CCXI

Local Government Bond and Financing Vehicles

Quarterly Report

April 29, 2019

Issuance and Trading Continue to Recover, with Concerns of Risk Differentiation Remaining

-- Review and Outlook of Local Government Financing Vehicles in the First Quarter of 2019: Market Operation

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Debt replacement is completed, issuance of new bonds is accelerated, and special debts continue to expand to improve weakness, December 6, 2018.

Major viewpoints

✧ **Operation: Overall warming, continued differentiation**

- Primary market: the issuance has recovered, and the issuance costs witnessed an overall fall.
  In the first quarter of 2019, the issuance scale continued the recovery trend of the second half of last year, registering both year on year and quarter on quarter rise. The scale of monthly issuance declined first and then increased. The net financing amount rose steadily in the first quarter. The issuance interest rate of LGFV bonds continued to fall on the whole, and the structural differentiation was intensified. The issuance cost of AA- grade LGFV bonds continued to rise from that of 2018.
- Secondary market: trading is active, and credit spreads continued to narrow.
  Benefiting from the relatively loose fund supply and the recovering market sentiment, the activeness of the LGFV bonds at the secondary market rose sharply in the first quarter. The yield trend of different maturities diverged, the yield of short-term bonds fell back obviously, while the yield of the medium - and long-term bonds rose with fluctuations. The credit spreads continued to narrow, and the regional differentiation was obvious, with Guizhou recording the highest credit spreads.

✧ **Credit risk: The non-standard debt risk of LGFVs continued to be exposed, with no LGFVs downgraded**

- **Credit events:** Four LGFVs involved in non-standard debt defaults, which decreased from the fourth quarter of 2018.
- **Rating adjustment:** In the first quarter, the rating of LGFVs was not downgraded, and the major reason for upgrade lies in strengthened government support.
- **Redemption in advance:** The scale of redemption in advance rose slightly compared with the previous quarter, with AAA grade entities accounting for 70%

✧ **Maturities: The average maturities from April to December exceeds RMB100 billion, and the rolling pressure of debt was relatively heavy**

- **In September, the pressure from matured bonds and repurchase is significant, and the main matured bonds are medium to high level.** After a smooth March peak, the LGFV bond market is still facing the pressure of maturity and repurchase in September. The main bond entities facing maturity are of AAA grade, with AA+ accounting for a large proportion.
- **Jiangsu led the scale of matured bonds, with a rising proportion of bonds with special terms.** In order to effectively isolate and prevent the non-standard bond default of LGFVs from encumbering the LGFV entities, the proportion of "cross default", "prior constraint" and "controller change" rebounded.
- **The cash flow of nearly one third of the matured entities cannot cover the interest-bearing debt, and the payment depends on the government collection.** The overall debt pressure of LGFVs has fallen from the end of last year, but the solvency is still insufficient.

✧ **Risk outlook: Debt pressure still remains, and the risk differentiation of LGFVs will continue**

In the first quarter, under the support of multiple favorable policies, the primary and secondary markets of the LGFV bond market recovered on the whole, but the structural divergence was still intensifying, and the debt repayment pressure has not been resolved in the real sense. In the next stage, the "accommodative monetary, fiscal and credit" orientation will be shifted to the "structurally accommodative monetary and fiscal policy with stable credit", the macroeconomic regulation and control will maintain steady growth, guard against risks and seek dynamic stability, and risk prevention may become the focus of policy again. LGFVs undertaking projects under construction with strong features of public welfare and high importance will still get more support, while LGFVs with weak financial strength and in areas of lower administrative levels are expected to get limited support as before, so the risks of LGFVs will continue to diverge in different dimensions. In the next stage, special attention can be paid to the following aspects:

1) **Paying attention to the impact of implicit debt resolution schemes on the outstanding debts of LGFVs**
2) **Paying attention to the impact of integration and transformation of LGFVs on credit risk**
3) **Paying attention to the non-standard debt and contingent debt of LGFVs to guard against risk resonance**
4) **Focusing on non-core LGFVs that are highly dependent on government collection and have weak regional financial resources**

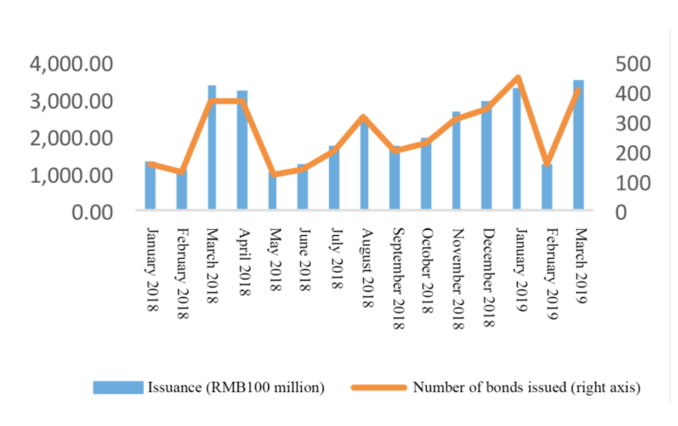
In the first quarter of 2019, macroeconomic stability slowly recovered. In the context of the policy of "stabilizing regulation, relaxing monetary supply and credit", the financing enterprises of local government financing vehicles (LGFV) improved significantly, and the refinancing pressure was eased to certain extent. The trading of LGFV bonds continued to rebound, the overall credit spreads narrowed, and the LGFV bonds maturity peak time passed smoothly. However, the subsequent LGFV bonds maturity pressure will remain high, and the market structural risk is still outstanding. In this report, by analyzing the market performance of LGFV bonds in the first quarter of 2019 and integrating policy orientation and maturity situations, the outlook on the risk of LGFV bonds in the next stage will be discussed.

I. The operation in the first quarter: Overall warming and continued differentiation

i. Primary market: The offerings recovered, and issuance costs declined on the whole

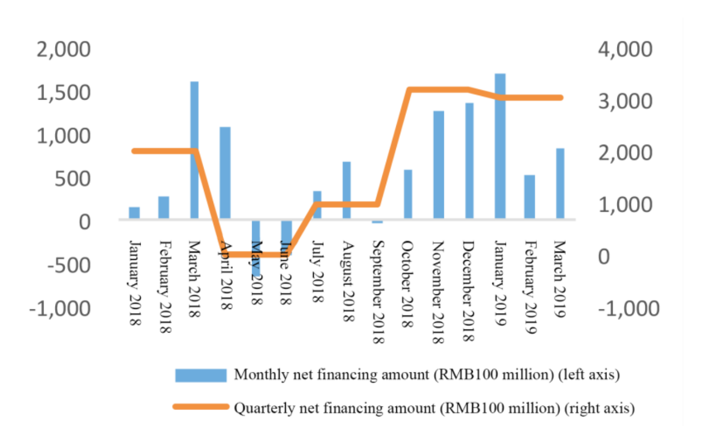
In the first quarter of 2019, LGFV bonds continued the recovery trend since the second half of last year. A total of 1,001 LGFV bonds were issued, with the issuance scale of RMB808.128 billion, up 40.92% year on year and 6.57% quarter on quarter. **From the perspective of the monthly trend,** the issuance scale decreased first before witnessing an increase later. In January, the issuance scale reached RMB332.582 billion, with a sharp rise of 156.78% year on year. In February, due to the impact of the Spring Festival, the issuance scale decreased to certain extent. In March, due to the favorable policies of the Shanghai and Shenzhen stock exchanges, such as easing the application conditions of LGFVs, the issuance scale rebounded significantly, recording the highest level since January 2018. **With respect to net financing amount,** the monthly trend was consistent with the issuance scale. In the first quarter, the net financing amount reached RMB304.067 billion, up 51.37% year on year, and down slightly quarter on quarter. January posted the highest net financing amount, reaching RMB167.60 billion, the highest monthly amount since 2018.

Figure 1 Issuance scale of LGFV bonds increased after a decline in Q1



Data source: choice, compiled by CCXI

Figure 2 Net financing amount remained positive, with January registering the highest amount



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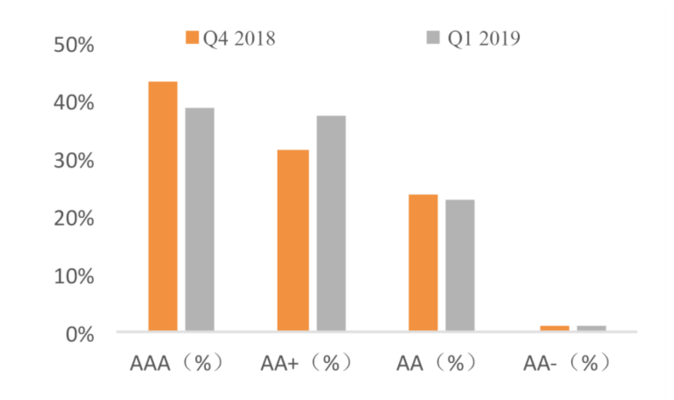
1. The newly issued LGFV bonds were mainly super-short-term financing bonds and medium-term notes (MTNs), and the ratio of borrowing new debt to repay old debt increased

In terms of issuance area, Jiangsu Province ranked the first in both the number of bonds and scale of issuance in the first quarter, accounting for 23.87% in terms of the issuance scale. **With respect to issuance term,** the term of one year or below accounted for 32.10%, up 0.69 percentage point quarter on quarter; the term of one to five years accounted for 57.70%, up 2.38 percentage points quarter on quarter; the term of five years or above accounted for 10.20%, down 3.07 percentage points quarter on quarter. **In terms of the credit rating of bonds issuers,** AAA grade accounted for 39%, but it is down by 5 percentage points year on year, while AA+ grade accounted for 37%, up by 3 percentage points year on year and 6 percentage points quarter on quarter. **In terms of bond types,** super-short-term financing bonds accounted for the highest proportion, reaching 26.40%, an increase of 1.78 percentage points quarter on quarter. Although corporate bond issuance policies were somewhat relaxed, the proportion of newly issued corporate bonds did not recover significantly. **With respect to the use of funds raised by bond issuance,** among the bonds which disclose the use of funds, 66.41% of the funds raised through bonds are used for repayment of early borrowings, rising by 1.64 percentage points on a quarterly basis year on year and 2.94 percentage points quarter on quarter respectively, but falling by 3.5 percentage points as compared with the whole year of last year.

Figure 3 Proportion of AA+ LGFV bonds issued increased remarkably in Q1



Data source: choice, compiled by CCXI

Figure 4 Newly-issued LGFV bonds are mainly short-term financing and MTNs

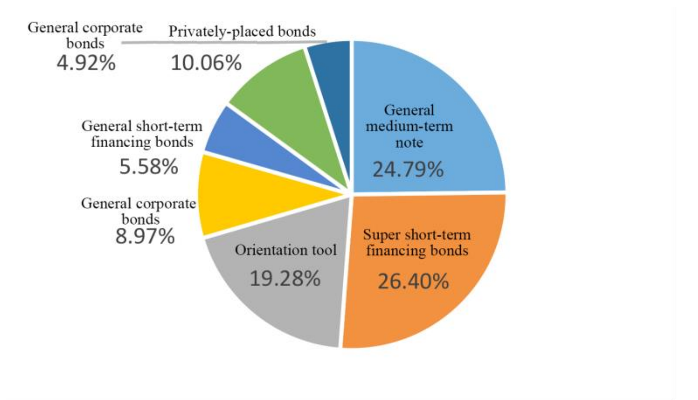


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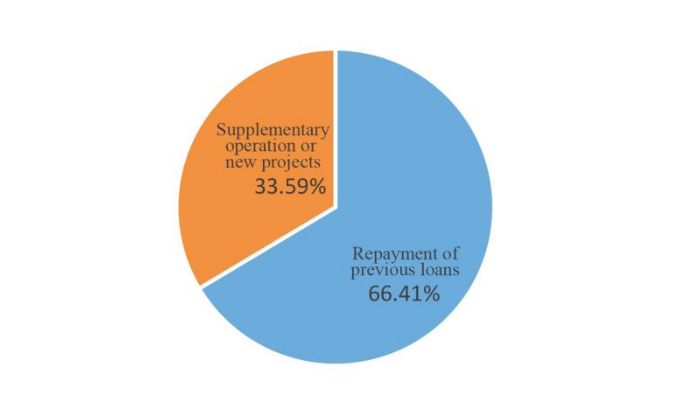
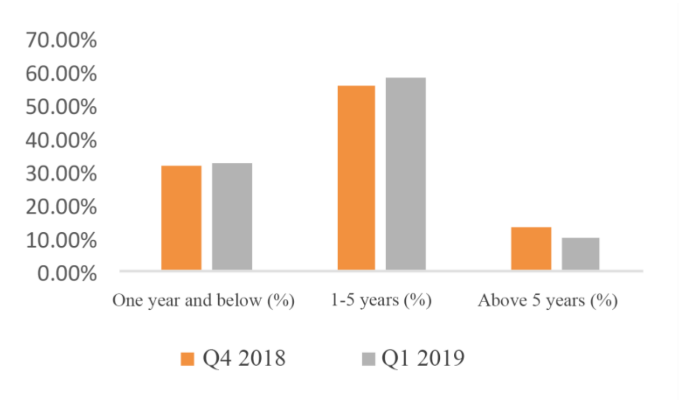
Figure 5 60%+ newly-issued LGFV bonds are used to repay previous debts increased remarkably in Q1



Data source: choice, compiled by CCXI

Figure 6 The term of newly-issued LGFV bonds is mainly 1-5 years

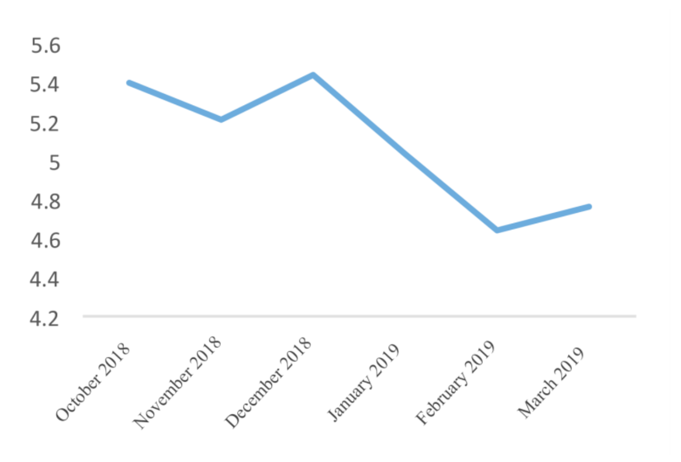


Data source: choice, compiled by CCXI

2. The cost of issuance fell back on the whole and structural differentiation intensified

From the perspective of the overall trend of issuance cost, thanks to the relatively loose monetary policy in the first quarter, the interest rate of LGFV bonds fell on the whole. However, affected by the marginal tightening of monetary policy in March, the interest rate of LGFV bonds rose slightly. **With respect to credit rating,** the issuance costs of various credit ratings show clear differentiation. AAA, AA+ and AA grades witnessed falling issuance costs from 2018. Among them, the issuance costs of AAA grade and AA+ grade dropped significantly compared with that of 2018, with the weighted average issuance interest rate dropping by more than 80 bps, and the issuance cost of AA- grade LGFV bonds kept increasing compared with that of 2018, with the weighted average issuance interest rate reaching 7.66% in the first quarter. **In terms of bond types,** the issuance cost of all kinds of bonds fell back, among which short-term and super-short-term bonds fell the most, with a decline of more than 100 bps. The issuance cost of corporate bonds fell the least, making it the type of bond with the highest issuance cost, recording the weighted average issuance interest rate of 6.45% in the first quarter. **From the perspective of the administrative level of LGFVs,** the issuance costs of LGFVs at all administrative levels decreased, with the most obvious decline in the issuance costs of provincial LGFVs. Their weighted average issuance interest rate in the first quarter was only 4.32%, which was 83 bps lower than that in 2018.

Figure 7 Issuance costs fell in Q1 on the whole and rose slightly in March

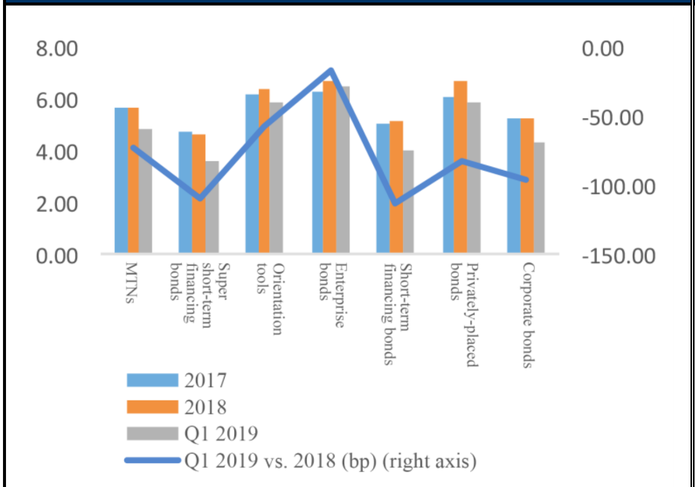


Data source: choice, compiled by CCXI

Figure 8 The issuance costs of medium- and high-grade bonds fell significantly

Data source: choice, compiled by CCXI

Figure 9: The issuance costs of various kinds of bonds fell on the whole



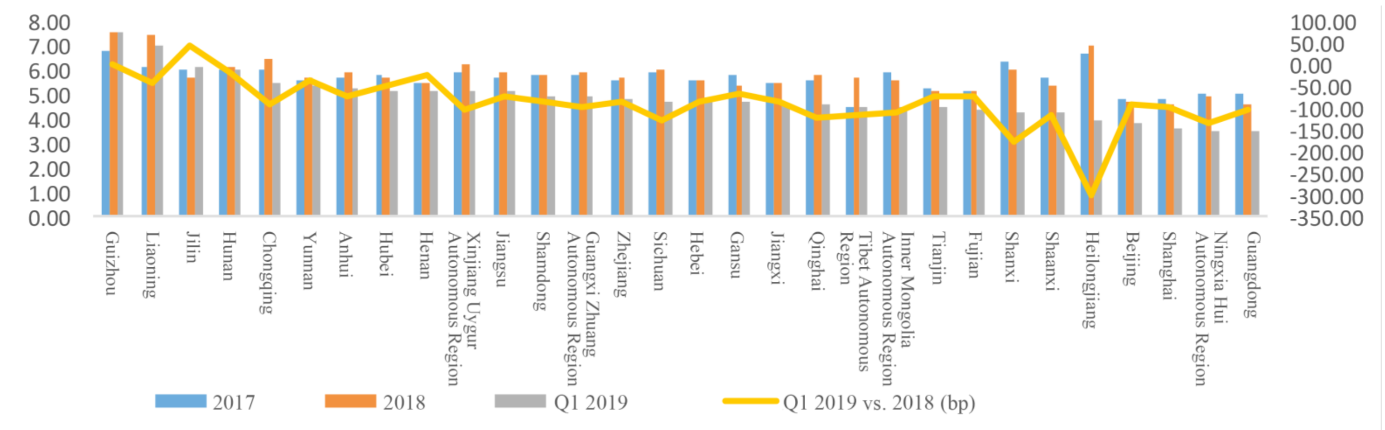
Data source: choice, compiled by CCXI

Figure 10: Provincial-level LGFV bonds witnessed the sharpest decline in issuance costs

Data source: choice, compiled by CCXI

In terms of regions of issuance, in the first quarter, the costs of LGFV bond issuance of Guizhou, Liaoning, Jilin, Hunan, Chongqing and Yunnan were higher. However, based on the issuance cost trend of the first quarter relative to late 2018, except Guizhou and Jilin that recorded an increase (Guizhou rose by 1.6 bps, and Jilin by 42.3 bps), other provinces all registered a decline in issuance costs, with Heilongjiang recording the biggest drop, down by 303 bps from the end of 2018.

Figure 11: The issuance costs of LGFV bonds fell back on the whole and showed remarkable regional differentiation



Data source: choice, compiled by CCXI

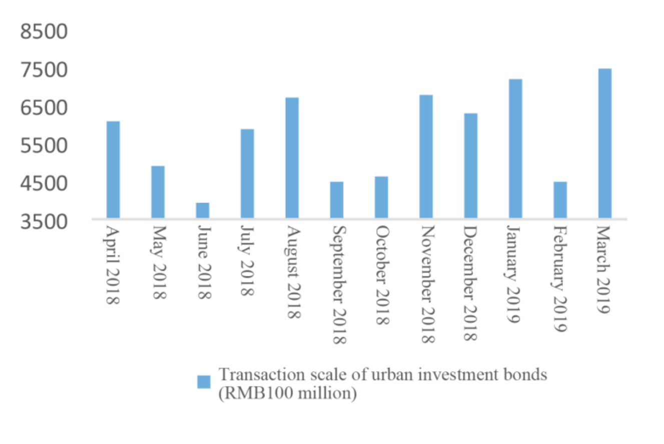
ii. Secondary market: The trading was active, and the credit spreads continued to narrow

1. The trading scale of transaction of bonds in cash recovered, and the trend of yield varied with different maturities

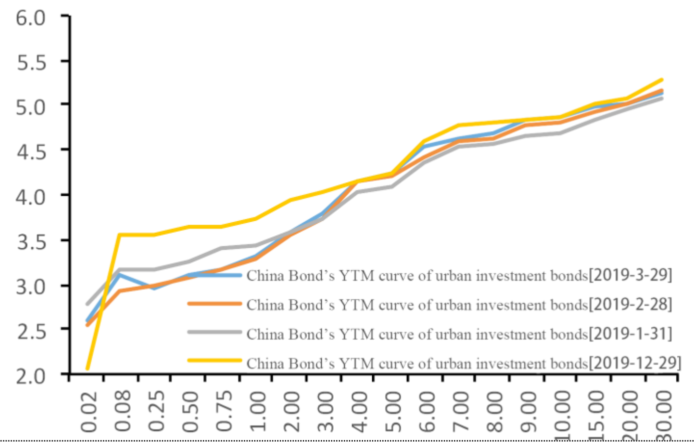
Benefiting from the relatively loose capital supply and the recovering market sentiment, the activity at the secondary market of LGFV bonds witnessed a sharp rise in the first quarter. In the first quarter, the scale of LGFV bonds trading in cash reached RMB1,915.178 billion, up 30.99% year on year and 8.23% quarter on quarter, accounting for roughly 37.85% of the trading volume in the secondary market of credit bonds, which is relatively stable. **In terms of the distribution of ratings,** the transactions were mainly in the medium and high levels, with AAA and AA+[1] grades accounting for 43.82% and 31.41% respectively. **Based on the monthly trading trend of bond transactions in cash,** the trading scale decreased first before registering an increase. Particularly, in February, due to the impact of the Spring Festival, the trading time was short and the trading scale fell to certain extent. **With respect to the yield to maturity trend,** the first quarter showed an overall downward trend compared with that of the end of 2018, but the trend of bonds with different maturities was diverging. The yield of short-term bonds fell significantly, while that of medium - and long-term bonds showed a trend of rising amid fluctuations.

Figure 12: The scale of LGFV bond trading fell first and then rose	Figure 13: The yield to maturity of short-term LGFV bonds fell, while that of long-term bonds increased

[1] The statistics are conducted on the total of bonds with ratings.



Data source: choice, compiled by CCXI

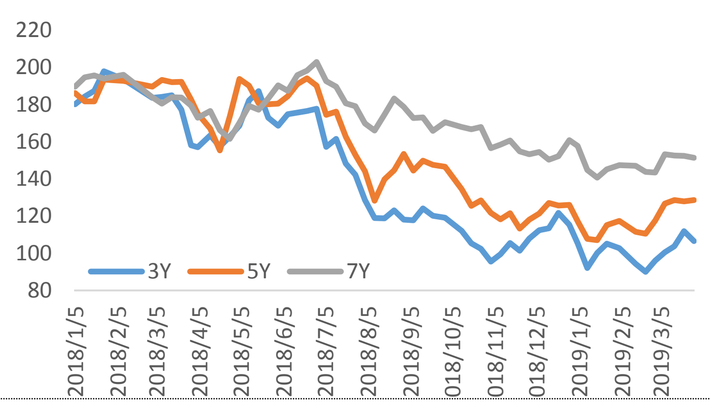


Data source: choice, compiled by CCXI

2. Credit spreads continued to narrow, with obvious regional differentiation

On the whole, the credit spread of LGFV bonds of various maturities continued the trend of narrowing since the second half of 2018, and rose in March to certain extent. **In terms of the distribution of ratings,** the credit spreads of various rating displayed obvious differentiation. Except AA- grade, all other ratings were narrowed. **With respect to regions,** the credit spreads of LGFV bonds of Guizhou, Heilongjiang, liaoning and Hainan were the highest, among which Guizhou, Heilongjiang and Hainan's credit spreads widened significantly, rising by 152 bps, 70 bps and 186 bps respectively compared with 2018.

Figure 14: The scale of LGFV bond trading fell first and then rose

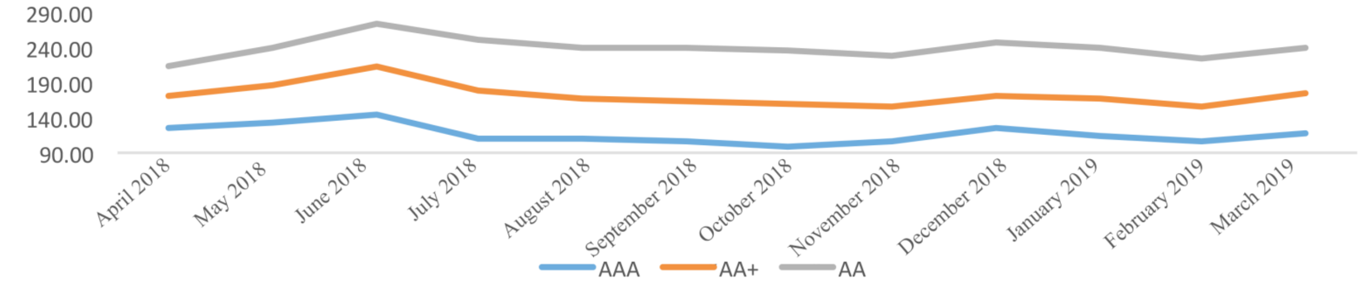


Data source: choice, compiled by CCXI

Figure 15: The credit spreads of different grades are remarkably differentiated

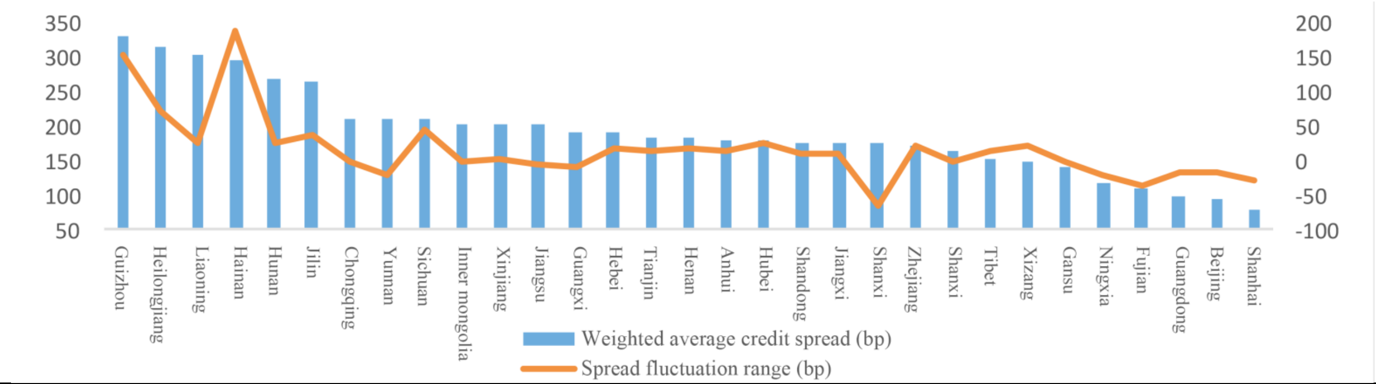
Data source: choice, compiled by CCXI

Figure 16: Credit spreads of LGFV bonds of various ratings narrowed steadily in Q1, but widened in March



Data source: choice, compiled by CCXI

Figure 17: Credit spreads widened in Guizhou, Heilongjiang and Hainan Provinces

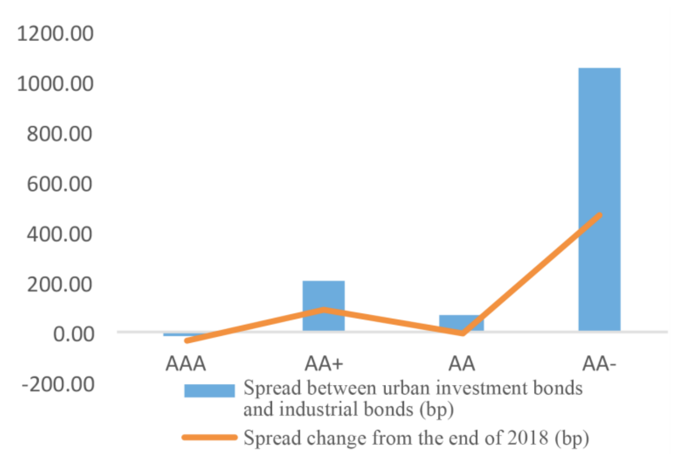


Data source: choice, compiled by CCXI

The trend of spread[2] between LGFV bonds and industrial bonds is significantly differentiated, among which the spread between AAA grade LGFV bonds and industrial bonds was the lowest among all ratings, which was -16 bps. The spread of AA- grade bonds was the highest, reaching 1053 bps, 471 bps higher than that of the end of 2018. The spread of AA+ and AA grades was 205 bps and 72 bps respectively. **In terms of regional distribution,** the spreads of Tibet, Hainan, Guangxi, Guizhou and Hainan's LGFV bonds were the highest compared with that of industrial bonds. However, despite the relatively high spread of Hainan's LGFV bonds, it narrowed significantly since the end of 2018, with a decline of more than 200 bps. **From the perspective of monthly trend,** except that the spread of AA- grade LGFV bonds widened remarkably relative to the industrial bonds, the spread between other LGFV bonds and the industrial bonds was relatively stable, but the gap between different ratings was more prominent, with AAA grade bonds maintaining negative spread.

Figure 18: Spread of LGFV bonds at various ratings are more differentiated than that of industrial bonds	Figure 19: Spreads of LGFV bonds of Tibet and Hainan are higher than that of industrial bonds

[2] In this report, the spread samples of LGFV bonds and industrial bonds are selected to compare the LGFV bonds and non-LGFV bonds in the medium-term notes at the end of 2018. The spread between LGFV bonds and industrial bonds is the valuation yield of industrial bonds minus the valuation yield of LGFV bonds.



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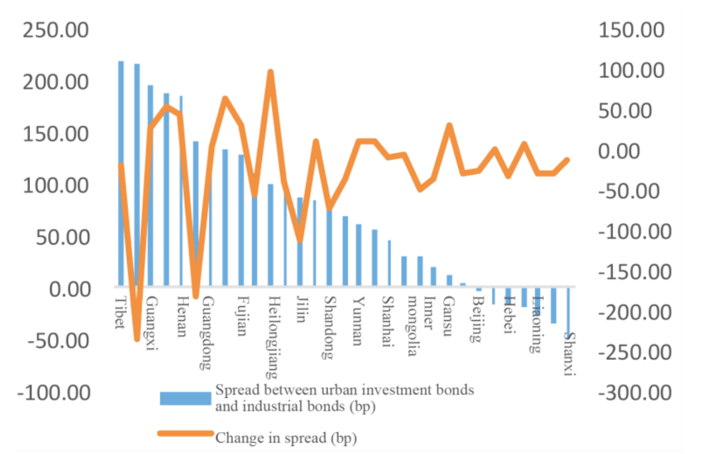
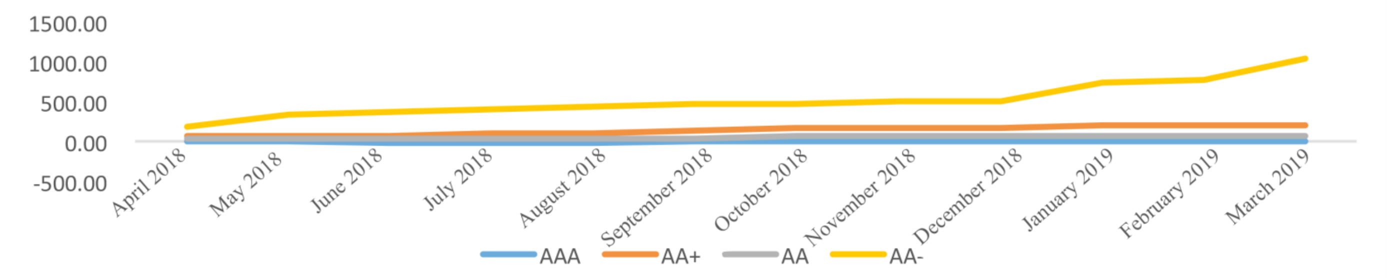


Data source: choice, compiled by CCXI

Figure 20: The trend of spread of LGFV bonds diverged from that of industrial bonds in Q1, with AA- bonds witnessing obvious spread widening



Data source: choice, compiled by CCXI

II. Credit risk: The non-standard debt risk of LGFV bonds continued to be exposed, and no LGFVs were downgraded

i. Credit events: Four LGFVs involved in non-standard debt defaults, which decreased since the fourth quarter of 2018

There was no default in the LGFV bond market in the first quarter of 2019, but the credit events of non-standard debt continued to be exposed, with a total of four cases, which decreased from the number of such cases in the fourth quarter of 2018. Of the four non-standard debt defaults, three were trust plans and one was a private fund, involving a total amount of roughly RMB380 million. **In terms of regional distribution and administrative level of relevant entities,** the main defaulters in the four events are all district/county-level platforms in regions with relatively weak financial resources, two of which are located in Guizhou, and the rest are located in Sichuan and Inner Mongolia respectively. **With respect to the project types involved,** the three trust plans are respectively invested in the construction of standard plant of Jinqiao New Area Industrial Park in Pengxi County, the construction of small streets and alleys renovation project in Nuoer Town of Duolun County, and the construction of resettlement housing project of shanty town reconstruction in Kaili City. The investment of the private fund is not disclosed. **In terms of the causes of debt default,** although the refinancing environment of LGFVs has improved, for LGFVs in regions with weak financial resources, some public welfare projects rely heavily on government collection or subsidy. In the period when government collection or subsidy is not timely and debt repayment is concentrated, relevant non-standard debt defaults occur.

Table 1 Summary of credit risk events of LGFVs in the first quarter of 2019

Name of LGFV	Product name involved	amount involved	Causes of outbreak of risk events	Risk event handling process
Chishui City State-owned Assets Investment and Development Co., Ltd. (Guizhou)	Account receivable	RMB52.0533 million	On January 29, Chishui State-owned Assets Investment and Development Co., Ltd. said that on January 21, it already deposited the first phase of funds into a bank account and applied to pay the private fund manager. However, due to the large amount of business undertaken by the bank at the end of the year and the complicated inter-bank transfer procedure of large amount of funds, Chishui State-owned Assets Investment and Development Co., Ltd. failed to transfer the funds on time on January 23.	Repayment was made on January 28, 2019.
Pengxi County Jinfu Industrial Co., Ltd. (Sichuan)	Zhongjiang Trust – Jinma No. 547 Receivables investment collective fund trust plan of Pengxi County Jinfu Industrial Co., Ltd.(1st phase)	RMB40.80 million	Due to the difficulties in fund turnover of infrastructure construction projects, most of the receivables can't be collected in time, and there has been a serious shortage of working capital, so the fund cannot be timely organized to repay the financing of this trust plan	The financier applied to extend the repayment period of each installment of the trust scheme for 12 months respectively
Duolun Chunhui Urban Investment Co., Ltd. (Inner Mongolia)	Zhongjiang Trust ·Jinma No. 508 Chunhui investment revenue accounts investment collective fund trust plan	RMB40.81 million	Under the impact of the economic downward pressure, debt alleviation and other factors, the county's local finance is short of funds, so it is difficult to pay the accounts payable of the small streets and alleys renovation project in Nuoer Town of Duolun County	The financier applies to extend the term of maturity for trust products of RMB80 million by one year
Guizhou Kaili Kaiyuan Urban Investment and Development Co., Ltd. (Guizhou)	Zhongtai ·Guizhou Kaili project loan collective fund trust plan	RMB246 million	The economic growth of Qiandongnan Prefecture has slowed down, and the budget revenue of public finance of Kaili Economic Development Zone has decreased remarkably. The company's future investment scale is large, the external financing pressure is heavy, its total profit depends heavily on government subsidy, and its profitability is weak.	According to the announcement provided for investors of this product, Zhongtai Trust has assigned on-site collection team to follow up the implementation of repayment funds. The subsequent repayment funds will be successively received through the multi-channel coordination of Qiandongnan Prefecture government, Kaili Municipal Government, the financing party Kaili Kaiyuan LGFV and the guarantor Kaihong Assets. The trustee will continue to follow up the repayment progress to ensure the smooth repayment of the trust funds and timely disclose the latest progress to investors. The announcement was signed on March 11.

Source: choice, organized by CCXI

ii. Rating adjustment: In the first quarter, the rating of LGFVs was not downgraded, and the upgrade was mainly attributed to the strengthened government support

Based on the adjustment of corporate ratings, there were no downgrades of LGFVs in the first quarter, and the ratings of a total of seven LGFVs were upgraded. The upgrade of ratings in the first quarter is mainly attributed to the improvement of status of LGFVs due to strengthened government support they received. **In terms of debt rating adjustment,** 20 LGFV bonds were upgraded, all consistent with the upgrade of corporate ratings. Specifically, the corporate rating of Shao Dong New Area Development and Construction Investment Co., Ltd. was raised from AA- to AA, the mortgage security of land use right of the credit enhancement measures can still effectively enhance the level of bond credit, and the debt rating was upgraded from AA to AA +.

Table 2 LGFV enterprises with upgraded ratings in the first quarter

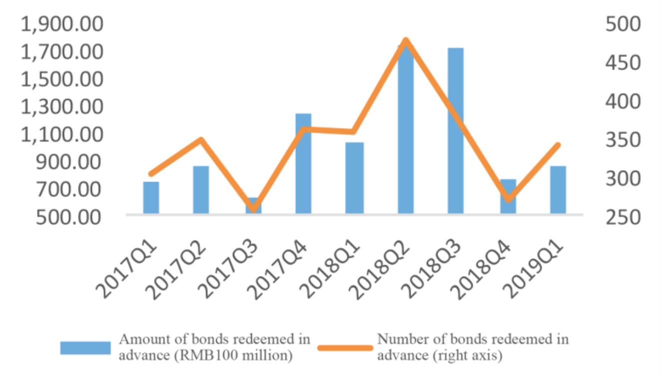
Adjustment direction	Name of enterprise	Region	Grading adjustment	Adjustment reason
Upgrades	Jincheng State-owned Capital Investment and Operation Co., Ltd.	Shanxi Province	AA→AA+	(1) As a key investment and operation company of State-owned assets established by Jincheng City, the company's functional positioning and status has been further enhanced, and the company assumes the responsibilities of investors in major projects on the people's livelihood of Jincheng on behalf of the government (2) The company enjoys strong support from shareholders, its competition and risk tolerance capabilities have been improved remarkably, and it has received vigorous support from the Jincheng municipal people's government with respect to absorption and merger as well as equity transfer of State-owned assets (3) In the future, the company's capital and operational strength is expected to be further reinforced, and the Jincheng municipal government plans to transfer all its operational assets and State-owned equity of enterprises to the company.
	Guangxi Beibu Gulf Investment Group Co., Ltd.	Guangxi Zhuang Autonomous Region	AA+→AAA	(1) The company has merged Guangxi New Development Communications Group Co., Ltd. with controlling stake, which is a wholly-owned subsidiary of the former State-owned Assets Supervision and Administration Commission of the people's government of the Guangxi Zhuang Autonomous Region. After the restructuring, the status of the Beibu Gulf Group has been significantly improved, and its positioning in Guangxi fruit enterprises has become clearer. (2) The business sector has become more diversified, and a complete industrial chain integrating highway design, construction, operation and other business sectors has been built. (3) The company's financial leverage has been reduced, and its profitability has been significantly improved.
	Fujian Construction Engineering Group Co., Ltd.	Fujian Province	AA→AA+	As one of the important provincial-level enterprise under the supervision of the provincial authorities of the SASAC in Fujian, the company has received vigorous support from the provincial government of Fujian in all aspects and enjoyed the favorable conditions brought by the construction of the Free Trade Area of Fujian and the Xiafuquan National Independent Innovation Demonstration Zone. In 2018, the company's primary business of construction showed a satisfactory development trend, achieved the vertical extension along the industrial chain, and the company has become one of the few construction enterprises in the province which can produce prefabricated parts for construction independently.
	Guangxi Beibu Gulf International Port Group Co., Ltd.	Guangxi Zhuang Autonomous Region	AA+→AAA	(1) By merging Xijiang Group, the strategic position has been significantly improved (2) The company's size of assets has been significantly increased, and its comprehensive strength has been improved
	Shaodong New Area Development and Construction Investment Co., Ltd.	Hunan Province	AA-→AA	(1) The favorable external environment has provided a good foundation for the company (2) The company's project construction business has remained satisfactory (3) The company has obtained vigorous external support. As an important player in infrastructure construction as well as investment and financing in Shaodong County, the company has received support in terms of asset injection, government subsidies and tax exemption (4) The land use right mortgage guarantee can still effectively enhance the credit level of bonds issued this time.
	Dongguan Traffic Investment Group Co., Ltd.	Guangdong Province	AA+→AAA	(1) Since the completion of the SOE structuring in Dongguan City, the company's regional monopoly status has become more apparent and grown into the unique operator of traffic-related business in Dongguan. The company's assets have increased dramatically and the company has become largest municipal SOE in Dongguan City in terms of scale (2) The capital fund for Rail Line No. 1 and No. 2 under the supervision of Dongguan Rail Company, which was integrated after the restructuring, shall be borne by Dongguan's fiscal authorities, and the project has received strong government support (3) The company's business has become more diversified
	Nantong Hi-tech Industrial Development Zone Corporation	Jiangsu Province	AA→AA+	The economic strength of Nantong High-tech Industrial Development Zone has continued to increase, and the Management Committee of Nantong High-tech Zone provides strong support in terms of capital injection, equity transfer etc. The restructured developable land provides sufficient space for the company's development.

Data source: Database for LGFV sector of CCXI

iii. Redemption in advance: The scale of redemption in advance rose slightly from the previous quarter, with AA grade entities accounting for 70%

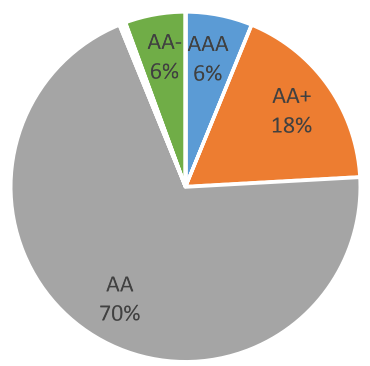
With the end of local debt replacement, the scale of LGFV bond redemption in advance in the first quarter remained the low trend of the fourth quarter of 2018, but slightly increased from the fourth quarter. According to the statistics of the announcement on advance redemption of LGFV bonds, the number of bonds with advance redemption totaled 340 in the first quarter, involving a total amount of RMB84.749 billion. In terms of regional distribution, Jiangsu, Hunan and Zhejiang ranked the first in terms of the scale of advance redemption, among which Jiangsu ranked the first with the total amount of advance redemption reaching RMB14.77 billion. **With respect to the qualification of LGFV entities,** the proportion of AA grade entities further increased, reaching 70%, registering a growth of 2 percentage points quarter on quarter, while the proportion of AA+ grade entities fell back, with a decline of 4 percentage points quarter on quarter.

Figure 21: The advance redemption scale and numbers of LGFV bonds rose quarter on quarter in Q1



Data source: choice, compiled by CCXI

Figure 22: The LGFV bonds redeemed in advance were mainly of AA grade



Data source: choice, compiled by CCXI

III. Maturities: The scale of average monthly matured bonds from April to December exceeds RMB100 billion, and the rolling pressure of debt is quite big

i. The pressure caused by matured bonds and repurchase in September is big, and the majority of matured bonds are of medium and high grades

After the maturity peak was passed smoothly in March, the follow-up maturity and repurchase pressure is still relatively large on the whole. **From April to December, the amount of LGFV bonds facing maturity and repurchase[3] total RMB1,718.228 billion, of which the matured bonds amount to RMB1,237.694 billion and the repurchase is RMB480.534 billion.** In September, the pressure of maturity and repurchase is particularly prominent, with the size reaching RMB232.605 billion. **From the perspective of corporate credit rating,** the enterprises of bonds facing maturity are of AA+ grade or above, with the maturity scale reaching RMB660.824 billion, accounting for 38%. **With respect to bond issuance,** publicly offered bonds constitute the majority, accounting for 76.24%, while the rest are all privately placed bonds. **In terms of bond types,** short-term bond (including super short-term bond) topped the list of short-term bonds and super short-term bonds, reaching RMB555.140 billion, accounting for 27.63%, while corporate bonds, PPN, medium-term notes and corporate bonds account for 4.73%, 18.10%, 15.95% and 10.03%, respectively.

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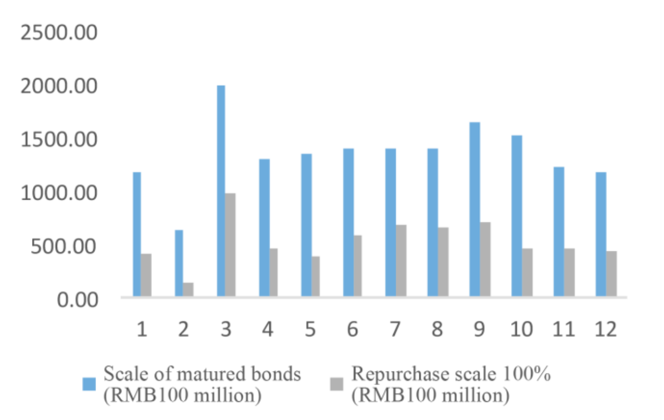
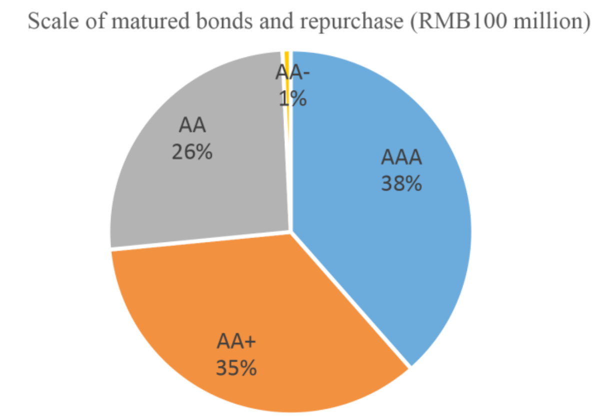
[3] The statistics of matured bonds are subject to the LGFV bonds with a term of maturity on December 31, 2018, and the total amount has excluded duplicate items.

Figure 23: LGFV bonds were under remarkable maturity and repurchase pressure in September



Data source: choice, compiled by CCXI

Figure 24: The matured LGFV bonds and repurchase bonds were mainly of AAA grade



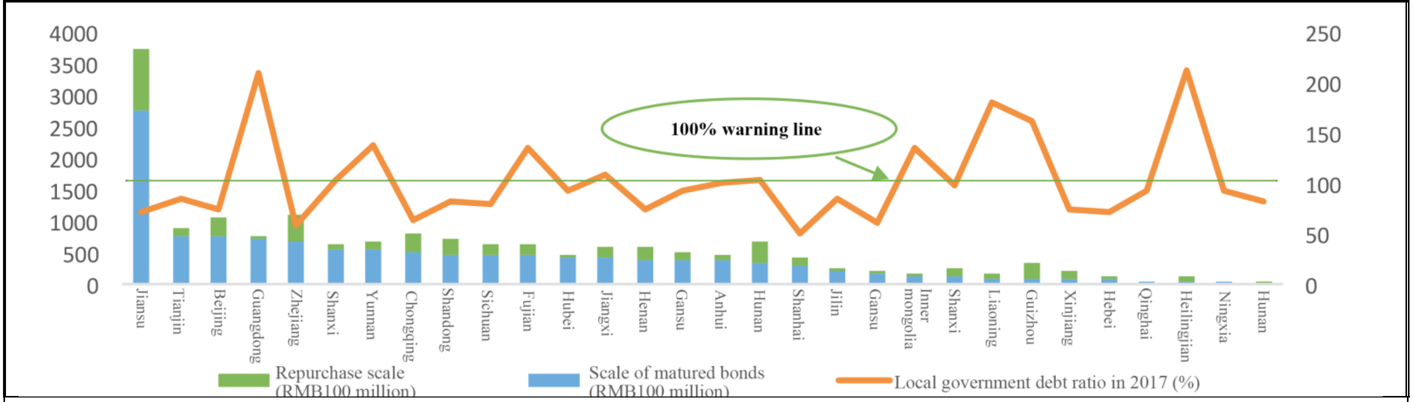
Data source: choice, compiled by CCXI

ii. Jiangsu tops the list in terms of the size of matured bonds, and the proportion of bonds with special terms increase

In terms of regional distribution, from April to December 2019, the LGFV bonds of Jiangsu Province top the list of maturity and repurchase scale, reached RMB371.133 billion, followed by Zhejiang (RMB111.98 billion), Beijing (RMB106.275 billion) and Tianjin (RMB86.965 billion), while all other provinces are all less than RMB80 billion. Provinces with high debt ratio, such as Heilongjiang, Liaoning and Inner Mongolia, have relatively low level of matured bonds and repurchase, which are all below RMB20 billion. **Based on the situation of new and old LGFV bonds,** the maturity and repurchase of old LGFV bonds issued before the end of 2014 totaled RMB449.895 billion, accounting for 26.18%, down 1.07 percentage points from the end of last year.

In terms of special terms for bonds, in order to effectively isolate and prevent the non-standard debt default of LGFV bonds from encumbering the LGFV enterprises, the proportion of bonds with special terms reached 50.73%, 2.4 percentage points higher than the end of last year. Among them, the proportion of bonds with special terms involving **"coupon rate adjustment"** is 56.86%, down 1.56 percentage points from the end of last year. The bonds involving **"cross defaults"** account for 21.28%, up 8.7 percentage points from the end of last year. Those bonds involving **"prior restraint"** and **"change of control right or controller"** account for 21% and 1.82% respectively, slightly recovering from the end of last year.

Figure 25: After Q1, regions with high debt ratio had less pressure on subsequent maturity and repurchase, and Jiangsu Province has the biggest scale of maturity and repurchase

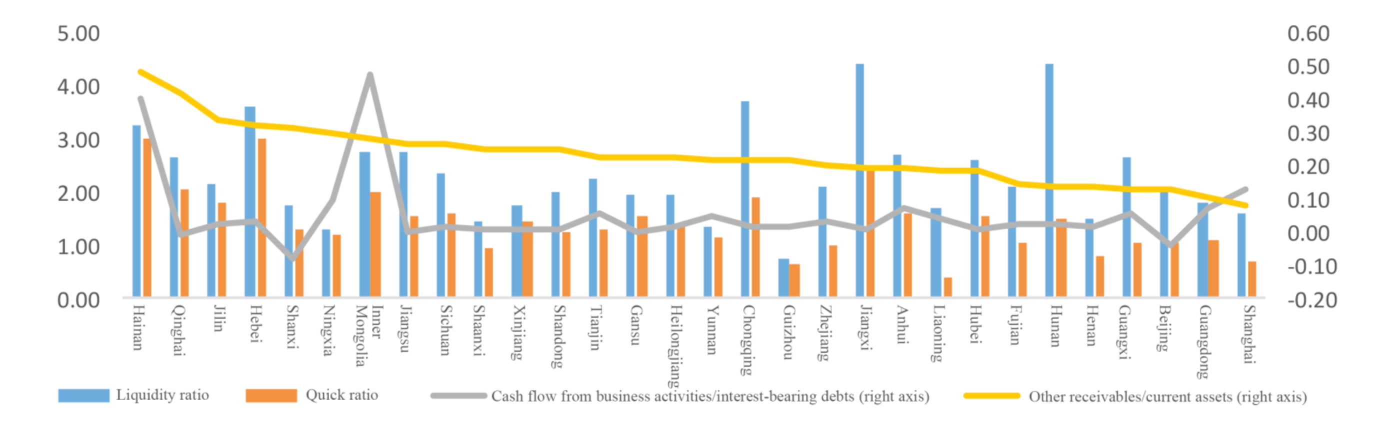


Data source: choice, compiled by CCXI

iii. The cash flow of nearly one third of the issuers of matured bonds cannot cover the interest-bearing debt, and the payment depends on government collection

There are 746 LGFV enterprises involving matured bonds or repurchase in 2019, and the overall debt pressure of LGFV enterprises fell back from the end of last year. The average asset-liability ratio is 49.19%, down 10 percentage points, and the median is 58.05%, down 3 percentage points. **From the perspective of solvency,** about one third of LGFV enterprises have negative net cash flow. Such enterprises are under considerable pressure to repay debts with their own cash flow and have a high reliance on refinancing and realization of current assets. The average and median coverage degree of net cash flow to interest-bearing debt (net cash flow/interest-bearing debt) are 0.02 and 0 respectively, and the proportion of coverage degree below zero reaches 31.37%, which is about 5 percentage points higher than the end of last year. Meanwhile, the average and median current ratios of LGFV enterprises are 2.46 and 1.91 respectively, and the average and median quick ratios are 1.37 and 1.07 respectively, which also show a certain degree of decline from the end of last year. **In terms of asset liquidity,** the average and median proportion of other receivables of LGFV enterprises in current assets is 20.76% and 16.52% respectively, which is basically stable compared with the end of last year, indicating a relatively high dependence of liquidity of the enterprises on government collection. **From the data of all provinces,** other receivables of Hainan, Qinghai, Jilin and Hebei account for a high proportion of current assets, which exceeds 30% and indicates relatively weak liquidity of assets.

Figure 26: Overview of the short-term solvency of issuers of matured LGFV bonds in various provinces, April -December



Data source: choice, compiled by CCXI

IV. Risk outlook: Debt pressure still exists, and LGFV risk differentiation will continue

In the first quarter, thanks to the support of multiple favorable policies, the primary and secondary markets of the LGFV bond market recovered on the whole, but the structural divergence was still intensifying, and the improved financing environment is conducive to easing the liquidity risk of LGFV enterprises. However, the debt repayment pressure was not really resolved. In the next stage, the macro-economic downward pressure will be alleviated to certain extent, the monetary policy will face preliminary adjustment and fine-tuning, the “accommodative monetary, fiscal, and credit” policy orientation will be shifted to the “structurally accommodative monetary, fiscal policy and steady credit”, and the macro-control will continue the basic tone of maintaining steady growth and seeking dynamic stability by preventing risks. In the second quarter or the latter half of the year, risk prevention may become the focus of policy again, so the regulatory environment faced by LGFV enterprises can hardly be eased. LGFV enterprises undertaking projects under construction with strong features of public welfare and high importance will still get more support, while non-core LGFV enterprises in areas of weak financial strength and lower administrative levels are expected to get limited support as before, so the risks of LGFV enterprises will continue to diverge in different dimensions. In the next stage, special attention can be paid to the following aspects:

i. Paying attention to the impact of implicit debt resolution schemes on the outstanding debts of LGFV enterprises

The *Report on the Work of the Government in 2019* once again emphasizes the importance of taking effective measures to prevent and defuse major risks, and points out that “China's fiscal revenue and expenditure policies will effectively prevent and control the implicit debt risks of local governments in 2019.” In the context of risk prevention, various regions have introduced programs to resolve local government debts, especially the implicit debts of local governments. Since LGFV enterprises are an important carrier of the implicit debts of local governments, the local debt resolution program will have an important impact on the disposal of outstanding debts of LGFV enterprises. **In the short term,** the implicit debt alleviation promoted by the government will help relieve the rolling debt pressure of urban development enterprises and reduce the debt cost. Taking Zhenjiang as an example, by replacing loans with China Development Bank, lowering the debt interest rate and extending the term, the debt cost will be remarkably reduced, with the interest expense reduced by about 20% to 40%. The alleviation of implicit debt aims to exchange time for space and create favorable conditions for LGFV enterprises to make transformation, improve quality and efficiency, and enhance profitability and debt repayment capabilities. **However, in the long run,** the government has introduced the implicit debt alleviation plan covering LGFVLGFV bonds, but it has not reduced the size of debt in aggregate. In the future, the responsibility of debt repayment parties will be changed. However, the overall debt pressure of LGFV enterprises still exists, so attention shall continue to be paid to the credit risk of relevant LGFV enterprises.

ii. Paying attention to the impact of LGFV enterprise integration and transformation on credit risk

Since the Two Sessions in 2019, the Ministry of Finance has emphasized the promotion of the open, transparent, legitimate and compliant operation of financing platforms, prohibited the establishment of new financing platforms, promoted the market-oriented transformation of platforms by category, and separated the government financing functions from financing platforms. With the acceleration of the transformation of LGFV enterprises, diversified integration and transformation methods will have a great impact on the outstanding debts of the enterprises involved. For example, the government will coordinate resources within its jurisdiction to **inject high-quality operational assets or franchise rights** into qualified financing platforms, which can effectively enhance the profitability of enterprises and improve the debt repayment capabilities. Efforts will be made to **introduce social capital into LGFV enterprises to implement the mixed ownership reform,** and relieve the debt pressure of the platform by means of debt investment or debt-for-equity swap. For example, Zhenjiang is located in the economically developed area, and it has introduced active social capital for mixed ownership reform to promote debt alleviation. In addition, **in the context of responding to the bailout of private enterprises, stabilizing growth and conducting transformation of LGFV enterprises,** LGFV enterprises can improve its profitability through mergers and acquisitions of listed companies, **increase operating assets and operating income in the statements,** and gradually realize mechanism transformation, talent aggregation and operation optimization. In the restructuring and integration process of LGFV enterprises, it is necessary to pay attention to the specific disposal of existing debts, such as whether the repayment subject of the debt has changed, whether the primary business of the debtor has changed after restructuring, whether the government support has changed, and so on, so as to comprehensively consider the credit risk of the debt.

iii. Paying attention to the non-standard debt and contingent debt of LGFV enterprises, and preventing risk resonance

In 2019, despite the marginal easing of regulatory policy and the improvement of non-standard refinancing environment, the non-standard debt risks of LGFV enterprises continue to be exposed, and **the default of non-standard debt is likely to trigger cross default, which will in turn affect the bond market and cause risk resonance.** In 2018, Lufeng Industrial Investment Co., Ltd. of Kailu County, Tongliao city of Inner Mongolia defaulted on the relevant trust plan. Although cross default was not triggered due to timely repayment of part of the money, the similar risk of debts still needs to be vigilantly guarded against. From April to December 2019, LGFV bonds with cross terms account for more than 20% of the matured LGFV bonds, so the potential risk of cross default cannot be ignored. In addition, **LGFV enterprises still need to pay attention to the contingent debt, prevent regional risk resonance caused by joint guarantee and mutual guarantee.** At the end of the first quarter of 2019, nearly 90% issuers of outstanding LGFV bonds had external guarantee, with guaranty amount exceeding RMB5 trillion, and the guaranteed are mostly SOEs in the same region. Such enterprises rely heavily on debt collection and subsidies of local government, therefore liquidity risk is likely to be triggered and spread across the region in the period of concentrated debt repayment.

iv. Focusing on non-core LGFV bonds that rely heavily on government collection in regions with weak financial resources

Under the guidance of the policy of stabilizing growth, **LGFV enterprises undertaking major infrastructure projects will receive more resources and support.** However, for **non-core platforms that are less important in undertaking projects, external support is limited.** If the regional financial resources are weak and the enterprises are highly dependent on the government collection, the debt repayment will face great uncertainty. Close attention can be paid to LGFV bonds in districts and counties with relatively weak financial resources as well as LGFV enterprises in such regions with high proportion of government receivables in assets and greater dependence on government subsidies, and to the repayment preparation, government support willingness and capabilities of LGFV enterprises in the concentrated maturity stage of their debts.

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