

Shandong Xingyu Investment and Construction Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	2 February 2024

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

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Yutai County, Jining City (“Yutai government”) would provide very strong support to SXICG if needed, in light of its full ownership of SXICG, SXICG’s strategic importance as the sole local investment and development company (“LIDC”) that is responsible for infrastructure construction and land development in Yutai County, Jining City (“Yutai”), and the linkage between the Yutai government and SXICG, 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 Yutai government may face significant negative impact on its reputation and financing activities if SXICG encounters any operational and financial difficulties.

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

Rating Rationale

Yutai Government’s Ownership and Supervision: The Yutai government holds the full ownership of SXICG through the State-owned Assets Supervision and Administration Bureau of Yutai County (“Yutai SASAB”). The Yutai 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 Yutai government has assessment mechanism over the company and appoints auditors to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Yutai and Strategic Alignment: SXICG, as the key LIDC in Yutai, is primarily responsible for the investment, development and operation of infrastructure projects and land development projects within the city. Serving as the sole entity in charge of infrastructure projects throughout the region, SXICG is mainly engaged in shantytowns development, urban renewal, road construction and upgrading and other infrastructure related projects with strong regional advantages. It is also entrusted with the function of land development and sewage treatment in Yutai. SXICG 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: SXICG received operational and financial support from the Yutai government. SXICG received a total subsidy amount of RMB867.2 million from 2020 to the first six months of 2023. The Yutai government continued to inject capital, project-related assets, right of use assets, equities of other companies and other kinds of assets into SXICG to expand its asset size and diversify its business. Besides, the Yutai government will repurchase some infrastructure projects and provide policy supports to SXICG to ensure its business operation. Given that it is the sole entity for infrastructure

Key Figures of Yutai and SXICG

(RMB billion)	2021	2022
Yutai		
GDP	22.0	23.3
GDP growth rate (%)	9.3	4.4
Budgetary revenue	1.3	1.4
Government fund	2.3	2.2
Transfer payment	1.8	1.9
Budgetary expenditure	3.1	3.3
SXICG		
	2022	2023.6
Assets	16.3	16.9
Equity	8.0	8.2
Revenue	1.1	0.6

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

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Applicable Criteria

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

construction and land development in Yutai, SXICG has an advantage in acquiring related resources and major projects. We believe SXICG is likely going to receive government support to support its daily business operation.

SXICG's Financial Matrix and Liquidity Position: SXICG's total assets showed a continuous growth trend in the past few years and reached RMB16.9 billion at end-June 2023, largely attributed to the increase of inventories that related to the company's infrastructure construction business. The current assets of SXICG accounted for 95.5% of the total assets at end-June 2023, yet the overall asset liquidity was moderately weak due to large amount of inventories and receivables. SXICG's financial leverage (total liabilities to total assets) was 51.7% and its adjusted debt increased to RMB6.5 billion at end-June 2023 from RMB3.6 billion at end-2020. The liquidity of SXICG was sufficient. At end-June 2023, SXICG had a cash balance and unused credit facilities of RMB421.1 million and RMB897.2 million, respectively, compared with its debt due within one year of RMB904.4 million. Besides, SXICG 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 Strength of Yutai: Yutai realized GDP of RMB23.3 billion in 2022, representing a year-on-year growth rate of 4.4%. Its economic growth was mainly fueled by the tertiary industries in the past few years, which accounted for 46.7% in 2022. Yutai's economic development focused on cultural tourism and digital economy industry in recent years. Its fixed asset investment growth rate was on an upward trend in the past few years, recording at 11.2% in 2022.

The Yutai government's budgetary revenue maintained continued growth in the past few years and reach RMB1.4 billion in 2022. The tax revenue accounted for 73.3% of the budgetary revenue in 2022, down from 84.3% in 2021, mainly due to related tax-advantaged policies. As another substantial component of the local fiscal revenue, Yutai's government fund income decreased to RMB2.2 billion in 2022 from RMB2.3 billion in 2021, owing to the weak property market. The budgetary expenditure remained at a high level in recent years, thus its budget balance recorded at -142.6% in 2022. The transfer payment increased to RMB1.9 billion in 2022 from RMB1.8 billion in 2021. The outstanding debt of the Yutai government continued to grow. At end-2022, the Yutai government's outstanding debt was RMB7.2 billion. Given the Yutai government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 125.7% at end-2022 from 88.9% at end-2020.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Yutai

Yutai is a county directly under the jurisdiction of Jining City, and located in the southwestern part of Shandong Province. Known as the hometown of fish and rice, Yutai is a time-honored county with abundant nature resources and cultural sites. Yutai has jurisdiction over 9 towns, 2 streets and 1 provincial economic development zone, with a total land area of 654 square kilometers. At end-2022, Yutai had a resident population of 0.4 million, with an urbanization rate of 44.8%.

Yutai's GDP reached RMB18.7 billion, RMB20.0 billion, RMB23.3 billion in 2020, 2021 and 2022, respectively, representing year-over-year (y-o-y) growth rates of 3.0%, 9.3% and 4.4%. Yutai's economic growth was mainly fueled by the tertiary industries in the past few years, which accounted for 46.7% in 2022. Its economic development focused on cultural tourism and digital economy industry in recent years. Its fixed asset investment growth rate was on an upward trend in the past few years, recording at 11.2% in 2022.

Yutai's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	18.7	22.0	23.3
-Primary industry (%)	26.7	26.1	25.7
-Secondary industry (%)	28.5	27.9	27.6
-Tertiary industry (%)	44.8	46.0	46.7
GDP growth rate (%)	3.0	9.3	4.4
Fixed asset investment	15.9	17.8	19.8
Fixed asset investment growth rate (%)	1.0	12.2	11.2
Population (million)	0.4	0.4	0.4

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Yutai

The Yutai government's budgetary revenue maintained continued growth in the past few years and reach RMB1.4 billion in 2022. The tax revenue accounted for 73.3% of the budgetary revenue in 2022, down from 84.3% in 2021, mainly due to related tax-advantaged policies. As another substantial component of the local fiscal revenue, Yutai's government fund income, mainly generated by land sales, decreased to RMB2.2 billion in 2022 from RMB2.3 billion in 2021, owing to the weak property market. The budgetary expenditure remained at a high level in recent years, thus its budget balance recorded at -174.7%, -148.3% and -142.6% in 2020, 2021 and 2022, respectively. Although the budget balance had improved, the fiscal self-sufficiency rate of the Yutai government was still low (c. 41.2% in 2022), hence it continuously received a certain number of subsidies from higher government authorities, and the transfer payment increased to RMB1.9 billion in 2022 from RMB1.8 billion in 2021.

The outstanding debt of the Yutai government continued to grow. At end-2022, the Yutai government's outstanding debt was RMB7.2 billion, including RMB0.9 billion of general obligations and RMB6.3 billion of special debt. Given the Yutai government borrowed heavily in special debts to support its public projects, its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 125.7% at end-2022 from 88.9% at end-2020.

Yutai's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	1.1	1.3	1.4
Budgetary revenue growth rate (%)	0.4	18.6	8.5

Tax revenue	0.9	1.1	1.0
Tax revenue (% of budgetary revenue)	80.8	84.3	73.3
Government fund income	2.1	2.3	2.2
Transfer payment	1.9	1.8	1.9
Aggregate revenue	5.0	5.3	5.7
Budgetary expenditure	2.9	3.1	3.3
Budget balance ¹ (%)	-174.7	-148.3	-142.6

¹ Budget balance = (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

SXICG was established in March 2021 with an initial registered capital of RMB0.1 billion, funded by Yutai SASAB. In December 2021, the Yutai SASAB increased the registered capital of the company to RMB1.0 billion.

At end-June 2023, SXICG had a shareholding structure in which the Yutai SASAB, as the solo shareholders and actual controller, held 100% of the company's equity, with the registered and paid-in capital recording at RMB1.0 billion and RMB0.821 billion, respectively.

Strategic Importance and Government Linkage

Strategic Importance of SXICG to Yutai

SXICG, as the key LIDC in Yutai, is primarily responsible for the investment, development and operation of infrastructure projects and land development projects within the city. Serving as the sole entity in charge of infrastructure projects throughout the region, SXICG is mainly engaged in shantytowns development, urban renewal, road construction and upgrading and other infrastructure related projects with strong regional advantages. It is also entrusted with the function of land development and sewage treatment in Yutai. SXICG 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

SXICG's linkage with the local government is strong as the Yutai government holds the full ownership of SXICG through Yutai SASAB. The Yutai 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 Yutai government has assessment mechanism over the company and it appoints auditors to supervise the operating performance and financial position on a periodic basis.

Government Support

SXICG received operational and financial support from the Yutai government. SXICG received a total subsidy amount of RMB867.2 million from 2020 to the first six months of 2023. The Yutai government continued to inject capital, project-related assets, right of use assets, equities of other companies and other kinds of assets into SXICG to expand its asset size and diversify its business. Besides, the Yutai government will repurchase some

infrastructure projects and provide policy supports to SXICG to ensure its business operation. Given that it is the sole entity for infrastructure construction and land development in Yutai, SXICG has an advantage in acquiring related resources and major projects. We believe SXICG is likely going to receive government support to support its daily business operation.

Business Profile

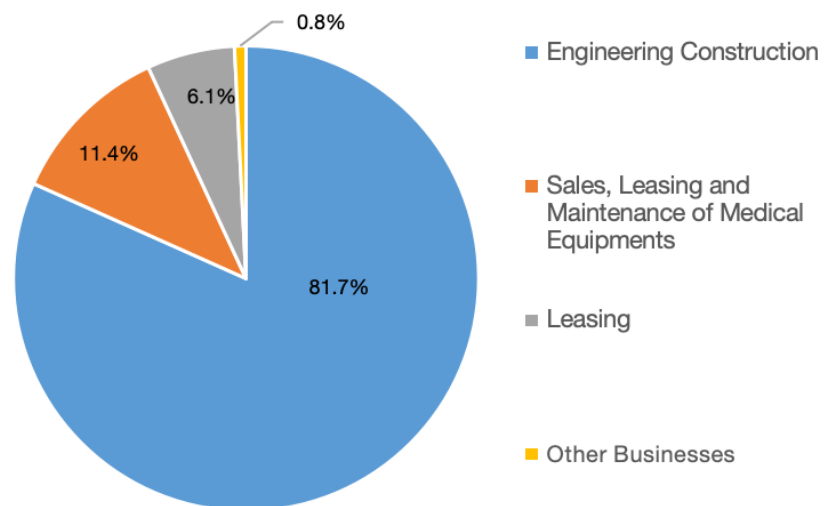
The Sole Entity Responsible for Infrastructure Construction in Yutai

SXICG, as an important LIDC in Yutai, is mainly responsible for the construction of municipal infrastructure projects, land consolidation and asset leasing within the region. As the major platform designated by the Yutai SASAB to undertake infrastructure construction projects within the region, the company has received strong support from the government in terms of capital injection, asset transfer and fiscal subsidies.

The primary sources of operating revenue for SXICG are engineering construction, medical equipment and leasing business, while it also engaged in land transfer, sales of building materials, accommodation and dining, etc. The company's total revenue remained relatively stable in the past few years, recording at RMB0.8 billion, RMB1.0 billion, RMB1.1 billion and RMB0.6 billion in 2020, 2021, 2022 and the first half of 2023, respectively. The overall gross profit margin of SXICG fluctuated between 13.7% and 36.5% over the same period. In general, SXICG's business was relatively concentrated, and it has regional advantages in its major businesses.

Revenue Breakdown

(Total revenue: RMB0.6 billion in the first half of 2023)



Source: The company and Lianhe Global's Calculation

Engineering Construction

SXICG, as an important infrastructure construction body within the region, undertakes the engineering construction, which has a strong franchised advantage in Yutai. The project in this segment are generally conducted under the agent construction model, where the company signs the agent construction agreements with the the Yutai government and is responsible for fundraising and construction of entrusted projects. The company settles construction costs plus a percentage (c.20%) of management fees annually with the entrusting party according to the project's progress. The revenue of engineering construction remained stable in the past few years, recording at c. RMB0.8 billion, RMB1.0 billion, RMB1.1 billion and RMB0.5 billion in 2020, 2021, 2022 and the first half of 2023, respectively. Its gross profit margin in this segment kept stable at 16.5% over the same period. Currently, the company's projects under construction and to be constructed still require a large scale of investment, thus it incurs high pressure on capital expenditure.

Other Businesses

The sales, leasing and maintenance of medical equipment as well leasing business mainly play the role of supplementing the revenue of the main business and make the revenue structure more diversified. Other businesses of SXICG include land transfer, sales of building materials, accommodation and dining, etc., with each segment accounted for a relatively small proportion of the company's total revenue.

Financial Profile

Balance Sheet Structure and Quality

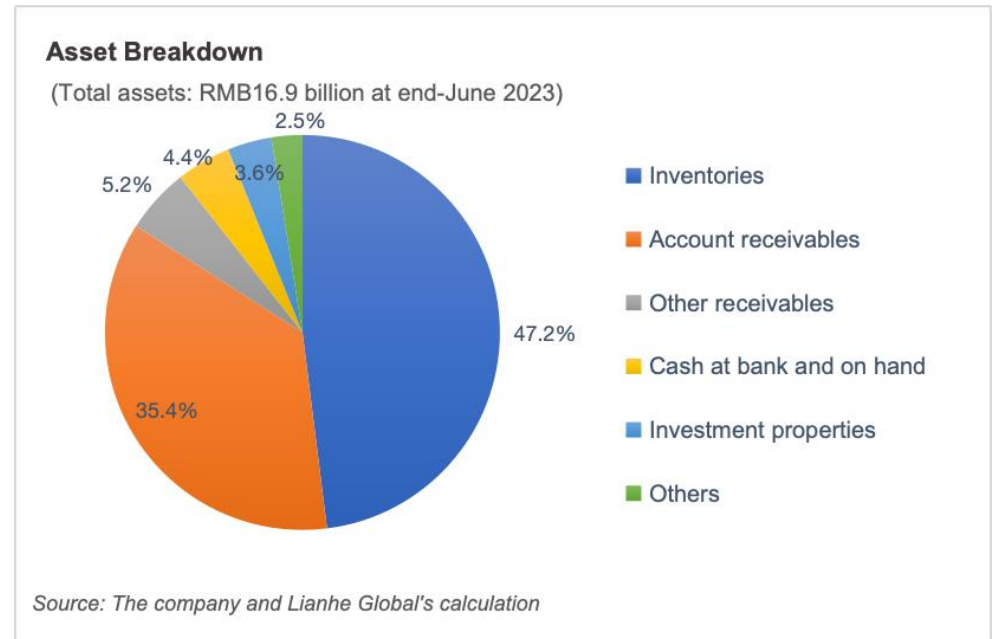
Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	June-2023
Total Asset	11,130	12,591	16,313	16,917
Equity	4,469	5,356	7,997	8,178
Debt	3,585	3,449	6,975	6,513
Debt / (Debt + Equity) (%)	44.5	39.2	46.6	44.3
LT Debt	3,115	2,658	5,872	5,608
LT Debt / (LT Debt + Equity) (%)	41.1	33.2	42.3	40.7

Source: Company information and Lianhe Global's calculations

SXICG's asset size grew moderately to RMB16.9 billion at end-June 2023 from RMB11.1 billion at end-2020, largely attributed to the increase of inventory. The company's financial leverage, as measured by total liability/total asset declined to 51.7% at end-June 2023 from 59.8% at end-2020. The total adjusted debt increased to RMB7.0 billion at end-2022 from RMB3.6 billion at end-2020, mainly due to the increase of long-term borrowings. Having said that, The reliance on debt financing was alleviated in the first half of 2023, as the total debt ratio measured as total debt/the sum of debt and equity and the long-term debt ratio measured as long-term debt/the sum of long-term debt and equity fell to 44.3% and 40.7% at end-June 2023 from 46.6% and 42.3% at end-2022, respectively.

Nevertheless, SXICG's asset liquidity was weak, as it has a large part of inventories and account receivables. The company's project construction activities accumulated sizeable inventories (mainly lands and construction costs), investment properties and fixed assets, which added up to RMB14.7 billion, representing 86.7% of total asset at end-June 2023. These assets usually take a long time to monetize due to the protracted construction and

payment collection period. In addition, the company had a large number of account receivables and other account receivables, primarily due from government agencies. Their repayment schedules are highly subject to the fiscal conditions of the local government.



Debt Servicing Capability

The liquidity of SXICG was sufficient. At end-June 2023, SXICG had a cash balance and unused credit facilities of RMB421.1 million and RMB897.2 million, respectively, compared with its debt due within one year of RMB904.4 million. Besides, SXICG 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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