

# Sanya Yazhou Bay Science and Technology City Holding Group Co., Ltd.

## Initial Issuer Report

### Summary

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

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB’ global scale Long-term Issuer Credit Rating with Stable Outlook to Sanya Yazhou Bay Technology City Holding Group Co., Ltd. (“STCH” or “the company”)

### Summary

The Issuer Credit Rating reflects a high possibility that the Sanya Municipal People’s Government (“the Sanya government”) would provide strong support to STCH if needed. This mainly considers the Sanya Yazhou Bay Science and Technology City Authority’s (“YZBSTC Authority”, a specially established institution of the Sanya government) full ownership of STCH, STCH’s strategic importance as the most important local investment and development company (“LIDC”) responsible for infrastructure construction and state-owned assets operation in Yazhou Bay Science and Technology City (“YZBSTC”) of Sanya, and the linkage between the local government and STCH, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing operational and financial support. In addition, the Sanya government may face significant negative impact on its reputation and financing activities if STCH encounters any operational and financial difficulties.

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

### Rating Rationale

**Government’s Ownership and Supervision:** STCH is fully owned by YZBSTC Authority, a specially established institution of the Sanya government with municipal administrative and approval rights. The local government has strong control over the company, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government has formulated a performance assessment policy for the company, and regularly appoints auditors to review the company’s operating performance and financial position.

**Strategic Importance and Strategic Alignment:** STCH is the most important construction and operation entity supporting the development of YZBSTC, a provincial technology development zone focusing on Nanfan and the deep sea industries in Sanya. STCH’s business operations and strategic planning have been aligned with the local government’s economic and social development policies.

**Ongoing Government Support:** STCH received ongoing support in the forms of capital injections, asset injections and operational subsidies from the local government. The local government injected sizeable assets into STCH, including cash, properties, lands, equity and of state-owned enterprises between 2020 and 2022. In addition, STCH received increasing operational subsidies to support the company in carrying out more public functions. We expect STCH to receive ongoing support from the local government in the coming years considering its strategic importance in Sanya.

### Key Figures of Sanya and STCH (RMB billion)

Sanya	2021	2022
GDP	83.5	84.7
GDP growth rate (%)	12.1	-4.5
Budgetary revenue	11.7	9.8
Government fund	9.7	7.1
Transfer payment	10.6	6.9
Budgetary expenditure	20.2	22.9
SYTH	2021	2022
Asset	21.2	30.0
Equity	15.4	21.9
Revenue	0.91	1.21

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

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### Applicable Criteria

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

**Economy and Fiscal Condition of Sanya:** Sanya is a prefecture-level city of Hainan Province, located at the southern end of Hainan Island, with convenient transportation and abundant tourism resources. As an international tourist destination featured with tropical seaside scenery, the tourism industry plays an important role in Sanya's economy. The total tourism revenue was equivalent to c. 50% of its GDP in 2022. This also promotes Sanya's tertiary industry development, accounting for over 70% of the GDP in the past three years. However, Sanya's economy was severely hit by Covid related travel restrictions in 2022. It recorded a GDP of RMB84.7 billion in 2022, representing a year-over-year drop of 4.5%.

Due to the significant impact of Covid, the Sanya government's budgetary revenue dropped by 14.1% to RMB9.8 billion in 2022 from RMB11.7 billion in 2021, with the tax revenue's contribution decreased to 61.0% from 71.3% over the same period as the result of large-scale value-added tax credit refunds in 2022 to support local enterprises. At the same time, the Sanya government's budgetary expenditure continued to grow, mainly to support initiatives of improving people's well-being. Therefore, its fiscal self-sufficiency capacity decreased, with a budget deficit of 133.6% in 2022, up from 72.8% in 2021. In addition, Sanya's government fund income, mainly generated by land sales, dropped to RMB7.1 billion from RMB9.7 billion over the same period, owing to the weak property market.

At end-2022, the Sanya government's outstanding debt was RMB51.4 billion, including RMB14.8 billion of general obligations and RMB36.5 billion of special debts. Given that the Sanya government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 215.7% at end-2022 from 105.5% at end-2020.

**STCH's Financial and Liquidity Position:** STCH's asset size grew significantly to RMB32.5 billion at end-March 2023 from RMB13.5 billion at end-2020. This was mainly due to the surge in equity resulting from the local government's capital and asset injection (most of them were cash). The company's total debt also increased by 182.4% to RMB8.2 billion at end-March 2023 from RMB2.9 billion at end-2020. As a result, the company's financial leverage, as measured by total debt/capitalization, increased slightly to 27.1% from 22.9% over the same period.

The liquidity risk of STCH was manageable. At end-March 2023, the company had cash of RMB2.0 billion (including restricted cash of RMB60 million). At the same time, the company had debt due within one year of RMB1.8 billion. STCH has access to various financing channels, including bank borrowings, bond issuances and other non-traditional financings, to support its debt repayments and business operations. Moreover, the company had unused credit lines of RMB5.8 billion at end-March 2023.

## Rating Sensitivities

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

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

## Operating Environment

### Economic Condition of Sanya and YZBSTC

Sanya is a prefecture-level city of Hainan Province, located at the southern end of Hainan Island, with convenient transportation and abundant tourism resources. Sanya has jurisdiction over four districts, with a land area of 1,921 square kilometers and a sea area of 3,226 square kilometers. At end-2022, Sanya had a resident population of 1.07 million, with an urbanization rate of 71.8%.

As an international tourist destination featured with tropical seaside scenery, the tourism industry plays an important role in Sanya's economy. The total revenue from tourism was equivalent to c. 50% of its GDP in 2022. This also promotes Sanya's tertiary industry development, accounting for over 70% of the GDP in the past three years. However, Sanya's economy was severely hit by Covid related travel restrictions in 2022. It recorded a GDP of RMB84.7 billion in 2022, representing a year-over-year drop of 4.5%.

YZBSTC is a provincial technology development zone located in the western part of Sanya, with a total area of 26 square kilometers. It is managed by YZBSTC Authority, a specially established Sanya government institution with municipal administrative and approval rights, which is mainly responsible for the development, operation and investment promotion of YZBSTC. However, YZBSTC has no independent financial treasury. YZBSTC consists of Nanfan Science and Technology City (an agricultural science and technology experimental base aiming to research and breed crops), Deep Sea Science and Technology City, University City, Nanshan Port and Global Animal and Plant Germplasm Resources Introduction and Transfer Base. In recent years, YZBSTC has focused on developing the Nanfan and deep sea industries, such as manufacturing, communication, and developing deep sea materials.

#### Sanya's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	69.5	83.5	84.7
-Primary industry (%)	11.4	11.2	13.0
-Secondary industry (%)	16.3	14.9	13.6
-Tertiary industry (%)	72.3	73.9	73.4
GDP growth rate (%)	3.1	12.1	-4.5
Fixed asset investment growth rate (%)	5.3	10.8	-19.7
Population (million)	1.04	1.06	1.07

Source: Public information and Lianhe Global's calculations

### Fiscal Condition of Sanya

Due to the significant impact of Covid, the Sanya government's budgetary revenue dropped by 14.1% to RMB9.8 billion in 2022 from RMB11.7 billion in 2021, with the tax revenue's contribution decreased to 61.0% from 71.3% over the same period as the result of large-scale value-added tax credit refunds in 2022 to support local enterprises. At the same time, the Sanya government's budgetary expenditure continued to grow, mainly to support initiatives of improving people's well-being. Therefore, its fiscal self-sufficiency capacity decreased, with a budget deficit of 133.6% in 2022, up from 72.8% in 2021. In addition, Sanya's government fund income, mainly generated by land sales, dropped to RMB7.1 billion from RMB9.7 billion over the same period, owing to the weak property market.

The outstanding debt of the Sanya government continued to grow. At end-2022, the Sanya government's outstanding debt was RMB51.4 billion, including RMB14.8 billion of general obligations and RMB36.5 billion of special debts, up from RMB35.1 billion at end-2020. Given that the Sanya government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, increased to 215.7% at end-2022 from 105.5% at end-2020.

#### Sanya's Fiscal Conditions

(RMB billion)	2020	2021	2022
Budgetary revenue	11.0	11.7	9.8
Budgetary revenue growth rate (%)	1.2	6.1	-14.1
Tax revenue	6.2	8.4	6.0
Tax revenue (% of budgetary revenue)	56.2	71.3	61.0
Government fund income	11.0	9.7	7.1
Transfer payment	11.3	10.6	6.9
<b>Aggregate revenue</b>	<b>33.4</b>	<b>32.1</b>	<b>23.8</b>
Budgetary expenditure	20.0	20.2	22.9
Budget deficit <sup>1</sup> (%)	-80.9	-72.8	-133.6

<sup>1</sup> Budget deficit = (1 - budgetary expenditure / budgetary revenue) \* 100%

<sup>2</sup> Transfer payment in 2022 is an estimated figure given the lack of information

Source: Public information and Lianhe Global's calculations

## Ownership Structure

### Full Government Ownership

STCH was established in February 2019 with an initial registered capital of RMB3.0 million, funded by Sanya's state-owned assets supervision and administration commission. In December 2020, the company's shareholder changed to YZBSTC Authority, which the Sanya government authorizes to perform the shareholder's duties for the company.

At end-2022, YZBSTC Authority, as the sole controlling shareholder, held 100% of the company's equity, with the registered and paid-in capital being RMB10.0 billion and RMB5.0 billion, respectively.

## Strategic Importance and Government Linkage

### Strategic Importance of STCH to Sanya

STCH is the most important construction and operation entity supporting the development of YZBSTC, a provincial technology development zone focusing on Nanfan research and the deep sea industry in Sanya. STCH's business operations and strategic planning have been aligned with the local government's economic and social development policies.

### Strong Linkage with the Local Government

YZBSTC Authority holds 100% shares of STCH directly. The local government has strong control over the company, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government has formulated a performance assessment policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

## Ongoing Government Support

STCH received ongoing support in the forms of capital injections, asset injections and operational subsidies from the local government. The local government injected assets into STCH, including cash, properties, lands, equity and of state-owned enterprises, amounting to RMB18.7 billion between 2020 and 2022. Its paid-in capital and capital reserves were enlarged to RMB5 billion and RMB16.2 billion, respectively, from RMB3 million and RMB9.5 billion over the same period.

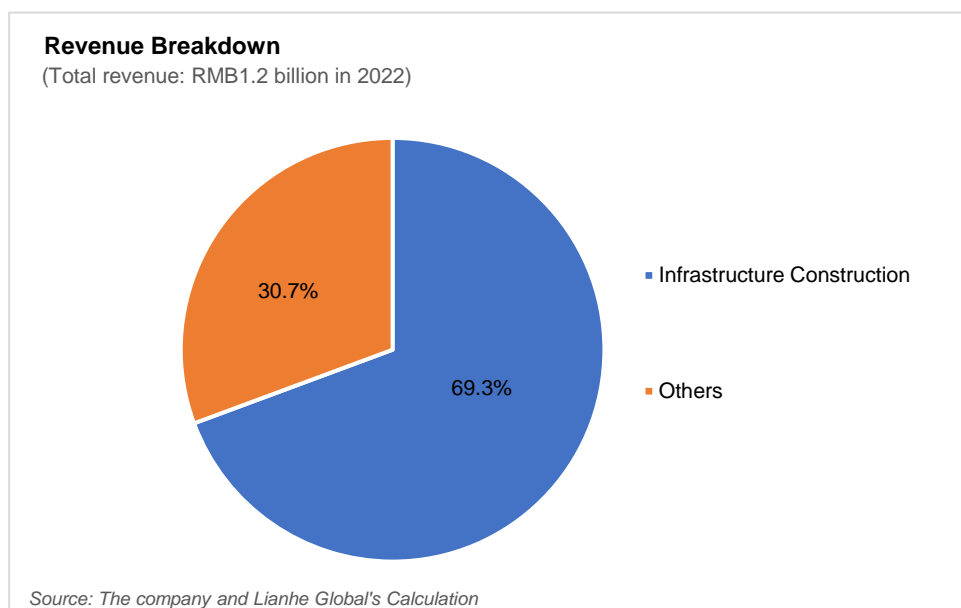
In addition, as STCH carried more and more public functions, the company received increasing operational subsidies of RMB97 million, 165 million and 219 million in 2020, 2021 and 2022, respectively. We expect STCH to receive ongoing support from the local government in the coming years considering its strategic importance in Sanya.

## Business Profile

### An Important Infrastructure Development and State-owned Assets Operation Entity focusing on YZBSTC of Sanya

STCH, as an important LIDC in Sanya, is mainly responsible for infrastructure construction and state-owned assets management in YZBSTC. The company's strong regional franchise advantage enables it to undertake important infrastructure construction projects under the instruction of the YZBSTC Authority, and it plays an important role in promoting economic and social development within the region.

The company's primary sources of revenue are infrastructure construction, operation and management of the fishing harbor and cargo port. At the same time, it also engaged in merchandise sales, leasing, consulting and training businesses. The company realized revenue of RMB568 million, 910 million and 1,210 million in 2020, 2021 and 2022, respectively, representing an upward trend. Its gross margin also increased to 12.6% in 2022, up from 9.7% in 2020. In general, the company's business is relatively concentrated and has regional advantages in its major businesses.



## Infrastructure Construction

The YZBSTC designates STCH to undertake an array of key infrastructure projects, including roads, pipelines, and environment improvement projects, as well as public facilities such as sport center, library, schools and hospital. The projects in this segment are generally conducted under the agent construction model, where the revenue recognition includes construction costs incurred plus 20% of profit upon completion. The revenue in this segment was RMB511 million, 780 million and 839 million in 2020, 2021 and 2022, respectively, indicating an upward trend. The gross profit margin of this segment remained at a 9% level in recent years. The payment period usually is two to three years.

At end-2022, STCH had twelve major projects under construction with a total planned investment of RMB15.6 billion, of which RMB8.2 billion was needed to be invested in the next one to two years. At the same time, STCH had seven major projects scheduled to be invested with a total planned investment of RMB5.0 billion. We expect the company's strong project pipeline to support the segment's development in the next two to three years. However, it could also incur high capital expenditure pressure on STCH.

## Other Businesses

STCH is also involved in operating and managing the fishing harbor and cargo port, leasing, merchandise sales and consulting, with each segment accounting for a relatively small proportion of the company's total revenue. These businesses mainly play the role of supplementing the revenue of the main business and making the revenue structure more diversified.

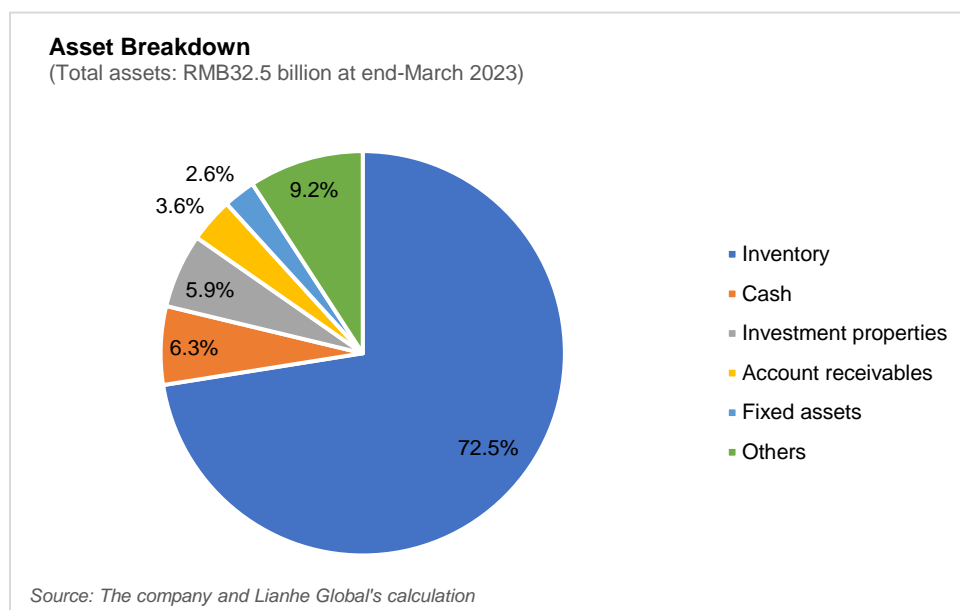
## Financial Profile

### Balance Sheet Structure and Quality

<b>Balance Sheet Structure and Quality</b>				
<b>(RMB million)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>March 2023</b>
Total Asset	13,494	21,121	29,969	32,465
Equity	9,726	15,379	21,856	21,966
Debt	2,894	4,534	6,416	8,172
Debt / (Debt + Equity) (%)	22.9	22.8	22.7	27.1
LT Debts	2,483	3,670	4,748	6,378
LT Debt / (LT Debt + Equity) (%)	20.3	19.3	17.8	22.5

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

STCH's asset size grew significantly to RMB32.5 billion at end-March 2023 from RMB13.5 billion at end-2020. This was mainly due to the surge in equity resulting from the local government's capital injection and asset injection (most of them were cash). The company's total debt also increased by 182.4% to RMB8.2 billion at end-March 2023 from RMB2.9 billion at end-2020. As a result, the company's financial leverage, as measured by total debt/capitalization, increased slightly to 27.1% from 22.9% over the same period.



STCH's asset liquidity was moderately weak. The company's active participation in YZBSTC's project construction had accumulated sizeable inventories of RMB23.5 billion (mainly construction costs), representing 72.5% of the company's total asset at end-March 2023. The company's inventories usually need a long time to monetize due to extended construction and cash collection period (usually two to three years).

At end-March 2023, STCH had investment properties of RMB1.9 billion, accounting for 5.9% of the company's total asset. However, a significant part of these properties have not obtained the certificate of title yet. Besides, STCH had a relatively small account receivables of RMB1.2 billion, accounting for 3.6% of the total asset. Most of the receivables have a short account period. The company also had fixed assets amounting to RMB833 million, mainly public houses for leasing.

### Debt Servicing Capability

The liquidity risk of STCH was manageable. At end-March 2023, the company had cash of RMB2.0 billion (including restricted cash of RMB60 million). At the same time, the company had debt due within one year of RMB1.8 billion. STCH has access to various financing channels, including bank borrowings, bond issuances and other non-traditional financings, to support its debt repayments and business operations. Moreover, the company had unused credit lines of RMB5.8 billion at end-March 2023.

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