

Yancheng High-tech Zone Investment Group Corporation Limited

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Positive
Location	China
Industry	Local Government
	Financing Vehicle
Date	6 April 2022

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Positive Outlook to Yancheng High-tech Zone Investment Group Corporation Limited (“YHZIG”)

Summary

The Issuer Credit Rating reflects a high possibility that the Yancheng municipal government would provide strong support to YHZIG if needed, in light of YHZIG’s strategic position as the major developing and operating body of Yancheng High-tech Zone and the strong linkage between the Yancheng municipal government and YHZIG including management supervision, strategic alignment, and ongoing operational and financial support. In addition, the Yancheng municipal government may face significant negative impact on its reputation and business and financing activities should YHZIG encounter any operational or financial difficulties.

The Positive Outlook reflects our expectation that YHZIG’s importance would be strengthened given its strategic development role, while the Yancheng municipal government will continue to support YHZIG to ensure its stable operation.

Rating Rationale

Yancheng Municipal Government’s Full Ownership: The Yancheng municipal government has 100% ownership of YHZIG and it is the only shareholder of YHZIG. Its registered capital was enlarged to RMB3 billion at end-September 2021 after the latest capital injection of RMB2.5 billion in October 2015.

High Strategic Importance: YHZIG is one of Yancheng’s major LGFVs and has undertaken various functions including infrastructure construction, primary land development and property leasing and management businesses to support the economic development primarily in the Yancheng High-tech Zone. In the future planning of the Yancheng municipal government, YHZIG will continue to be responsible for construction-related projects. YHZIG has a leading role as the sole provider and platform for infrastructure construction, investment and financing within the Yancheng High-tech Zone. The scope of business of YHZIG is relatively consistent and demand for its services is expected to be stable given the macroeconomic environment of the Yancheng High-tech Zone.

Government Supervision and Strategic Alignment: The Yancheng municipal government have strong control and supervision over YHZIG, including control of the board of directors, senior management appointments, major strategic, investment and financing planning. YHZIG’s business operation and development have been aligned with the government’s economic and social policies.

Ongoing Government Support: YHZIG has received strong support from the government such as government subsidies, capital injections and financial supports. The Yancheng municipal government has purchased a considerable amount of the completed infrastructure projects from YHZIG during the past three years. YHZIG is expected to continue receiving repayments from the government in the future from the projects under development.

Moderate Economic and Fiscal Strength of Yancheng: Yancheng’s GDP growth further slowed to 3.5% in 2020, compared with Jiangsu’s 3.7% and China’s 2.3%. Yancheng’s

Key Figures of Yancheng and YHZIG

(RMB billion)	2019	2020
Yancheng		
GDP	570.2	595.3
GDP growth rate (%)	10.9	11.1
Budgetary revenue	38.3	40.0
Government fund	39.0	63.4
Transfer payment	31.7	36.3
Budgetary expenditure	87.8	97.4
YHZIG		
Assets	53.9	69.1
Equity	17.7	21.7
Revenue	2.1	2.4

Source: Yancheng municipal government, Finance Bureau of Yancheng, YHZIG and Lianhe Global’s calculations

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Applicable Criteria

China Local Government Financing Vehicle Criteria (31 December 2021)

economic growth in 2020 was mainly fueled by the tertiary industry, which accounted for 48.9% of Yancheng's total GDP and reported a growth rate of 4.3%.

In 2020, Yancheng reported a budget deficit of 143.5% largely due to increased expenditure to combat the pandemic. Yancheng's budget deficit was the second largest among all municipal cities in Jiangsu Province in 2020. It has significantly relied on government transfer payment and funds from other sources (namely, funds transferred from the Central Budget Stabilization Fund and local budget stabilization funds, the budgets of central and local government-managed funds, and the budgets of central and local government state capital operations), to support its budgetary expenditure. In addition, Yancheng's local government debt totaled RMB137 billion and its debt ratio (i.e. total government debt divided by aggregate revenue) improved to 96.9% at end-2020 (compared with 106.9% at end-2019).

Moderately Weak Financials: YHZIG's earnings generation capability has been weak given its focus on contracting construction and limited commercial-oriented activities. YHZIG's financial leverage (total liabilities to assets) was moderately high at around 69.0% in recent years. YHZIG has access to financing channels such as bank loans, syndicated loans and issued bonds etc. to support its debt repayment and business operation. RMB17.3 billion of its outstanding debt will be due within one year as of end-September 2021, compared with YHZIG's unrestricted cash of RMB7.5 billion and available credit lines of RMB9.8 billion.

Rating Sensitivities

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

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

Operating Environment

Overview of Yancheng and Yancheng High-tech Zone

Yancheng is a prefecture-level city in Jiangsu Province with a registered population of 8.2 million (residential population: 6.7 million) at end-2020. It is located in the northeast of Jiangsu Province and east to the Yellow Sea, and it has a land area of 16,931 square kilometers, making it the largest prefectural city in Jiangsu Province. Yancheng administers 3 districts (Tinghu, Yandu and Dafeng) and Yancheng High-tech Zone, 5 counties (Xiangshui, Binhai, Funing, Jianhu and Sheyang) and 1 county-level cities (Dongtai). In addition to the 9 county-level divisions, Yancheng also administers two economic and technological development zones, Yancheng Economic and Technological Development Zone and Yannan High-tech Industrial Development Zone, of which both have individual fiscal settlement systems and report their fiscal budgets separately to the Yancheng municipal government.

Yancheng High-tech Zone, located in the west of Yancheng, was established in 2006, which was formerly known as Yandu Economic Development Zone. In 2012, it was identified as the city's first provincial-level high-tech zone by the provincial government. It was further identified as a state-level high-tech zone by the State Council in 2015, and implemented the "区政合一" system with Yandu District. The total planned area of Yancheng High-tech Zone is 116 square kilometers, which consists of three sub-streets: Yanlong, Yandu, and Panhuang. It is one of the key development zones in Jiangsu Province and plays an important role in the industry upgrading of Yancheng. In 2020, the Yancheng High-tech Zone achieved a GDP of RMB31 billion and budget revenue of RMB2.4 billion, making its comprehensive assessment ranking at 80th among the 168 national high-tech zones in China.

Yancheng realized RMB595.3 billion GDP in 2020, represented a year-over-year growth of 3.5%, compared with Jiangsu's 3.7% and China's 2.3%. Yancheng's economic growth in 2020 was mainly fueled by the tertiary industry, which accounted for 48.9% of Yancheng's total GDP and reported a growth of 3%. Yancheng's whole-year GDP amount and GDP growth rate were ranked 8th and 7th respectively in Jiangsu Province in 2020 (8th and 13th in 2019, out of a total of 13 municipal cities). GDP per capita was stable in recent years between c. RMB70,000 and RMB88,000 level.

Yancheng's GDP and Fixed Asset Investment

(RMB billion)	2017	2018	2019	2020
GDP	508.3	548.7	570.2	595.3
-Primary industry (%)	11.1	10.5	10.9	11.1
-Secondary industry (%)	44.4	44.4	41.6	40.0
-Tertiary industry (%)	44.5	45.1	47.5	48.9
GDP growth rate (%)	6.8	5.5	5.1	3.5
Fixed asset investment	427.9	312.6	313.6	303.6
Fixed asset investment growth rate (%)	10.2	9.4	4.9	-7.4
Population (million)	7.2	7.2	7.2	6.7

*Note: Some numbers were estimated by Lianhe Global due to insufficient public information
 Source: Yancheng Bureau of Statistics*

A Weakened but Stabilizing Fiscal Picture

Yancheng's budgetary revenue experienced a year-over-year double-digit decrease in 2016 and 2017, mainly due to the decrease in tax revenue, and rebounded to about RMB38 billion

in 2018 and in 2019 as its tax revenue stabilized. Yancheng's aggregate revenues were mainly derived from budgetary revenues with tax revenue accounting for more than 75% between 2016 and 2020, but less on the more volatile government fund income and transfer payment from the higher government. However, going-forward Yancheng may see more contributions from land sales under the government fund income.

In 2020, Yancheng reported a budget deficit of 143.5% largely due to increased expenditure to combat the pandemic. Yancheng's budget deficit was the second largest among all municipal cities in Jiangsu Province in 2020. It has significantly relied on the government transfer payment and funds from other sources (namely, funds transferred from the Central Budget Stabilization Fund and local budget stabilization funds, the budgets of central and local government-managed funds, and the budgets of central and local government state capital operations), to support its budgetary expenditure. In addition, Yancheng's local government debt totaled RMB137 billion and its debt ratio (i.e. total government debt divided by aggregate revenue) improved to 96.9% at end-2020 (compared with 106.9% at end-2019).

Yancheng's Fiscal Condition

(RMB million)	2018	2019	2020
Budgetary revenue	38.1	38.3	40.0
Budgetary revenue growth rate (%)	5.8	0.5	4.5
Tax revenue	30.5	29.5	30.0
Tax revenue (% of budgetary revenue)	80.1	77.0	75.1
Government fund income	35.5	39.0	63.4
Transfer payment	31.3	31.7	36.3
Aggregate revenue	105.4	110.2	141.5
Budgetary expenditure	84.0	87.8	97.4
Budget deficit¹ (%)	-120.5	-129.3	-143.5

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

Source: Jiangsu Budget and Final Accounts Open Access Platform (江苏省预决算公开统一平台), and Lianhe Global's calculations

Ownership Structure and Profile

Full State Ownership with Strong Government Supervision

Yancheng High-tech Zone Investment Group Co., Ltd. was established in September 2009 under approval from the Yancheng municipal government with an initial registered capital of RMB50 million. YHZIG has continually received capital injections from the Yancheng municipal government during 2009 to 2015 to support its ongoing business operation and project development. Its registered capital was enlarged to RMB3 billion at end-September 2021 after the last capital injection of RMB2.5 billion in October 2015.

YHZIG is wholly and directly owned by the Yancheng municipal government. It is the only authorized entity that engages in the infrastructure construction and management of state-owned assets and operations in Yancheng High-tech Zone. According to YHZIG, YHZIG's controlling shareholder and ultimate controller didn't pledge any company's equity.

Strategic Importance and Government Linkage

Strategic importance of YHZIG to Yancheng

YHZIG is one of the major investing and financing platforms for the Yancheng municipal government. There was a total of 20 LGFVs under the Yancheng municipal government according to DMI at end-September 2021. YHZIG was the third largest LGFV by asset size in Yancheng at end-September 2021. We believe that the Yancheng municipal government is willing to extend support to YHZIG in view of its strategic important role as one of the major investing and financing platforms to support the local economic development.

Strong linkage with the Yancheng Municipal Government

YHZIG's linkage with the local government is strong as it is wholly owned by the Yancheng municipal government and is supervised by the High-tech Zone Administrative Committee ("Administrative Committee").

The Yancheng municipal government has strong control and supervision over YHZIG, including control of the board of directors, and approvals of senior managers and major operating and financing plans. YHZIG's strategic planning and development have been aligned with the local government's economic and social policies.

YHZIG supports the local government in carrying out its policies, i.e. borrowing money from banks and/or capital markets and then distributing the funds to responsible third-parties to execute the related construction projects.

Ongoing Government Support

YHZIG has received financial support in the form of capital injections and government subsidies to support YHZIG's operations. Since its establishment, YHZIG has received capital injections from the Yancheng municipal government in an aggregate amount of approximately RMB2.68 billion.

As a state-owned enterprise wholly owned by the Yancheng municipal government, YHZIG regularly receives financial supports and preferential treatments from the Yancheng municipal government. These supports may come in various forms, such as favorable policies, government grants and subsidies, asset transfers and capital injections. For 2018 to 2020 and for the first nine months of 2021, the governmental fiscal subsidies received by YHZIG amounted to RMB163.0 million, RMB254.6 million, RMB266.0 million and RMB170 million respectively.

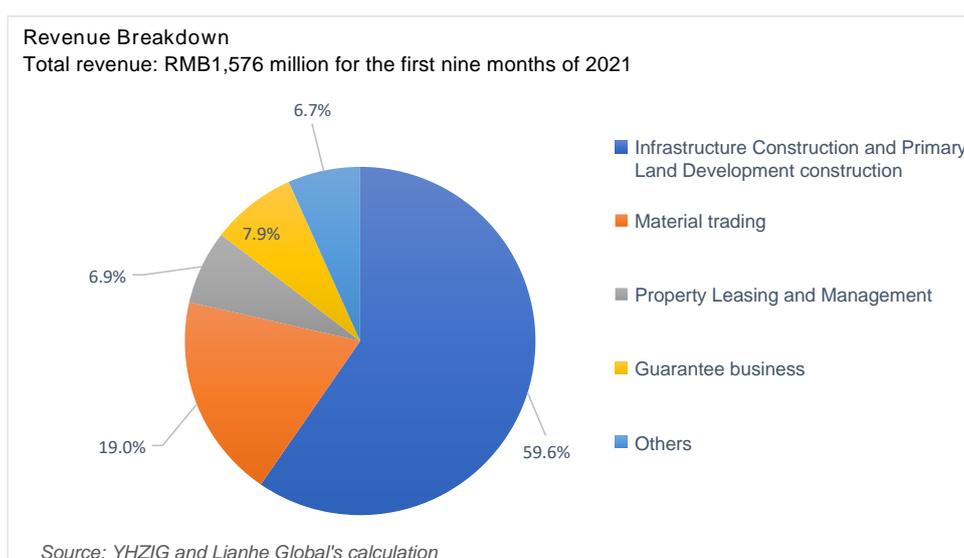
The Yancheng municipal government has established a reserve fund of RMB5.0 billion for its LGFVs in time of financial needs. To date, the reserve fund has not been used by any of the LGFVs under the Yancheng municipal government.

Business Profile

YHZIG primarily engages in infrastructure construction, primary land development, material trading, property leasing and management and other businesses. The Administrative Committee has recognized YHZIG's leading role as the sole provider and platform for infrastructure construction, investment and financing primarily within the Yancheng High-tech Zone. The scope of business of YHZIG is relatively stable and there is rigid demand for

its services and is expected less likely to be affected by the macroeconomic policy adjustments.

YHZIG realized revenue of RMB1.6 billion for the first nine months of 2021, compared with the revenue of RMB1.4 billion for the first nine months of 2020 and RMB2.4 billion for 2020. As the main drivers of YHZIG's total revenue, infrastructure construction and primary land development accounted for 59.6% of YHZIG's total revenue, followed by material trading contributing 19.0% of total revenue for the first nine months of 2021. YHZIG also faces the problem of declining gross margin from 27.1% in 2019 to 22.0% for the first nine months of 2021, mainly due to the increasing cost of material trading segment.



Infrastructure Construction

Infrastructure construction operation is one of the main businesses of YHZIG. The Administrative Committee entrusts YHZIG to undertake constructions of municipal roads and bridges, water conservancy facilities and public and social welfare facilities within the Yancheng High-tech Zone. YHZIG also acts as a financing platform for constructions of municipal public facilities primarily in the Yancheng High-tech Zone. The business is mainly operated by YHZIG and its subsidiary Yancheng Yongheng Investment Development Co., Ltd. [鹽城詠恒投資發展有限公司].

The Administrative Committee enters repurchase agreements with YHZIG and will buy back the project after they were completed. The total consideration paid by the Administrative Committee to YHZIG upon the completed projects will be the total cost of the projects plus approximately 15% profit. It is paid in the form of installments by the Administrative Committee. According to the agreement, it is generally paid off within five years.

The total investment amount of YHZIG's major completed infrastructure projects and the proposed collection amount was RMB20.3 billion and RMB23.4 billion respectively at end-September 2021. Total amount collected was RMB3.9 billion at end-September 2021. It is expected the collection amount from 2022-2024 will be RMB2.80 billion, RMB3.79 billion and RMB11.8 billion respectively.

Primary Land Development

The Administrative Committee entrusts YHZIG to conduct primary land development primarily in the Yancheng High-tech Zone. YHZIG had completed the development of 35 plots of land with a total area of 8134.9 mu at end-September 2021. The business is mainly operated by its subsidiary Yancheng Yongheng Investment Development Co., Ltd. [鹽城詠恒投資發展有限公司].

The primary land development segment did not realize any revenue in 2017-2019. Revenue has started to be recognized since 2020. The revenue recognized for the first nine months of 2021 was RMB409.5 million. In general, YHZIG's land development income is greatly affected by the progress of land development in the Yancheng High-tech Zone. As the land development and consolidation business is greatly affected by changes in policies and market environment, the income generated from this business segment tends to be uncertain.

Material Trading

YHZIG mainly procures materials such as coal and steel from upstream suppliers and sell them to downstream buyers. The business is mainly operated by its subsidiaries Yancheng Lizhiyong Trading Co., Ltd. [鹽城利之詠貿易有限公司] and Yancheng Ruiyang Technology Co., Ltd. [鹽城瑞陽科技有限公司]. In recent years, the market price declined and the price risk had increased. The revenue generated from this segment was RMB427.4 million, RMB469.7 million and RMB299.4 million for 2019, 2020 and for the first nine months of 2021, respectively. The profit margin of the material trading business stays low and YHZIG mainly relies on its capital advantages to expand the business scale. This segment overall is vulnerable to the influence of the macroeconomy and real estate market which has relatively weak stability.

Property Leasing and Management

YHZIG engages in the construction, operation, management and leasing of office buildings, factories and other rental properties within the Yancheng High-tech Zone. The primary sites in the zone including the research and development building, the cultural industrial park, the wind power industrial park, the agricultural products processing park, and the park for Korean-owned automobile parts. YHZIG managed a portfolio of leasable properties with a total area of approximately 1.32 million square meters at end-September 2021. The business is mainly operated by YHZIG and its subsidiary Yancheng Yongheng Property Management Co., Ltd. [鹽城詠恒物業管理有限公司].

Other Business

YHZIG has also engaged in other business segments including guarantee business and greening to diversify its business profile. For the guarantee business, YHZIG provides guarantee for SMEs and obtains guarantee fee income through external guarantees. The revenue generated from this segment were RMB98.0 million, RMB166.8 million and RMB124.1 million for 2019, 2020 and for the first nine months of 2021, respectively. The gross margin was 74.8%, 77.1% and 86.6% for 2019, 2020 and for the first nine months of 2021, respectively.

For landscaping, YHZIG is mainly responsible for the construction design and construction of landscaping projects in the Yancheng High-tech Zone. YHZIG's landscape project business revenue was RMB 10.6 million, RMB 21.6 million and RMB26.5 million for 2019, 2020 and for the first nine months of 2021, respectively.

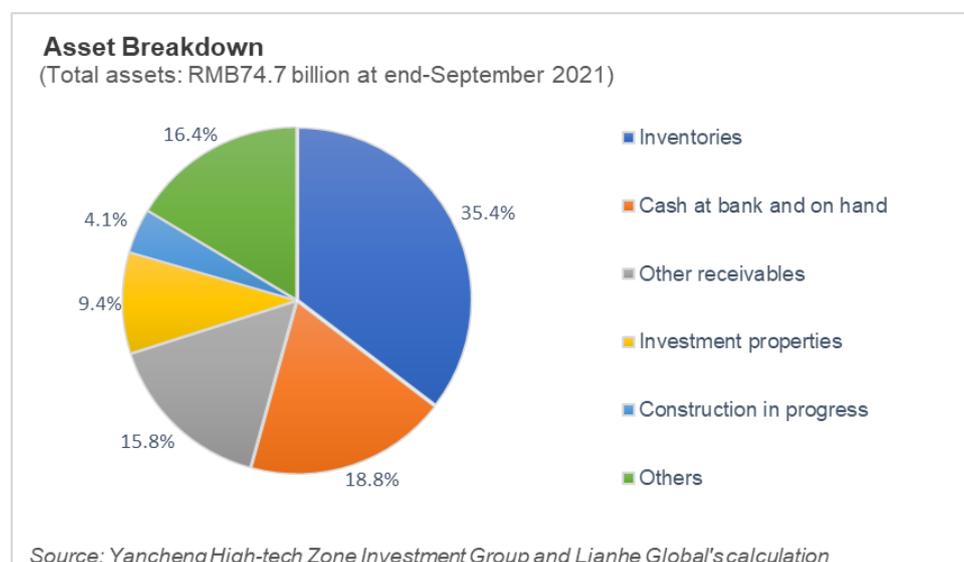
Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2018	2019	2020	3Q2021
Total Asset	48,910	53,902	69,114	74,722
Equity	16,461	17,735	21,746	22,877
Debt	26,555	31,366	43,444	48,998
Debt / (Debt + Equity) (%)	61.7	63.9	66.6	68.2
LT Debt	18,937	20,946	30,217	31,699
LT Debt / (LT Debt + Equity) (%)	53.5	54.2	58.2	58.1

Source: YHZIG, YHZIG's 3Q2021 financial report and Lianhe Global's calculations

YHZIG's total asset showed a continuous growth trend in the past few years, with growth rate of 10.2%, 28.2% and 8.1% at end- 2019, 2020 and September 2021, respectively. The asset increase in 2021 was mainly due to the increase in inventories and property under development. The asset structure was stable, which mainly consists of inventories (35%), cash (19%), other receivables (16%) and investment properties (4%) at end-September 2021. The other receivables reached RMB11.8 billion at end-September 2021, accounting for c. 20.5% of the current asset, including a large amount from the government. The inventories reached RMB26.5 billion at end-September 2021, accounting for c. 46.0% of the current asset. It mainly included projects under construction and land to be developed, which increased by 19.8% to RMB24.8 billion and stayed unchanged at RMB1.6 billion at end-September 2021, respectively.



YHZIG's financial leverage (total liabilities to assets) was moderately high at around 69.0% in the last three years. The total liabilities increased by 9.5% to RMB51.8 billion at end-September 2021, while the total equity increased by 5.2% to RMB22.9 billion and the equity structure remained largely unchanged at the time. The entity relies on external financing to support its capital expenditure. In view of its projects under construction and to be development, we expect YHZIG's capital expenditure to increase.

Cash Flow

Cash Flow

(RMB million)	2018	2019	2020	9M2021
Cash Inflows from Operation	10,734	9,345	10,503	6,829
Cash Outflows from Operation	9,234	11,155	11,021	7,709
Net CF from Operation	1,499	-1,809	-518	-880
Cash Inflows from Investment	721	761	1,725	489
Cash Outflows from Investment	2,608	3,471	7,427	2,331
Net CF from Investment	-1,887	-2,710	-5,703	-1,842
Cash Inflows from Financing	15,873	17,525	30,387	22,617
Capital Contribution	451	22	1,514	-
Borrowings	12,411	13,162	21,146	17,842
Others	3,011	4,341	7,727	4,774
Cash Outflows from Financing	13,961	16,046	23,131	10,565
Net CF from Financing	1,913	1,479	7,256	3,447
Net Increase in Cash and cash equivalent	1,525	-3,041	1,034	1,929

Source: YHZIG Annual and Interim Reports

Debt Servicing Capability

YHZIG has access to multiple channels, including bank loans, non-bank loans, and bond issues for funding to support its debt repayment and business development. Overall liquidity is sufficient to support YHZIG's debt repayments, as it had unrestricted cash of RMB7.5 billion, credit facilities of RMB26.3 billion (RMB9.8 billion unused), and other debt financing vehicles at end-September 2021, compared with its outstanding debt of RMB17.3 billion to be due within one year.

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