

Taixing Zhiguang Environmental Protection Technology Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	3 January 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Taixing Zhiguang Environmental Protection Technology Co., Ltd. (“TZEPT” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Taixing City (“Taixing government”) would provide strong support to TZEPT if needed, in light of its indirectly full ownership of TZEPT, TZEPT’s strategic importance as the important investment and development company (“LIDC”) responsible for infrastructure construction and land development in Jiangsu Taixing High-tech Industrial Development Zone (“Taixing HTZ”), and the linkage between the Taixing government and TZEPT, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and other government support. In addition, the Taixing government may face significant negative impact on its reputation and financing activities if TZEPT encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Taixing government via the LIDC of the State-owned Assets Supervision and Administration Office of Taixing (“Taixing SASAO”), Taixing Zhongxin Investment Group Co., Ltd. (“Zhongxin Group”), indirectly holds 100% stake of TZEPT. The Taixing government has strong supervision over the company through the Taixing SASAO, including appointment and supervision of the senior management, development strategy and investment plan decisions, major financing plans and daily operations. In addition, the Taixing government has formulated a performance appraisal policy for the company, and regularly appoints auditors to review the company’s operating performance and financial position.

Strategic Importance and Strategic Alignment: As one of the important LIDCs in Taixing, TZEPT is mainly responsible for the infrastructure construction and land development project in the Taixing HTZ, with a regional franchise advantage. The company aims to maintain its prominent position as the primary entity for infrastructure construction in the region, while further diversify its business portfolio at the same time. The company’s development plan has been aligned with the local government’s urban development and construction plan. TZEPT plays an important role in the urban development of the Taixing HTZ. Under the guidance of the government’s plan, the company undertakes the integration of asset in the region, revitalizes high-quality assets and resources to further develop and construct the zone. The major customers of the company are the Management Committee of the Taixing HTZ (“Taixing HZTMC”) and other governmental entities and companies in the zone.

Key Figures of Taixing and TZEPT

(RMB billion)	2020	2021
Taixing		
GDP	112.7	127.3
GDP growth rate (%)	3.9	9.9
Budgetary revenue	8.5	9.3
Government fund	12.6	13.9
Transfer payment	4.1	2.9
Budgetary expenditure	10.8	11.8
TZEPT		
Assets	28.2	28.3
Equity	10.6	10.7
Revenue	7.5	2.5

Source: Public information, TZEPT and Lianhe Global’s calculations

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Applicable Criteria

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

Ongoing Government Support: As the primary LIDC for infrastructure construction in the Taixing HTZ, TZEPT has been supported by the local government since its establishment. The government support it has received was mainly been in the form of capital injection and operational subsidies. In 2020, the company received a capital injection of RMB1.0 billion from the shareholder, which increased its paid-in capital to RMB2.0 billion. The subsidies amount received from the government was c. RMB256 million, RMB357 million and RMB376 million and RMB265 million in 2019, 2020, 2021 and the first nine months of 2022, respectively. Considering the function and strategic importance of the company, we believe that the company is likely going to receive timely government support in the form of operational and/or financial subsidies in the future.

TZEPT's Financial and Liquidity Position: The total asset of TZEPT was c. RMB31.6 billion at end-September 2022. The company's financial leverage as measured by total liabilities/total assets was moderately high and it maintained at c. 62%-64% in the past three years. The company's total adjusted debt was c. RMB13.05 billion at end-September 2022, of which short-term and long-term debt accounted for 30.1% and 69.9% of its total debt, respectively. Meanwhile, TZEPT had a cash balance of c. RMB5.06 billion (among which the restricted cash was RMB4.75 billion) and unused credit facilities of c. RMB6.08 billion, compared with its debt due within one year of c. RMB3.93 billion. TZEPT has access to various financing channels, including bank loans, onshore and offshore bond issuance and non-traditional financing (such as trust loan, financial lease and asset management), to support its debt repayment and business operations. TZEPT mainly relies on external financing to support its capital expenditures, which we expect the company to have certain capital expenditure needs in the future given its projects under construction.

Economy and Fiscal Condition of Taixing: Taixing is a county-level city in Jiangsu Province, which is an important economic link between the north and south of the Yangtze River. Taixing maintained growth in economic development in 2021, achieving a GDP of c. RMB127.3 billion, with a year-on-year growth of 9.9%. The aggregate fiscal revenue of the Taixing government was mainly derived from the budgetary revenue and government fund income. In 2021, the budgetary revenue of the Taixing government reached c. RMB9.3 billion, with a year-on-year increase of 9.0%, of which tax revenue accounted for 80.7% of its budgetary revenue. In addition, the government fund income was another important part of its aggregate fiscal revenue. However, it was vulnerable to market and policy changes. In 2021, the government fund income of the Taixing government was c. RMB13.9 billion, up 10.7% year-on-year. Taixing government's debt ratio (total outstanding debt/ aggregate fiscal revenue) was relatively high. At end-2021, the local government's outstanding debt was c. RMB27.5 billion, including RMB10.4 billion of general obligations and RMB17.1 billion of special debt.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Taixing

Taixing is a county-level city under the jurisdiction of Taizhou City, Jiangsu Province. Taixing is located in the middle of Jiangsu Province and in the Yangtze River Economic Belt, which is an important economic link between the north and south of the Yangtze River. It enjoys good economic development and has been ranked among the top 100 counties in China for years (2022: Ranked 28th). At end-2021, Taixing has jurisdiction over 3 streets, 13 towns and 1 township, with a total area of 1,172 square kilometers, and the residential population of Taixing was c. 1.0 million, with an urbanization rate of 62.9% in 2021. Taixing maintained growth in economic development, achieving a GDP of c. RMB127.3 billion, with a year-on-year growth of 9.9% in 2021. In terms of industrial structure, Taixing's economy was mainly dominated by the secondary industry and the tertiary industry, of which the tertiary industry accounted for an increasing proportion year by year. The GDP per capita of Taixing reached c. RMB128,000 in 2021, compared with that of c. RMB137,000 in Jiangsu Province at the same time.

Taixing HTZ is a provincial-level zone, located in the east of the main urban area of Taixing, with a total area of 28 square kilometers. Taixing HTZ mainly focuses on energy conservation and environmental protection industry, new energy and new materials industry and intelligent manufacturing service industry.

Taixing's GDP and Fixed Asset Investment

(RMB billion)	2019	2020	2021
GDP	108.4	112.7	127.3
-Primary industry (%)	6.0	6.2	5.6
-Secondary industry (%)	51.3	50.1	50.3
-Tertiary industry (%)	42.7	43.7	44.1
GDP growth rate (%)	6.8	3.9	9.9
Fixed asset investment	100.8	95.6	102.4
Fixed asset investment growth rate (%)	10.9	-5.2	7.1
Population (million)	1.1	1.0	1.0

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Taixing

The aggregate fiscal revenue of the Taixing government was mainly derived from the budgetary revenue and government fund income. The budgetary revenue of the Taixing government maintained growth in the past three years, reaching c. RMB9.3 billion with a year-on-year increase of 9.0% in 2021, of which tax revenue accounted for 80.7% of its budgetary revenue. The fiscal self-sufficiency rate of the Taixing government was relatively high at about 75%-80% for the past three years, but it still insufficient that led it continued to receive a certain number of subsidies from higher government authorities. In addition, the government fund income was another important part of its aggregate fiscal revenue. However, it was vulnerable to market and policy changes. In 2021, the government fund income of the Taixing government kept growing, reaching c. RMB13.9 billion, up 10.7% year-on-year.

The outstanding debt of the Taixing government continuously increased in the past three years, and the debt ratio (total outstanding debt/ aggregate fiscal revenue) was relatively high. At end-2021, the local government's outstanding debt was c. RMB27.5 billion, including RMB10.4 billion of general obligations and RMB17.1 billion of special debt.

Taixing's Fiscal Condition (RMB billion)	2019	2020	2021
Budgetary revenue	8.1	8.5	9.3
Budgetary revenue growth rate (%)	8.2	6.0	9.0
Tax revenue	6.6	6.7	7.5
Tax revenue (% of budgetary revenue)	82.2	78.7	80.7
Government fund income	9.3	12.6	13.9
Transfer payment	3.3	4.1	2.9
Aggregate revenue	20.6	25.2	26.2
Budgetary expenditure	10.6	10.8	11.8
Budget deficit ¹ (%)	-32.1	-26.8	-27.1

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

TZEPT was established with an initial registered capital of RMB1.18 million in 2004. The initial shareholders of the company were Taixing City Yaowang Town Rural Collective Asset Management Committee ("Yaowang AMC") and Tang Suqing, which held 84.7% and 15.3% stake of the company, respectively. In 2009, the Yaowang AMC became the only shareholder of the company after the change of shareholders. Through the capital injection by Yaowang AMC, the registered capital of the company increased to RMB448.18 million in 2013. During 2014 to 2019, the shareholders of the company changed several times, with Taixing Zhongxin Investment Group Co., Ltd. ("Zhongxin Group") ultimately holding 100% of TZEPT's equity. At end-September 2022, the registered capital of the company was RMB2 billion. Zhongxin Group is the only shareholder of the company, while the ultimate controller of the company is the Taixing government.

Zhongxin Group is the largest LIDC in terms of asset size in the region that 100% owned by the Taixing SASAO. Zhongxin Group is a holding company which mainly engages in the development and construction of the development park through its subsidiaries.

Strategic Importance and Government Linkage

Strategic Importance of TZEPT to Taixing HTZ

TZEPT is an important LIDC that is mainly responsible for infrastructure construction and land development project in the Taixing HTZ, with a regional franchise advantage. The company aims to maintain its prominent position as the primary entity for infrastructure construction in the region, while further diversify its business portfolio, such as trading business, at the same time. The company's development plan has been aligned with the local government's urban development and construction plan. TZEPT plays an important role in the urban development of the Taixing HTZ. Under the guidance of the government's plan, the company also undertakes the integration of asset in the region, revitalizes high-quality assets and resources to further develop and construct the zone. The major customers of the company are Taixing HZTMC and other governmental entities and companies in the zone.

Strong Linkage with the Local Government

TZEPT has a strong linkage with the local government, as the Taixing government via the Taixing SASAO indirectly holds 100% ownership of the company through Zhongxin Group. The Taixing government has strong supervision over the company, including appointment

and supervision of the senior management, development strategy, major investment and financing plan decisions and other government support, etc. In addition, the Taixing government has formulated a performance appraisal policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

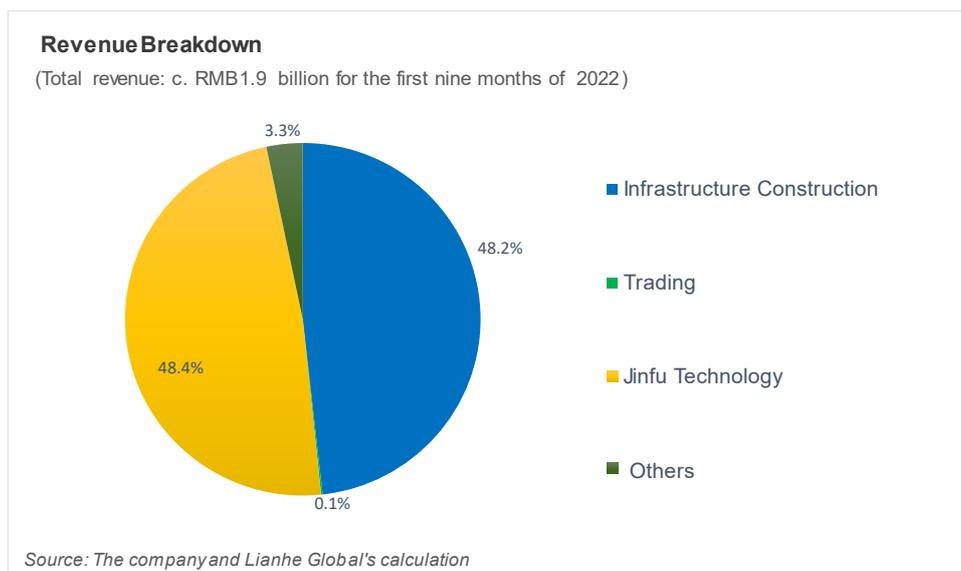
Ongoing Government Support

As the primary LIDC for infrastructure construction in the Taixing HTZ, TZEPT has been supported by the local government since its establishment. The government support it has received was mainly been in the form of capital injection and operational subsidies. In 2020, the company received a capital injection of RMB1.0 billion from the shareholder, which increased its paid-in capital to RMB2.0 billion. The subsidies amount received from the government was c. RMB256 million, RMB357 million and RMB376 million and RMB265 million in 2019, 2020, 2021 and the first nine months of 2022, respectively. Considering the function and strategic importance of the company, we believe that the company is likely going to receive timely government support in the form of operational and/or financial subsidies in the future.

Business Profile

The Important LIDC Responsible for Infrastructure Construction in Taixing HTZ

As one of the important LIDCs in Taixing, TZEPT is mainly responsible for infrastructure construction in Taixing HTZ with strong regional franchise advantages. While maintaining its position as an important regional infrastructure construction entity, the company has further diversified its business structure. TZEPT has gradually formed its main business in construction engineering (e.g., greening engineering, road engineering and earthmoving engineering etc.), manufacturing and trading, all of which are closely related to regional infrastructure construction and urban development planning. TZEPT recognized operating revenues of approximately RMB6.14 billion, RMB7.54 billion, RMB2.49 billion and RMB1.92 billion in 2019, 2020, 2021 and the first nine months of 2022, respectively. In terms of operating revenue structure, TZEPT's major sources of revenue are engineering and construction related business, trading business and Jinfu Technology related business. The operating income of TZEPT has decreased significantly since 2021 as a result of the change in revenue recognition methodology in its trading business, which modified from the gross method to the net method, resulting in a significant decrease of revenue from this segment. Besides, as the revenue from the trading segment accounted for a relatively large proportion (over 60%) of the total operating revenue in 2019-2020, it has a significant impact on the scale of the company's operating revenue. Having said that, the company's gross margin was thus improved, rising from 9.5% in 2020 to 25% in 2021.



Infrastructure Construction

TZEPT's infrastructure construction projects are concentrated in Taixing HTZ, mainly including 1) road works, 2) greening works and 3) land development. The infrastructure construction projects are mainly carried out through the headquarter and the corresponding subsidiaries in the mode of commissioned construction, where TZEPT and the entrusted party, predominantly the Taixing HZTMC, signed the construction agreement. The project owner would settle the project in accordance with the agreed additional margin, which varies from project to project (e.g., 25%-55%), upon the completion and delivery of the project. TZEPT obtained project funds through self-financing and external financing. The entrusted party would pay for the project in installments according to related progress, where the construction period varied from project to project. At end-September 2022, the company's projects under construction included several plants, park supporting construction projects, landscape projects and land development projects, indicating a certain capital expenditure needs in the future.

In addition, TZEPT was also engaged in the construction of resettlement housing projects in Taixing HTZ. Entrusted by Taixing HTZMC, the company constructed resettlement houses according to the actual demolition and relocation situation. The business model was the same as the construction of other projects. The agreement was signed with the Taixing HTZMC, who would settle the project after the completion and delivery according to the agreed additional margin. Having said that, the project payback schedule mainly depended on the funding arrangement of the entrusted party, indicating a certain degree of uncertainty. All of TZEPT's resettlement housing projects under construction are expected to be completed in 2023, and there are no proposed resettlement housing projects in the future.

Trading

TZEPT's trading business was mainly operated by its subsidiaries and recognized revenue/profit through the difference in price between buying and selling commodities. TZEPT started its trading business in 2016 with an order-oriented business model, where it purchased and sold related commodities based on customer orders. The segment's major suppliers and customers are generally stable and highly concentrated. The main products of the segment were bulk commodities, which were subject to fluctuations in commodity

prices. The market risk of trading products, as well as inventory risk were both borne by TZEPT.

As a result of the national policy, TEZPT changed the revenue recognition method of its trading business from the gross method to the net method starting from 2021, resulting in a significant decrease in the revenue of this segment from c. RMB4.7 billion in 2020 to RMB1.2 million in 2021. As a result of this change, the gross profit margin of this segment was also subsequently increased significantly, soaring from 0.5% in 2019 to 100% in 2021.

Jinfu Technology

In 2019, TEZPT became the largest shareholder of the listed company Suzhou Jinfu Technology Co., Ltd. ("JFT", stock code: 300128.SZ) by means of share acquisition through its subsidiary Taixing Zhicheng Industrial Investment Fund (Limited Partnership), holding 19.19% of JFT's shares and forming control over it. Founded in 2004 and listed on the Shenzhen Stock Exchange in 2010, JFT mainly produces LCD parts, electronic functional components, heat insulation and shock absorption products, IDC and its value-added services, all of which are widely used in consumer electronics, automotive, medical, new energy and other industrial fields. The total assets of JFT were c. RMB2.86 billion and the asset-liability ratio was 55.3% at end-September 2022. TZEPT expected to promote the industrial development of Taixing HTZ by bringing JFT into the High-tech Zone and making it play the role of investment promotion.

The scale of operating revenue of JFT has been declining in recent years due to factors such as the epidemic and foreign trade. It recognized a revenue of RMB972 million in 2021, decreasing from RMB1.6 billion in 2019. At the same time, JFT's inventory suffered a decline in value due to factors such as the non-conformance business orders and the addition of new equipment. In addition, JFT was exposed to risks such as non-operating capital appropriation and disputes over foreign mergers and acquisitions.

Other Businesses

Other businesses of TZEPT included manufacturing business, rental business and sales of materials. The manufacturing business was mainly operated by its subsidiaries, where the products were mainly air source heat pump products. The revenue of manufacturing business accounted for less than 1% of the total operating revenue of TZEPT in recent periods. The rental business mainly included renting out the company's own property to Taixing Zhiguang Talent Technology Plaza Management Co., Ltd. The rent was RMB550 per square meter per year. The sales of materials mainly included the sale of air-conditioning parts. The revenue from other businesses was relatively small and would not have a significant impact on the company's overall operations and solvency.

Financial Profile

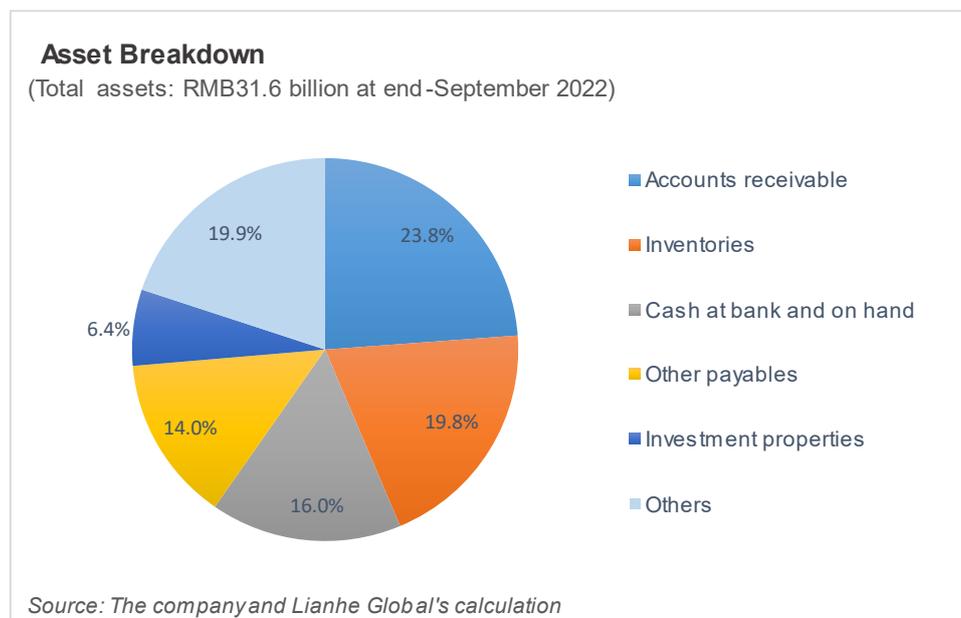
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Sept 2022
Total Asset	25,794	28,154	28,329	31,609
Equity	9,288	10,633	10,672	11,461
Debt	11,918	13,545	12,765	13,049
Debt / (Debt + Equity) (%)	56.2	56.0	54.5	53.2

LT Debt	6,395	5,908	8,269	9,115
LT Debt / (LT Debt + Equity) (%)	40.8	35.7	43.7	44.3

Source: The company's financial reports and Lianhe Global's calculations

TZEPT's total assets increased from c. RMB25.8 billion at end-2019 to c. RMB31.6 billion at end-September 2022, the asset structure was relatively stable. At end-September 2022, the company's assets mainly consisted of accounts receivable, inventories, cash and investment properties. The accounts receivable mainly consisted of the project settlement from the main entrusted party of its infrastructure construction business, the Taixing HTZMC, with low bad debt accrual and recovery risk. The other receivables were mainly from related transactions with other state-owned enterprises, such as Taixing Dunzhi Trading Co., Ltd., and government agencies in Taixing, where the ageing was mainly within 1 year. The inventories were mainly composed of inventory goods and development costs of infrastructure construction related projects. With the increase in the number of projects under construction, TZEPT's inventories also maintained a growing trend. The investment properties were mainly self-built properties used for its rental business and land acquired through land sales, where the overall book value showed a downward trend. Although TZEPT has a relatively large proportion of current assets, its assets quality was less liquid given the relatively large proportion of receivables and the long projects payback period.



TZEPT's financial leverage (total liabilities/total assets) was moderately high and it maintained at c. 62%-64% in the past three years, of which reached to 63.7% at end-September 2022. At end-September 2022, the company's liabilities mainly consisted of long-term and short-term borrowings, notes and bonds payables and other non-current liabilities. In addition, the company's long-term payables also included non-traditional financings such as financial lease payable. The company's total adjusted debt was c. RMB13.05 billion at end-September 2022, of which short-term and long-term debt accounted for 30.1% and 69.9% of its total debt, respectively. Apart from the capital injection of RMB1 billion in 2020, the equity structure of the company was relatively stable. There were no significant changes in its equity structure from the previous year-end as of end-September 2022. TZEPT mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure projects under construction and to be constructed in the future.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	9M2022
Cash Inflows from Operation	8,509	8,761	8,760	5,006
Cash Outflows from Operation	10,505	9,755	10,890	3,330
Net CF from Operation	-1,996	-994	-2,129	1,677
Cash Inflows from Investment	598	283	112	126
Cash Outflows from Investment	1,374	146	245	575
Net CF from Investment	-776	137	-133	-449
Cash Inflows from Financing	13,544	12,659	13,879	8,077
Cash Outflows from Financing	10,727	11,348	12,034	9,501
Net CF from Financing	2,817	1,311	1,845	-1,425
Net Increase in Cash and cash equivalent	46	446	-419	-195

Source: The company's financial reports

Debt Servicing Capability

The liquidity of TZEPT was moderate. At end-September 2022, TZEPT had a cash balance of c. RMB5.06 billion (among which the restricted cash was RMB4.75 billion) and unused credit facilities of c. RMB6.1 billion, compared with its debt due within one year of c. RMB3.93 billion. TZEPT has access to various financing channels, including bank loans, onshore and offshore bond issuance and non-traditional financing (such as trust loan, financial lease and asset management), to support its debt repayment and business operations. At end-September 2022, the non-traditional financing accounted for a relatively high proportion (over 40%) in TZEPT's financing structure.

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