

Huai'an Traffic Holding Group Company Limited

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Government Financing Vehicle
Date	21 June 2022

Key Figures of Huai'an and Huai'an Traffic

(RMB billion)	2020	2021
Huai'an		
GDP	402.5	455.0
GDP growth rate (%)	3.2	10.0
Budgetary revenue	26.4	29.7
Government fund	28.5	39.7
Transfer payment	15.0	8.8
Budgetary expenditure	56.8	61.3
Huai'an Traffic		
Assets	52.4	53.4
Equity	22.1	22.6
Revenue	2.5	3.0

Source: Finance Bureau of Huai'an, Statistical Bureau of Huai'an, Huai'an Traffic and Lianhe Global's calculations

Lianhe Global has assigned 'BBB' global scale Long-term Issuer Credit Rating with Stable Outlook to Huai'an Traffic Holding Group Company Limited (formerly known as Huai'an Traffic Holding Company Limited)

Summary

The Issuer Credit Rating reflects a high possibility that the Huai'an municipal government would provide strong support to Huai'an Traffic Holding Group Company Limited ("Huai'an Traffic" or "the company") if needed, in light of its full ownership of Huai'an Traffic, Huai'an Traffic's strategic position as the sole LGFV that is responsible for transportation development. There is a strong linkage between the Huai'an municipal government and Huai'an Traffic, including management supervision, strategic alignment, and ongoing operational and financial support. In addition, the Huai'an municipal government may face significant negative impact on its reputation, business, and financing activities should Huai'an Traffic encounter any operational or financial difficulties.

The Stable Outlook reflects our expectation that Huai'an Traffic's strategic importance would remain intact while the Huai'an municipal government will continue to ensure Huai'an Traffic's stable operation.

Rating Rationale

Huai'an Municipal Government's Full Ownership and Strong Supervision: The Huai'an municipal government has 100% ownership of Huai'an Traffic. It also has strong control and supervision over Huai'an Traffic, including control of the board of directors, senior management appointments, major strategic, investment and financing planning.

High Strategic Importance and Strategic Alignment: Huai'an Traffic is the principal investment and construction entity of transportation infrastructures in Huai'an, as well as the primary operator of the city's public buses and trams. The company's business operation and development have been aligned with the government's economic and social policies. In the future planning of the Huai'an municipal government, Huai'an Traffic will continue to be responsible for transportation developments in Huai'an to support the local economy. We expect its scope of business is stable, and there is rigid demand for its services.

Ongoing Government Support: The Huai'an municipal government provided financial subsidies to Huai'an Traffic consistently, which amounted to RMB242 million, RMB369 million, RMB272 million and RMB87 million in 2019, 2020, 2021 and the first three months of 2022, respectively. These subsidies were mainly for supporting the operations of public buses and trams as they are non-for-profit in nature. The government also injected fixed assets such as ship locks, waterways as well as roads and transferred the shareholdings of other state-owned enterprises to Huai'an Traffic. However, these assets are mainly not-for-profit.

Moderate Economic and Fiscal Conditions of Huai'an: Huai'an's economic growth was relatively high. Its GDP recorded a compound annual growth rate ("CAGR") of 8.4% from 2019 to 2021, which was higher than that of China (7.7%) and comparable to Jiangsu province (8.1%) during the same period. However, Huai'an's GDP and GDP per capita in

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Applicable Criteria

China Local Government Financing
 Vehicle Criteria (31 December 2021)

absolute amount were relatively low among the 13 prefecture-level cities in Jiangsu province. Meanwhile, Huai'an's government debt grew moderately to RMB69.3 billion at end-2021 from RMB56.6 billion at end-2019, with a CAGR of 10.7%, while its budget deficit has exceeded 100% for three straight years since 2019.

Moderately Weak Financials: Huai'an Traffic's financial leverage as measured by total liabilities/total assets was stable but relatively high in the past three years, which stayed at c. 57%-58% level. Considering the company's scheduled investments, we expect its financial leverage to grow but remain below 65% in the next three years. However, its balance sheet consists of various not-for-profit and hard-to-sell assets injected by the government, as aforementioned. The company reported not-for-profit assets of RMB5 billion at end-March 2022. In addition, the company's cash/short-term debt ratio was only 0.63x at end-March 2022. Having said that, Huai'an Traffic has wide access to financing channels and established relationships with banks, with available credit line of RMB5.85 billion at end-March 2022.

Rating Sensitivities

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

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

Operating Environment

Moderate Economy with High Growth of Huai'an

Huai'an is a prefecture-level city in northern Jiangsu, which is a coastal province in eastern China. It has four districts (Qingjiangpu, Huaiyin, Huai'an and Hongze) and three counties (Lianshui, Xuyi and Jinhu). The city also administers Huai'an Economy and Technology Development Zone and Huai'an Industrial Park. It has a land area of 10,030 square kilometers and a residential population of 4.56 million, with an urbanization rate of 66% at end-2021.

Huai'an realized a GDP of RMB455.0 billion in 2021, representing a high year-on-year growth of 10%. Its economic growth was mainly fueled by the secondary and tertiary industries, accounting for 41.5% and 49.2% of the total GDP in 2021, respectively. Despite the high growth rate, Huai'an's GDP in absolute amount was relatively low. It was ranked 11th in Jiangsu Province at end-2021 (out of 13 prefecture-level cities). At the same time, Huai'an's GDP per capita was RMB99,768, which was ranked 9th in Jiangsu Province and was well below the province's average of RMB137,039.

Huai'an's GDP and Fixed Asset Investment

(RMB billion)	2018	2019	2020	2021
GDP	360.1	387.1	402.5	455.0
-Primary industry (%)	10.0	10.0	10.2	9.3
-Secondary industry (%)	41.8	41.8	40.5	41.5

-Tertiary industry (%)	48.2	48.3	49.3	49.2
GDP growth rate (%)	6.5	6.6	3.2	10.0
Fixed asset investment	309.5	329.0	330.0	347.2
Fixed asset investment growth rate (%)	9.0	6.1	0.3	5.2
Residential Population (million)	4.65	4.64	4.56	4.56

Source: Statistical Bureau of Huai'an and Lianhe Global's calculation

Moderate Fiscal Conditions of Huai'an

Huai'an's budgetary revenue growth slowed down in 2020 but bounced back in 2021, with a growth rate of 2.7% and 12.4%, respectively. The tax revenue as a percentage of the budgetary revenue has stood at the c. 80% level since 2018, except in 2020 (78.2%). The anomaly in 2020 was caused by various government policies in response to the Covid-19 pandemic, including tax and fee cuts, etc.

Huai'an's government debt and budget deficit were high. Its government debt increased to RMB69.3 billion at end-2021 from RMB63.1 billion at end-2020, representing a year-on-year growth rate of 9.8%, while its fiscal debt ratio (i.e. total government debt outstanding / aggregate revenue) stayed at high levels of 95.6%, 95.4%, 99.1% and 93.4% from end-2018 to end-2021, respectively.

Huai'an's Fiscal Conditions				
(RMB billion)	2018	2019	2020	2021
Budgetary revenue	24.7	25.7	26.4	29.7
Budgetary revenue growth rate (%)	7.2	4.1	2.7	12.4
Tax revenue	20.3	20.9	20.7	23.8
Tax revenue (% of budgetary revenue)	82.3	81.3	78.2	80.3
Government fund income	21.6	26.1	28.5	39.7
Transfer payment	125.5	142.2	150.5	88.4
Aggregate revenue	59.5	66.9	71.3	80.7
Budgetary expenditure	48.7	52.9	56.8	61.3
Budget deficit ¹ (%)	-96.9%	-105.6%	-115.2%	-106.4%

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

Source: Finance Bureau of Huai'an and Lianhe Global's calculations

Ownership Structure and Profile

Full Ownership with Strong Government Supervision

Huai'an Traffic was established in 2003 and is wholly owned by Jiangsu's Huai'an municipal government. The Huai'an State-owned Assets Supervision and Administration Commission is authorized to exercise the right as a shareholder. Huai'an Traffic carries out the directions and policies of transportation development designated by the Huai'an municipal government to support the local economy.

Strategic Importance and Government Linkage

The Strategic Importance of Huai'an Traffic to Huai'an municipal government

Huai'an Traffic plays a critical role in Huai'an's transportation development to support economic growth. The company is responsible for funding, constructing and maintaining transportation infrastructures such as national and provincial highways across Huai'an, as well as bridges and municipal roads in the urban areas. Huai'an Traffic is also the primary

operating entity of the city's public transportation system, including its public buses and trams.

Strong Linkage with Huai'an municipal government

Huai'an Traffic's business operation and development have been aligned with the government's economic and social policies. In addition, Huai'an Traffic needs to seek approval from the Huai'an municipal government regarding its major strategies, investment and financing planning. The government also controls Huai'an Traffic's board of directors and senior management's appointments.

Ongoing government support including capital injections and financial subsidies

Huai'an Traffic has received strong support from the government, such as capital and asset injections and financial subsidies. At end-March 2022, Huai'an Traffic had paid-in capital of approximately RMB14.3 billion. The last capital injection was implemented in 2016. The Huai'an municipal government injected a series of non-cash assets into Huai'an Traffic, such as properties, ship locks, land use rights, waterways, and roads, with a total valuation of RMB12.9 billion. This injection enlarged Huai'an Traffic's paid-in capital to RMB14.3 billion from RMB139 million. Nevertheless, c. RMB5 billion of the injected assets were not-for-profit roads.

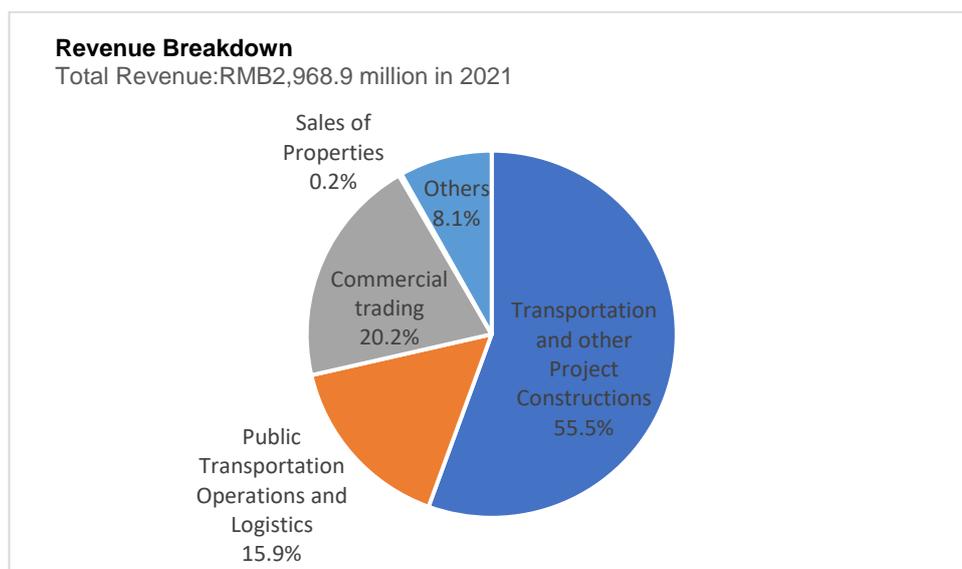
Huai'an Traffic received substantial financial subsidies from 2019 to the first three months of 2022, of which the total amount was RMB970 million. The government provided financial subsidies to support Huai'an Traffic's not-for-profit activities, including public buses and trams operations.

Huai'an Traffic also received multiple assets injections in 2020 and 2021, including 22.5% share of 淮安高新控股有限公司 with a book value of RMB900 million, 100% share of 江苏冲浪软件科技有限公司 with a book value of RMB16 million, 100% share of 淮安市直属粮食储备库有限公司 with a book value of RMB92 million, and 1.6% share of 淮扬菜集团股份有限公司 with a book value of RMB10 million. However, these companies are mainly not-for-profit in nature.

Business Profile

The Sole LGFV responsible for transportation infrastructure investments and public transportation operations in Huai'an

Huai'an Traffic has built a series of important projects, such as national and provincial highways across the city, bridges, and municipal roads in Huai'an. The company also operates public buses and trams in the city. In addition, Huai'an Traffic is involved in logistics business such as inland water and railway transport for cargoes.



Transportation and other Project Constructions

The transportation and other project construction segment contributed a significant proportion of revenue to Huai'an Traffic (40%-55%). At the same time, its operating scale has grown steadily, which increased to RMB1.65 billion in 2021 from 1.26 billion in 2019, representing a CAGR of 14.5%.

This segment reported a relatively high gross profit margin of c. 30% in the past three years, partially because it recognized revenue of c.195 million without cost of goods sold annually. That was generated from Huai'an Traffic's agent construction agreements with the Huai'an municipal government for transportation infrastructures prior to end-2014. Under those agreements, Huai'an Traffic was responsible for raising funds and constructing designated projects, and the government would repurchase them upon completion at cost plus a 15% margin. However, the Huai'an municipal government stopped buying back completed projects after end-2014. Instead, the government pays an annual management fee for these projects. These completed but non-repurchased projects are booked as construction in progress, while related management fees were recognized as revenue. At end-2014, Huai'an Traffic had completed but hadn't been repurchased projects amounting to RMB1.95 billion, and it hasn't entered into any new agent construction agreements with the government since then. The current annual management fee for the aforementioned projects is 10% of the book value. If we were to remove such management fees, the segment's gross profit margin would have been 15.8%, 18.7% and 23.3% in 2019, 2020 and 2021, respectively.

Huai'an Traffic had also engaged in two shantytown re-development projects under certain government procurement of public service agreements in 2016 and 2017. However, it faces uncertainty over revenue recognition and cash collection from its completed projects. According to the agreements, Huai'an Traffic needs to raise funds and conduct related work such as house demolition and land leveling. The total contracted amount was RMB6.04 billion, and the government would reimburse the company annually for 20 or 25 years from the starting date of the projects. However, the total reimbursement received by the company only amounted to RMB272 million by end-2021, which was far below the scheduled amount. Huai'an Traffic hasn't entered into any new agreements with the government due to the stringent regulation over government procurement of public service activities.

Currently, Huai'an Traffic participates in transportation and other project constructions such as national and provincial roads, highways, relocation houses and public parks through its three subsidiaries 江苏捷达交通工程有限公司, 江苏天成建设集团有限公司 and 江苏万成钢结构科技有限公司, of which c. 51%, 60% and 60% of the shares were held by the company, respectively. These three subsidiaries acquire projects through open tender and receive payments based on the progress of projects. At end-2021, Huai'an Traffic had a large number of projects under construction. The total scheduled investments amounted to c. RMB5 billion and c. RMB1.2 billion had been invested. We expect the project pipeline could support Huai'an Traffic's development in the next three years.

Public Transportation Operations and Logistics

Huai'an Traffic operates most public buses and trams in Huai'an, which are crucial to the city's public transportation. However, in the past three years, the public transportation business recorded continuous losses given its not-for-profit nature.

The company is also involved in logistics business such as inland water and railway transport for cargoes. Huai'an Traffic plans to further participate in inland water port, high-speed railway and airport investments and operations. The logistics business is able to break even and usually contributes c. 85% of the segment revenue.

Overall, this segment's gross profit margin was -65.3%, -73.2%, and -83.0% in 2019, 2020, and 2021, respectively.

Commercial Trading

Huai'an Traffic engages in the trading of building materials, grain and oil, as well as domestic appliances. The company also sells water pipes produced by its own production facilities. The commercial trading segment's revenue grew significantly by 56.9% to RMB600.4 million in 2021 from RMB382.7 million in 2020. However, its gross profit margin dropped to 5.8% in 2021 from 15.3% in 2020.

Sales of Properties

Huai'an Traffic has developed three residential property projects since 2017. The company mainly obtains land parcels through open auctions and sells properties to private home buyers. Its gross profit margin was generally in line with the market average. However, the properties segment's revenue was relatively small and fluctuated due to its limited project number.

By end-2021, Huai'an Traffic had three residential properties under construction, namely 云河湾, 河晏小区 and 九里颐荷府, of which 云河湾's first and second phase had been completed and mostly sold. The third phase of 云河湾 and the other two projects are expected to be completed by the first half of 2023, and c. RMB272 million of investments were required to complete the aforementioned projects. We expect the scheduled projects will improve the segment's share in the company's total revenue in 2023 and 2024. The company has no other new projects to be developed.

Others

Other businesses of Huai'an Traffic include leasing, catering, advertising and tourism etc., which contribute a small fraction to the company's total revenue in the past three years.

Financial Profile

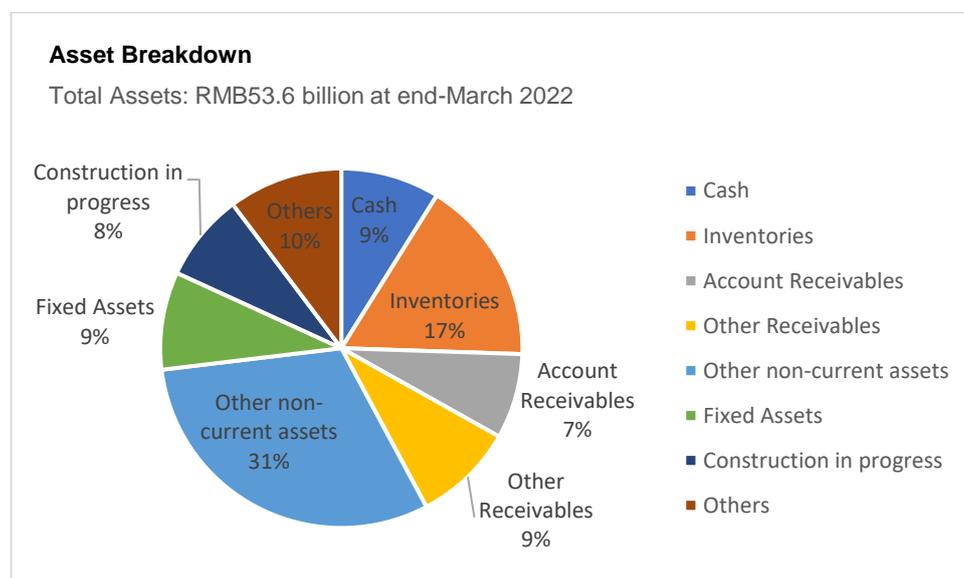
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality					
(RMB million)	2019	2020	2021	March-2022	March-2022 (Adjusted*)
Total Asset	47,790	52,362	53,446	53,619	53,619
Equity	20,986	22,138	22,627	22,968	21,168
Debt	22,442	25,512	27,266	27,561	29,361
Debt / (Debt + Equity) (%)	51.7	53.5	54.6	54.5	58.1
LT Debt	17,463	15,792	18,809	17,495	19,295
LT Debt / (LT Debt + Equity) (%)	45.4	41.6	45.4	43.2	47.7

*Note: * Adjusted numbers and ratios reflect the perpetual debts reallocating to long-term debts and total debts from equity*

Source: Huai'an Traffic's audited annual reports, unaudited quarterly report and Lianhe Global's calculations

Huai'an Traffic's total assets grew significantly in 2020 but grew moderately in 2021, with growth rates of 9.6% and 2.1%, respectively. Its total debt increased by 13.7% in 2020, and the company slowed down its debt-driven expansion in 2021, with a total debt growth rate of 6.9%. As measured by total liabilities / total assets, Huai'an Traffic's financial leverage was stable, which was 56.1%, 57.7%, 57.7% and 57.2% at end-2019, 2020, 2021 and end-March 2022, respectively. Its capital structure has been stable in the past three years as well. The current assets have accounted for 44%-45% of the total assets since 2019. At the same time, the company's short-term debt / total debt ratio has remained below 40%.



Source: Huai'an Traffic's unaudited quarterly report and Lianhe Global's calculation

Huai'an Traffic's balance sheet quality was moderately weak. The company had other non-current assets of RMB16.6 billion at end-March 2022, representing 30.9% of its total assets. However, the other non-current assets mainly comprise roads, waterways, ship locks, and railways under construction. We believe these assets are not-for-profit and hard to sell.

Its transportation and other project constructions segment generated sizeable account receivables, inventories and other receivables. Their turnover rate was 0.72x, 0.33x and 0.55x, respectively, in 2021, and many such assets face uncertainty over cash collection.

That included RMB3.8 billion worth of completed shantytown re-development projects that were booked as inventories, receivables and other receivables from Huai'an City Transportation Bureau amounting to c. RMB2 billion and RMB1 billion, respectively, at end-March 2022. In addition, the company had completed but hadn't been repurchased agent construction projects amounting to RMB1.95 billion that were booked as construction in progress. The government will not repurchase these projects but will pay 10% of their book values annually in the form of management fees.

Huai'an Traffic's contingent liability risk is moderately high. The company provided c. RMB4.3 billion worth of guarantees to other LGFVs in Huai'an city accounting for c. 18.7% of its net asset, at end-March 2022. According to the management, equivalent reciprocal guarantees were provided to Huai'an Traffic by the guaranteed companies. Huai'an Traffic also pledged or hypothecated its assets such as cash, properties and receivables with the total book value of c. RMB1,040 million to obtain bank loans.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	3M2022
Cash Inflows from Operation	5,238	5,282	6,098	2,203
Cash Outflows from Operation	5,123	4,735	5,970	2,192
Net CF from Operation	116	547	129	11
Cash Inflows from Investment	23	253	120	0
Cash Outflows from Investment	2,413	952	982	74
Net CF from Investment	-2,390	-699	-862	-74
Cash Inflows from Financing	9,329	9,335	13,165	4,157
Capital Contribution	3	595	359	0
Borrowings and Bond Issuances	9,325	8,740	12,806	4,157
Cash Outflows from Financing	8,232	7,832	13,684	3,966
Net CF from Financing	1,096	1,503	-519	191
Net Increase in Cash and cash equivalent	-1,178	1,351	-1,252	129

Source: Huai'an Traffic's audited annual reports, unaudited quarterly report and Lianhe Global's calculations

Debt Servicing Capability

Debt Maturity Profile at end-March 2021		
(RMB million)	Amount	%
2Q2022	1,301.38	4.8%
3Q2022	3,192.20	11.7%
4Q2022	3,982.71	14.6%
2023	6,052.03	22.2%
2024	6,870.71	25.2%
2025	1,596.61	5.8%
2026	421.63	1.5%
2027 and thereafter	3,894.66	14.3%
Total	27,311.93	100.0

Source: Huai'an Traffic and Lianhe Global's calculations

Huai'an Traffic's liquidity was tight, as the company had c. RMB5.36 billion cash (including restricted cash of RMB201.05 million) at end-March 2022, compared with its debt due within one year of c. RMB8.48 billion. Yet the company has access to multiple financing channels, including bank borrowings, onshore and offshore bond issuance, as well as asset management plans. The company had a total credit line of c. RMB15.79 billion, of which c. RMB5.85 billion was available.



At end-March 2022, Huai'an Traffic's major financing sources were onshore bonds and bank loans, which accounted for 33.2% and 56.0% of its total borrowings, respectively. The company was also financed through offshore bonds (6.9%), asset management plans (3.9%) and leasing (0.1%). Its average financing cost was c. 4.45%.

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