

Dongyang State-owned Assets Investment Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	31 January 2023

Key Figures of Dongyang and DSAI (RMB billion)

	2020	2021
Dongyang		
GDP	63.8	73.1
GDP growth rate (%)	0.1	10.5
Budgetary revenue	7.3	8.3
Government fund	3.6	10.6
Transfer payment	3.6	3.1
Budgetary expenditure	10.0	11.1
DSAI		
Assets	38.7	50.8
Equity	20.3	22.7
Revenue	2.7	3.5

Source: Public information, DSAI and Lianhe Global's calculations

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB’ global scale Long-term Issuer Credit Rating with Stable Outlook to Dongyang State-owned Assets Investment Co., Ltd. (“DSAI” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Dongyang City (“Dongyang government”) would provide strong support to DSAI if needed, in light of its indirect full ownership of DSAI, DSAI’s strategic importance as the important state-owned entity for infrastructure construction and land development, state-owned capital investment, as well as settlement house construction in Dongyang City (“Dongyang”), and the linkage between the Dongyang government and DSAI, including control and supervision over the management, strategic alignment and ongoing operational and financial support. In addition, the Dongyang government may face significant negative impacts on its reputation, business and financing activities if DSAI encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that DSAI’s strategic importance would remain intact while the Dongyang government will continue to ensure DSAI’s stable operation.

Rating Rationale

Dongyang Government’s Ownership and Supervision: The Dongyang government indirectly holds full ownership of DSAI through the State-owned Assets Supervision and Administration Office of People’s Government of Dongyang City (“Dongyang SASAO”) and Zhejiang Financial Development Co., Ltd. Dongyang SASAO is the ultimate controller of the company. The Dongyang government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Dongyang government has assessment mechanism over the company and it will appoint auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Dongyang and Strategic Alignment: DSAI, as the most important LIDC in Dongyang, is mainly responsible for municipal infrastructure construction, land development, investment and development of urban public resource projects, investment and management of state-owned assets, real estate development, etc. with franchise advantages. In addition, DSAI is also responsible for the water related business, mainly including water supply and sewage treatments in the region. DSAI is the core entity for the operation of state-owned assets in a monopoly position in Dongyang. It plays an important role in promoting the economic and social development of Dongyang. DSAI’s business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: DSAI received operational and financial support from the Dongyang government. DSAI had received a total subsidy amount of c. RMB1,005 million from 2019 to the first six months of 2022. The Dongyang government will repurchase some infrastructure projects upon completion and provide policy supports to DSAI to ensure its business operation. Given the franchise advantage in infrastructure projects construction and land development in Dongyang, DSAI has advantages to obtain land resources and

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Applicable Criteria

China Local Investment and Development Companies Criteria (5 December 2022)

main projects. We believe DSAI is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

DSAI's Financial Matrix and Liquidity Position: DSAI's total assets showed a continuous growth trend in the past years and reached RMB60 billion at end-June 2022, mainly due to the increase of fixed asset and inventories. DSAI's financial leverage (total liabilities to assets) was 60.5% and its adjusted debt increased to c. RMB27.9 billion at end-June 2022. The liquidity of DSAI was moderate. DSAI had a cash balance and unused credit facilities of c. RMB6.4 billion and RMB16.8 billion at end-June 2022, compared with its debt due within one year of c. RMB7.5 billion. Besides, DSAI has access to various financing channels, including bank loans, bond issuance and non-traditional financing (e.g. trust loans), to support its debt repayment and business operations.

Economy and Fiscal Strength of Dongyang: Dongyang, as one of the county-level cities under the jurisdiction of Jinhua, is located in the middle of Zhejiang Province, adjacent to Yiwu City in the west. Dongyang's economy maintained steady growth, with GDP reaching RMB73.1 billion and high year-on-year growth of 10.5% in 2021. The GDP was mainly fueled by the secondary and tertiary industries, which accounted for 45.0% and 52.5% of aggregate GDP in 2021.

The aggregate fiscal revenue of the Dongyang government was mainly derived from the budgetary revenue and government fund income. The Dongyang government's budgetary revenue grew moderately and increased to RMB8.3 billion in 2021, where its tax revenue accounted for more than 89% of its budgetary revenue in the past three years. Besides, Dongyang's government fund income grew significantly due to the increase in revenue from industrial land transfer and comprehensive land transfer and recognized RMB10.6 billion in 2021. The fiscal self-sufficiency rate of the Dongyang government was manageable. Its budget deficit was improving in the past three years, which was -41.6%, -37.2% and -32.8% in 2019, 2020 and 2021, respectively, due to the relatively strong growth of budgetary revenue. The debt ratio (i.e. total government debt divided by aggregate revenue) of the Dongyang government was c. 80.1% at end-2021, down from c. 81.2% at end-2019.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Dongyang

Dongyang is a county-level city under the jurisdiction of Zhejiang Province, administered by Jinhua City. It is located in the middle of Zhejiang Province, adjacent to Yiwu City in the west. Dongyang has jurisdiction over 6 streets, 11 towns and 1 township with a total land area of c. 1,747 square kilometers. Its residential population reached c. 1.1 million with an urbanization rate of c. 68% at end-2021.

Dongyang has a good economic foundation, with outstanding contributions from the construction industry. At the same time, the modern service industry, which focuses on film, television, culture and tourism, has developed rapidly. It was ranked 61th among China's Top 100 Districts in 2021.

Dongyang's economy has maintained steady growth, with GDP reaching RMB73.1 billion and high year-on-year growth of 10.5% in 2021. Dongyang's GDP was ranked 2nd among the 4 county-level cities in Jinhua City (behind Yiwu). The economic growth was mainly fueled by the secondary and tertiary industries, accounting for 45.0% and 52.5% of Dongyang's aggregate GDP, respectively, in 2021.

During the same period, Dongyang's GDP per capita was approximately RMB67,120. The fixed asset investment also supported Dongyang's economic development. Its fixed asset investment growth rates rebounded to 19.7% in 2021, up from -0.3% in 2020.

Dongyang's GDP and Fixed Asset Investment (RMB billion)

	2019	2020	2021
GDP	63.8	63.8	73.1
-Primary industry (%)	2.7	2.9	2.6
-Secondary industry (%)	44.3	42.8	45.0
-Tertiary industry (%)	52.9	54.3	52.5
GDP growth rate (%)	5.7	0.1	10.5
Fixed asset investment	40.3	40.2	48.1
Fixed asset investment growth rate (%)	5.5	-0.3	19.7
Population (million)	0.9	1.1	1.1

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Dongyang

The aggregate fiscal revenue of the Dongyang government was mainly derived from the budgetary revenue and government fund income. The Dongyang government's budgetary revenue grew moderately between 2019 and 2021, which increased to RMB8.3 billion in 2021 from RMB7.0 billion in 2019, representing a compound annual growth rate ("CAGR") of 6.1%. Over the same period, the contribution of the tax revenue stood at c. 89-92% level.

The government fund income increased sharply by c. 197.1% to RMB10.6 billion in 2021 from RMB3.8 billion in 2019, mainly due to the increase in revenue from industrial land transfer and comprehensive land transfer, which is mainly benefit from government land transfer planning and property market heat.

The Dongyang government's fiscal self-sufficiency rate was manageable. Its budget deficit was improving in the past three years, which was -41.6%, -37.2% and -32.8% in 2019, 2020 and 2021, respectively, due to the relatively strong growth of budgetary revenue. Yet the

government debt ratio, as measured by total government debts/ aggregate revenue, was relatively high at 80.1% at end-2021.

Dongyang's Fiscal Condition			
(RMB billion)	2019	2020	2021
Budgetary revenue	7.0	7.3	8.3
Budgetary revenue growth rate (%)	6.3	3.9	14.8
Tax revenue	6.2	6.6	7.6
Tax revenue (% of budgetary revenue)	89.3	91.0	91.6
Government fund income	3.8	3.6	10.6
Transfer payment	2.8	3.6	3.1
Aggregate revenue	13.6	14.5	22.1
Budgetary expenditure	9.9	10.0	11.1
Budget deficit ¹ (%)	-41.6	-37.2	-32.8

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

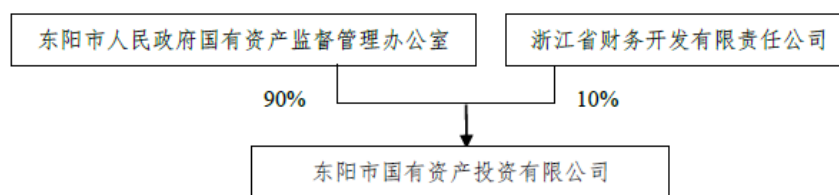
Source: Finance Bureau of Dongyang City and Lianhe Global's calculations

Ownership Structure

Government's Ownership

DSAI (former name: Dongyang City Development Co., LTD. [东阳市城市发展有限公司]) was established with an initial registered capital of RMB300 million fully contributed by the Finance Bureau of Dongyang City ("Dongyang FB") in 2003. In 2004, DSAI carried out capital reduction, and the registered capital after capital reduction was RMB 250 million. The controlling shareholder of DSAI was transformed to State-owned Assets Supervision and Administration Office of People's Government of Dongyang City ("Dongyang SASAO") in 2008. In 2020, Dongyang SASAO transfers 10% of its shares to Zhejiang Financial Development Co., LTD ("ZFDC"). Dongyang SASAO is the ultimate controller of DSAI, holding 90% shares and the registered capital and paid-in capital of the company were both RMB250 million at end-June 2022.

The shareholding structure of DSAI at end-June 2022:



Source: DSAI

DSAI had 102 subsidiaries within the scope of consolidation as of end-June 2022.

Strategic Importance and Government Linkage

Strategic Importance of DSAI to Dongyang

DSAI, as the most important LIDC in Dongyang, is mainly responsible for municipal infrastructure construction, land development, investment and development of urban public resource projects, investment and management of state-owned assets, real estate development, etc. with franchise advantages. In addition, DSAI is also responsible for the water related business, mainly including water supply and sewage treatments in the region. DSAI is the core entity for the operation of state-owned assets in a monopoly position in

Dongyang. It plays an important role in promoting the economic and social development of Dongyang. DSAI's business operation and development have been aligned with the government's development plans.

Linkage with the Local Government

DSAI's linkage with the local government is strong as the Dongyang government indirectly holds the whole ownership of DSAI through Dongyang SASAO and ZFDC. Dongyang SASAO is the ultimate controller of the company. The Dongyang government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Dongyang government has assessment mechanism over the company and it will appoint auditor to supervise the operating performance and financial position on a periodic basis.

Government Support

DSAI continued to receive financial subsidies from the local government to maintain its business operation. DSAI received subsidies of c. RMB140 million, RMB297 million and RMB568 million in 2019, 2020 and 2021, respectively. The Dongyang government will repurchase some infrastructure projects upon completion and provide policy supports to DSAI to ensure its business operation. Given the franchise advantage in infrastructure projects construction and land development in Dongyang, DSAI has advantages to obtain land resources and main projects. We believe DSAI is likely going to receive government support in the form of operational and/or financial subsidies in the future.

Business Profile

The Core Entity Responsible for State-owned Asset Operation in Dongyang

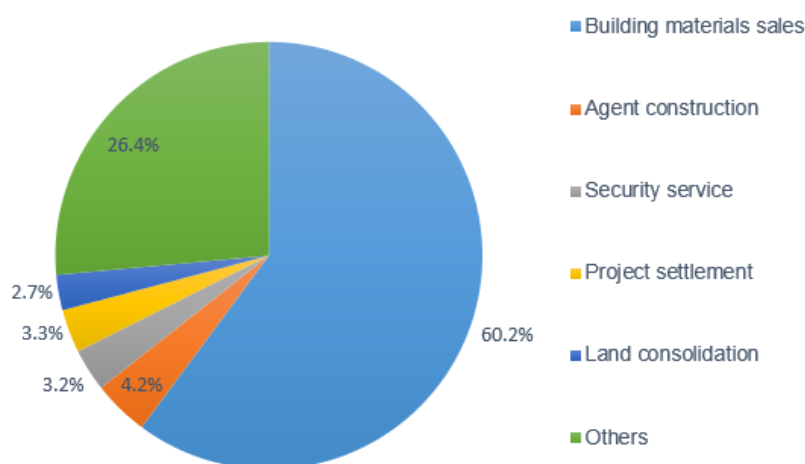
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DSAI's operating income is mainly derived from its operating business, including sales of building materials, property sales, engineering services and water services and security services, etc. Its revenue showed an upward trend in the past three years, which reached c. RMB2.2 billion, RMB2.7 billion and RMB3.5 billion in 2019, 2020 and 2021, respectively, while it recognized a revenue of c. RMB2.3 billion in the first six months of 2022. The revenue increase in 2020 was mainly due to the increase in revenue from the newly started agent construction business, while the increase in 2021 was mainly driven by the revenue from property sales, land concession income and low-utility land business. DSAI's overall gross profit margin remained at 6.5%-12.0% in 2020, 2021 and the first six months of 2022. The lower gross margin in the first half of 2022 was mainly due to unrecognized property sales proceeds, which will be recognized by the end of 2022. Per management, DSAI's gross

profit margin would increase for the full year of 2022. Overall, DSAI's business is well diversified, most of which have franchise advantages in Dongyang.

Revenue Breakdown

(Total revenue: c. RMB 2,260 million for 1H2022)



Source: DSAI and Lianhe Global's calculation

Agent construction

As the sole entity for infrastructure investment and construction in Dongyang, DSAI undertakes the construction of municipal projects such as road networks and bridges in the region, as well as other infrastructure-related projects such as urban village renovation and settlement house construction. Given the important position of DSAI as the core entity that is responsible for the construction-related infrastructure in Dongyang, DSAI has certain regional franchise advantages in this segment. The revenue generated from this segment reached RMB559.9 million, RMB432.6 million and RMB95.5 million in 2020, 2021 and the first six months of 2022, respectively.

DSAI and its subsidiaries entered into agreements with municipal units such as Dongyang Housing and Urban-Rural Development Bureau, Dongyang Transportation Bureau, Dongyang Water Bureau and Dongyang Luzhai Protection and Utilization Management Committee to entrust the company with the investment and construction of municipal supporting projects in Dongyang. In the initial phase, the project is financed by the company's own funds and external financing borrowings. The entrusting party will repurchase the project with an added margin of c. 20% on top of the total construction cost upon completion and handover. Considering the large scale of the projects under construction or to be constructed (e.g. No.37 and No.39 provincial road reconstruction projects), DSAI may face a high pressure on its capital expenditure.

Land consolidation

DSAI engaged in the land consolidation business in Dongyang with strong regional franchise, including the disposal of low-utility land, disposal, development, and utilization of idle assets, development, operation and utilization of state-owned forestry resources and other comprehensive remediation business such as mine rehabilitation and low-quality hazards.

In terms of business model, each township and street are the main body of implementation, while DSAI is responsible for raising funds and paying the development costs of each township and street according to regulations. The non-agricultural construction indicators to be traded are applied for by DSAI, reviewed by the Municipal Land Development and Collation Center and reported to the Municipal Natural Resources and Planning Bureau for approval, after which they will be publicly traded by DSAI.

The revenue generated from this segment reached RMB14.1 million, RMB162.7 million and RMB60.6 million in 2020, 2021 and the first six months of 2022. The gross profit margin was negative in 2020 as the land traded during the year (mainly land for transportation and education) was regarded as non-agricultural land according to the Dongyang government's guideline, which charged only 50% while the cost was recognized at 100%. The gross margin bounced back at positive in 2021 and first six months of 2022.

Operational businesses

DSAI was engaged in building materials sales, property sales, project services and security services in Dongyang. Building materials sales remain the company's main source of revenue. The revenue generated from this segment reached RMB1359.6 million, accounting for 60.2% of total revenue in the first six months of 2022. Building materials sales are rooted in the local industry background. The construction industry belongs to the pillar industry of Dongyang City. The annual purchase amount of construction materials exceeds RMB100 billion, covering hundreds of building materials such as steel, cement and concrete.

DSAI's property sales business mainly focuses on the sales of resettlement housing, supplemented by the sales of commercial housing. There is risk of potential loss given the selling price of resettlement housing may be lower than the cost and/or the market price.

DSAI's project services mainly include project construction, road maintenance, supervision, test and inspection. The project services are mainly concentrated in Dongyang City, and a small number of projects in Quzhou and Jiaying are also undertaken. DSAI undertakes business in the form of general contracting, and needs to pay for engineering materials and operating costs during construction.

DSAI's security services mainly include various security services such as security dispatch, security escort, auxiliary police service, online alarm, etc. In 2018, a government purchase service agreement was signed with Public Security Bureau of Dongyang City ("Dongyang PSB") to purchase the services of auxiliary police personnel. However, as the total expenses agreed in the agreement paid to the relevant auxiliary police personnel are subject to the list of funds provided by the Dongyang PSB, the cost is high and the gross profit margin is relatively low.

DSAI was engaged in water business in Dongyang, mainly including residential and commercial water supply and water meter installation, as well as design, installation and maintenance of water pipes. The revenue generated from this segment reached RMB111.0 million, RMB110.0 million, RMB137.7 million and RMB56.9 million in 2019, 2020, 2021 and the first six months of 2022, respectively.

Other business

DSAI's business is well diversified. DSAI's other businesses mainly included grain sales, property leasing, property management, supervision fees, environmental sanitation services,

etc. The other businesses have limited impact and contribution to DSAI's total revenue due to their small business scales.

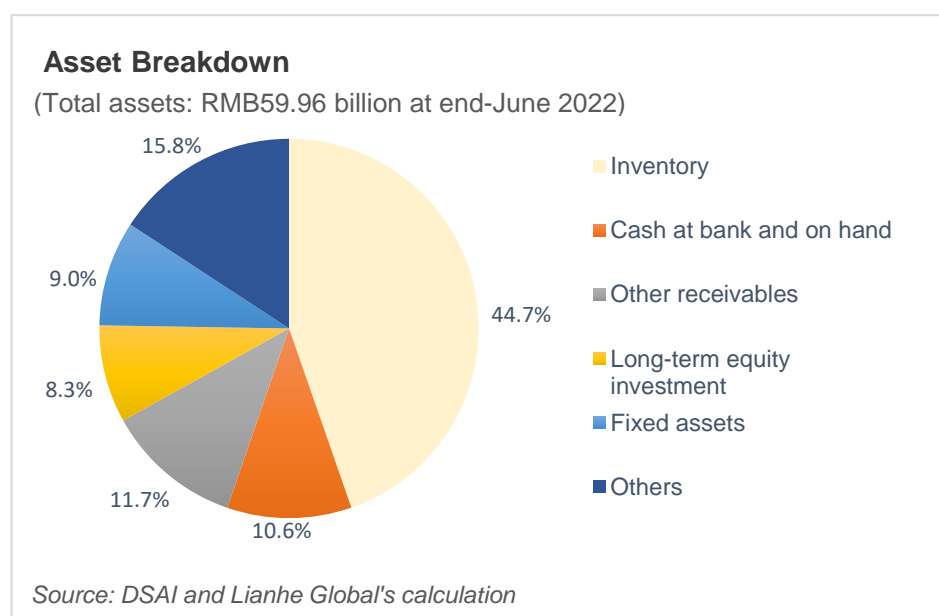
Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Jun 2022
Total Asset	20,230	38,688	50,769	59,955
Equity	10,606	20,320	22,704	23,700
Debt	4,004	11,854	21,334	27,914
Debt / (Debt + Equity) (%)	27.4	36.8	48.4	54.1
LT Debt	2,346	9,183	15,974	20,337
LT Debt / (LT Debt + Equity) (%)	18.1	31.1	41.3	46.2

Source: Company Information and Lianhe Global's calculations

DSAI's total assets showed a continuous growth in the past few years, with a growth rate of 91.2%, 31.2% and 18.1% at end-2020, end-2021 and end-June 2022, respectively, and reached RMB60 billion at end-June 2022. The significant increase in total assets in 2020 was mainly caused by the increase in fixed asset, which mainly consisted of reservoir assets transferred by Dongyang government. The asset increase at end-June 2022 was mainly due to the increase in inventories. The current assets of DSAI accounted for a large portion of c. 69.3% of the total assets at end-June 2022. The asset structure of DSAI has not changed significantly in recent years and was mainly composed of inventories, cash at bank and on hand, long-term equity investment and fixed asset. Inventories mainly included development costs related to DSAI's main business (e.g. agent construction etc.) and contract performance costs, which grew in tandem with the increase in DSAI's related projects in Dongyang. The long-term equity investment mainly consisted of DSAI's investment in other companies in Dongyang in the form of joint ventures or associated enterprises. A large portion of other receivables' counterparties were state-owned enterprises in Dongyang, representing a controllable counterparty risk. Fixed assets were mainly property and equipment for the company's own use, which were transferred in after the completion of some projects (e.g. sewage treatment projects).



DSAI's financial leverage (total liabilities to assets) was 47.5%, 55.3% and 60.5% at end-2020, end-2021 and end-June 2022, respectively, representing an upward trend. Given the relevant guidelines of the Dongyang government, we expect the leverage of DSAI to maintain at the current level. DSAI's adjusted total debt increased significantly from c. RMB4 billion at end-2019 to c. RMB27.9 billion at end-June 2022, due to the increase in short-term and long-term borrowings, with long-term debt accounting for c. 72.9% of its total debt at end-June 2022. There was no significant change in the ownership equity structure of DSAI at end-June 2022, compared with that at end-2021. DSAI mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure projects and water related projects under construction and to be constructed in the future.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	6M2022
Cash Inflows from Operation	4,080	4,356	5,417	3,299
Cash Outflows from Operation	5,398	9,622	10,971	5,913
Net CF from Operation	-1,318	-5,266	-5,554	-2,615
Cash Inflows from Investment	51	1,819	1,182	22
Cash Outflows from Investment	1,680	8,158	5,238	2,731
Net CF from Investment	-1,629	-6,339	-4,056	-2,709
Cash Inflows from Financing	4,297	14,116	19,366	12,724
Cash Outflows from Financing	1,687	3,637	6,993	5,866
Net CF from Financing	2,610	10,479	12,373	6,858
Net Increase in Cash and cash equivalent	-337	-1,126	2,763	1,534

Source: DSAI's financial reports

Debt Servicing Capability

The liquidity of DSAI was moderate. At end-June 2022, DSAI had a cash balance and unused credit facilities of c. RMB6.4 billion and RMB16.8 billion, respectively, compared with its debt due within one year of c. RMB7.5 billion at the same time. Having said that, DSAI has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

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