

Sichuan Hengji Industrial Group Co., Ltd.

Initial Issuer Report

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Sichuan Hengji Industrial Group Co., Ltd. (“SHIG” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Qu County (“Qu County government”) would provide very strong support to SHIG if needed, in light of its indirect majority ownership of SHIG, SHIG’s strategic importance as an important local investment and development company (“LIDC”) responsible for infrastructure construction and state-owned asset operation in Qu County, especially in the Qu County Economic Development Zone (“Qu County EDZ”), and the linkage between the Qu County government and SHIG, including appointment of the senior management, strategic alignment, supervision of major investment and financing plans and ongoing operational and financial support. In addition, the Qu County government may face significant negative impact on its reputation and financing activities if SHIG encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: SHIG is wholly-owned by Dazhou Investment Co., Ltd. (“DZIC”). Dazhou City State-owned Assets Supervision and Administration Bureau (“Dazhou SASAB”), as the SHIG’s actual controller, holds 90% of the company’s ownership through its 90% stake in DZIC. The remaining 10% stake of DZIC is directly held by the Sichuan Provincial Department of Finance (“Sichuan DF”). The Qu County government has the final decision-making authority and strong supervision over the company, including appointment and supervision of the senior management, strategic alignment and decision on its major investment and financing plan decisions. In addition, the Qu County government has assessment mechanism over the company and regularly appoints auditors to review the company’s operating performance and financial position.

Strategic Importance and Strategic Alignment: SHIG is an important LIDC that is responsible for infrastructure construction and state-owned asset operation in Qu County. Specifically, the company is the sole LIDC responsible for the investment, construction and operation of industrial parks and ancillary facilities in Qu County EDZ. Also, SHIG expanded its operation to the areas outside Qu County EDZ in Qu County. SHIG plays an important role in the construction and development of Qu County EDZ, which is a key task of the Qu County government according to its development plans. Therefore, SHIG’s business operation and strategic planning have been aligned with Qu County government’s development plans.

Ongoing Government Support: SHIG receives support from both the People’s Government of Dazhou City and the Qu County government for its business operations. SHIG received asset injections amounting to RMB0.9 billion and RMB5.4 billion from the Qu County government in 2022 and 2023, respectively. The injected assets included land management rights, sand and gravel resources and infrastructure construction projects,

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	27 December 2024

Key Figures of Qu County and SHIG (RMB billion)

	2022	2023
Qu County		
GDP	250.3	265.7
GDP growth rate (%)	3.5	6.5
Budgetary revenue	15.0	18.3
Government fund	21.9	21.5
Transfer payment	37.6	37.7
Budgetary expenditure	48.3	55.1
SHIG	2023	2024.6
Assets	16.9	17.7
Equity	11.4	11.4
Revenue	0.2	0.1

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

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Applicable Criteria

China Local Investment and Development Companies Criteria (31 July 2024)

which strongly enhanced the company's asset scale. In addition, SHIG received subsidies amounting to RMB37.7 million, 10.0 million, and 19.9 million in 2021, 2022, and 2023, respectively. Given SHIG's strategic importance in Qu County, we believe SHIG is likely going to receive government support in the future.

SHIG's Financial and Liquidity Position: SHIG's total assets increased to RMB17.7 billion at end-June 2024 from RMB8.7 billion at end-2021, owing to the large amount of asset injections in 2023. The total debt of the company increased to RMB2.5 billion at end-June 2024, compared with RMB0.9 billion at end-2021. At end-June 2024, the short-term debt and long-term debt accounted for 22.5% and 77.5% of the total debt, respectively. The company's financial leverage, as measured by debt/capitalization, stayed at a low level of 18.2% at end-June 2024.

However, SHIG's liquidity was tight. At end-June 2024, SHIG had unrestricted cash balance of RMB43.0 million, compared with its debt to be due within one year of RMB574.8 million. Having said that, most of the loans are bank borrowings, which are expected to be rolled over upon maturity. Also, SHIG may rely on the credit facilities of its parent company, if necessary, to support its debt repayment and business operations.

Economy and Fiscal Condition of Qu County: Qu County is located in the eastern part of Sichuan Province, in the upper reaches of Qujiang River, with a total area of 2,013 square kilometers. Qu County maintained medium-high economic growth during the past three years, with its GDP growth rate recording 8.5%, 3.7% and 7.0% in 2021, 2022 and 2023, respectively. The GDP of Qu County reached RMB42.0 billion in 2023, which was ranked 3rd among all Dazhou's jurisdictions.

The aggregate fiscal revenue of the Qu County government was mainly derived from government fund income and transfer payment from the higher government. The budgetary revenue of the Qu County government increased to RMB2.3 billion in 2023 from RMB1.6 billion in 2021, while the contribution of tax revenue was reduced to 28.9% from 37.9% over the same period. The financial self-sufficiency of Qu County was weak but moderately improving, with the budget deficit narrowing to 247.8% in 2023 from 260.2% in 2021. The outstanding amount of the Qu County government's debt continued expanding in 2021-2023, mainly due to the rise in special purpose debts. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, fell to 119.8% at end-2023 from 136.3% at end-2021, mainly due to the large increase in aggregate revenue.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Qu County

Qu County is located in the eastern part of Sichuan Province, China, in the upper reaches of Qujiang River, with a total area of 2,013 square kilometers. It is a large agricultural county under the jurisdiction of Dazhou City, with a large population and rich mineral resources.

The economic level ranks third among seven districts and counties in Dazhou City, and consumption and investment are the main driving forces for economic growth. At end-2023, Qu County had a resident population of 0.9 million, with an urbanization rate of 45.5%.

Qu County maintained medium-high economic growth during the past three years, with its GDP growth rate recording 8.5%, 3.7% and 7.0% in 2021, 2022 and 2023, respectively. The GDP of Qu County reached RMB42.0 billion in 2023, which was ranked 3rd among all Dazhou's jurisdictions. The economic structure of Qu County was mainly driven by the secondary and tertiary industries, which accounted for 24.8% and 53.2% of its GDP in 2023, respectively.

Qu County's GDP and Fixed Asset Investment (RMB billion)	2021	2022	2023
GDP	38.0	40.1	42.0
-Primary industry (%)	22.4	22.5	22.0
-Secondary industry (%)	28.6	29.7	24.8
-Tertiary industry (%)	49.0	47.8	53.2
GDP growth rate (%)	8.5	3.7	7.0
Fixed asset investment	30.8	33.8	36.1
Fixed asset investment growth rate (%)	11.4	9.7	6.7
Population (million)	0.9	0.9	0.9

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Qu County

The aggregate fiscal revenue of the Qu County government was mainly derived from government fund income and transfer payment from the higher government. The budgetary revenue of the Qu County government increased to RMB2.3 billion in 2023 from RMB1.6 billion in 2021, while the contribution of tax revenue was reduced to 28.9% from 37.9% over the same period. The financial self-sufficiency of Qu County was weak but moderately improving, with the budget deficit narrowing to 247.8% in 2023 from 260.2% in 2021. The government fund income increased steadily to RMB4.6 billion in 2023 from RMB3.1 billion in 2021, while the transfer payment from the higher government fluctuated between RMB4.8 billion and RMB6.0 billion over the same period.

The outstanding amount of the Qu County government's debt continued expanding in 2021-2023, mainly due to the rise in special purpose debts. At end-2023, the Qu County government's outstanding debt was RMB14.8 billion, including RMB5.7 billion of general obligations and RMB9.1 billion of special purpose debts. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, fell to 119.8% at end-2023 from 136.3% at end-2021, mainly due to the large increase in aggregate revenue.

Qu County's Fiscal Condition (RMB billion)	2021	2022	2023
Budgetary revenue	1.6	1.9	2.3
Budgetary revenue growth rate (%)	22.0	15.0	23.5
Tax revenue	0.6	0.6	0.7
Tax revenue (% of budgetary revenue)	37.9	33.0	28.9
Government fund income	3.1	4.1	4.6
Transfer payment	4.8	6.0	5.4
Aggregate revenue	9.6	12.0	12.4
Budgetary expenditure	5.9	6.8	8.1
Budget balance ¹ (%)	-260.2	-259.5	-247.8

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

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

SHIG was established in 2013 by DZIC with registered capital of RMB2 million. In December 2023, DZIC allocated most of its scenic spot assets to SHIG. In April 2024, the company's registered capital was enlarged to RMB200 million. At end-June 2024, SHIG is wholly-owned by DZIC. Dazhou SASAB, as the SHIG's actual controller, holds 90% of the company's ownership through its 90% stake in DZIC. The remaining 10% stake of DZIC is directly held by the Sichuan DF.

Strategic Importance and Government Linkage

Strategic Importance of SHIG to Qu County

SHIG is an important LIDC that is responsible for infrastructure construction and state-owned asset operation in Qu County. Specifically, the company is the sole LIDC responsible for the investment, construction and operation of industrial parks and ancillary facilities in Qu County EDZ. Also, SHIG expanded its operation to the areas outside Qu County EDZ in Qu County. SHIG plays an important role in the construction and development of Qu County EDZ, which is a key task of the Qu County government according to its development plans. Therefore, SHIG's business operation and strategic planning have been aligned with Qu County government's development plans.

Strong Linkage with the Local Government

SHIG has a strong linkage with the Qu County government, as the Qu County government has the final decision-making authority and strong supervision over the company, including appointment and supervision of the senior management, strategic alignment and decision on its major investment and financing plan decisions. In addition, the Qu County government has assessment mechanism over the company and regularly appoints auditors to review the company's operating performance and financial position.

Ongoing Government Support

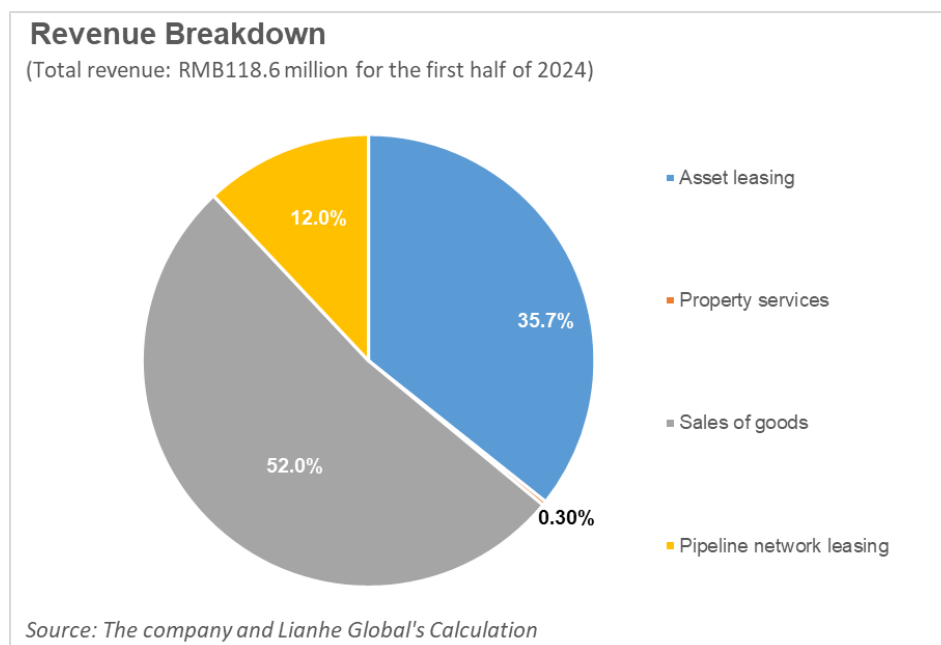
SHIG received asset injections amounting to RMB0.9 billion and RMB5.4 billion from the Qu County government in 2022 and 2023, respectively. The injected assets included land management rights, sand and gravel resources and infrastructure construction projects, which strongly enhanced the company's asset scale. In addition, SHIG received subsidies amounting to RMB37.7 million, 10.0 million, and 19.9 million in 2021, 2022, and 2023, respectively. Given SHIG's strategic importance in Qu County, we believe SHIG is likely going to receive government support in the future.

Business Profile

An Important LIDC Responsible for Infrastructure construction and state-owned asset operation in Qu County

SHIG is an important LIDC that is responsible for infrastructure construction and state-owned asset operation in Qu County. SHIG's main business income sources are asset leasing, sales of goods, pipeline network leasing and property services.

The total revenue of SHIG was RMB59.0 million, 154.9 million and 118.6 million in 2022, 2023 and the first half of 2024, respectively, representing an upward trend. The gross profit margin decreased from 64.4% in 2022 to 46.3% in the first half of 2024, which was mainly due to the decreasing profit margin of the sales of goods segment.



Asset leasing

The company is the sole LIDC within the Qu County EDZ, and thus it is entrusted with the pivotal role of constructing factories and supporting infrastructure within the Qu County EDZ. Upon the completion of factories, office buildings, staff dormitories, parking lots, and basic supporting facilities, SHIG will generate revenue from the operation in the Qu County EDZ by renting out factories and operating the parking spaces, etc.

Sales of goods

This sector primarily encompasses manufacturing and sales of electronic components, automotive parts, household appliances, communication equipment, and hardware products. It also includes the sale of leather goods, chemicals, import/export services, daily chemicals, household items, footwear and headwear, and cosmetics, catering to the wholesale market for daily necessities.

Pipeline network leasing

The company owns and operates a network of pipelines and is engaged in the leasing of usage rights for these pipelines. These networks are used for energy supply, including water and heating services. By leasing these rights, the company provides clients with access to the utility networks for a specified period in exchange for rental payments.

Others

The company also generates revenue from real estate development, property sales and trading business, etc.

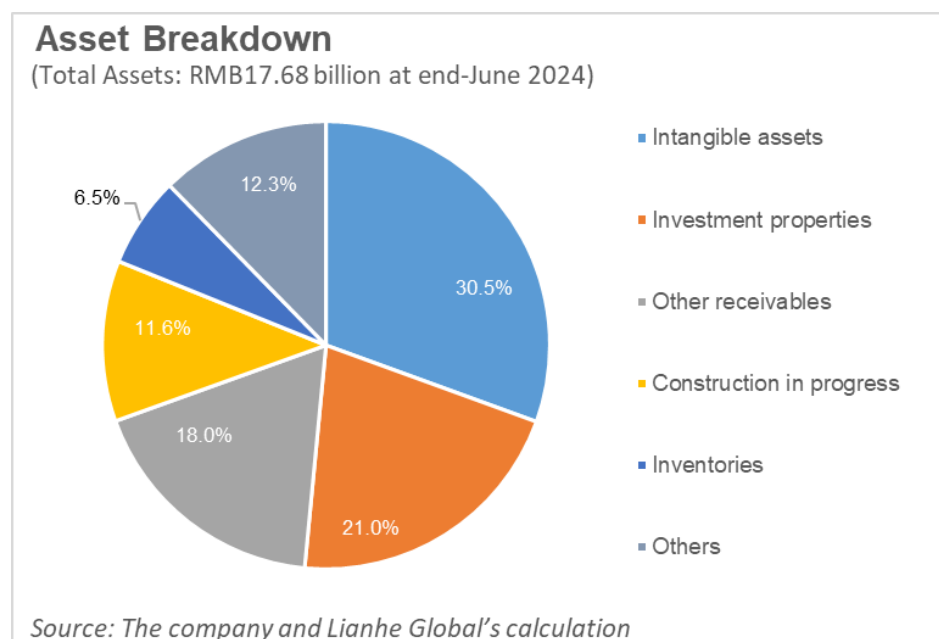
Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2021	2022	2023	June 2024
Total Asset	8,749	7,989	16,850	17,679
Equity	6,566	4,562	11,396	11,427
Debt	864	1,558	2,386	2,551
Debt / (Debt + Equity) (%)	11.6	25.5	17.3	18.2
LT Debt	837	1,464	1,888	1,976
LT Debt / (LT Debt + Equity) (%)	11.3	24.3	14.2	14.7

Source: The company's financial reports and Lianhe Global's calculations

SHIG's total assets increased to RMB17.7 billion at end-June 2024 from RMB8.7 billion at end-2021, owing to the large amount of asset injections in 2023. The total debt of the company increased to RMB2.5 billion at end-June 2024, compared with RMB0.9 billion at end-2021. At end-June 2024, the short-term debt and long-term debt accounted for 22.5% and 77.5% of the total debt, respectively. The company's financial leverage, as measured by debt/capitalization, stayed at a low level of 18.2% at end-June 2024.



SHIG's asset quality was moderately weak. At the end-June 2024, the company's main asset component was intangible assets, investment properties, and other receivables. In addition, the company had a large number of constructions in progress and inventories, which usually take a long time to monetize.

Debt Servicing Capability

SHIG's liquidity was tight. At end-June 2024, SHIG had unrestricted cash balance of RMB43.0 million, compared with its debt to be due within one year of RMB574.8 million. Having said that, most of the loans are bank borrowings, which are expected to be rolled over upon maturity. Also, SHIG may rely on the credit facilities of its parent company, if necessary, to support its debt repayment and business operations.

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