

Shiyan Economic and Technological Development Zone Construction Investment Development Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	21 September 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Shiyan Economic and Technological Development Zone Construction Investment Development Group Co., Ltd. (“SETD” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Shiyan City (“Shiyan government”) would provide strong support to SETD if needed, in light of its full ownership of SETD, SETD’s strategic importance as the key local investment and development company (“LIDC”) that is responsible for infrastructure construction and state-owned asset management in Shiyan City, especially in the Shiyan Economic and Technological Development Zone (“Shiyan EDZ”) and the linkage between the Shiyan government and SETD, 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 Shiyan government may face significant negative impact on its reputation and financing activities if SETD encounters any operational and financial difficulties.

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

Rating Rationale

Shiyan Government’s Ownership and Supervision: The Shiyan government holds the full ownership of SETD through the Shiyan Economic and Technological Development Zone State-owned Assets Management Bureau (“EDZ SAMB”). The Shiyan government is the actual controller of the company. It 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 Shiyan government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Shiyan and Strategic Alignment: SETD, as the key LIDC in Shiyan, is primarily responsible for infrastructure construction and state-owned asset management in Shiyan EDZ. Serving as the sole entity in charge of infrastructure projects in Shiyan EDZ, SETD focuses on land development, road and bridge construction and other main municipal engineering projects in the region. In addition, the company is also responsible for the industrial park projects, pipe network leasing and other state-owned asset management and operation business within Shiyan EDZ, with strong regional advantages. SETD plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: SETD received operational and financial support from the government, mainly including operating subsidies. The Shiyan government and EDZ SAMB will inject capitals, land and other state-owned assets into SETD to expand its asset size. Besides, the EDZ SAMB will repurchase some infrastructure projects and provide policy

Key Figures of Shiyan and SETD

(RMB billion)	2021	2022
Shiyan		
GDP	216.4	230.5
GDP growth rate (%)	11.5	3.6
Budgetary revenue	11.6	11.6
Government fund	14.4	10.7
Transfer payment	27.1	28.9
Budgetary expenditure	37.6	40.8
SETD	2022	2022.6
Assets	30.6	31.3
Equity	25.0	25.4
Revenue	1.1	0.5

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

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Applicable Criteria

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

supports to SETD to ensure its business operation. Given it is the sole entity for infrastructure construction in Shiyan EDZ, SETD has an advantage in acquiring land resources and major projects. We believe SETD is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

SETD's Financial Matrix and Liquidity Position: SETD's total assets showed a continuous growth trend in the past years and reached RMB31.3 billion at end-June 2023, mainly due to the increase of intangible assets. The current assets of SETD accounted for 66.5% of the total assets at end-June 2023, but the overall asset liquidity was moderately weak due to large proportion of inventories and intangible assets.

SETD's financial leverage (total liabilities to total assets) was 18.9% and its adjusted debt decreased to c. RMB3.6 billion at end-June 2023. A relatively high level of SETD's debts were related to non-traditional financings. The liquidity of SETD was sufficient. SETD had an unrestricted cash balance and unused credit facilities of RMB35.9 million and RMB2.3 billion at end-June 2023, respectively, compared with its debt due within one year of c. RMB30 million. Besides, SETD has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

Economy and Fiscal Condition of Shiyan: Shiyan is a prefecture-level city in Hubei Province ("Hubei"), with a total land area of c. 23,000 square kilometers. Owing to Covid's disruption, Shiyan's GDP growth rate fluctuated in the past three year, which was -5.1%, 11.5% and 3.6% in 2020, 2021 and 2022, respectively. Its GDP reached RMB230.5 billion in 2022, which was ranked 7th among 16 prefecture-cities under the jurisdiction of Hubei.

The aggregate fiscal revenue of the Shiyan government was mainly derived from the budgetary revenue, government fund income and transfer payment. From 2020 to 2022, the Shiyan government's budgetary revenue increased to RMB11.6 billion from RMB8.9 billion, with the tax revenue accounted for 68%-75% of its budgetary revenue. The government fund income decreased to c. RMB10.7 billion in 2022 from c. RMB14.4 billion in 2021, owing to the weak property market. The fiscal self-sufficiency rate of the Shiyan government was relatively low, and it recorded a budget deficit of 252.9% in 2022. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, was lifted to 117.6% at end-2022 from 84.7% at end-2020, mainly due to the increase in special debt.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Shiyan

Shiyan is a prefecture-level city in Hubei, and is located in the northwestern part of Hubei. Shiyan is a regional center city connecting Hubei, Henan, Shaanxi, and Chongqing, a core

city in the ecological and cultural tourism circle of western Hubei, and the capital of commercial vehicles in China. With a land area of 23,000 square kilometers, Shiyan has jurisdiction over one county-level city, four counties and three districts. In addition, it also owns the Wudang Tourism Special Economic Zone and the Shiyan Economic and Technological Development Zone. At end-2022, Shiyan had a resident population of c. 3.2 million, with an urbanization rate of 62.6%.

Owing to Covid's disruption, Shiyan's GDP growth rate fluctuated in the past three year, which was -5.1%, 11.5% and 3.6% in 2020, 2021 and 2022, respectively. Shiyan's GDP reached c. RMB230.5 billion in 2022, which was ranked 7th among 16 prefecture-cities under the jurisdiction of Hubei. Shiyan's economic growth was mainly fueled by the secondary and tertiary industries in the past few years, which accounted for 40.1% and 50.2% in 2022, respectively. Shiyan is building a modern industrial system featured with one leading industry (automobile), three major industries (tourism, health and ecological industries), and five emerging industries (digital economy, new materials, intelligent equipment, clean energy and modern service). GDP per capita of Shiyan was c. RMB72,882 in 2022, which was lower than the GDP per capita of China (c. RMB85,700) as well as that of Hubei (c. RMB92,059).

Shiyan Economic and Technological Development Zone ("Shiyan EDZ") was founded in August 1991 and upgraded to a national-level economic development zone in 2012. With a planned area of 20.1 square kilometers, Shiyan EDZ consists of Shiyan Economic Industrial Park, Dongcheng Industrial Park and Xicheng Industrial Park. Shiyan EDZ is an important automobile and auto parts production base in China, as well as one of China's top 10 development zones powered by technological innovations.

Shiyan's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	189.1	216.4	230.5
-Primary industry (%)	10.0	9.6	9.8
-Secondary industry (%)	39.4	38.8	40.1
-Tertiary industry (%)	50.6	51.6	50.2
GDP growth rate (%)	-5.1	11.5	3.6
Fixed asset investment	136.1	173.3	206.8
Fixed asset investment growth rate (%)	-21.1	27.3	19.3
Population (million)	3.2	3.2	3.2

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Shiyan

From 2020 to 2022, the Shiyan government's budgetary revenue increased to c. RMB11.6 billion from c. RMB8.9 billion, with the tax revenue accounted for 68%-75% of its budgetary revenue. The fiscal self-sufficiency rate of the Shiyan government was relatively low, and it recorded a budget deficit of 252.9% in 2022. Therefore, the Shiyan government highly relies on the transfer payments from upper governments, which reached c. RMB28.9 billion in 2022, accounting for 56.4% of aggregate revenue. In addition, Shiyan's government fund income, mainly generated by land sales, decreased to c. RMB10.7 billion in 2022 from c. RMB14.4 billion in 2021, owing to the weak property market.

The outstanding debt of the Shiyan government continued to grow. At end-2022, the Shiyan government's outstanding debt was c. RMB60.3 billion, including RMB32.4 billion of general obligations and RMB27.9 billion of special debt. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, was lifted to 117.6% at end-2022 from 84.7% at end-2020, mainly due to the increase in special debt.

Shiyan's Fiscal Condition (RMB billion)	2020	2021	2022
Budgetary revenue	8.9	11.6	11.6
Budgetary revenue growth rate (%)	-25.5	29.4	10.5*
Tax revenue	6.7	8.6	7.9
Tax revenue (% of budgetary revenue)	75.1	74.6	68.6
Government fund income	13.5	14.4	10.7
Transfer payment	33.1	27.1	28.9
Aggregate revenue	55.6	53.2	51.3
Budgetary expenditure	45.9	37.6	40.8
Budget deficit ¹ (%)	-413.9	-225.1	-252.9

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

*Excluding the influence of value-added tax credit refund

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

SETD, formerly known as Shiyan City Operation and Management Group Co., Ltd., was established in June 2019 with an initial registered capital of RMB0.5 million, funded by Shiyan Airport Construction Development Co., Ltd. ("SACD"). In June 2022, the shareholder of the Company was changed from SACD to EDZ SAMB, and its registered capital increased to RMB1.0 billion from RMB0.5 million. In July 2023, the company changed its name to its current one.

At end-June 2023, SETD had a shareholding structure in which the Shiyan EDZ SAMB, as the sole and actual controlling shareholder, held 100% of the company's equity, with the registered and paid-in capital were both RMB1.0 billion.

Strategic Importance and Government Linkage

Strategic Importance of SETD to Shiyan

SETD, as the key LIDC in Shiyan, is primarily responsible for infrastructure construction and state-owned asset management in Shiyan EDZ. Serving as the sole entity in charge of infrastructure projects in Shiyan EDZ, SETD focuses on land development, road and bridge construction and other main municipal engineering projects in the region. In addition, the company is also responsible for the industrial park projects, pipe network leasing and other state-owned asset management and operation business within Shiyan EDZ, with strong regional advantages. SETD plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government's development plans.

Strong Linkage with the Local Government

SETD's linkage with the local government is strong as the Shiyan government holds the full ownership of SETD through EDZ SAMB. The Shiyan 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 Shiyan government has assessment mechanism over the company and it appoints auditor to supervise the operating performance and financial position on a periodic basis.

Government Support

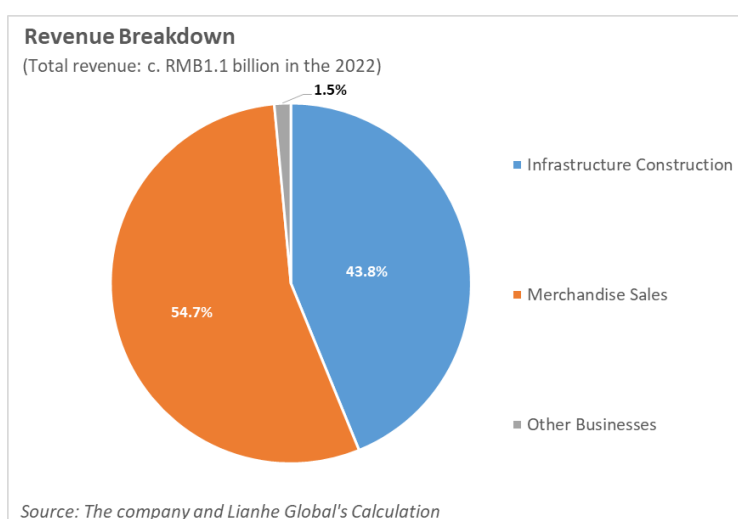
SETD continued to receive financial subsidies, mainly including operating subsidies (such as urban construction subsidies and tax breaks), from the local government to maintain its business operation. Per government, the Shiyang government and EDZ SAMB will inject some land assets other state-owned assets to SETD if needed. The government will repurchase some infrastructure projects constructed by SETD and provide policy supports to ensure its business operation. Given it is the sole entity for infrastructure construction and resettlement housing construction in Shiyang EDZ, SETD has an advantage in acquiring land resources and major projects. We believe SETD is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

Business Profile

The Key Entity Responsible for Infrastructure Construction in the Shiyang EDZ

SETD, as an important LIDC in the Shiyang EDZ, is mainly responsible for the land consolidation, road and bridge construction and municipal projects within the region. As the core platform designated by the Shiyang government to undertake important infrastructure construction projects, the company has received strong support from shareholders in terms of capital injection, asset transfer and government subsidies, which enhances the capital strength and profitability of the company.

The primary sources of operating revenue for SETD are infrastructure construction and merchandise sales, while it also engaged in pipeline leasing and other business. The company's total revenue reached c. RMB0.8 billion, RMB0.9 billion, RMB1.1 billion and RMB495.5 million in 2020, 2021, 2022 and the first six months of 2023, respectively, representing a steady growth trend. The overall gross profit margin of SETD was moderate, remaining at 13.7% to 15.5% from 2020 to 2022. In general, SETD's business was relatively concentrated, and it has regional advantages in its major businesses.



Infrastructure Construction

The company's monopoly on infrastructure construction in Shiyang EDZ gives it a strong franchise advantage in the region. The projects in this segment are generally conducted

under the agent construction model, where the revenue recognition includes construction costs incurred plus a certain percentage of profit. Its revenue in this segment increased over the past years, with c. RMB0.4 billion, RMB0.4 billion, RMB0.5 billion and RMB0.3 billion in 2020, 2021, 2022 and the first six months of 2023, respectively. Its revenue in this segment increased from 25.9% to 33.9% between 2020 and 2022. Currently, the company's projects under construction and to be constructed are adequate, but still require a large scale of investment, which it incurs high pressure on capital expenditure.

Merchandise Sales

The merchandise sales business of the company plays an important role in safeguarding the security of the local food supply system. SETD is mainly engaged in the sales of food and agricultural products, like wheat, corn, flour, oilseeds, meat, etc. The revenue generated from this segment reached c. RMB0.4 billion, RMB0.5 billion, RMB0.6 billion and RMB0.2 billion in 2020, 2021, 2022 and the first six months of 2023, respectively, representing an upward trend. The gross profit margin of the segment relatively low, with 2%-3% from 2020 to 2022, mainly due to the large scale of operating expenses leading to a loss in net profit, with profitability and cost-control ability need to be improved.

Other Businesses

Other businesses of SETD mainly include pipeline leasing, which accounted for a relatively small proportion of the company's total revenue. Other businesses mainly play the role of supplementing the revenue of the main business and make the revenue structure more diversified.

Financial Profile

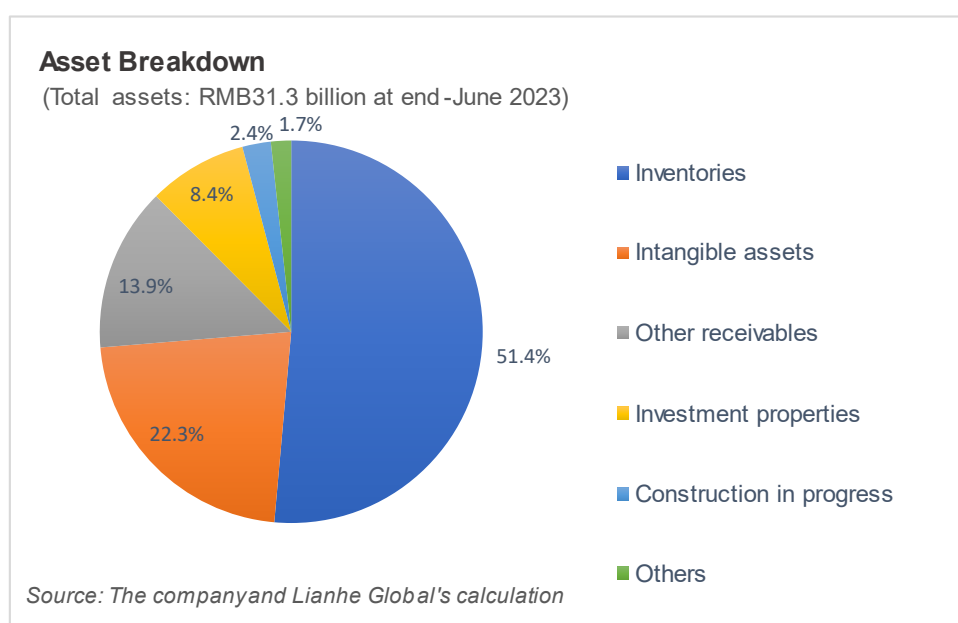
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	2023.6
Total Asset	18,271	25,778	30,573	31,303
Equity	13,745	19,877	25,068	25,393
Debt	2,941	3,977	3,291	3,558
Debt / (Debt + Equity) (%)	17.6	16.7	11.6	12.3
LT Debt	2,072	2,882	2,310	3,528
LT Debt / (LT Debt + Equity) (%)	13.1	12.7	8.4	12.2

Source: Company information and Lianhe Global's calculations

SETD's total assets showed a continuous growth in the past few years, with a growth rate of 41.1%, 18.6% and 2.4% at end-2021, end-2022 and end-June 2023, respectively, and reached RMB31.3 billion at end-June 2023. The increase of SETD's total assets was largely due to the intangible assets. SETD's assets mainly consisted of inventories, intangible assets, other receivables, investment properties, construction in progress and investment properties.

SETD's asset liquidity was moderately weak, primarily attributed to a substantial portion of inventories and intangible assets, collectively accounting for 73.7% of the company's total assets as of end-June 2023. The company's inventories mainly comprised land transferred from the Shiyang government and construction costs related to its infrastructure projects, which usually need a relatively long time to monetize due to the long construction and cash collection period. The intangible assets, comprising land use rights and mining rights, demonstrated a significant growth from RMB4.7 billion at end-2021 to RMB7.0 billion at end-June 2023. In addition, SETD had other receivables of RMB2.3 billion at end-June 2023, mainly due from other government agencies and LIDCs in Shiyang, with relatively high concentration of indebted party, controllable counterparty risk and low bad debt provision. In particular, the outstanding of RMB1.2 billion was due from Shiyang City Urban Infrastructure Construction Investment Co. Ltd., another LIDC owned by Shiyang State-owned Assets Supervision and Administration Commission. Most of SETD's receivables were relatively recent, with an aging period of within 3 years.



SETD has maintained a stable and relatively low financial leverage (total liabilities to assets) over the past few years, which reached 24.8%, 22.9%, 18.0% and 18.9% at end-2020, end-2021, end-2022 and end-June 2023, respectively. Given the substantial demand for new financing to support its projects funding needs, the company's financial leverage is expected to rise in the future. SETD's total adjusted debt decreased from c. RMB4.0 billion at end-2020 to c. RMB3.6 billion at end-June 2023 due to the reduction of non-traditional debt, with short-term debt accounting for 1% of the total debt. The proportion of non-traditional debt in its financing structure remained relatively high, standing at 29% at end-June 2023. Per company, SETD aims to gradually replace its non-traditional debt with mid- and long-term bank loans and bond issuances to lower the level of non-traditional debt and further decrease its financing cost. There was no significant change in the ownership equity structure of SETD at end-June 2023, compared with that at end-2020. SETD mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure related projects under construction and to be constructed in the future.



Debt Servicing Capability

The liquidity of SETD was sufficient. SETD had an unrestricted cash balance and unused credit facilities of RMB35.9 million and RMB2.3 billion at end-June 2023, respectively, compared with its debt due within one year of c. RMB30 million. Besides, SETD 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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