

Taizhou Huaxin Pharmaceutical Investment Co., Ltd.

Surveillance Report

Summary

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

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

Summary

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

The Stable Outlook reflects our expectation that THPI’s current position in the region will remain while Taizhou Government will continue to ensure THPI’s stable operation.

Rating Rationale

Strong linkage and Strategic alignment with Taizhou Government: THPI’s linkage with the local government is strong as it is majority owned by Taizhou Government. Taizhou Government holds a 99.45% stake in THPI, and it is THPI’s ultimate shareholder. The rest of the 0.55% share is held by CDB Development Fund Co., Ltd.

Taizhou 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. In addition, the government will assign auditor to audit THPI’s financial and operational data periodically.

THPI’s strategic planning and development have been aligned with the local government’s economic and social policies, aiming to support the pharmaceutical industry development and urban development in High-tech Zone.

Strategic Importance of THPI to Taizhou City and Hi-tech Zone: THPI is the largest LGFV in terms of asset size under Taizhou Government and the major investment and operating entity in High-tech Zone.

THPI’s primary business focuses on pharmaceutical areas. The company actively engages in the trading of pharmaceutical products and provides offices and factory leasing, warehousing and logistic services for pharmaceutical companies within High-tech Zone. We believe THPI’s business activities effectively promote the development of the pharmaceutical industry in the area by facilitating related companies’ sales and operations.

However, these activities also present more commercial elements and risks than other typical LGFVs that focus on providing public goods such as infrastructure and social-housing developments. In addition, THPI’s primary policy roles are limited in Hi-tech Zone, which would constrain its strategic positioning in Taizhou.

Key Figures of Taizhou and THPI

(RMB billion)	2020	2021
Taizhou		
GDP	531.3	602.5
GDP growth rate (%)	3.6	10.1
Budgetary revenue	37.5	42.0
Government fund	55.0	68.1
Transfer payment	17.9	15.1
Budgetary expenditure	62.8	66.8
THPI		
Total Asset	79.5	85.9
Equity	29.6	30.8
Revenue	3.3	4.4

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

Analysts

Ben Yau
 +852 3462 9586
ben.yau@lhratingsglobal.com

Alex Kung
 +852 3462 9577
alex.kung@lhratingsglobal.com

Applicable Criteria

China Local Government Financing Vehicle Criteria (31 December 2021)

THPI's strategic importance might be reduced as the company had completed most of the designated public projects. THPI had only one resettlement house project under construction, which was expected to be completed by end-2023, and it has not entered into other new public projects since end-2021. This could put THPI's diminishing government function on question.

Ongoing Government Support: THPI has received support from the local government for its business operation, which is not limited to capital injection, financial subsidies, allocation of land resources or assets and guidance in its daily management.

THPI received 2 rounds of capital injection from Taizhou Government in 2020 and 2021, respectively, with a total amount of RMB2 billion. By end-2021, the company's registered capital increased to RMB7.3 billion from RMB5.3 billion at end-2019.

THPI also received financial subsidies from Taizhou Government continuously in the past three years, which were mainly for supporting projects related to public infrastructure or special projects. However, the size of subsidies has shown a decreasing trend, amounting to RMB417 million, RMB303 million and RMB246 million in 2019, 2020 and 2021, respectively. The company did not receive financial subsidies in the first half of 2022.

Moderately Weak Financials: THPI's financial leverage, as measured by total liability/total asset, increased to 63.9% at end-June 2022 from 57.8% at end-2019. This was because THPI mainly relied on external financing to support its capital expenditures, mainly in infrastructure construction and primary land development projects as well as self-owned offices and factories for leasing. However, these projects could take a prolonged period to convert to cash due to the long construction, recognition and payment period. In addition, its return on property leasing was decreasing due to rental discounts amid Covid-19 period.

THPI's liquidity was moderately tight. At end-June 2022, the company had short-term debt of RMB18.6 billion, while it only had cash of RMB6.0 billion (including restricted cash of RMB2.4 billion). Yet it had a total credit line of c. RMB45.1 billion from banks, trust companies, financial leasing and factoring companies at end-June 2022, of which RMB13.9 billion was available. THPI also had available bond issuance quotas of RMB3.1 billion.

THPI's contingent liability risk was moderately high. THPI provided guarantees of RMB9.5 billion to external parties at end-June 2022, representing 31.6% of the company's net assets.

Regional Economy and Fiscal Strength Underpin Taizhou: Taizhou's economy rebounded from the impact of Covid-19 in 2021, realizing GDP of RMB602.5 billion and representing a year-on-year growth rate of 10.1%, which was higher than that of China (8.1%) and Jiangsu province (8.6%). Taizhou also continued investing heavily in fixed assets to boost the regional economy. The fixed assets investment amounted to RMB455.1 billion in 2021, representing a year-on-year growth rate of 8.3%.

Taizhou Government's fiscal revenue had maintained a steady growth from 2019 to 2020, which grew by 2.4% and 2.6%, respectively, and recorded a high growth rate of 12.0% in 2021.

Despite Taizhou Government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, stayed at c. 75% level due to the rapid increase in aggregate revenue. Its special debt outstanding reached RMB52.5 billion at end-2021, up from RMB36.8 billion at end-2020.

Rating Sensitivities

We would consider downgrading THPI's rating if (1) there is perceived weakening in support from Taizhou Government, particularly due to its reduced strategic importance with



diminished government functions, or (2) there is a significant reduction of Taizhou Government's ownership of THPI, or (3) there is a downgrade in our internal credit assessment on Taizhou Government.

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

Company Profile

THPI was established in December 2005 under approval from Taizhou Government with an initial registered capital of RMB100 million. After several rounds of capital injections, THPI's registered capital enlarged to RMB7.3 billion at end-2021.

Currently, THPI is Taizhou's largest in terms of asset size and major investment and operation entity, focusing on the trading of pharmaceutical products, development and sales of residential properties, leasing of offices and factories, as well as primary land developments and infrastructure constructions in Hi-tech Zone.

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