

Credit Opinion

11 November 2024

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

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Wenzhou Lucheng District State-owned Holding Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Wenzhou Lucheng District State-owned Holding Group Co., Ltd., with stable outlook.

Summary

The BBB_g+

Our assessment of Lucheng District Government's capacity to support reflects its good comprehensive strength as the central urban area in Wenzhou City, with ongoing economic growth and good fiscal profile.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) leading position in infrastructure construction and land development of Lucheng District; (2) good track record of receiving ongoing government payments; and (3) access to diversified funding channels.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities; (2) increasing debt burden and moderate asset liquidity; and (3) medium contingent liability risk from external guarantees provided to local SOEs.

The stable outlook on LSHG's rating reflects our expectation that the local government's capacity to support will remain stable, and the Company will maintain its leading position in the development of Lucheng District.

Rating Drivers

- Leading position in infrastructure construction and land development of Lucheng District
- Medium exposure to commercial activities
- Good track record of receiving ongoing government payments
- Increasing debt burden and moderate asset liquidity
- Access to diversified funding channels
- Medium contingent liability risk from external guarantees provided to local SOEs

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as decrease in exposure to commercial activities or improvement in assets quality.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to support, such as decrease in its strategic significance; decrease in government payments; or increase in debt burden.

Key Indicators

	2021FY	2022FY	2023FY	2024Q1
Total Asset (RMB billion)	54.5	78.0	95.0	101.4
Total Equity (RMB billion)	20.2	23.6	23.9	24.2
Total Revenue (RMB billion)	1.8	1.4	1.5	0.3
Total Debt/Total Capital (%)	48.1	59.8	66.1	67.2

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

Source: Company data, CCXAP research

Corporate Profile

Established in 1997, LSHG is an important local infrastructure investment and financing company ("LIIFC") in Lucheng District. The Company is primarily focused on urban development activities including the development of resettlement housing, agent construction, parking service, municipal management service, public housing operation service and property leasing. LSHG is ultimately controlled and 100% owned by the State-owned Assets Supervision and Administration Office of Lucheng District Government ("Lucheng District SASAO").

Exhibit 1. Revenue structure in 2023

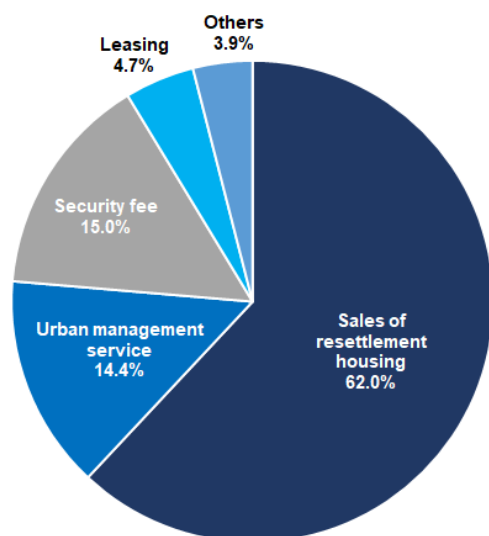
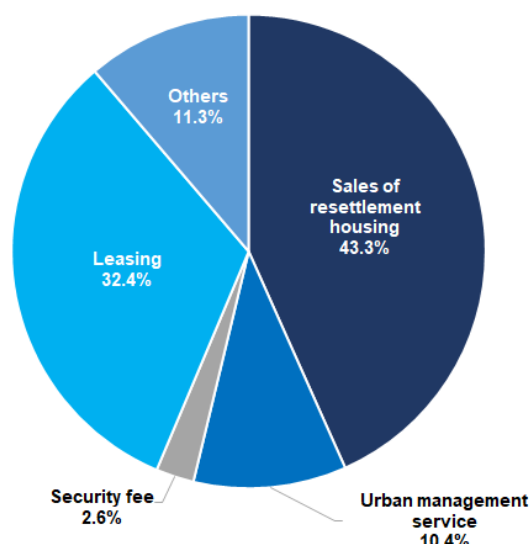


Exhibit 2. Gross profit structure in 2023



Source: Company information, CCXAP research

Rating Considerations

Government Capacity to Support

We believe Lucheng District Government has a strong capacity to provide support given its relatively good comprehensive strength as the central urban area in Wenzhou City, with ongoing economic growth and good fiscal profile.

Zhejiang Province is one of the most economically developed provinces in China, and its comprehensive economic strength and private economy lead in China. In 2023, the gross regional product ("GRP") of Zhejiang Province was RMB8.3 trillion, ranking 4th among all provinces in China, with a year-on-year ("YoY") increase of 6.0%. In 2023, its general budgetary revenue reached RMB0.9 trillion, ranking 3rd among all provinces in China.

Located in the southeast of Zhejiang Province, Wenzhou City is one of China's 45 highway main hub cities and one of the country's 25 main hub ports, with convenient transportation and abundant tourism resources. In recent years, Wenzhou City has promoted the development of five pillar industries, including electrical, footwear, clothing, auto parts and pumps. In 2023, Wenzhou City's GRP increased by 6.9% YoY to RMB873.1 billion, ranking 3rd among all prefecture-level cities in Zhejiang Province. Benefiting from economic recovery and industrial development, the Wenzhou Municipal Government's general budgetary revenue increased from RMB57.4 billion in 2022 to RMB62.3 billion in 2023. However, Wenzhou City's debt profile is modest and its outstanding governmental debt amounted to RMB307.5 billion at the end of 2023, equivalent to 35.2% of its GRP.

Exhibit 3. Key Economic and Fiscal Indicators of Wenzhou City

	2021FY	2022FY	2023FY
GRP (RMB billion)	758.5	803.0	873.1
GRP Growth (%)	7.7	3.7	6.9
General Budgetary Revenue (RMB billion)	65.8	57.4	62.3
General Budgetary Expenditure (RMB billion)	106.7	113.8	117.6
Local Government Debt (RMB billion)	212.7	263.5	307.5

Source: Statistics Bureau of Wenzhou City, CCXAP research

Lucheng District is one of the four districts of Wenzhou City, with relatively good comprehensive strength. In 2024, it ranked 50th among the top 100 comprehensive strength districts in China. It has two pillar industries, including shoe leather manufacturing and equipment manufacturing. It is located in the central urban area of Wenzhou City, which is also the location of the People's Government of Wenzhou City. Its tertiary industry holds a dominant position within the district. From 2021 to 2023, the GRP of Lucheng District increased from RMB126.2 billion to RMB140.1 billion. With the ongoing economic growth, Lucheng District Government's general budgetary revenue also increased from RMB4.1 billion in 2021 to RMB3.6 billion in 2023. However, due to the fiscal allocation policy between municipal government and district government, the scale of tax retention and the general public budget revenue of Lucheng District is relatively small. Besides, Lucheng District has high fiscal stability. For the past three years, its average tax income accounted for 76.9% of general budgetary revenue. However, it has modest fiscal self-sufficiency, with fiscal balance ratio at 49.5%. Lucheng District Government reported outstanding governmental debt of RMB35.3 billion at end-2023, representing 25.2% of GRP. In the first half of 2024, Lucheng District's economy grew steadily, achieving a GRP of RMB72.1 billion, a YoY increase of 5.7%.

Exhibit 4. Key Economic and Fiscal Indicators of Lucheng District

	2021FY	2022FY	2023FY
GRP (RMB billion)	126.2	130.8	140.1
GRP Growth (%)	6.2	2.0	5.3
General Budgetary Revenue (RMB billion)	4.1	4.7	3.6
General Budgetary Expenditure (RMB billion)	7.9	8.5	8.9
Local Government Debt (RMB billion)	20.8	26.2	35.3

Source: Statistics Bureau of Lucheng District, CCXAP research

Government Willingness to Support**Leading position in infrastructure construction and land development of Lucheng District**

As the largest LIIFC by total assets and the main urban development and operation entity in Lucheng District, the Company focuses on infrastructure construction, land development and consolidation as well as resettlement housing project in the region. It has completed a large amount of land consolidation, infrastructure construction, and resettlement housing construction projects in Lucheng District, making great contributions to the region's urbanization. Considering its strategic significance to the development of Lucheng District, we believe the Company is unlikely to be replaced by other local state-owned enterprises in the foreseeable future.

Entrusted by the Lucheng District Government, the Company undertakes infrastructure construction projects under agent construction model. The Company enters into a repurchase agreement with the local government. Upon construction completion, the local government agrees to buy back the infrastructure project in instalments

at a price equal to the investment costs plus a 5% markup to the Company. The Company has undertaken a number of infrastructure construction projects in Lucheng District. As of 31 March 2024, the Company had 24 infrastructure construction projects under construction, with a total planned investment of around RMB15.6 billion and uninvested amount of around RMB12.0 billion, indicating high capital expenditure pressure. However, the Company had no infrastructure construction projects under planning, indicating certain uncertainty to this business. In addition, affected by the slow project settlement progress, there are large amounts of unsettled projects, causing uncertainty to the future project payments. From 2021 to 2023, the Company has received a repayment of RMB38 million for its construction projects. However, as of 31 March 2024, there are RMB144.3 billion unsettled infrastructure construction costs in the Company's inventory.

Besides, entrusted by the local government, the Company also undertakes resettlement housing projects. According to the planning of Wenzhou City, the Company is using self-raised funds to carry out the reconstruction of urban villages and the construction of affordable housing projects within Lucheng District. According to the settlement guidance prices determined by the government, the Company will sell the resettlement housing to the specific relocated households. The Company's resettlement housing business mainly includes three models, including self-built resettlement housing, externally purchased resettlement-oriented commercial housing, and raising funds for resettlement housing. As of 31 March 2024, the Company has 6 resettlement housing projects, with a total planned investment of around RMB7.5 billion and uninvested amount of around RMB3.4 billion. As for the externally purchased resettlement-oriented commercial housing, the Company purchased 12 resettlement housing projects in 2020 with total housing purchase price of RMB17.8 billion and an unpaid amount of RMB3.1 billion. The Company plans to sell or lease the projects to relocated households and ordinary residents at market prices. As of 31 March 2024, some of the purchased resettlement-oriented commercial housing had been completed and transferred to the Company, with a total recorded value of RMB11.3 billion. For the fundraising of resettlement housing, the urban village construction center selects the Company as the service provider for resettlement housing through government procurement procedures. The Company will procure resettlement-oriented commercial housing and use market-based sourcing to accommodate the relocated households.

LSHG is entrusted by the local government to engage in land development business through its subsidiary. The Company raises funds to carry out land consolidation in the relevant areas. The government will transfer out the consolidated land after completion, and the Company can receive a certain income from land consolidation. The Company has been in discussions with local government departments to adjust the land development business model. As the specific settlement method is currently not determined, the Company has not recognized any land development revenue from 2021 to 2023. As of 31 March 2024, the Company had completed 6 land development projects, with a total investment of RMB1.0 billion and the land area of 909.2 thousand square meters. The Company has one land development project under construction with a land area of 33.9 square meters and a total planned investment of RMB226 million.

Medium exposure to commercial activities

LSHG's commercial businesses mainly include urban management services and security services businesses. We consider the Company's exposure to commercial businesses to be medium, accounting for around 15% of its total assets. However, the self-operated projects under construction have exert high capital expenditure pressure to the Company.

The Company's urban management services are mainly operated by its subsidiary. The Company undertakes cleaning and sanitation projects within the eight main streets and historical and cultural districts of Lucheng

District. From 2021 to 2024Q1, the Company has generated totally revenue of RMB627 million. However, the contracts for urban management services were terminated at the end of June 2024, indicating an uncertainty in the going-forward operation of this business.

The Company's security service business is primarily operated by a second-tier subsidiary. As of 31 March 2024, the Company had over 1,900 security personnels and more than 2,000 labor dispatch workers. The main services include providing security services, labor dispatch services, and recruiting auxiliary police for Lucheng Public Security Bureau. From 2021 to 2024Q1, the Company has generated revenue of RMB503 million in total.

Additionally, the Company is also involved in self-operated project construction, including parking lots and industrial parks. As of the 31 March 2024, the Company has four self-operated projects under construction with a total planned investment of RMB30.7 billion, out of which RMB16.2 billion was uninvested. It also has 3 self-operated projects under construction with a total planned investment of RMB9.3 billion. However, the future operation of these self-operated projects faces uncertainties in operating income.

Good track record of receiving ongoing government payments

As the primary state-owned asset investment and operation entity in Lucheng District, the Company has a proven record of receiving support from Lucheng District government through various channels including fiscal funding, capital injections and subsidies. From 2021 to 2023, the Company had received capital contributions of RMB7.3 billion in total from the Lucheng District Finance Bureau. It also has received subsidies of RMB280.0 million in total from government during the same period. Besides, the Company had received capital injections of a total of RMB1.7 billion in the past three years. In June 2022, the Lucheng District State-owned Assets Supervision and Administration Commission has injected capital of RMB2.5 billion into the Company, increasing its registered capital to RMB3.5 billion. Given its important position in the development of Lucheng District, we believe that the Lucheng District Government will continue to provide support to the Company.

Increasing debt burden and moderate asset liquidity

With the increasing financing demand for the infrastructure construction projects, LSHG has a fast debt growth over the past three years. The Company's total debt increased from RMB17.8 billion at end-2021 to RMB48.0 billion at end-2024Q1, with total capitalization ratio of 67.2%. In addition, the Company has a relatively large short-term debt burden. As of 31 March 2024, its short-term debt accounted for about 14.9% of total debt and its cash to short-term debt ratio was 0.2x, indicating insufficient cash flow to service its short-term debts. With pipeline of land development, infrastructure construction and resettlement housing projects under construction, the Company will continue to rely on external financing to meet its future capital expenditure needs. As a result, we expect that its debt burden will continue to grow in the next 12 to 18 months.

LSHG's asset liquidity is moderate, which may undermine its financial flexibility. The Company's assets mainly consist of inventories and receivables, all with low liquidity. The inventories are development costs from construction projects, while the receivables mainly consist of uncollected payments from the local government and other state-owned enterprises, totally accounting for about 55% of total asset at end-2024Q1.

Access to diversified funding channels

LSHG has good access to funding from banks and bond market. The Company has sufficient standby liquidity. As of 31 March 2024, it had available credit facilities of RMB12.5 billion from banks. The Company also has access to debt capital markets. As of 31 March 2024, the Company's subsidiary had outstanding onshore debt of RMB6 billion at a low average rate of 3.9%. Additionally, the Company also had outstanding offshore debt of

about USD277 million. The Company has moderate reliance on non-standard financing, accounting for around 17% to total debt.

Medium contingent liability risk from external guarantees provided to local SOEs

The Company is exposed to a medium contingent liabilities risk. As of 31 March 2024, the Company recorded an external guarantee amount of RMB9.2 billion, accounting for 38.0% of its total equity. Those guaranteed entities are the state-owned enterprises ("SOE") in Lucheng District. The credit risk of the Company and other local SOEs might be heightened if one of the guaranteed entities suffers from credit issues.

ESG Considerations

LSHG assumes environmental risks through its urban infrastructure 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, LSHG has played a crucial role in the social welfare of Lucheng District by involving the construction of public projects and indemnificatory housing projects in Lucheng District.

In terms of corporate governance, LSHG'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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