

Taizhou Huangyan State-owned Capital Investment and Operation Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB+
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	28 February 2024

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB+’ global scale Long-term Issuer Credit Rating with Stable Outlook to Taizhou Huangyan State-owned Capital Investment and Operation Group Co., Ltd. (“THSCI” or “the company”)

Summary

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

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

Rating Rationale

Huangyan Government’s Ownership and Supervision: The Huangyan government holds the full ownership of THSCI through the Finance Bureau of Huangyan District, Taizhou City (“Huangyan FB”). The Huangyan 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 Huangyan 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 Huangyan and Strategic Alignment: THSCI, as the key LIDC in Huangyan, is primarily responsible for the investment, development and operation of infrastructure projects and state-owned asset management within the city. Serving as the sole entity in charge of infrastructure projects throughout Huangyan, THSCI is mainly engaged in resettlement housing development, road construction and other infrastructure related projects with strong regional advantages. It is also entrusted with the function of water supply and labor service in Huangyan. THSCI 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: THSCI received operational and financial support from the Huangyan government. The Huangyan government continued to inject capital and other kinds of assets into THSCI to expand its asset size and diversify its business. Given that it is the sole entity for infrastructure construction and state-owned asset operation in Huangyan, THSCI has an advantage in acquiring related resources and major projects. We

Key Figures of Huangyan and THSCI

(RMB billion)	2021	2022
Huangyan		
GDP	58.7	61.2
GDP growth rate (%)	6.5	3.5
Budgetary revenue	4.4	4.1
Government fund	4.1	10.1
Transfer payment	1.6	2.5
Budgetary expenditure	6.0	6.8
THSCI	2022	2023.9
Assets	90.6	100.0
Equity	35.4	36.5
Revenue	2.9	1.4

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

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Applicable Criteria

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

believe THSCI is likely going to receive government support to support its daily business operation.

THSCI's Financial Matrix and Liquidity Position: THSCI's total assets showed a continuous growth trend in the past few years and reached around RMB100.0 billion at end-June 2023, largely attributed to the increase of inventories that related to the company's resettlement housing and infrastructure construction business. The current assets of THSCI accounted for 78.9% of the total assets at end-June 2023, yet the overall asset liquidity was moderately weak due to large amount of inventories and receivables. THSCI's financial leverage (total liabilities to total assets) was 63.5% and its adjusted debt increased to RMB53.2 billion at end-June 2023 from RMB33.8 billion at end-2021. The liquidity of THSCI was sufficient. At end-June 2023, THSCI had a cash balance and unused credit facilities of RMB5.5 billion and RMB16.0 billion, respectively, compared with its debt due within one year of RMB15.5 billion. Besides, THSCI has access to various financing channels, including bank loans, non-traditional financing and bond issuance, to support its debt repayment and business operations.

Economy and Fiscal Strength of Huangyan: Huangyan is a district-level city of Taizhou City, Zhejiang Province, and is located in the south part of Taizhou. Huangyan's GDP growth rate fluctuated in the past three years due to Covid's disruption, which was 3.7%, 6.5% and 3.5% in 2020, 2021 and 2022, respectively. In 2023, the overall economic performance of Huangyan stabilized and improved. The district achieved a GDP of RMB63.8 billion, ranking 6th out of all districts and counties under Taizhou's jurisdiction.

The aggregate fiscal revenues of the Huangyan government are mainly derived from budgetary revenue and government fund income. In 2022, Huangyan government's budgetary revenue decreased to RMB4.1 billion due to significant value-added tax credit refunds supporting the economy, resulting in a budget deficit of 66.3%. However, in 2023, the revenue improved by 22.1% to RMB5.0 billion, with a reduced deficit of 41.2%. Tax revenue constituted 81%-90% of total budgetary revenue over the past three years. Government fund income, primarily from land use rights transfers, rose from RMB4.1 billion in 2021 to RMB10.1 billion in 2022. The government's outstanding debt increased modestly from RMB10.8 billion in 2020 to RMB15.4 billion in 2022, with the fiscal debt ratio (total government debt outstanding/aggregate revenue) declining to 89.7% by end-2022 from 134% at end-2021.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Huangyan

Huangyan is under the jurisdiction of Taizhou, Jiangsu Province, and located in the south of the central part of Taizhou. It is one of the main urban areas of Taizhou City and serves as a land transportation hub. Huangyan has jurisdiction over 11 towns and 8 streets, with a

land area of 988 square kilometers. At end-2022, Huangyan had a residential population of 0.7 million, with an urbanization rate of 65.1%.

Huangyan's GDP growth rate fluctuated in the past three years due to Covid's disruption, which was 3.7%, 6.5% and 3.5% in 2020, 2021 and 2022, respectively. In 2023, the overall economic performance of Huangyan stabilized and improved. The district achieved a GDP of RMB63.8 billion, ranking 6th out of all districts and counties under Taizhou's jurisdiction. Huangyan's economic growth was mainly driven by the secondary and tertiary industries, which accounted for 44.5% and 51.8% of the GDP in 2023, respectively.

Huangyan's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	55.7	58.7	61.2
-Primary industry (%)	3.5	3.5	3.8
-Secondary industry (%)	45.5	46.7	49.1
-Tertiary industry (%)	51.0	49.8	49.1
GDP growth rate (%)	3.7	6.5	3.5
Fixed asset investment	28.3	25.3	29.5
Fixed asset investment growth rate (%)	8.5	(10.9)	16.9
Population (million)	0.7	0.7	0.7

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Huangyan

The aggregate fiscal revenues of the Huangyan government are mainly derived from budgetary revenue and government fund income. The budgetary revenue decreased to RMB4.1 billion in 2022 from RMB4.4 billion in 2021, due to the large-scale value-added tax credit refunds to support the economy. However, Huangyan government's budgetary revenue experienced a significant improvement in 2023, increasing by 22.1% to reach RMB 5.0 billion. The tax revenue accounted for 81%-90% of the total budgetary revenue over the past three years. The fiscal self-sufficiency of the Huangyan government was relatively weak, and it recorded a budget deficit of 66.3% in 2022, but it improved to 41.2% in 2023. The government fund income, most of which was derived from land use rights transfers, increased from RMB4.1 billion in 2021 to RMB10.1 billion in 2022.

The outstanding debt of the Huangyan government grew modestly in the past three years, increasing from RMB10.8 billion at end-2020 to RMB15.4 billion at end-2022. The fiscal debt ratio (total government debt outstanding/aggregate revenue) of the Huangyan government decreased to 89.7% at end-2022 from 134% at end-2021.

Huangyan's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	4.0	4.4	4.1
Budgetary revenue growth rate (%)	(7.6)	10.5	5.8*
Tax revenue	3.6	3.9	3.3
Tax revenue (% of budgetary revenue)	89.4	89.7	81.2
Government fund income	5.1	4.1	10.1
Transfer payment	1.4	1.6	2.5
Aggregate revenue	10.5	10.2	17.2
Budgetary expenditure	5.9	6.0	6.8
Budget balance ¹ (%)	-48.1	-37.4	-66.3

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

THSCI was established in November 2001 under the instruction of Taizhou Huangyan District State-owned Assets Management Committee with an initial registered capital of RMB10 million. After a series of capital injections, as of the end-June 2023, the registered capital and paid-up capital was enlarged to RMB2.3 billion and RMB 396.3 million, respectively, with the entire contribution coming from the Huangyan FB. Since its establishment, there has been no change in the actual controlling entity, with the Huangyan FB maintaining control over the company.

Strategic Importance and Government Linkage

Strategic Importance of THSCI to Huangyan

THSCI, as the key LIDC in Huangyan, is primarily responsible for the investment, development and operation of infrastructure projects and state-owned asset management within the city. Serving as the sole entity in charge of infrastructure projects throughout Huangyan, THSCI is mainly engaged in resettlement housing development, road construction and other infrastructure related projects with strong regional advantages. It is also entrusted with the function of water supply and labor service in Huangyan. THSCI 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

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

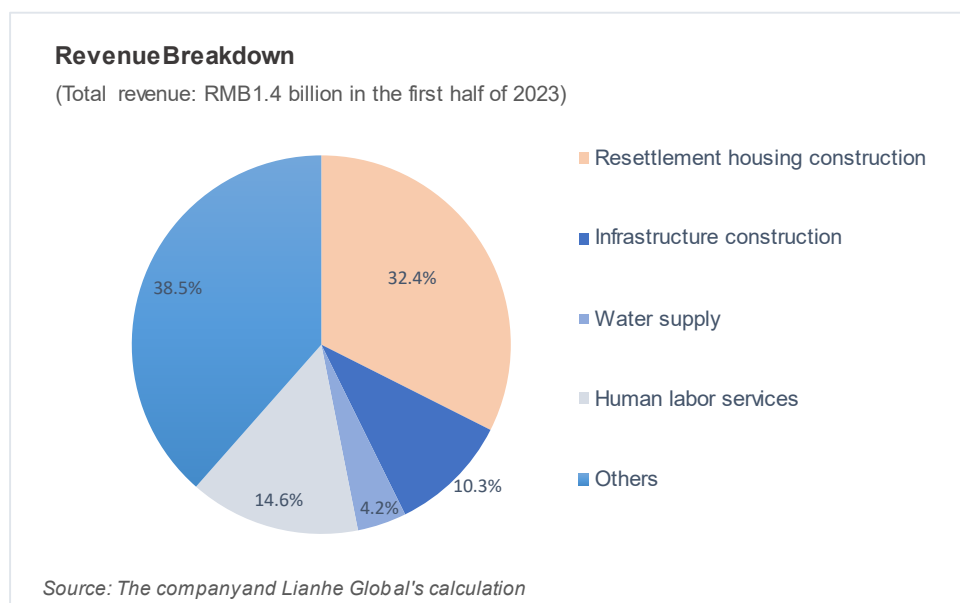
Government Support

THSCI received operational and financial support from the Huangyan government. The Huangyan government continued to inject capital and other kinds of assets into THSCI to expand its asset size and diversify its business. Given that it is the sole entity for infrastructure construction and state-owned asset operation in Huangyan, THSCI has an advantage in acquiring related resources and major projects. We believe THSCI is likely going to receive government support to support its daily business operation.

Business Profile

The Sole Entity Responsible for Infrastructure Construction in Huangyan

THSCI engages in a range of operations, including infrastructure construction, affordable housing development, water supply, security, property management, and trading activities in Huangyan. The total revenue of THSCI exhibited notable figures of RMB 1.9 billion, RMB 2.2 billion, RMB 2.8 billion, and RMB 1.4 billion in 2020, 2021, 2022, and the first six months of 2023, respectively. However, the gross profit margin demonstrated a declining trend during the corresponding periods. Specifically, it stood at 9.1%, 7.8%, and 1.14% in 2020, 2021, and 2022, respectively. This trend continued in the first half of 2023, reaching -5.62%, primarily attributed to the timing of revenue recognition from its affordable housing project. In terms of revenue sources, the primary contributors for THSCI are infrastructure construction and affordable housing development, collectively accounting for 42.7% of the total revenue during the first six months of 2023.



Resettlement Housing Construction

The operational framework for the THSCI resettlement housing business encompasses direct external sales, agency construction, and government procurement. In the direct external sales model, THSCI constructs and directly sells resettlement housing to generate revenue. Local governments establish specific resettlement methods, determining standards, prices, and external sales prices for surplus housing, parking spaces, or commercial spaces. THSCI independently finances and constructs projects in accordance with local government planning, selling resettlement housing directly to affected households at predetermined prices.

The agency construction model involves the government commissioning the company to construct resettlement housing projects at a cost-plus basis. Agreements are signed, specifying cost-plus methods to determine the contract amount. Upon completion, the government confirms the contract amount based on project progress, and revenue recognition follows cost accounting and confirmation of cost expenditures by government units. After the projects are finished, the payment will be settled based on the actual cost plus a markup of no more than 20%. The income derived from this segment was RMB897.2 million, RMB612.4 million, RMB1.1 billion and RMB451.1 million in 2020, 2021, 2022 and the first half of 2023, respectively.

Infrastructure Construction

Infrastructure construction is one of the THSCI's core businesses. The primary model for the infrastructure construction business is the agency construction model. Under this model, THSCI enters into framework agreements with the Huangyan FB and other government departments, allowing them to act as agents in the construction of specific projects. The company charges agency construction fees based on agreed-upon cost-plus rates for the relevant engineering projects, aiming to recover investments and generate related income.

Currently, the company has several ongoing projects, including the Qixiang Street municipal engineering, the westward extension of Tianyuan Road to the Second Ring South Road, and the realignment of Yongning River to Qingfeng Avenue. Additionally, there are several planned projects in the future, leading to potential capital expenditure pressures.

Leasing

THSCI is responsible for water supply services in Huangyan, including the main district and its five townships and one town, leveraging a strong regional advantage. Currently, the company has initiated the second phase of the Huangyan Water Plant project, designed to have a water supply capacity of 200,000 cubic meters per day. Additionally, the company is actively advancing an integrated urban and rural water supply project, gradually incorporating the township water plants within Huangyan District into its operational management scope. This strategic initiative aims to expand the water supply coverage year by year. Furthermore, the company is also involved in water infrastructure construction within Huangyan, including the installation of water pipes and water meters as part of the ongoing expansion outlined on the official website.

Labor Service and Other Businesses

Except for the businesses mentioned above, the company also operates labor service and other businesses to supplement its operating revenue, whose revenue accounts for a relatively small part 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	61,340	72,797	90,586	99,964
Equity	27,716	30,443	35,388	36,509
Debt	23,967	33,804	44,389	53,168
Debt / (Debt + Equity) (%)	46.4	52.6	55.6	59.3
LT Debt	17,166	22,909	32,074	37,700
LT Debt / (LT Debt + Equity) (%)	38.2	42.9	47.5	50.8

Source: Company information and Lianhe Global's calculations

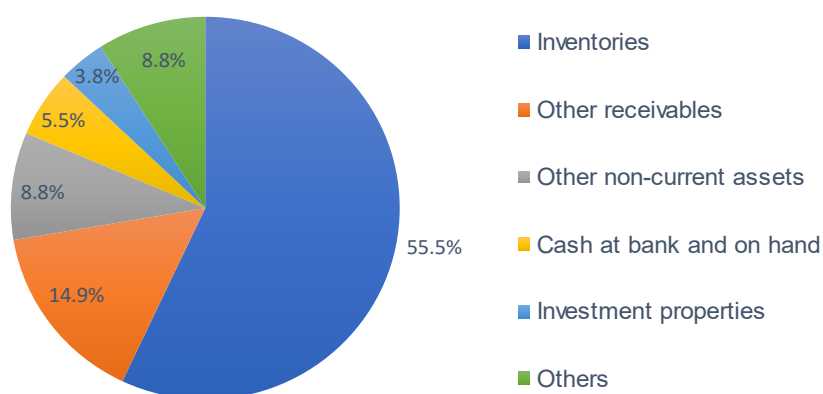
THSCI's total assets surged to around RMB100.0 billion at end-June 2023 from RMB61.3 billion at end-2020, largely attributed to the increase of inventory that related to its main business. The total debt of the company reached RMB53.2 billion at end-June 2023, more than doubled compared with that at end-2020 (RMB24.0 billion). Both the long-term and short-term debts rose rapidly in the past few years, and the reliance on debt financing of THSCI increased over the same period, with 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 lifted to 59.3% and 50.8% from 46.4% and 38.2% at end-2020, respectively. The company's financial leverage, as measured by debt/capitalization, also increased to 63.5% at end-June 2023 from 54.8% at end-2020.

THSCI's asset quality was relatively weak. By end-June 2023, the company had accumulated sizeable inventories of RMB55.5 billion (mainly construction costs) from its infrastructure construction projects. 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 other account receivables (primarily due from government agencies), representing 14.9% of total asset at end-June 2023. Their repayment schedules are highly subject to the fiscal conditions of the local government.

Asset Breakdown

(Total assets: RMB100.0 billion at end -June 2023)



Source: The company and Lianhe Global's calculation

Debt Servicing Capability

The liquidity of THSCI was sufficient. At end-June 2023, THSCI had a cash balance and unused credit facilities of RMB5.5 billion and RMB16.0 billion, respectively, compared with its debt due within one year of RMB15.5 billion. Besides, THSCI has access to various financing channels, including bank loans, non-traditional financing and bond issuance, to support its debt repayment and business operations.



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