

Taizhou Huaxin Pharmaceutical Investment Co., Ltd.

Initial Issuer Report

Summary	
Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Government Financing Vehicle
Date	30 September 2021

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating to Taizhou Huaxin Pharmaceutical Investment Co., Ltd. (“THPI”). The Outlook is Stable.

Summary

The Issuer Credit Rating reflects a high possibility that the Taizhou municipal government would provide moderately strong support to THPI if needed, in light of its majority ownership of THPI, THPI’s strategic position as the major development and operation entity of the Taizhou Medical New & Hi-tech Industrial Development Zone (the “Hi-tech Zone”) and the strong linkage between the Taizhou municipal government and THPI including management supervision, strategic alignment, and ongoing operational and financial support. In addition, the Taizhou municipal government may face negative impact on its reputation and business and financing activities should THPI encounter any operational or financial difficulties.

The Stable Outlook reflects our expectation that THPI’s strategic importance will remain intact while the Taizhou municipal government will continue to ensure THPI’s stable operation.

Rating Rationale

Strong Linkage with the Taizhou Municipal Government: The Taizhou municipal government holds 99.37% stake in THPI and it is the ultimate shareholder. The rest is held by CDB Development Fund Co., Ltd. (“CDB Development Fund”). THPI’s linkage with the local government is strong as it is majority owned by the Taizhou municipal government. The Taizhou municipal government or the Taizhou SASAC plans to repurchase the equity stake held by the CDB Development Fund, which was 0.63% at end-June 2021.

Strategic Importance of THPI to Taizhou City and Hi-tech Zone: THPI is the flagship urban developer in the Hi-tech Zone and the platform for supporting the pharmaceutical industry in Taizhou. THPI is the largest LGFV by asset size in Taizhou at end-June 2021. However, THPI’s main business is focused on pharmaceutical areas, which present certain commercial elements in the operations, and its primary policy roles are in the Hi-tech Zone, which would constrain its strategic positioning in Taizhou vis-à-vis traditional LGFVs which focus on providing city-level public goods services.

Strong Government Supervision and Strategic Alignment: The Taizhou municipal government has strong control and supervision over THPI, including control of the board of directors and the supervisory committee, and approvals of senior managers and major operating and financing plans. THPI’s strategic planning and development have been aligned with the local government’s economic and social policies, aiming to develop Taizhou and the national development zone. In addition, the government will assign auditors to audit THPI’s financial and operating data on a periodic basis.

Ongoing Government Support: THPI has received supports from the local government for its business operation, including capital injections, government subsidies, and allocation of land resources or assets. THPI’s registered capital was increased to RMB6.3 billion after the RMB1 billion capital injection from the Taizhou SASAC in 2020. THPI has consistently received financial subsidies from the local government mainly for supporting projects related

Key Figures of Taizhou and THPI

(RMB billion)	2019	2020
Taizhou		
GDP	513.3	531.3
GDP growth rate (%)	6.4	3.6
Budgetary revenue	36.6	37.5
Government fund	36.3	55.0
Transfer payment	19.3	17.9
Budgetary expenditure	59.4	62.8
THPI		
Assets	68.0	79.5
Equity	27.1	29.6
Revenue	1.7	3.3

Source: Taizhou municipal government, Finance Bureau of Taizhou, THPI and Lianhe Global’s calculations

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Applicable Criteria

China Local Government Financing Vehicle Criteria (16 July 2018)

to public infrastructure or special projects. THPI received a total of RMB1.3 billion of government subsidies between 2018 and 1H2021. We believe THPI is likely to continue to receive government support in time of operational and/or financial subsidies.

Moderately Weak Financials: THPI's financial leverage (total liabilities to assets) was moderately high, increasing from 59.5% at end-2018 to 63.6% at end-June 2021. THPI mainly relies on external financing to support its capital expenditure. In view of its projects under construction and development, we expect THPI's capital expenditure needs will continue. THPI had a bank credit line of RMB30.3 billion of which approximately RMB8.93 billion was available at end-June 2021. Available bond issuance quota was RMB3.37 billion and cash was RMB5.2 billion at end-June 2021, comparing with its debt to be due within one year of c. RMB14.0 billion. The average financing cost of THPI was 6.64% at end-June 2021. In addition, THPI provided RMB9.6 billion of external guarantees to third parties, mainly other state-owned enterprises in Taizhou, accounted for c. 32% of THPI's net asset at end-June 2021.

Economy and Fiscal Strength Underpin Taizhou: Taizhou's GDP was RMB531.3 billion in 2020 and RMB286.0 billion in 1H2021, represented a year-over-year growth of 3.6% and 19.1%, respectively. Taizhou's aggregate fiscal revenue maintained steady growth in the past three years with continuing transfer payment received from higher level governments. Taizhou's debt ratio (total government debt divided by aggregate revenue) decreased from 81.9% at end-2019 to 76.0% at end-2020.

Rating Sensitivities

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

We would consider upgrading THPI's rating if (1) there is strengthened support from the Taizhou municipal government, or (2) an upgrade in our internal credit assessment on the Taizhou municipal government.

Operating Environment

Stable economy with sustained growth of Taizhou

Taizhou is a prefecture-level city in Jiangsu Province and it is also an important trade port city in China's Yangtze River Delta approved by the State Council. It is located in East China and middle of Jiangsu Province. Taizhou administers 3 county-level cities (Xinghua, Jingjiang and Taixing), three districts (Hailing, Gaogang and Jiangyan) and two development zones (the Hi-tech Zone and the Agriculture Development Zone). It has a land area of 5,787 square kilometres and a residential population of 4.5 million with an urbanization rate of 68% at end-2020, according to the 7th National Census.

The Hi-tech Zone, also called China Medical City ("CMC"), is a national development zone that was established in 2009 approved by the State Council. The Administrative Committee of Hi-tech Zone ("the Administrative Committee") was set up in 2010 and it currently administers seven functional zones including the Medical Park, Taizhou Economic Development Zone, Taizhou Export Processing Zone, Taizhou Higher Education Park, Taizhou Zhoushanhe Block, Taizhou Data Industrial Park and Taizhou Binjiang Industrial Park, as well as other streets. Currently, the Hi-tech Zone and Gaogang District plan to cooperate and merge into one district to expand and further develop CMC.

Taizhou's GDP was RMB531.3 billion GDP in 2020 and RMB286.0 billion in 1H2021, represented a year-over-year growth of 3.6% and 19.1%, respectively. Taizhou's economic growth is mainly fuelled by the secondary and tertiary industries in the past few years. GDP per capita was stable in recent years between c. RMB110,000 and RMB115,000 level.

Taizhou's GDP and Fixed Asset Investment

(RMB billion)	2018	2019	2020	1H2021
GDP	510.8	513.3	531.3	286.0
-Primary industry (%)	5.5	5.7	5.8	3.3
-Secondary industry (%)	47.6	49.2	47.8	48.9
-Tertiary industry (%)	46.9	45.1	46.4	47.8
GDP growth rate (%)	6.7	6.4	3.6	19.1*
Fixed asset investment	395.7	419.4	420.2	N/A
Fixed asset investment growth rate (%)	9.2	6.0	0.2	16.6*
Population (million)	4.6	4.6	4.5	-

Source: *Taizhou municipal government and Lianhe Global's calculation*

* Year-over-year growth rate

Moderate Fiscal Condition of Taizhou

Taizhou's fiscal strength has maintained a steady growth in the past three years. Its budgetary revenue grew by 6.4%, 2.4% and 2.6% in 2018, 2019 and 2020, respectively. However, tax revenue as a percentage of budgetary revenue have declined from c. 80% to 75% from 2018 to 2020, mainly because of various government policies implementation, including tax cuts, interest cuts and the response to the pandemic. The revenue from government-managed fund increased in 2020, mainly due to the increase in land use rights revenue. Taizhou's financial self-sufficiency rate is relatively low, but it continued to receive subsidies from higher level government.

Taizhou's fiscal debt ratio (total government debt outstanding / aggregate revenue) is slightly higher than the average provincial level with a relatively weak fiscal strength. Taizhou's

government debt increased from RMB75.9 billion at end-2019 to RMB84.4 billion at end-2020, mainly due to the increased in special debt.

Taizhou's Fiscal Condition

(RMB million)	2018	2019	2020
Budgetary revenue	35,715	36,567	37,520
Budgetary revenue growth rate (%)	6.4	2.4	2.6
Tax revenue	28,580	27,915	28,206
Tax revenue (% of budgetary revenue)	80.0	76.3	75.2
Government fund income	33,318	36,294	55,023
Transfer payment	15,226	19,327	17,912
Aggregate revenue	84,447	92,730	111,006
Budgetary expenditure	53,236	59,424	62,754
Budget deficit ¹ (%)	-49.1	-62.5	-67.3

¹ Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%

Source: Taizhou Finance Bureau and Lianhe Global's calculations

Ownership Structure and Profile

Majority Ownership with Strong Government Supervision

THPI was established in December 2005 under approval from the Taizhou municipal government with an initial registered capital of RMB100 million injected by 泰州市华泰工业控股经营有限公司 ("Huatai Company") and 泰州海华工业建设发展有限公司 ("Haihua Industry Company"). According to Document No.23 [2007] issued by the State-owned Assets Supervision and Administration Commission of Taizhou ("Taizhou SASAC"), Huatai Company transferred THPI's equity held by Haihua Industry Company with cash in September 2007 and then THPI became a wholly-owned subsidiary of Huatai Company. In November, THPI gained the approval from the Taizhou municipal government, Document No.229 [2007], for change of its ultimate shareholder from Huatai Company to the Taizhou municipal government. THPI became a wholly state-owned entity and is mainly responsible for assisting the development of the "Big Health" Industry in Taizhou. THPI takes an important role of investment, land development, infrastructure construction and leasing in the Hi-tech Zone.

THPI has received capital injections from the Taizhou municipal government during 2008 to 2020 to support its ongoing business operation and project development. THPI's share capital was enlarged to c. RMB6.3 billion at end-June 2021 after the last capital injection of RMB1 billion in the form of cash by the Taizhou SASAC in May 2020. At the same time, the Taizhou SASAC will repurchase or replace equity from other shareholders in the form of cash contribution. At end-June 2021, the Taizhou municipal government held 99.37% of THPI's equity, while CDB Development Fund held the other 0.63%.

Strategic Importance and Government Linkage

Strategic importance of THPI to Taizhou and the Hi-tech Zone

THPI is the largest LGFV platform for the development of the national development zone, and the flagship LGFV for urban development and supporting the pharmaceutical industry in the Hi-tech Zone. THPI is the largest LGFV by asset size in Taizhou at end-June 2021. However, as THPI's main business is focused on pharmaceutical areas, which present certain commercial elements in the operations, and its primary policy roles are in the Hi-tech Zone, which would constrain its strategic positioning in Taizhou vis-à-vis traditional LGFVs who focus on providing city-level public goods services.

Strong Linkage with Taizhou Government

The Taizhou municipal government holds 99.37% stake in THPI and it is the ultimate shareholder. The Taizhou municipal government or the Taizhou SASAC plans to repurchase the equity stake held by the CDB Development Fund, which was 0.63% at end-June 2021.

The Taizhou municipal government has strong control and supervision over THPI, including control of the board of directors and the supervisory committee, and approvals of senior managers and major operating and financing plans. THPI's strategic planning and development have been aligned with the local government's economic and social policies, aiming to develop Taizhou and the national development zone. In addition, the government will assign auditors to audit THPI's financial and operating data on a periodic basis.

Ongoing Government Support

THPI has received supports from the local government for its business operation, including capital injections, government subsidies and allocation of land resources or assets. THPI's registered capital increased to c. RMB6.3 billion after the capital injection from the Taizhou SASAC in 2020. THPI has received financial subsidies from the local government mainly for supporting projects related to public infrastructure or special projects. THPI received a total of RMB1,327.7 million of government subsidies between 2018 and end-June 2021.

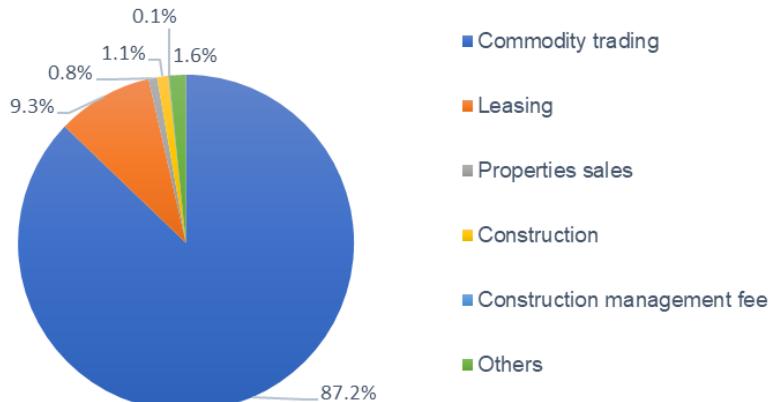
Business Profile

THPI is the largest and main investment entity of Taizhou with total assets of RMB79.5 billion at end-2020, and increased to RMB81.4 billion at end-June 2021. THPI is mainly responsible for infrastructure construction and assisting the development of "Big Health" Industry in Taizhou. It plays an important role in the development of the Hi-tech Zone.

THPI's businesses mainly consist of commodity trading, leasing, infrastructure construction and management etc. The main revenue resource is commodity trading business which includes sale of pharmaceutical products and industrial products. THPI's total revenue was RMB3.3 billion in 2020, representing a year-on-year increase of 97% compared with 2019, mainly due to the increase in the revenue from commodity trading. Income generated from this business segment accounted for c. 87.2% of THPI's total revenue in 2020.

Revenue Breakdown

Total revenue: RMB3,287 million in 2020



Source: THPI's annual report and Lianhe Global's calculation

Commodity trading

THPI's commodity trading business mainly includes pharmaceutical products sale and industrial products sale. The pharmaceutical business is operated by its subsidiary Jiangsu Huawei Medicine Logistics Co., Ltd. ("Huawei Medicine"). There are over 8,000 products through three sales channels: 1) wholesale to hospitals, 2) retail and 3) regional agents, in Jiangsu Province and other provinces. Huawei Medicine has a large number of suppliers, among which the key suppliers and long-term partners are relatively stable. In terms of clients, the quality of hospital clients is high, mainly the people's hospitals in Taizhou. Retail and agency customers are scattered, including pharmacies, clinics, individuals and other pharmaceutical sales companies. The implementation of policies in the health industry in recent years, such as "两票制" reduced the price of medicine, and the sale of pharmaceutical products had been affected. However, we expect the future effect would be less severe due to THPI's competitive advantages in Taizhou.

In order to respond to the regional development strategy and to enhance the cash position and profitability, THPI started the industrial products business segment in 2H2019. THPI's revenue grow rapidly in 2020 as a result. However, the industrial products business segment's lower gross margin also affected THPI's gross margin to a certain extent.

Leasing

Revenue from THPI's leasing business was mainly attributed to rental income from the Administrative Committee and other enterprises in the Hi-tech Zone. With the development of the CMC and the implementation of the government rent subsidy policy, there are more small and medium-sized enterprises, especially those in the pharmaceutical industry, to settle in the Hi-tech Zone, which led to a higher occupancy rate. The rent subsidy is paid by the Finance Bureau. THPI's rental business income is relatively stable.

Infrastructure construction and land development/transfer

THPI is responsible for infrastructure construction and land development or/and land transfer in Taizhou and in the Hi-tech Zone as designated by the Administrative Committee. The main infrastructure projects that THPI undertakes are road, factory building, water and power supply station and some green projects. The Taizhou municipal government and the Administrative Committee will buy back after the projects were completed and have been examined, based on the relevant contracts. THPI had several projects under construction at end-June 2021, therefore it is expected that there will be a continuous need for capital expenditure spending in the near future.

In addition, the land parcels in THPI's land transfer business are invested and developed by THPI itself, which are then sold or leased to enterprises in the Hi-tech Zone. The main target customers of the land transfer business are the enterprises located in the Hi-tech Zone, while preferential land supply policies are implemented for some companies. There is no gross profit in this business segment as the cost and income are balanced out by the Finance Bureau.

Property sales

Revenue generated from this segment was RMB473 million, RMB334 million and RMB27 million, and accounted for 25.0%, 21.3% and 0.8% of THPI's total revenue in 2018, 2019 and 2020, respectively. THPI's property sales revenue increased in 2018 and 2019, mainly

due to the recognized income of 香樟湾. The drop in revenue in 2020 was mainly due to the lack of new projects delivered. There were two property projects under construction at end-June 2021.

Other Businesses

THPI is also involved in other businesses including transportation and services, utilities and consulting services for enterprises located in the Hi-tech Zone, as well as environmental and other services. However, these businesses only accounted for a small percentage of THPI's total revenue.

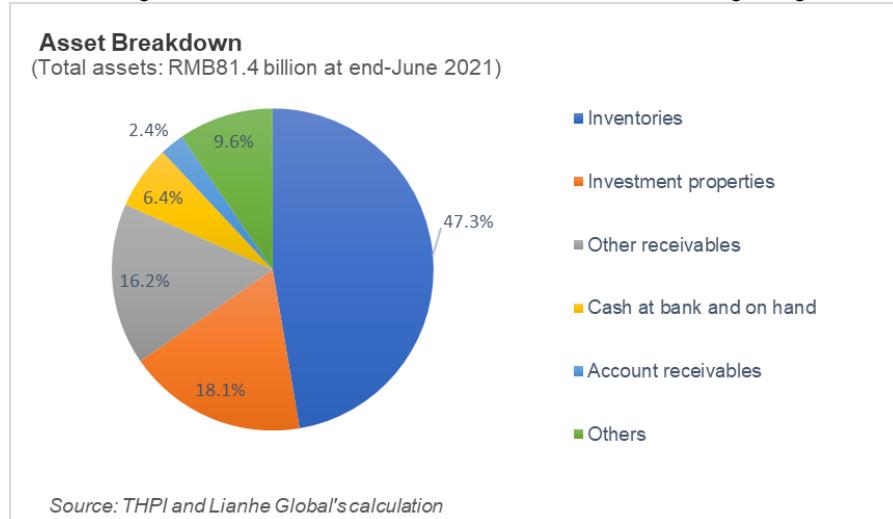
Financial Profile

Balance Sheet Structure and Quality

(RMB million)	2018	2019	2020	1H2021
Total Asset	66,200	68,044	79,476	81,387
Equity	26,843	27,075	29,625	29,596
Debt	34,374	37,131	43,986	44,274
Debt / (Debt + Equity) (%)	56.2	57.8	59.8	59.9
LT Debt	20,381	18,223	26,118	28,835
LT Debt / (LT Debt + Equity) (%)	43.2	40.2	46.9	49.4

Source: THPI's financial reports, THPI and Lianhe Global's calculations

THPI's total asset showed a continuous growth trend in the past few years, with growth rate of 2.8%, 16.8% and 2.4% at end-2019, end-2020 and end-June 2021, respectively. The increase in asset at end-2020 was mainly due to the capital injection from the government, increase in inventories and the change in accounting standard for the investment properties. The asset structure was stable, which mainly consisted of cash (6%), other receivables (16%), inventories (47%) and investment properties (18%) at end-June 2021. Among the other receivables, the amount from the Administrative Committee accounted for the majority. Per THPI, the Administrative Committee has a plan to settle the receivables with stable payments per annum. The inventories mainly include infrastructure construction, projects to be developed and land. The increase in investment properties was primarily due to a change in accounting standard which resulted in an increase in fair value beginning 2021.



THPI's financial leverage (total liabilities to assets) is moderately high, increasing from 59.5% at end-2018 to 63.6% at end-June 2021. The total liabilities increased by 22% at end-2020, mainly due to the increase in total borrowings (including short and long term) during the same period. THPI's received capital injections from the Taizhou SASAC in 2020, and the equity structure remained largely unchanged at end-June 2021. THPI has a perpetual capital of RMB1 billion at end-June 2021. THPI relies on external financing to support its capital expenditure. In view of its projects under construction and to be developed, we expect THPI's capital expenditure to increase.

Operation and Profitability

	2018	2019		2020		1H2021		
(RMB million)	Revenue	Gross Margin						
Commodity sales	1,031.8	31.6%	724.2	7.1%	2,864.9	6.8%	1,757.5	6.8%
Leasing	296.6	38.5%	304.2	20.4%	304.1	97.2%	125.8	97.1%
Property sales	472.7	18.5%	333.9	-5.3%	27.0	13.2%	3.4	24.7%
Land transfer	-	-	129.9	0.0%	-	-	-	-
Construction	-	-	-	-	36.0	9.7%	-	-
Construction management fee	31.1	100.0%	25.2	100.0%	2.2	100.0%	-	-
Others	113.9	56.8%	154.9	77.5%	52.8	3.6%	19.8	73.2%
Total	1,946.1	32.0%	1,672.4	18.9%	3,287.0	15.3%	1,906.5	13.4%

Source: THPI and Lianhe Global's calculations

The revenue structure of THPI remained largely unchanged between 2018 and 2020. The commodity trading income has been the main source of revenue. Total revenue increased by 97% from c. RMB1.7 billion in 2019 to c. RMB3.3 billion in 2020, mainly due to an increase of c. 296% in commodity trading, supplemented by its new business, industrial products sale.

THPI's gross margin showed a downward trend in recent years. The gross margin of commodity trading was only 6.8% in 2020, mainly due to the low margin from industrial products sale and margin pressure in the pharmaceutical industry. The gross margin of leasing business fluctuated, decreasing to 20.4% in 2019, mainly due to the increase of maintenance and repair costs during the year. Since the investment properties was measured at fair value instead of cost due to a change in accounting standard, there was no depreciation recognized and the gross margin increased significantly in 2020.

Cash Flow

	2018	2019	2020	1H2021
(RMB million)				
Cash Inflows from Operation	4,999	4,964	8,201	5,363
Cash Outflows from Operation	4,903	4,909	8,124	5,003
Net CF from Operation	97	55	77	360
Cash Inflows from Investment	201	1,631	439	312
Cash Outflows from Investment	1,657	2,373	3,170	3,001
Net CF from Investment	-1,456	-742	-2,730	-2,689
Cash Inflows from Financing	16,164	15,248	27,462	19,004
Capital Contribution	500	300	1,037	205
Borrowings	13,823	14,621	26,031	15,579
Others	1,841	327	394	3,220
Cash Outflows from Financing	16,798	17,812	25,380	16,934
Net CF from Financing	-634	-2,564	2,082	2,070
Net Increase in Cash and cash equivalent	-1,940	-3,233	-498	-242

Source: THPI's financial reports

THPI's net cash flow from operation remained positive during the past few years, however, it had large cash outflow from investing activities, primarily due to the capital expenditure for projects under development and investment in subsidiaries. THPI mainly relies on borrowings and corporate bonds to finance and support its capital expenditure. In 2020, THPI received some cash from capital contribution and borrowings and the net cash flow from financing turned to positive.

Debt Servicing Capability

THPI has access to multiple financing channels including bank borrowings, bond issuance, trust loan and leasing etc. At end-June 2021, the total debt (adjusted) of THPI increased to RMB44.3 billion, while the short-term debt (adjusted) decreased to RMB15.4 billion from RMB17.9 billion at end-2020. THPI's interest coverage (EBITDA over interest) was weak at 1.0x at end-2020. The average financing cost of THPI was 6.64% at end-June 2021.

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