

Tongcheng Economic Development Zone Construction Investment Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	13 September 2023

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

Summary

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

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

Rating Rationale

Tongcheng Government’s Ownership and Supervision: The Tongcheng government holds the full ownership of TEDZ through the Tongcheng Economic and Technological Development Zone Management Committee (“EDZ MC”). The Tongcheng 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 Tongcheng 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 Tongcheng and Strategic Alignment: TEDZ, as the key LIDC in Tongcheng, is primarily responsible for infrastructure construction and state-owned asset management in Tongcheng EDZ. Serving as the sole entity in charge of infrastructure projects in Tongcheng EDZ, TEDZ focuses on constructing industrial parks, sewage treatment plants and other main municipal engineering projects in the region. In addition, the company is also responsible for the resettlement housing construction projects, office spaces and parking spaces operation, pipe network leasing and other state-owned asset management and operation business within Tongcheng EDZ, with strong regional advantages. TEDZ 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: TEDZ received operational and financial support from the government. TEDZ received a total subsidy amount of c. RMB33.3 million from 2020 to the

Key Figures of Tongcheng and TEDZ

(RMB billion)	2021	2022
Tongcheng		
GDP	41.9	45.2
GDP growth rate (%)	6.2	4.5
Budgetary revenue	2.0	2.2
Government fund	1.0	3.3
Transfer payment	2.3	2.7
Budgetary expenditure	5.8	6.1
TEDZ	2022	2022.3
Assets	10.1	11.0
Equity	5.0	5.0
Revenue	0.4	0.1

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

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Applicable Criteria

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

first three months of 2023, mainly including operating subsidiaries. The Tongcheng government continued to inject capitals, equities, land and other assets into TEDZ to expand its asset size. Besides, the EDZ MC will repurchase some infrastructure projects and provide policy supports to TEDZ to ensure its business operation. Given it is the sole entity for infrastructure construction and resettlement housing construction in Tongcheng EDZ, TEDZ has an advantage in acquiring land resources and major projects. We believe TEDZ is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

TEDZ's Financial Matrix and Liquidity Position: TEDZ's total assets showed a continuous growth trend in the past years and reached RMB11.0 billion at end-March 2023, mainly due to the increase of inventories, which have steadily increased in tandem with the company's infrastructure construction projects. The current assets of TEDZ accounted for c. 75% of the total assets at end-March 2023, but the overall asset liquidity was moderately weak due to large proportion of inventories and receivables.

TEDZ's financial leverage (total liabilities to total assets) was 53.8% and its adjusted debt increased to c. RMB4.7 billion at end-March 2023. The liquidity of TEDZ was sufficient. TEDZ had a cash balance and unused credit facilities of c. RMB974 million and RMB4.3 billion at end-March 2023, respectively, compared with its debt due within one year of c. RMB484 billion. Besides, TEDZ 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 Tongcheng: Tongcheng is a county-level city in Anhui Province ("Anhui") and managed by Anqing City ("Anqing"), with a total land area of c. 1,571 square kilometers. Tongcheng's GDP growth rate fluctuated in the past three years, which was 3.0%, 6.2% and 4.5% in 2020, 2021 and 2022, respectively. Its GDP reached RMB45.2 billion in 2022, which was ranked 1st out of all jurisdictions of Anqing. The aggregate fiscal revenue of the Tongcheng government was mainly derived from the budgetary revenue and government fund income. The Tongcheng government's budgetary revenue increased to c. RMB2.2 billion in 2022 from c. RMB1.8 billion in 2020. At the same time, the government fund income increased to c. RMB3.3 billion in 2022 from c. RMB1.0 billion in 2021. The budget deficit of the Tongcheng government was c. 173.3% at end-2022, while the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Tongcheng government increased to 138.6% at end-2022 from 90% at end-2020.

Rating Sensitivities

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

We would consider upgrading TEDZ's rating if there is an upgrade in our internal credit assessment on the Tongcheng government.

Operating Environment

Economic Condition of Tongcheng

Tongcheng is a county-level city directly under the jurisdiction of Anhui Province ("Anhui") and managed by Anqing on behalf of Anhui, and is located in the northeast of Anqing.

Tongcheng has jurisdiction over 12 towns, three streets and one national development zone, with a total land area of c. 1,571 square kilometers. At end-2021, Tongcheng had a residential population of around 595 thousand, with an urbanization rate of 56.0%.

Tongcheng's GDP growth rate fluctuated in the past three years, which was 3.0%, 6.2% and 4.5% in 2020, 2021 and 2022, respectively. Tongcheng's GDP reached RMB45.2 billion in 2022, which was ranked 1st out of all jurisdictions of Anqing. Tongcheng's economy was mainly fueled by the secondary and tertiary industries, which accounted for 51.8% and 39.8% of GDP in 2022, respectively. Tongcheng's fixed assets investment increased to RMB61.4 billion in 2022 from RMB49.3 billion in 2020, maintaining two-digit growth in the past three years.

Tongcheng EDZ was established in 2001 and upgraded to a National Economic and Technological Development Zone in 2013. Currently, Tongcheng EDZ has four leading industries, including green packaging, electromechanical equipment, textiles and clothing, and medicine and food. The GDP of the Tongcheng EDZ has demonstrated consistent growth, propelled by robust fixed asset investments. Moreover, its contribution to the overall GDP of Tongcheng has remained remarkable, consistently ranging between c. 49% to 53% over the last three years.

Tongcheng's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	39.3	41.9	45.2
-Primary industry (%)	8.8	8.7	8.5
-Secondary industry (%)	50.2	50.9	51.8
-Tertiary industry (%)	41.0	40.4	39.8
GDP growth rate (%)	3.0	6.2	4.5
Fixed asset investment	49.3	55.7	61.4
Fixed asset investment growth rate (%)	12.1	12.9	10.2
Population (million)	0.6	0.6	0.6

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Tongcheng

The aggregate fiscal revenue of the Tongcheng government was mainly derived from the government fund income and transfer payment from the higher government. The budgetary revenue's contribution was relatively small in the past three years, though increased to RMB2.2 billion in 2022 from RMB1.8 billion in 2020. The fiscal self-sufficiency rate of the Tongcheng government was relatively low, and it recorded a budget deficit rate of -173.3% in 2022, despite the narrowing trend in recent years. Meanwhile, the government fund income fluctuated in the past three years, which was RMB2.6 billion, RMB1.0 billion, and RMB3.3 billion in 2020, 2021, and 2022, respectively. In addition, the Tongcheng government received about RMB2.6 billion in transfer payment on average in 2020-2022, indicating some dependence on support from higher government.

Tongcheng's outstanding government debt continued to grow in the past three years. At end-March 2023, the outstanding debt of the Tongcheng government was RMB8.4 billion, of which the general obligations and special debt were RMB3.1 billion and RMB5.3 billion, respectively. The debt ratio, which is measured as total government debt/aggregate revenue, surged to 140.5% in 2021 from 90.0% in 2020, but decreased slightly to 138.6% in 2022.

Tongcheng's Fiscal Condition

(RMB billion)	2020	2021	2022
Budgetary revenue	1.8	2.0	2.2

Budgetary revenue growth rate (%)	-4.1	8.0	13.3
Tax revenue	1.5	1.6	1.5
Tax revenue (% of budgetary revenue)	82.5	83.4	67.0
Government fund income	2.6	1.0	3.3
Transfer payment	2.8	2.3	2.7
Aggregate revenue	7.3	5.3	8.3
Budgetary expenditure	5.4	5.8	6.1
Budget deficit ¹ (%)	-198.7	-192.4	-173.3

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

TEDZ was established in May 2017 by EDZ MC with an initial registered capital of RMB798.0 million. At end-March 2023, both the company's registered capital and paid-in capital were RMB798.0 million. EDZ MC is the sole shareholder, and the Tongcheng government is the actual controller of the company.

Strategic Importance and Government Linkage

Strategic Importance of TEDZ to Tongcheng

TEDZ, as the key LIDC in Tongcheng, is primarily responsible for infrastructure construction and state-owned asset management in Tongcheng EDZ. Serving as the sole entity in charge of infrastructure projects in Tongcheng EDZ, TEDZ focuses on constructing industrial parks, sewage treatment plants and other main municipal engineering projects. In addition, the company is also responsible for the resettlement housing construction projects, office space, parking spaces and pipe network leasing and other state-owned asset management and operation business within Tongcheng EDZ, with strong regional advantages. TEDZ 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

TEDZ's linkage with the local government is strong as the Tongcheng government holds the full ownership of TEDZ through EDZ MC. The Tongcheng 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 Tongcheng 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

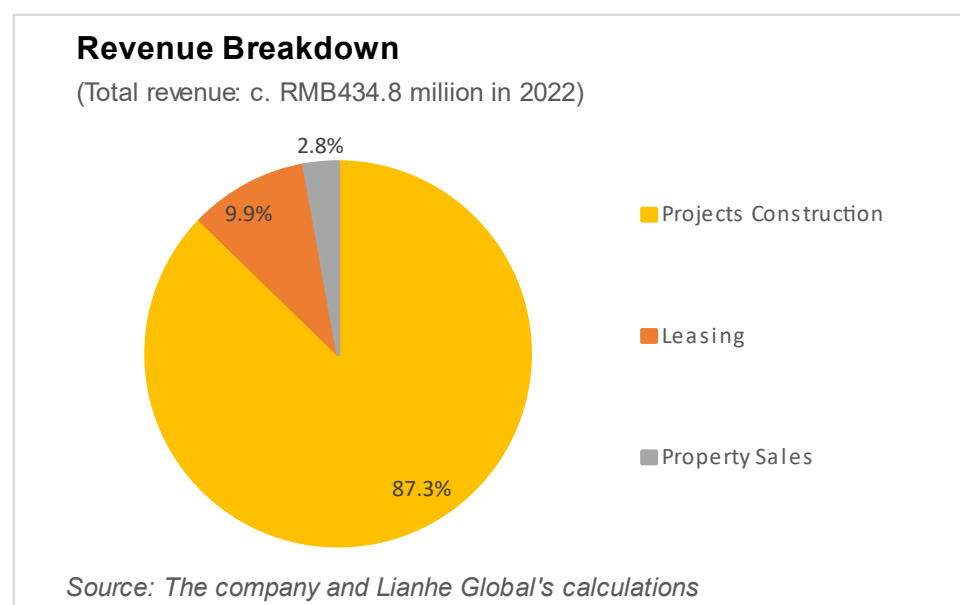
TEDZ continued to receive financial subsidies, mainly including operating subsidies (such as urban construction subsidies and tax breaks), from the local government to maintain its business operation. TEDZ received subsidies of c. RMB7.5 million, RMB10.1 million, RMB12.7 million and RMB3.0 million in 2020, 2021, 2022 and the first three months of 2023, respectively. Besides, the Tongcheng government injected some real estate assets, land assets and pipeline assets, as well as all shares of a local company to TEDZ in 2020 and 2021, amounted to RMB1.3 billion. The government will repurchase some infrastructure projects constructed by TEDZ and provide policy supports to ensure its business operation.

Given it is the sole entity for infrastructure construction and resettlement housing construction in Tongcheng EDZ, TEDZ has an advantage in acquiring land resources and major projects. We believe TEDZ 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 Sole Entity Responsible for Infrastructure Construction within Tongcheng EDZ

TEDZ is an important LIDC that operates in infrastructure and resettlement housing construction within the Tongcheng EDZ, and enjoys a strong regional franchise. In addition, the company also engages in businesses like leasing and property sales to diversify its business structure. The total revenue of TEDZ reached RMB486.8 million, RMB427.9 million, RMB434.8 million and RMB125.6 million in 2020, 2021, 2022 and the first three months of 2023, respectively. The overall gross profit margin of the company was stable, recorded at 14.8%, 15.0%, 13.5% and 12.0% in the corresponding period.



Projects Construction

The company is responsible for the infrastructure and resettlement housing construction business in Tongcheng EDZ and enjoys a strong franchise within the region. Both the infrastructure and resettlement housing construction adopt agent construction mode. The infrastructure construction business is handled by the subsidiary, Tongcheng Economic and Technology Development Zone Industry and City Integrity Construction and Investment Co., Ltd. The company signs Agent Construction Contracts with Anhui Tongcheng Economic and Technological Development Zone Property Co., Ltd. ("ATEDP") and operates infrastructure construction and management work according to the requirements, ATEDP will pay the company construction fee annually or semi-annually based on the construction progress. The resettlement housing construction business operates in a similar way to the infrastructure construction business. As the most important business of the company, the projects construction business achieved a revenue of RMB424.7 million, RMB333.4 million, RMB352.0 million and RMB105.9 million in 2020, 2021, 2022 and the first three months of

2023, respectively. The gross profit margin showed a downward trend, decreasing to 6.7% in 2022 from 11.6% in 2020.

Leasing

The company's leasing business is mainly managed by itself and its subsidiary, Tongcheng Economic and Technological Development Zone State-owned Assets Investment and Operation Co., Ltd. The leasing assets include office buildings, factories, parking lots and pipelines. The company signs leasing contracts with the tenants, transfers the right of use of leasing assets to the tenants and receives charges as income. The income derived from leasing business reached RMB57.7 million, RMB76.6 million, RMB67.9 million and RMB17.4 million in 2020, 2021, 2022 and the first three months of 2023, respectively. The gross profit margin was relatively high, which climbed from 37.1% in 2020 to 45.1% in 2022.

Property Sales

The property development business is undertaken by Tongcheng Real Estate Development Co., Ltd., which possesses Level 2 qualification for real estate development. TRED develops real estate projects and corresponding property services in cooperation mode and sells both completed and yet-to-be-built houses. The operating revenue from the property sales business reached RMB4.1 million, RMB18.0 million, RMB14.9 million and RMB2.2 million in 2020, 2021, 2022 and the first three months of 2023, respectively. The gross margin was 23.2%, 21.3%, and 28.9% in 2020, 2021, and 2022, respectively.

Financial Profile

Balance Sheet Structure and Quality

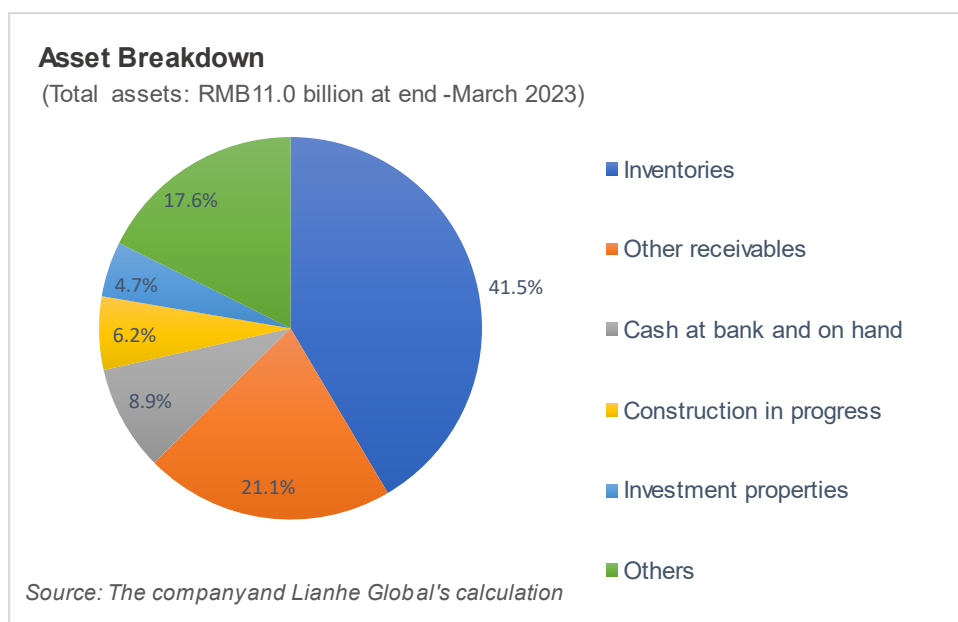
Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	2023.3
Total Asset	6,585	8,598	10,108	10,954
Equity	4,235	4,907	5,032	5,056
Debt	1,779	2,444	3,459	4,722
Debt / (Debt + Equity) (%)	29.6	33.2	40.7	48.3
LT Debt	832	2,050	2,975	4,238
LT Debt / (LT Debt + Equity) (%)	16.4	29.5	37.2	45.6

Source: Company information and Lianhe Global's calculations

TEDZ's total assets showed a continuous growth in the past few years, with a growth rate of 30.6%, 17.6% and 8.4% at end-2021, end-2022 and end-March 2023, respectively, and reached RMB11.0 billion at end-March 2023. The increase of TEDZ's total assets was largely due to the inventories, which have steadily increased in tandem with the company's infrastructure construction projects. TEDZ's assets mainly consisted of inventories, other receivables, cash at bank and on hand, construction in progress and investment properties.

TEDZ's asset liquidity was moderately weak, primarily attributed to a substantial portion of inventories and other account receivables, collectively accounting for 62.6% of the company's total assets as of end-March 2023. Most of these assets were related to the company's project construction business. The company's inventories mainly comprised land transferred from the Tongcheng government and construction costs, which usually need a relatively long time to monetize due to the long construction and cash collection period. In addition, TEDZ had other receivables of RMB2.3 billion at end-March 2023, mainly due from

other government agencies and LIDCs in Tongcheng, 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 Tongcheng Economic Development Zone Construction Development Co., Ltd., another LIDC fully owned by EDZ MC. Most of TEDZ's receivables were relatively recent, with an aging period of within 3 years.



TEDZ's financial leverage (total liabilities to assets) reached 35.7%, 42.9%, 50.2% and 53.8% at end-2020, end-2021, end-2022 and end-March 2023, respectively, representing an increasing trend. Given the relevant guidelines of the Tongcheng government, we expect the leverage of TEDZ to maintain at this level in the future. TEDZ's total adjusted debt increased from c. RMB1.8 billion at end-2020 to c. RMB4.7 billion at end-March 2023 due to the increase of bank borrowings and bond issuance, with short-term debt accounting for c. 10.2% of the total debt. There was no significant change in the ownership equity structure of TEDZ at end-March 2023, compared with that at end-2020. TEDZ 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.

Notably, TEDZ provided external guarantees of approximately RMB2.7 billion to third parties at end-2022. The external guarantees accounted for 24.3% of its total assets and 52.6% of its net assets, respectively. The entities receiving guarantees are exclusively local state-owned enterprises. However, none of these enterprises had set up counter-guarantee measures, indicating a certain level of contingent liability risk.

Debt Servicing Capability

The liquidity of TEDZ was sufficient. TEDZ had a cash balance and unused credit facilities of c. RMB974 million and RMB4.3 billion at end-March 2023, respectively, compared with its debt due within one year of c. RMB484 billion. Besides, TEDZ 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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