

Credit Opinion

5 August 2024

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

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Yuzhou Water Development Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Yuzhou Water Development Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Yuzhou Water Development Co., Ltd. ("YZWD" or the "Company") reflects Yuzhou City Government's (1) strong capacity to provide support, and (2) very high willingness to provide support based on our assessment of the Company's characteristics.

Our assessment of Yuzhou City Government's capacity to support reflects Yuzhou City's good economic fundamentals with gross regional product ("GRP") ranking first among all the counties or districts in Xuchang City with moderate fiscal metrics.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) important role in water conservancy infrastructure construction and water supply service of Yuzhou City; and (2) track record of receiving government support.

However, the rating is constrained by the Company's (1) increasing exposure to commercial activities; (2) moderate weak asset liquidity; and (3) limited financing channels and standby liquidity.

The stable outlook on YZWD's rating reflects our expectation that the Yuzhou City Government's capacity to provide support will remain stable, and the Company characteristics such as its important role in water conservancy construction and water supply in Yuzhou City will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Important role in water conservancy infrastructure construction and water supply service of Yuzhou City
- Increasing exposure to commercial activities
- Track record of receiving government support
- Increasing debt burden
- Moderate asset liquidity
- Limited financing channels and standby bank facilities

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Yuzhou City 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 decreased exposure to commercial activities.

What could downgrade the rating?

The rating could be downgraded if (1) Yuzhou City Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to provide support, such as deteriorated debt management or increased exposure to external guarantees.

Key Indicators

	2021FY	2022FY	2023FY
Total Asset (RMB billion)	14.8	15.7	16.1
Total Equity (RMB billion)	13.2	13.5	13.6
Total Revenue (RMB billion)	0.7	0.7	0.7
Total Debt/Total Capital (%)	10.1	11.3	12.0

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

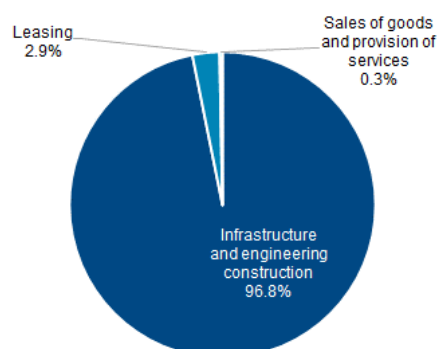
Source: Company data, CCXAP research

Corporate Profile

Established in 2016, YZWD is one of the major local infrastructure investment and financing companies ("LIIFCs") in Yuzhou City. YZWD is primarily engaged in water conservancy infrastructure construction and water supply in Yuzhou City. The Company also involves in other commercial activities, including photovoltaic power generation and national forest reserve. As of 31 December 2023, the Yuzhou City Government was the ultimate controller of YZWD and indirectly hold 100% shares of the Company through Yuzhou Investment Corporation ("YZIC"). YZIC is the largest LIIFC in Yuzhou City by assets and is mandated by the local government to invest and undertake local public activities, including infrastructure construction, shantytown reconstruction, and water supply service.

Exhibit 1. Shareholding chart as of 31 December 2023

Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2023

Source: Company information, CCXAP research

Rating Considerations**Government's Capacity to Provide Support**

We believe that the Yuzhou City Government has strong capacity to provide support, reflects Yuzhou City's status as the largest county or district by GRP in Xuchang City for years with good economic fundamentals, but is constrained by its moderate fiscal metrics.

Henan Province is located at the junction of the three major regions in China, including eastern, central and western regions. It has a strategic position as an important transportation and communication hub, and a material distribution center in China. With the good transportation and location advantages, Henan Province's GRP ranked 6th among all provinces in China in 2023.

Xuchang City is located in the central of Henan Province, which is the one of the core cities in the Central Plains Urban Agglomeration and Central Economic Zone. Xuchang City focuses on promoting six emerging industries, including new generation information technology, new materials, biopharmaceuticals, intelligent equipment, intelligent connected networks and new energy vehicles, as well as energy conservation and environmental protection industries. Supported by its industrial development, Xuchang City demonstrated steadily increasing economic strength over the past three years. In 2023, it reported a GRP of RMB323.8 billion, representing a year-over-year ("YoY") increase of 0.9%. Xuchang Municipal Government's general budgetary revenue increased to RMB21.2 billion in 2023 from RMB18.9 billion in 2021, and tax accounted for around 66.9% of its general budgetary revenue on average over the past three years. However, Xuchang Municipal Government's

fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was relatively low, averaging at 59.2% over the past three years. Xuchang Municipal Government highly relied on fiscal support from higher-tier government. Moreover, the government fund revenue of Xuchang Municipal Government sharply decreased from RMB11.9 billion in 2021 to RMB6.9 billion in 2023 due to the reduction of land sales. As of end-2023, its government debt outstanding amount further increased to RMB82.8 billion from RMB67.7 billion as of end-2022.

Exhibit 3. Key economic and fiscal indicators of Xuchang City

	2021FY	2022FY	2023FY
GRP (RMB billion)	365.5	374.7	323.8
GRP Growth (%)	5.5	1.8	0.9
General Budgetary Revenue (RMB billion)	18.9	20.4	21.2
General Budgetary Expenditure (RMB billion)	32.6	34.7	34.9
Local Government Debt (RMB billion)	56.7	67.7	82.8

Source: Xuchang Municipal Government, CCXAP research

Yuzhou City is a county-level city under the jurisdiction of Xuchang City and is located in the core area of the Central Plains Economic Zone. With its location advantages and transportation and abundant mineral resources such as coal and limestone, Yuzhou City has developed and expanded its three leading industries, namely, new materials, equipment manufacturing as well as medical health. After years of development, Yuzhou City also cultivated three distinctive industries, namely, Chinese herbal medicine planting and processing, sweet potato planting and processing, and animal husbandry.

Benefited from the location advantages and reasonable industrial structure, rapid industrial growth supports Yuzhou City's economic to maintain growth. Yuzhou City is the largest county or district by GRP in Xuchang City with good economic fundamentals. Yuzhou City's GRP steadily increased to RMB97.2 billion in 2023 from RMB90.4 billion in 2021, ranking first among all the districts or counties in Xuchang City for the past three years. In 2023, Yuzhou City Government's general budgetary revenue increased to RMB3.4 billion from RMB2.7 billion in 2021, ranking second among all the districts or counties in Xuchang City for years. Yuzhou City has good fiscal stability with a 3-year average fiscal stability ratio (tax revenue/general budget revenue) of 79.2%, indicating a relatively strong revenue generating ability. However, the fiscal sufficiency of Yuzhou City is relatively weak, with average fiscal balance ratio (general budgetary revenue/general budgetary expenditure) of 51.6% over the past three years, indicating high reliance on support from high-tier governments. In addition, the government fund revenue is an important supplement to the financial resources of the Yuzhou City Government, which highly depends on the performance of land market. As of 31 December 2023, the outstanding debt of Yuzhou City Government was RMB12.9 billion, accounting for 13.3% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Yuzhou City

	2021FY	2022FY	2023FY
GRP (RMB billion)	90.4	92.7	97.2
GRP Growth (%)	6.3	2.7	1.4
General Budgetary Revenue (RMB billion)	2.7	3.1	3.4
General Budgetary Expenditure (RMB billion)	5.9	5.9	6.0
Local Government Debt (RMB billion)	8.2	10.7	12.9

Source: Yuzhou City Government, CCXAP research

Government's Willingness to Provide Support

Important role in water conservancy infrastructure construction and water supply service of Yuzhou City

YZIC is the largest and the most important LIIFC in Yuzhou City by assets, carrying out investment and construction of infrastructure in accordance with the planning of the Yuzhou City Government. As an important subsidiary of YZIC and a sole water conservancy infrastructure construction entity in Yuzhou City, YZWD has strong regional advantage in undertaking water conservancy infrastructure construction projects in the region, such as river regulation work, water quality improvement and water supply plant projects. The Company is also an important utilities services provider, responsible for water supply in Yuzhou City. Given the Company's important role to local economic and social development, we believe it will remain its important business position in water-related segments.

YZWD conducts water conservancy infrastructure construction projects by self-owned funds or through external financing. Entrusted by the local government or local state-owned enterprises, the Company undertakes construction projects under agency construction model. Upon completion of construction, the entrusting parties will settle with the Company based on the project investment amount plus a certain markup. As of 31 December 2023, the Company had 6 infrastructure construction projects under construction with a total estimated investment of RMB4.0 billion and an uninvested amount of around RMB1.3 billion. Meanwhile, the Company had 2 infrastructure construction projects under planning, requiring a total estimated investment of RMB902 million.

YZWD has strong competitiveness in water supply and drainage services in Yuzhou City. The Company obtained a 30-year franchise right (for 2019-2049) from the local government with signed agreement. The scope of the concession area includes all the water supply and drainage service areas covered by water supply plants, sewage plants, and the public water supply and drainage pipeline network of the Yuzhou City's urban area and townships. YZWD provides water to more than 153,000 residents in 7 townships via one water supply plant with a daily water supply capacity of 20,000 tons and water pipe network of 234 kilometers. It has strong regional position in the water supply of Yuzhou City. However, due to the low prices and the high depreciation of the pipe network, the profitability of water supply businesses is relatively weak, and the local government has provided subsidies to support their operations. Along with the completion of the water plants under construction, we expect that the Company's water supply capacity will increase in the future.

Increasing exposure to commercial activities

In addition to public activities, YZWD is also involved in other commercial activities, including photovoltaic power generation and national forest reserve. Both are policy-based investment projects held in the form of long-term equity investments. The Company is planning to expand its business scope to the sales of sand and gravel business as well as the cultural tourism business, along with the completion of its construction project, namely Yuzhou Shatuo Lake Storage Project of the South-to-North Water Diversion Project Middle Route. Considering the Company's ongoing investment in these projects, we believe that YZWD's exposure to commercial activities will increase in the future.

YZWD also had some self-operated water construction projects. As of end-2023, the Company had 2 self-operated projects under planning including environmental improvement and river regulation work, with a total investment of RMB7.6 billion. Shatuo Lake Regulation Project is one of the key projects. As a water backup for South-to-North Water Diversion Project with high strategic importance, it has been listed as a key project of the National Development and Reform Commission and is expected to achieve fund balancing through income from

water supply, land appreciation, cultural tourism, and sand and gravel sales. However, the project is still in the early stage of development, and the large scale of investment may exert certain capital expenditure pressure to the Company.

YZWD also has invested in a policy-based poverty alleviation project to take part in the photovoltaic power generation business. The Company is mainly responsible for the construction, operation and maintenance management of the photovoltaic power generation project in Yuzhou City. As of end-2023, the Company had 53 photovoltaic power stations with an installed capacity of 25.78MW. The Company performs daily management of the photovoltaic power stations and obtains management fee as income. The net proceeds were handover to the Poverty Alleviation Office after deducting principal and interest payments and the operation and maintenance fees.

In addition, YZWD participated in the investment and operation of the reserve forest business through a joint-venture company with a private-owned enterprise. The Yuzhou National Forest Reserve Project includes two sub-projects, namely the Demonstration Site Project and the Jucishan Project. The Company is responsible for the construction and operation supervision of the Demonstration Site Project. As of end-2023, the Demonstration Site Project's has been completed with planted area of 20,284 mu. At the same time, the Jucishan Project required a total investment amount of RMB1.1 billion with an outstanding investment of RMB890 million. The Company is responsible for the external financing, construction and operation of the Jucishan Project. This project has obtained loans of RMB820 million from policy bank. The Company will receive some management fees for the operation of the Yuzhou National Forest Reserve Project. In 2023, the Company received a total management fee of RMB271.1 thousands. However, the relatively large scale of investment may exert certain capital expenditure pressure and operating risk to the Company. Moreover, the projects' investment recovery cycles are long, making it difficult to achieve fund balancing in a short period of time.

Track record of receiving government support

YZWD has track record of receiving support from the local government in the form of capital injection, asset transfers and financial subsidies, to support its investments and the operation of its businesses. The Company has received ongoing capital injection, significantly enhancing its capital strength. In 2020, Yuzhou City Government injected the income rights of sand and gravel resources into the Company, increasing the capital reserves by RMB8.9 billion. This capital injection is not only enhancing the Company's capital strength, but also support its business development. In 2022, the local government further injected cash of RMB200 million to the Company, increasing its paid-in capital. From 2021 to 2023, the Company totally received government subsidies of RMB780 million. In addition, the Company also received support from its parent company, as YZID provided guarantee on some of the bank loans. Given its vital role in water conservancy infrastructure construction and water supply of Yuzhou City, we expect YZWD will continue receiving support from the local government in the next 12-18 months.

Increasing debt burden

YZWD's total debt continuously increased over the past three years due to the ongoing investment for water conservancy infrastructure projects. As of 31 December 2023, the Company's total debt increased to RMB1.8 billion from RMB1.5 billion as of end-2021. The Company has maintained a relatively low leverage. Its total capitalization ratio, as measured by total debt to total capital, increased to 12.0% from 10.1% during the same period. In addition, the short-term debt accounted for around 28.3% of its total debt as of the same date, and the cash to short-term debt ratio was only 0.1x, indicating certain short-term debt repayment pressure. Considering its large capital expenditure pressure on its water construction projects, we expect the Company's

debt level will continue to grow in the next 12 to 18 months.

Moderate asset liquidity

YZWD has relatively weak asset liquidity, undermining the Company's financial flexibility. As of 31 December 2023, intangible assets, other receivables, and account receivables accounted for around 78.3% of total assets. The intangible assets accounted for 55.4% of total assets, mainly including the income rights of sand and gravel resources transferred by local government. The account receivables and other receivables were mainly receivables from the local government and other state-owned enterprises ("SOEs"), which are considered low liquidity. In addition, the Company had restricted assets of RMB8.9 billion, accounting for 55.3% of total assets as of 31 December 2023, all of which were the intangible assets pledged for loans.

Limited financing channels and standby bank facilities

The Company mainly finances its construction projects through bank loans, accounting for the majority of its total debts. As of 31 December 2023, the Company had obtained total bank facilities of RMB3.2 billion with available bank facilities of RMB1.0 billion, indicating limited standby bank facilities. The Company had no exposure to non-standard financing. Due to the capital expenditure pressure from its business plan, the Company plans to expand the financing channels to debt capital market in the next 12-18 months.

ESG Considerations

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

YZWD bears social risks as it implements public policy initiatives by building public infrastructure and providing water supply service in Yuzhou 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.

YZWD's governance considerations are also material as the Company is subject to oversight by local government and has to meet several 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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