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Lianhe Ratings Global

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Lianhe Ratings Global Limited has assigned 'BBB' global scale Long-term Issuer Credit Rating with Stable Outlook to Science City (Guangzhou) Financial Leasing Co., Ltd.

HONG KONG, 16 April 2024 – Lianhe Ratings Global Limited ("Lianhe Global"), an international credit rating company, has assigned 'BBB' global scale Long-term Issuer Credit Rating to Science City (Guangzhou) Financial Leasing Co., Ltd. ("SCFL" or "the company"). The Outlook is Stable.

The Issuer Rating reflects SCFL's franchise in Guangdong's leasing market, especially in Guangzhou's Huangpu District (Guangzhou Development Zone) ("Huangpu District") and Guangzhou Science City ("Science City"), sound business growth and strategy, sufficient capital adequacy and good access to funds, as well as the strong support received from Science City (Guangzhou) Investment Group Co., Ltd. ("SCI Group"), its major shareholder. The rating also considers its concentrated business profile and limited operating scale.

The Stable Outlook reflects our expectation that SCFL will maintain its current market position in the Science City while the SCI Group will continue to ensure SCFL's stable operation.

Key Rating Rationales

The Key Finance Lease Company in Science City with Strong Market Position and Pivotal Strategic Role: SCFL is a prominent finance leasing entity in Huangpu District, with operations mainly cantered in Science City. It's distinguished by its clear functional distribution, serving the real economy through leasing services. As a subsidiary of the SCI Group, it's pivotal in the local financing leasing industry. Leveraging the SCI Group's advantages, it focuses on Huangpu District, extending to the Pearl River Delta. Its investments cover high-tech sectors like medical, energy conservation, biomedicine, and new-generation IT, fostering synergy between finance and industry for mutual growth and development in the area.

Strong External Support from SCI Group: SCFL would likely receive strong support from SCI Group to ensure its stable operation, considering SCI Group's majority ownership of SCFL, strong integration and linkage, the potential impact on SCI Group's reputation. SCI Group directly and indirectly owns 86.88% shares of SCFL, and SCFL is the only financial lease company under SCI Group. As the majority shareholder, SCI Group has strong control over SCFL, including management appointments and decisions on major investment and funding plans. SCI Group has provided financial guarantees to most of SCFL's debt, significantly increasing SCFL's access to funds.

SCI Group is primarily responsible for project development, industrial investment and city operation within the region. SCI Group received ongoing operational subsidies from the local government in relation to providing public services. The local government also injected assets and cash capital into SCI Group to enhance its equity base. Considering the high strategic importance of SCI Group in promoting economic and social development, and the relatively strong economy and fiscal conditions of Huangpu District (Guangzhou Development Zone), we believe SCI Group's ability to provide support is high.

Sound Business Growth with High Concentration: SCFL, operational since 2017, has experienced steady growth in its leasing business from 2020 to end-September 2023, securing numerous contracts totalling RMB18.7 billion. Yet its total asset slightly decreased due to weakened demand for leasing assets following a decline in bank loan interest rates at end-September 2023. While SCFL maintained relatively good asset quality since its establishment, pandemic-related delays and undesirable financing environment has posed challenges for its credit profile.

SCFL leasing modes include direct, sale and leaseback, and intangible asset leasing, with assets mainly in machinery, equipment, and intangibles. Targeting sectors like consumer goods, electronics, and new energy vehicles, the company provides value-added services and structured financing solutions. However, 88.6% of SCFL's leasing projects are located in Guangdong province at end-September 2023, indicating a high geographical concentration.

Moderately volatile profitability: SCFL maintained stable gross profit margins of 34.5%-40% from 2020 to 2022, but experienced a slight decline in the first nine months of 2023 as the declining bank loan interest rates pressured SCFL's pricing. The annualized return on equity ("ROE") showed a downward trend over the same period, from 15.6% in 2020 to 3.0% in 2022 and -0.2% in the first nine months of 2023.

Having said that, the advantageous position of SCFL, stemmed from its strong market foothold in Huangpu, is anticipated to contribute to a favourable and stable profitability trajectory in the future. Besides, as the major finance leasing company in the Science City, the company enjoys a distinct advantage in securing key projects.

Adequate Capital but Moderately Tight Liquidity: SCFL's capital base strengthened significantly between 2020 and the first nine months of 2023, with paid-in capital growing from RMB300 million to RMB1.3 billion, boosting its capital adequacy ratio from 11.5% to 21.1%. This solid capitalization supports the company's expansion plans, with leverage standing comfortably below 8x (the regulatory requirement) at 4.34x at end-September 2023. Additionally, SCFL benefits from diverse funding sources, including bank borrowings and asset-backed securities issuance, with financial guarantees from its majority shareholder, the SCI Group.

However, SCFL's liquidity was moderately tight. At end-September 2023, liquidity assets only covered 17.6% of SCFL's debts due within one years. Moreover, the company highly relied on short-term fundings, as short-term debts contributed 68.3% of the company, while majority of outstanding leasing had a maturity of two to three years, creating a significant duration mismatch. As a result, SCFL need to frequently refinance its debts and thus subject to the market risks.

Rating Sensitivities

We would consider downgrading SCFL's rating if there is (1) significant deterioration in its capital adequacy, or (2) notable increase in impaired loans, or (3) weakened funding structure with notable duration mismatch and tightened liquidity, or (4) a significant reduction of SCI Group's shareholding with weakened operational and financial support from SCI Group's, or (5) significant deterioration in the access to the bank and/or capital market financings.

We would consider upgrading SCFL's rating if it were to further improve its 1) franchise with bigger business scale and wider market coverage, 2) funding diversity, 3) capital buffer to support business growth and withstand economic downturn, and 4) strategic alliance with SCI Group with greater business and financial linkages.

About Lianhe Global

Lianhe Global is an international credit rating company that provides credit ratings to corporations, banks, non-bank financial institutions, local investment and development companies, and other asset classes around the globe. Lianhe Global also provides credit risk research and other services related to credit ratings.

Rating Methodology

The principal methodology used in this SCFL's rating is Lianhe Global's Non-Bank Financial Institutions Criteria published on 21 November 2023 which can be found at the website www.lhratingsglobal.com.

Note: The above Issuer/Issuance Credit Ratings are solicited at the request of the rated entity or a related third party.

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