratio was 0.3x, indicating that its cash reserve could not fully cover the short-term debt. We expect the Company's debt burden will continue to increase, given its large capital expenditure needs for its extensive construction projects and further development of its diversified business.

Modest long-term debt servicing capability with moderate access to funding

As the Company's debt burden and financing costs increased, GIID's long-term debt servicing capability is modest. Its EBITDA interest coverage ratio descended from 7.0x in 2021 to 3.6x in 2023 and its FFO/total debt ratio decreased from 8.2% to 0.7% over the same period. Furthermore, the Company has large amount of restricted assets, which would limit its financing flexibility. As of 30 June 2024, the Company had pledged assets of RMB1.8 billion for loans, accounting for 19.5% of total assets.

The Company shows moderate access to funding, as it highly relies on bank loans and non-standard financing. As of 30 June 2024, the non-standard debts accounted for more than 60% of the total debt, which would bring higher refinancing pressure to the Company. Meanwhile, the Company has certain standby liquidity. As of 30 June 2024, the bank loans accounted for 38.5% of total debt, with total credit facilities of RMB2.5 billion from diversified domestic policy banks and commercial banks, and an available amount of RMB1.8 billion. Given the Company's limited available credit facilities amount and large outstanding investment amount on its construction projects, we consider additional funding channel is needed to fulfil its large capital expenditure, such as onshore and offshore debt capital market.

External Support

High likelihood of support from the Gaoyao District Government

We expect GIID has a high likelihood of receiving support from the Gaoyao District Government in times of need. This expectation incorporates our considerations of the Company's (1) ultimate control by the Gaoyao District Government; (2) significance in promoting the industrial development and integration of state-owned assets in Gaoyao District; and (3) solid track record of receiving support from the local government including subsidies, capital injections and asset transfers.

Gaoyao SASAB maintains an extremely high degree of control over GIID's operations, including the formulation of business strategies and the appointment of the board of directors and key management personnel. The Company is also required to report its annual budget, objectives, plans and performance to Gaoyao SASAB. Its strategy and investment aligns with Gaoyao District Government's policies by investing in industries, such as modern agriculture, renewable power, to promote industrial upgrading in the region.

Given its strategic and economic importance in cultivating local industries in Gaoyao District, GIID receives solid and meaningful supports from the Gaoyao District Government via assets and capital injections, subsidies and granting of franchise rights. In March 2024, the Gaoyao SASAB integrated and injected the high-quality assets of state-owned enterprises in Gaoyao District, including equities and properties, to the Company without compensation to broaden its business scope and enhance its competitiveness. Meanwhile, Gaoyao SASAB increased the Company's registered capital from RMB100 thousand to RMB300 million in March 2024. From 2022 to 2024H1, the local government has provided subsidies of RMB17.8 million to the Company to support its operations. The local government has also provided supports to the Company in terms of prioritized high-quality project resources and franchise rights granting such as grain reserve operation rights and civil explosives sales rights.

We considered the Company's socio-political implications to be high as the Company is commissioned by the local government to play an important role in safeguarding local water and gas supply and strategic investing and operation of many major industrial upgrading projects and public projects, such as the integration of regional market-driven resources, guiding the export of foreign trade, and undertaking grain reserves in Gaoyao District.

Given its strategic position in the development of Gaoyao District, we believe that the local government will continue to provide support to the Company.

Structural considerations

GIID'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 the industrial development of Gaoyao 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 General Corporate \(April 2019\)](#).

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