

Credit Opinion

14 April 2023

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

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Longyou State-owned Assets Management Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Longyou State-owned Assets Management Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Longyou State-owned Assets Management Co., Ltd. (“LSAM” or the “Company”) reflects (1) Longyou County Government’s relatively strong capacity to provide support; and (2) the local government’s extremely high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of Longyou County Government’s capacity to provide support reflects Longyou County’s relatively good investment potential, with relatively good industrial base and fiscal stability, but constrained by its relatively small economic scale and weak fiscal self-sufficiency.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) dominant strategic role as the largest state-owned enterprise in Longyou County; (2) high sustainability for public policy projects; and (3) good track record of receiving government payments.

However, the rating is constrained by the Company’s (1) medium exposure to commercial activities; (2) high debt leverage and moderate asset liquidity; and (3) medium exposure to contingent risks.

The stable outlook on LSAM’s rating reflects our expectation that Longyou County Government’s capacity to provide support will remain stable, and the Company will maintain its important strategic role in infrastructure construction from the local government over the next 12 to 18 months.

Rating Drivers

- Dominant strategic role as the largest state-owned enterprise in Longyou County
- High sustainability for the public policy projects
- Medium exposure to commercial activities
- Good track record of receiving government payments
- Good access to funding
- High debt leverage and moderate asset liquidity
- Medium exposure to contingent risks

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Longyou County Government's capacity to support strengthens; or (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as expansion of its policy role, material decrease in external guarantees, or improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Longyou County 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 importance of its policy role, material decrease in government payments, or deteriorated debt management.

Key Indicators

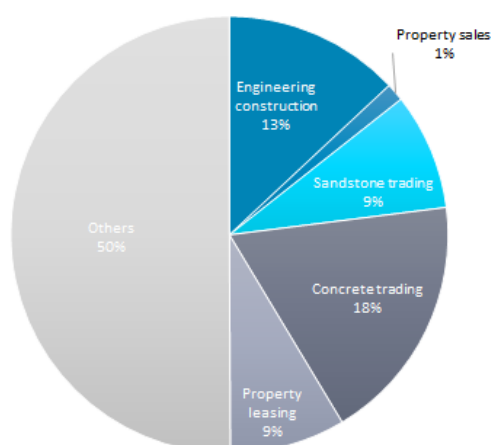
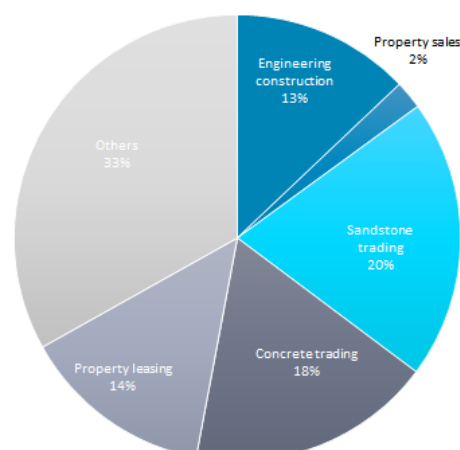
| | 2019FY | 2020FY | 2021FY | 2022Q3 |
|------------------------------|--------|--------|--------|--------|
| Total Asset (RMB billion) | 19.8 | 23.9 | 28.2 | 32.7 |
| Total Equity (RMB billion) | 8.6 | 10.4 | 13.5 | 13.6 |
| Total Revenue (RMB billion) | 1.2 | 1.4 | 1.7 | 1.3 |
| Total Debt/Total Capital (%) | 46.7 | 47.1 | 41.4 | 47.0 |

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

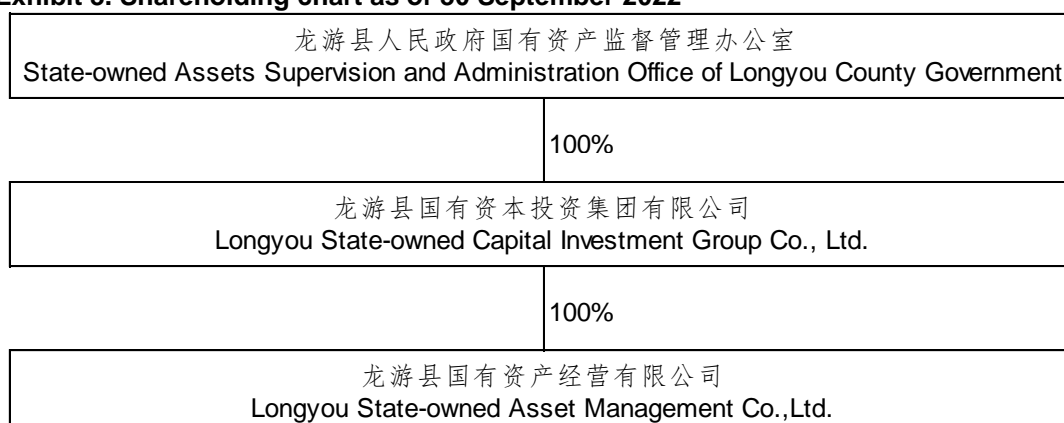
Source: CCXAP research

Corporate Profile

Established in 2003, LSAM is the largest local infrastructure investment and financing company ("LIIFC") by total assets in Longyou County. It plays the most important role in the local public policy activities, such as infrastructure construction, resettlement housing construction, water supply, sewage treatment, and tourism. Besides, the Company also engages in some commercial activities such as concrete and sandstone trading, property leasing, and. As of 30 September 2022, the Company was wholly owned by Longyou State-owned Capital Investment Group Co., Ltd ("LSCI"), and ultimately controlled by the State-owned Assets Supervision and Administration Office of Longyou County Government ("Longyou SASAO").

Exhibit 1. Revenue structure in 2021**Exhibit 2. Gross profit structure in 2021**

Source: Company information, CCXAP research

Exhibit 3. Shareholding chart as of 30 September 2022

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Longyou County Government has a strong capacity to provide support given its relatively good investment potential, with good industrial base and relatively good fiscal stability, but constrained by its relatively small economic scale and weak fiscal self-sufficiency.

Located in the western part of Zhejiang Province, Quzhou City has a good transportation network, connecting the four provinces of Fujian, Zhejiang, Jiangxi, and Anhui. It also has abundant resources, including mineral resources, human resources and ecological resources. The pillar industries in Quzhou City include chemicals, machinery, cement, papermaking, and food processing. With the ongoing industrial development, the economic strength of Quzhou City has grown at a fast pace. In 2022, the GRP of Quzhou City increased by 4.8% year-on-year ("YoY") to RMB200.3 billion, and its general budgetary revenue increased by 5.6% YoY to RMB17.3 billion. It has a good fiscal stability with tax income contributions of over 80% to the general budgetary revenue over the past three years. However, its fiscal balance is relatively weak with general budgetary revenue/general budgetary expenditure ratio of 30.5%. The local government relies on fiscal support from higher-tier

governments and proceeds from land sales to balance its fiscal budget. As of 31 December 2022, the outstanding government debt amounted to RMB86.4 billion, accounting for 43.1% of its GRP.

Exhibit 3. Key economic and fiscal indicators of Quzhou City

| | 2020FY | 2021FY | 2022FY |
|---|--------|--------|--------|
| GRP (RMB billion) | 163.9 | 187.6 | 200.3 |
| GRP Growth (%) | 3.5 | 8.7 | 4.8 |
| General Budgetary Revenue (RMB billion) | 14.1 | 16.4 | 17.3 |
| General Budgetary Expenditure (RMB billion) | 46.0 | 51.8 | 56.8 |
| Local Government Debt (RMB billion) | 60.6 | 72.0 | 86.4 |

Source: Statistic Bureau of Quzhou City, CCXAP research

Longyou County located in the central and western part of Zhejiang Province, with a total area of 1,143 square kilometers. Benefited by its advantageous location, Longyou County is an important transportation hub connecting Jiangxi, Anhui and Fujian provinces in the central and eastern regions of Zhejiang Province. Longyou County has a relatively good investment potential. In 2022, it ranked 30th by investment potential among top 100 counties/county-level cities in China. With ongoing development of its pillar industries such as special paper, green food, high-end furniture, high-end equipment, new materials and digital intelligent manufacturing, Longyou County has continued to grow and develop in recent years. In 2022, the GRP of Longyou County increased by 2.8% YoY to RMB29.9 billion, ranking the third among six districts/counties in Quzhou City. In 2022, the general budgetary revenue of Longyou County was RMB2.8 billion, of which tax revenue accounting for 77%, indicating relatively good fiscal stability. However, Longyou County has a relatively weak fiscal self-sufficiency, with a fiscal balance ratio of 39.9% in 2022, showing a high reliance on fiscal support from higher-tier government and proceeds from land sales to balance its fiscal budget. In 2022, Longyou County Government recorded an outstanding debt of RMB10.4 billion, accounting for 34.9% of its GRP.

Exhibit 4. Key Economic and Fiscal Indicators of Longyou County

| | 2020FY | 2021FY | 2022FY |
|---|--------|--------|--------|
| GRP (RMB billion) | 24.8 | 28.8 | 29.9 |
| GRP Growth (%) | 4.4 | 8.7 | 2.8 |
| General Budgetary Revenue (RMB billion) | 2.0 | 2.3 | 2.8 |
| General Budgetary Expenditure (RMB billion) | 6.6 | 6.7 | 6.9 |
| Local Government Debt (RMB billion) | 8.0 | 9.2 | 10.4 |

Source: Statistic Bureau of Longyou County, CCXAP research

Government's Willingness to Provide Support

Dominant strategic role as the largest state-owned enterprise in Longyou County

There are two main LIIFCs in Longyou County, including Longyou Transportation Investment Group Co. Ltd. ("LTIG") and LSAM. LTIG is mainly responsible for construction and operation of local transportation infrastructure, while the Company is responsible for municipal infrastructure construction and utilities services in Longyou County. As the largest LIIFC by total assets and the most important infrastructure construction and state-owned assets management entity in Longyou County, LSAM is mandated by the local government to undertake local public activities that are vital to local economic and social development, such as infrastructure construction, resettlement housing construction, water supply, sewage treatment, and tourism. Considering its

high strategic significance to the development of Longyou County, we believe the Company will not be easily replaced by other local state-owned enterprises in the foreseeable future.

High sustainability for the public policy projects

LSAM has undertaken a large amount of public policy projects, such as roads, schools, resettlement housings, and pipe networks, and provided utilities, tourism, and grain storage services in Longyou County. Given sufficient projects under construction, we consider the sustainability of the public-related businesses to be high, but the Company may face large capital expenditure pressure.

The Company carries out infrastructure projects by signing agency construction agreements with the entrusting parties, who would repurchase the constructions upon project completion. The repurchase payment is calculated based on the construction cost plus a 5% markup. As of 30 September 2022, the Company had 10 major infrastructure construction projects under construction, with a total estimated investment of RMB7.4 billion and an uninvested amount of RMB3.3 billion. The Company has a large amount of infrastructure construction projects in the pipelines, indicating strong sustainability of the business, but exerting a great capital expenditures pressure.

The Company is entrusted by the local government to undertake the construction of resettlement housing with self-raised funds. Most of the resettlement houses will be sold to the resettlement households below market prices, while the rest will be sold at market prices for fund balance. As of 30 September 2022, the Company had 6 major resettlement housing projects under construction, with a total estimated investment of RMB3.7 billion and an uninvested amount of RMB1.3 billion, indicating good sustainability of the business.

LSAM is the sole water supplier and sewage treatment provider in Longyou County, indicating strong regional position. As of 30 September 2022, the Company had 2 water supply plants with a daily water supply capacity of 78,000 tons and 1 sewage treatment plant with a daily sewage treatment capacity of 40,000 tons. In addition, the Company is responsible for the management and operation of tourism resources in Longyou County, including two 4A scenic spots, and the storage and sales of national grains. Given their public welfare nature, the local government has subsidized these businesses.

Exhibit 5. Major Projects under Construction as of 30 September 2022

| Project Types | No. of Projects | Budgeted | Invested | Outstanding |
|------------------------------------|-----------------|---------------|---------------|---------------|
| | | Amount | Amount | Amount |
| | | (RMB million) | (RMB million) | (RMB million) |
| Projects Under Construction | | | | |
| Infrastructure Construction | 10 | 7,408 | 4,146 | 3,262 |
| Resettlement Housing | 6 | 3,733 | 2,475 | 1,258 |
| Total | 16 | 11,141 | 6,621 | 4,520 |

Source: CCXAP research

Medium exposure to commercial activities

In addition to public activities, LSAM is also involved in various commercial activities such as concrete and sandstone trading, and property leasing. We consider LSAM's commercial business exposure to be medium, as its market-driven businesses account for around 25% to 30% of its total assets.

As the most important state-owned assets management entity in Longyou County, LSAM owns a large number

of leasable state-owned properties with total values of RMB1.9 billion at end-2022Q3. These properties are usually leased for three to five years, providing stable rental income to the Company. In addition, it is engaged in the construction of self-operated properties, such as financial centers, industrial parks, and tourism projects, which can generate rental income, parking fee, ticket fee, and property management fee upon completion of construction. However, the Company needs to construct these properties by self-raised funds, exerting certain capital expenditure pressure. As of 30 September 2022, it had 7 major self-operated projects under construction, with a total estimated investment of RMB2.8 billion and uninvested amount of RMB1.1 billion.

LSAM's concrete and sandstone trading business mainly involves production and sales of concrete and sandstone to construction companies in Longyou County and Zhejiang Province. The Company owns a 20-year franchise for mining sandstone through river dredging, ensuring competitive advantage of the business. It also owns a concrete production line with annual production capacity of 0.5 million cubic meters.

Good track record of receiving government payments

LSAM has a solid track record of receiving payments from the Longyou County Government. These payments take various forms, such as government subsidies, capital injections, and asset transfers. The Company regularly receives government subsidies and capital injections to support its business operation. From 2019 to 2021, the local government has provided total subsidies of RMB637.7 million and injected capital of RMB5.3 billion into the Company, including cash, real assets, parking project franchise, and the income right of river dredging, significantly enhancing its capital strength. From 2020 to 2021, the local government also transferred the equity interests of 11 state-owned enterprises to the Company, with total amount of RMB1.3 billion, broadening its business mix. Overall, given the Company's important position and its contribution to regional economic development, we believe that it will receive strong government support in times of need.

Exhibit 6. Government Support from 2019 to 2021

| (RMB million) | 2019FY | 2020FY | 2021FY |
|----------------------|--------------|--------------|--------------|
| Government Subsidies | 159 | 154 | 324 |
| Capital Injections | 936 | 1,005 | 3,382 |
| Equity Transfers | - | 763 | 570 |
| Total | 1,095 | 1,922 | 4,276 |

Source: CCXAP research

High debt leverage and moderate asset liquidity

With ongoing financing for its construction projects in recent years, LSAM has a high debt leverage. The Company's total debt increased from RMB7.5 billion at end-2019 to RMB12.5 billion at end-2022Q3, with total capitalization of 48.0%. Nevertheless, the Company has a reasonable debt structure and good liquidity profile. As of 30 September 2022, the Company's short-term debt accounted for 26.4% of its total debt. In addition, its cash to short-term debt ratio was over 1x over the past three years, indicating that it maintains sufficient cash reserves to cover its short-term debt. We expect that, given its large future capital needs, the Company's debt leverage will maintain at a relatively high level in the next 12 to 18 months.

Furthermore, LSAM has moderate asset liquidity. The Company's total asset mainly consists of inventories and non-current assets, which accounted for 82.7% of its total asset as of 30 September 2022. The inventories are mainly investment costs for infrastructure construction and resettlement housing projects, while the non-current assets are mainly investment properties and intangible assets, which are considered low liquidity. The moderate asset liquidity may undermine the Company's financial flexibility.

Good access to funding

LSAM has good access to funding as reflected by its good banking relationships and access to the onshore debt capital market. As of 30 September 2022, it held total credit facilities of RMB16.3 billion and available credit facilities of RMB7.6 billion, indicating sufficient standby liquidity. The Company and one of its subsidiaries have raised about RMB3.5 billion in onshore debt market since 2019. It also plans to issue offshore bonds to broaden its financing channel. Additionally, the Company has low reliance on non-standard financing.

Medium exposure to contingent risks

LSAM has medium exposure to contingent risks due to its relatively large amount of external guarantees. As of 30 September 2022, its external guarantee amount was RMB2.6 billion, accounting for 19.3% of its net asset. All of the external guarantees are provided to state-owned enterprises in Longyou County. However, should a credit event occurs, the Company may face certain contingent risks, which could inversely impact its credit quality.

ESG Considerations

LSAM bears environmental risks through its infrastructure projects. Such risks could be moderated by conducting environmental studies and detailed planning before the commencement of projects and close supervision during the construction.

The Company is also exposed to social risks as a public services provider in Longyou County. Demographic changes, public awareness and social priorities shape government's target for LSAM, or affect the government's propensity to support the Company.

LSAM's governance considerations are also material as the Company is subject to oversight and reporting requirements to the local government, 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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