

# Shaoxing City Investment Group Limited

## Initial Issuer Report

Summary	
Issuer Rating	A-
Outlook	Stable
Location	China
Industry	Local Government Financing Vehicle
Date	23 August 2021

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘A-’ global scale Long-term Issuer Credit Rating to Shaoxing City Investment Group Limited (“SCIG”). The Outlook is Stable.

### Summary

The Issuer Credit Rating reflects a high possibility that Zhejiang’s Shaoxing Municipal Government would provide strong support to SCIG if needed. This mainly considers the Shaoxing Municipal Government’s 90% ownership of SCIG, the high importance of SCIG to Shaoxing in the utilities (gas and water) infrastructures and services, as well as urban infrastructure and social-housing construction area, and the strong linkage between the Shaoxing Municipal Government and SCIG, including management supervision, ongoing operational and financial support. In addition, the Shaoxing Municipal Government may face significant negative impact on its reputation and financing activities should SCIG encounter any operational and financial difficulties.

The Stable Outlook reflects our expectation that SCIG’s strategic importance would remain intact while the Shaoxing Municipal Government will continue to ensure SCIG’s stable operation.

### Rating Rationale

**Strong Linkage with the Shaoxing Municipal Government:** Shaoxing Municipal Government, via Shaoxing State-owned Assets Supervision and Administration Commission (SASAC), holds 90% of SCIG, while the remaining 10% of SCIG’s shares was owned by Zhejiang Finance Development Co., Ltd., a wholly owned entity of Zhejiang Provincial Department of Finance, to subsidize the provincial Social Security Fund.

**High Strategic Importance of SCIG to the Local Government and Economy:** SCIG is an important LGFV in Shaoxing in terms of urban infrastructures and social-housing construction, gas and water infrastructure and services entity in the city. SCIG is responsible for the majority of the urban-related infrastructure projects such as National Highway 329 renovation projects, Olympic Center project and other municipal public projects. It is the only natural gas infrastructure and services provider in the urban area of Shaoxing.

**Government Supervision and Strategic Alignment:** Shaoxing Municipal Government is the ultimate shareholder of SCIG and has strong control and supervision over SCIG, including the decision on its strategic development plan and supervision of its major funding decisions. In addition, Shaoxing SASAC reviews the audit report of the operation of SCIG by an external auditor. SCIG’s business operation and development have been aligned with the government’s economic and social policies.

**Ongoing Government Support:** SCIG received continuing financial support from Shaoxing Municipal Government in 2018 to 2020. Government subsidies were RMB1.47 billion, RMB1.43 billion and RMB1.52 billion, and represented c. 22.2%, 16.7% and 20.6% of SCIG’s revenue in 2018, 2019 and 2020, respectively. Additionally, Shaoxing SASAC transferred 51% equity of Shaoxing City Public Utilities Group Co., Ltd. to SCIG free of charge in August 2018.

Key Figures of Shaoxing and SCIG		
(RMB billion)	2019	2020
Shaoxing		
GDP	578	600
GDP growth rate (%)	7.2	3.3
Budgetary revenue	52.8	54.3
Government fund	71.6	83.4
Transfer payment	3.3	7.4
Budgetary expenditure	64.1	66.7
SCIG		
Assets	53.6	54.5
Equity	23.0	22.7
Revenue	8.6	7.4

Source: Shaoxing Bureau of Statistics, Shaoxing Finance Bureau, SCIG and Lianhe Global’s calculations

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### Applicable Criteria

China Local Government Financing Vehicle Criteria (16 July 2018)

**Moderate Standalone Financials:** In 2020, SCIG realized total revenue of c. RMB7.4 billion, of which income from gas sales accounted for the biggest share. SCIG's gross margin showed a steady upward trend during 2018 to 2020. The main sources of its gross profits were from gas sales, and other businesses such as non-ferrous metal sales. Gross profits were affected, to a lesser extent, by those of water sales and sewage treatment as well. The negative gross margin of these two businesses was mainly due to tariffs restriction by the government in the previous years. However, tariffs for industrial sewage treatment have been adjusted upwards since May 2021, which would have the positive impact on the business growth of SCIG.

SCIG's financial leverage (total liabilities to assets) remained stable at a moderate level of c. 59% between 2018 to end-March 2021. SCIG has access to financing channels such as bank loans, syndicated loans and issued bonds etc. to support its debt repayment and business operation.

**Economic and Fiscal Strength Underpin Shaoxing:** With the continuous economic growth of GDP and fixed asset investment, Shaoxing's urban economic strength has been gradually improving, and its industrial structure is gradually optimized. Shaoxing's GDP reached RMB600.1 billion in 2020, which was ranked 4<sup>th</sup> in Zhejiang in the same period. The industrial structure of Shaoxing was 3.6% primary sector, 45.2% secondary sector and 51.2% tertiary sector in 2020, and the contribution from tertiary sector in 2020 was 2.7 percentage points higher than that in 2019.

Shaoxing's budgetary revenue is mainly derived from the stable tax revenue, which accounted for approximately 80% of budgetary revenue from 2018 to 2020. The government fund income increased rapidly in the past two years mainly from land sales. Shaoxing's debt ratio (i.e. total government debt divided by aggregate revenue) was at c. 81% and 86% at end-2019 and end-2020, respectively. At end-2020, Shaoxing's total outstanding debt increased by c. 20% to RMB124.8 billion compared with that at end-2019, including RMB44.2 billion of general obligations and RMB80.6 billion for special projects.

## Rating Sensitivities

We would consider downgrading SCIG's rating if (1) there is perceived weakening in support from Zhejiang's Shaoxing Municipal Government, particularly due to its reduced strategic importance with diminished government functions, or (2) there is a significant reduction of the Shaoxing Municipal Government's ownership of SCIG, or (3) there is a downgrade in our internal credit assessment on the Shaoxing Municipal Government.

We would consider upgrading SCIG's rating if there is an upgrade in our internal credit assessment on the Shaoxing Municipal Government.

## Operating Environment

### Strong Urban economic strength and sustained growth

Shaoxing is a prefecture-level city in Zhejiang Province and is a cultural and tourism city with the characteristics of Jiangnan Water Town approved by the State Council. It is also one of the important cities in the Yangtze River Delta (YRD) and the sub-central city of Hangzhou metropolitan area. With the continuous economic growth of GDP and fixed asset investment, Shaoxing's urban economic strength has been gradually improving, and its industrial structure is gradually optimized. Shaoxing's GDP reached RMB600.1 billion in 2020, which was ranked 4<sup>th</sup> in Zhejiang in the same period. The industrial structure of Shaoxing was 3.6% primary sector, 45.2% secondary sector and 51.2% tertiary sector in 2020, and the contribution from tertiary sector in 2020 was 2.7 percentage points higher than that in 2019.

Shaoxing's population has steadily grown to a total population of 5.3 million with an urbanization rate of 71% at end-2020. GDP per capita and disposable income per capita of Shaoxing were approximately RMB114,000 and RMB56,600 at end-2020, respectively. The economic development level of Shaoxing is above the average level of Zhejiang Province, as compared with Zhejiang's GDP per capita and disposable income per capita of approximately RMB100,000 and RMB52,400, respectively, at end-2020.

#### Shaoxing's GDP and Fixed Asset Investment

(RMB billion)	2018	2019	2020	1Q2021
GDP	541.7	578.1	600.1	143.4
-Primary industry (%)	3.6	3.6	3.6	2.4
-Secondary industry (%)	48.2	47.9	45.2	43.8
-Tertiary industry (%)	48.2	48.5	51.2	53.8
GDP growth rate (%)	7.1	7.2	3.3	17.4*
Fixed asset investment	317.5	349.9	373.4	-
Fixed asset investment growth rate (%)	1.9	10.2	6.7	21.0*
Population (million)	5.0	5.1	5.3	-

Source: Shaoxing Municipal Government and Lianhe Global's calculation

\* Year-on-year growth rate

### A Relatively High Debt Level on Moderate Fiscal Revenue

Shaoxing's aggregate fiscal revenues are mainly derived from stable budgetary revenue with tax revenue accounting for approximately 80% between 2018 and 2020. The government fund income increased rapidly in the past two years mainly from land sales, which accounted for c. 90% of the government fund income. The self-sufficiency rate of Shaoxing was relatively high mainly due to the steady growth of fiscal revenue, the increase in government fund income and continuous subsidies received from higher government authorities. We expect ongoing economic development to support persistent growth in Shaoxing's budgetary revenue, while land transfer planning remains a key factor affecting government fund income.

Shaoxing's debt ratio (i.e. total government debt divided by aggregate revenue) was at c. 81% in 2019 and c. 86% in 2020, respectively. Its budget deficit has been relatively high in recent years due to its high budgetary expenditure. At end-2020, Shaoxing's total outstanding debt increased by c. 20% of RMB124.8 billion compared with that at end-2019, including RMB44.2 billion of general obligations and RMB80.6 billion for special projects.

<b>Shaoxing's Fiscal Condition</b>			
(RMB million)	2018	2019	2020
Budgetary revenue	50,134	52,837	54,352
Budgetary revenue growth rate (%)	16.2	5.4	2.9
Tax revenue	41,267	41,840	44,387
Tax revenue (% of budgetary revenue)	82.3	79.2	81.7
Government fund income	46,972	71,616	83,424
Transfer payment	2,764	3,304	7,357
<b>Aggregate revenue</b>	<b>100,157</b>	<b>128,002</b>	<b>145,357</b>
Budgetary expenditure	55,665	64,087	66,716
Budget deficit <sup>1</sup> (%)	-11.0	-21.3	-22.7

<sup>1</sup> Budget deficit = (1-budgetary expenditure / budgetary revenue) \* 100%

Source: Shaoxing Finance Bureau and Lianhe Global's calculations

## Ownership Structure and Profile

### Full State Ownership with Strong Government Supervision

SCIG, formerly Shaoxing City Investment and Development Limited, was established as a fully state-owned entity in 1999 with an initial capital of RMB220 million. Under the No.48 [2011] of the Shaoxing Municipal Government, it was renamed as SCIG and the State-owned Assets Supervision and Administration Commission of Shaoxing ("Shaoxing SASAC") was the only shareholder with 100% equity. During 1999 to 2020, the registered capital had been increased multiple times to RMB3,300 million, including but not limited to capital and asset injection and equity transfer from local government and related departments. According to the decision of the Shaoxing SASAC, it transferred 10% of SCIG's equity free of charge to Zhejiang Finance Development Co., Ltd. [浙江省财务开发有限责任公司] in September 2020, which is a wholly-owned company of the Zhejiang Provincial Department of Finance [浙江省财政厅]. Consequently, Shaoxing SASAC holds 90% equity of SCIG and the Shaoxing Municipal Government is the ultimate controller.

SCIG had a total of 64 wholly-owned or controlled subsidiaries at end-2020, with operations across various business, including urban infrastructure construction, land development, road and landscape construction, real estate development, utilities (e.g. gas, water sales and sewage treatment), investment and other trading businesses, etc. As one of the most important state-owned infrastructure construction and investment entities in Shaoxing, SCIG has played a key role in the urban and economic development of Shaoxing, and has received ongoing support from the Shaoxing Municipal Government in terms of capital injection and financial subsidies.

## Strategic Importance and Government Linkage

### High Strategic Importance of SCIG to the Local Government and Economy

SCIG is an important LGFV in Shaoxing in terms of urban infrastructures and social-housing construction, gas and water infrastructure and services entity in the city. It is the only natural gas infrastructure and services provider in the urban area of Shaoxing.

## Strong Linkage with Shaoxing Government

Shaoxing SASAC holds 90% of SCIG, while 10% of SCIG's shares was transferred to Zhejiang Finance Development Co., Ltd., a wholly owned entity of Zhejiang Provincial Department of Finance, to subsidize the provincial Social Security Fund.

The Shaoxing Municipal Government has strong control and supervision over SCIG, including decision on its strategic development plan and supervision of its major funding decisions. In addition, Shaoxing SASAC will review the audit report of the operation of SCIG by external auditor. SCIG's business operation and development have been aligned with the government's economic and social policies.

## Ongoing Government Support

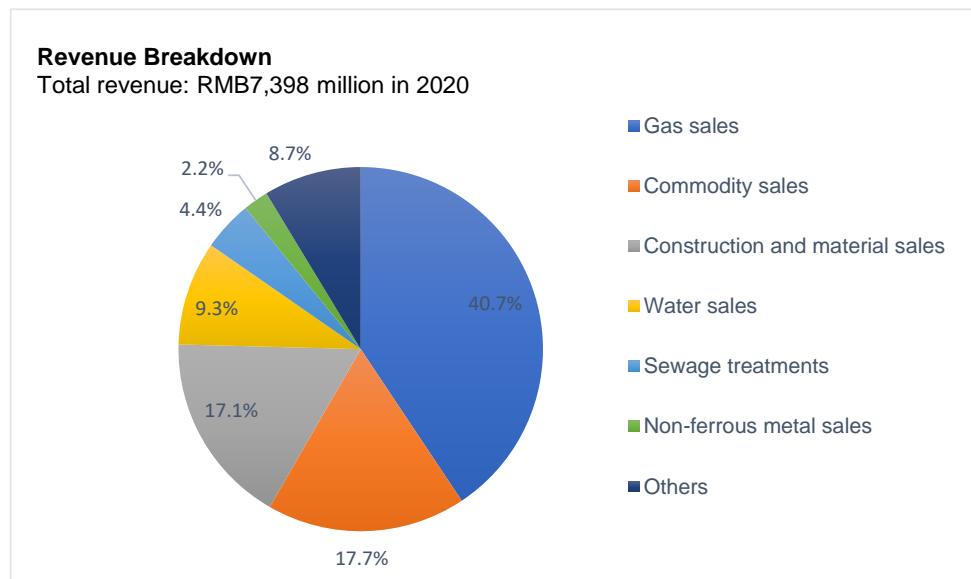
SCIG received continuing financial support from Shaoxing Municipal Government in 2018 to 2020. Government subsidies were RMB1.47 billion, RMB1.43 billion and RMB1.52 billion, and represented c. 22.2%, 16.7% and 20.6% of SCIG's revenue in 2018, 2019 and 2020, respectively. Additionally, Shaoxing SASAC transferred 51% equity of Shaoxing City Public Utilities Group Co., Ltd. to SCIG free of charge in August 2018.

## Business Profile

### An Important LGFV Responsible for Utilities, Urban Infrastructure Construction and Operation in Shaoxing

SCIG is one of the important LGFVs under the Shaoxing Municipal Government with total assets of RMB54.5 billion at end-2020 and increased to RMB58.1 billion at end-March 2021. SCIG's business mainly focuses on the municipal urban infrastructure construction, utilities, commodity sales, supplemented by other businesses like material sales, sewage treatment and rental etc. The main revenue sources include gas sales and municipal urban infrastructure construction and operation. We believe SCIG has developed good capability to take on major municipal urban infrastructure construction and operation, given its track record.

As one of Shaoxing's major construction and investment entities, Shaoxing's economic condition and future planning have a significant impact on SCIG's development. Ongoing demand for urban infrastructure construction and renewal of Shaoxing have provided a favorable environment for SCIG. In 2020, SCIG realized total revenue of c. RMB7.4 billion, while income from gas sales accounting for the biggest share. The contribution components of total revenue were generally unchanged in 1Q2021.



Source: SCIG

### Gas Sales

The gas sales business is operated by SCIG's subsidiary, Shaoxing Fuel Gas Industry Group Ltd. ("the Gas Company") [绍兴市燃气产业有限公司], with a sole franchise of pipeline gas business for 15 years among nine districts in Shaoxing since 2011. The Gas Company is the only operation and supply unit of natural gas in the urban area of Shaoxing. Meanwhile, the Gas Company has two liquefied gas station, with a market share of c. 30% in Shaoxing. Income generated from gas sales segment was RMB3.0 billion in 2020, experiencing a decrease of 21.8% compared with that in 2019. The decrease was mainly due to the impacts of COVID-19, causing a decline in the natural gas sold and the average selling price.

### Commodity Sales from Commercial Housing and Social-housing

This business segment is mainly operated by SCIG and its subsidiaries, Shaoxing Affordable Housing Construction Ltd. [绍兴市保障房建设有限公司] and Shaoxing Real Estate Comprehensive Development Co., Ltd. [绍兴市房地产综合开发有限公司]. In terms of commercial housing, SCIG acquires land bank from open-bid market and sells at prevailing market price after obtaining the presale permit. On the other hand, SCIG undertakes the construction of some demolition and resettlement housing projects in Shaoxing according to the planning of Shaoxing Municipal Government and Shaoxing Construction Bureau [绍兴市建设局]. The land for social-housing construction is mainly allocated by the government.

### Municipal Urban Infrastructure Construction and Operation

The urban infrastructure construction and operation is mainly operated by Shaoxing Infrastructure Construction and Investment Co., Ltd. [绍兴市基础设施建设投资有限公司] and Shaoxing City Construction Co., Ltd. [绍兴市城投建设开发有限公司]. SCIG is responsible for key municipal urban infrastructure construction and operation in Shaoxing, including social-housing construction, municipal public project construction, road construction and renovation, as well as other infrastructure construction within the urban area.

## Water Sales and Sewage Treatments

Water sales and sewage treatments became growing businesses after SCIG obtained 51% equity of Shaoxing City Public Utilities Group Co., Ltd. ("SCPU") [绍兴市公用事业集团有限公司] in 2018. SCIG is mainly responsible for water sales in the urban area, Keqiao district and Shangyu district etc. in Shaoxing, while it is the only state-owned entity responsible for sewage treatments in Shaoxing. Both businesses have been consistently loss-making in the past because of price restriction by the government. However, tariffs for industrial sewage treatment have been adjusted upwards since May 2021, which would have positive impact on the business growth of SCIG.

## Other Businesses

Other businesses such as non-ferrous metal sales, materials sales, rental etc., accounted for small portions of SCIG's business. SCIG ceased its mining and non-ferrous metals sales operation in July 2020, and SCIG expects this segment to play a gradually diminishing role from a revenue contribution perspective.

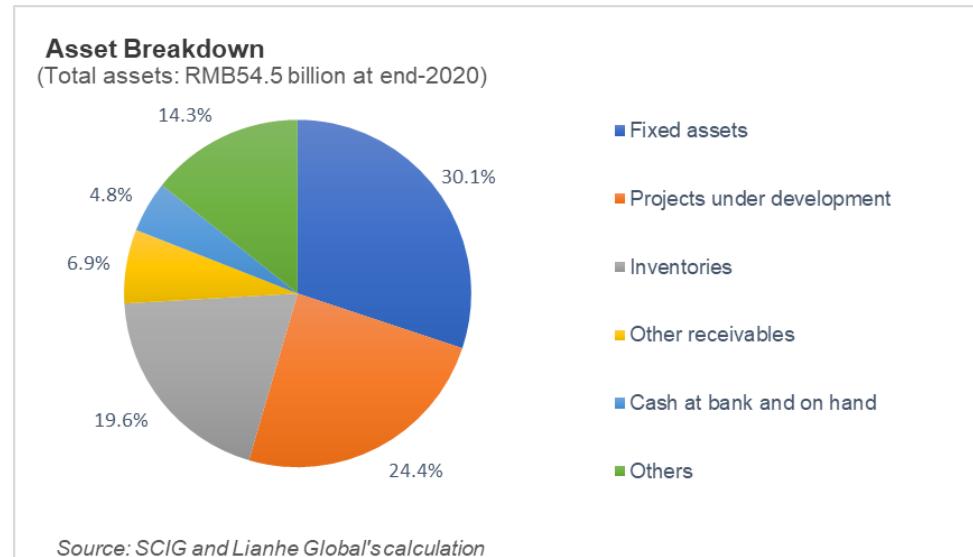
## Financial Profile

### Balance Sheet Structure and Quality

Balance Sheet Structure and Quality (RMB million)	2018	2019	2020	1Q2020
Total Asset	57,712	53,632	54,510	58,142
Equity	23,028	22,994	22,741	22,626
Debt	26,731	24,969	24,505	28,127
Debt / (Debt + Equity) (%)	53.7	52.1	51.9	55.4
LT Debt	19,276	21,607	16,345	20,199
LT Debt / (LT Debt + Equity) (%)	45.6	48.5	41.8	47.2

Source: SCIG and Lianhe Global's calculations

SCIG's total assets decreased by 7% from RMB57.7 billion at end-2018 to RMB53.6 billion at end-2019, then increased to RMB54.5 billion and RMB58.1 billion at end-2020 and end-March 2021, respectively, primarily due to the equity transfer of [浙越资产管理有限公司] in 2019 from SCIG, and the increase in non-current assets such as projects under development at end-2020 and cash on hand at end-March 2021. Inventory, fixed assets and projects under development accounted for most of SCIG's assets at end-2020. The projects under development amount of RMB13.3 billion at end-2020 mainly included river regulator projects, National Highway 329 renovation projects, Olympic Center project and other municipal public projects. In terms of current assets, other receivables increased c. 95% from RMB1.9 billion at end-2019 to RMB3.8 billion at end-2020, mainly due to the increase in receivables from Shaoxing SASAC and other government related parties. The cash account decreased c. 45% from RMB4.7 billion to RMB2.6 billion at the same time, while it increased to c. RMB5.0 billion at end-March 2021, primarily due to an increase in financing cash flow.



SCIG's financial leverage (total liabilities to assets) remained stable at a moderate level of c. 59% between 2018 to 1Q2021. SCIG's liabilities mainly comprised debentures payable (32% of its total liabilities at end-2020, same as below), short-term and long-term borrowings (24%), non-current liabilities due within one year (21%) and other payables (8%). The non-current liabilities due within one year increased two times from RMB2.2 billion at end-2019 to RMB6.6 billion at end-2020, mainly due to the increase in debentures payable due within one year. SCIG mainly relies on borrowings through guaranteed loan and credit loan. Short-term and long-term borrowings were RMB1.5 billion and RMB6.2 billion at end-2020, respectively. The short-term borrowings increased by 45% compared with that at end-2019. SCIG's total liabilities increased to RMB35.5 billion at end-March 2021 from RMB31.8 billion at end-2020, mainly due to the increase in total borrowings by c. 31%. In terms of equity, SCIG's total equities slightly decreased due to the transfer of Shaoxing Rail Transit Group Co., Ltd.'s [绍兴市轨道交通集团有限公司] equity to Shaoxing SASAC in 2020.

## Operation and Profitability

	2018	2019		2020		1Q2021		
(RMB million)	Revenue	Gross Margin						
Gas sales	2,855.7	7.3%	3,844.6	7.1%	3,007.5	5.5%	799.8	-
Commodity sales	467.7	13.8%	1,439.0	26.1%	1,307.2	29.2%	371.1	-
Construction and material sales	1,116.1	10.0%	1,288.3	14.1%	1,264.4	22.0%	-	-
Water sales	493.5	-5.7%	591.5	-0.9%	684.4	5.3%	584.3*	-
Sewage treatment	568.5	-28.7%	360.6	-23.3%	328.7	-1.9%		
Non-ferrous metal sales	464.9	10.0%	365.8	8.2%	165.1	15.2%	6.6	-
Others	664.5	48.3%	693.7	20.9%	640.9	20.7%	111.2	-
<b>Total</b>	<b>6,630.9</b>	<b>8.5%</b>	<b>8,583.5</b>	<b>10.7%</b>	<b>7,398.2</b>	<b>13.7%</b>	<b>1,873.0</b>	<b>-</b>

Source: SCIG and Lianhe Global's calculations

Note: \* Water affairs revenue consist of water sales and sewage treatment

The revenue structure of SCIG remained largely unchanged between 2018 and 1Q2021, with gas sales being the main source of revenue. After the equity transfer of SCPU, SCIG holds 51% of SCPU and has more business segments including pipeline installation and modification, water sales, sewage treatment, construction and material sales. After the equity transfer of 浙越资产管理有限公司 in 2019, the disposal of non-performing assets

business would no longer exist, but such would have no significant impacts to the total revenue of SCIG. Revenue from water sales and sewage treatments mainly relied on government subsidies.

SCIG's gross margin showed a steady upward trend during 2018 to 2020. The main sources of its gross profits are from gas sales, and other businesses such as non-ferrous metal sales. Gross profits were affected, to a lesser extent, by those of water sales and sewage treatment as well. The negative gross margin of these two businesses was mainly due to tariffs restriction by the government in the previous years. However, tariffs for industrial sewage treatment have been adjusted since May 2021, which would have the positive impact on the business growth of SCIG.

### Cash Flow

SCIG's net cash flow from operation remained stable and positive during the past few years. It has notably relied on debt financing to support its capital expenditure. Ongoing large capital expenditure such as investment in construction projects, fixed assets, intangible assets, financial assets and equity investment, have resulted in continuous negative cash flow from its investments.

Cash Flow (RMB million)	2018	2019	2020	1Q2020
Cash Inflows from Operation	12,772	10,613	10,510	3,697
Cash Outflows from Operation	11,459	9,660	8,704	2,827
<b>Net CF from Operation</b>	<b>1,313</b>	<b>953</b>	<b>1,806</b>	<b>870</b>
Cash Inflows from Investment	3,848	111	801	-
Cash Outflows from Investment	7,199	4,791	8,114	2,141
<b>Net CF from Investment</b>	<b>-3,351</b>	<b>-4,680</b>	<b>-7,313</b>	<b>-2,141</b>
Cash Inflows from Financing	16,567	13,370	10,500	4,434
Capital Contribution	488	145	3	-
Borrowings	15,031	10,583	7,674	4,099
Cash Outflows from Financing	9,133	13,858	7,091	798
<b>Net CF from Financing</b>	<b>7,434</b>	<b>-488</b>	<b>3,409</b>	<b>3,635</b>
Net Increase in Cash and cash equivalent	5,480	-4,234	-2,120	2,367

Source: SCIG's annual and quarterly reports

### Debt Servicing Capability

SCIG has access to multiple channels of financing, including bank loans, syndicated loans and bond issuances, etc. to support its debt repayment and business operation. Total debt over EBITDA ratio was continuingly high during 2018 to 2020. At end-March 2021, SCIG's total outstanding debt was RMB28.1 billion, while long-term debt accounted for the majority at 71.8%. It has monetary assets of RMB5.9 billion (include trading assets and receivables but exclude restricted cash), and unused credit facilities of c. RMB4.6 billion, compared with its outstanding debt of RMB7.9 billion to be due within one year at end-March 2021. SCIG's interest coverage (EBITDA over Interest) was moderate at an average of 1.96x between 2018 and 2020.

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