Special Comments

Analyst Contacts
Simon Chen
+852-2860 7131
simon_chen@ccxap.com

Pater Chong
+852-2860 7124
peter_chong@ccxap.com

Zhu Jie
+86-021-60330988
jzhu@ccxi.com.cn

Research on LGFV's financial statement changes and their risk profile

In recent years, the onshore and offshore financing of LGFVs have been strictly regulated. Therefore, affected by debt management, LGFVs have been restricted in financing and the growth rate of debts have continued to decline since 2021. The pace of project investment and outside investment has slowed down, as reflected in the balance sheet that the growth rate of construction in progress, inventory, investment property and long-term equity investment has slowed down significantly. In addition, under the strict regulation of investment and financing, the overall structural change in LGFVs' financial statements has declined.

Affected by the pandemic, local fiscal profile has continued to suffer since 2021, and some regions have shown negative growth of fiscal revenue. As a result, LGFVs have slower repayment of agency construction, and the overall financial status of LGFVs in those areas has also deteriorated. At the same time, the differentiation of LGFV is accelerating. LGFVs with weak status and located in low fiscal revenue area have suffered from worsened financial conditions, significantly higher financing costs, and higher reliance on non-standard financing such as trust and financial leases. Therefore, the credit risk of LGFVs continues to diverge.

External Financing of LGFV Is Tightening and Growth Rate of Debt is Declining

Since 2021, China has continued to strengthen regulating implicit debts of local governments, and strictly control the financing activities of LGFVs. On 26 March, 2021, the State-owned Assets Supervision and Administration Commission of the State Council officially issued the "Guidance on Improving the Debt Management of Local State-owned Enterprises". The document required local SOEs to constrain both on debt amount and asset-liability ratio. LGFVs need to determine their own objectives, and take multiple measures to reduce leverage ratio and debt burden. On 30 May, 2023, according to the latest guidelines of the Shanghai Stock Exchange, for those LGFVs located in districts or counties with the general public budget revenue less than RMB5 billion, new debts cannot be issued and the purpose of raising funds can only be used for refinancing, regardless of whether it is new issuance, debt category of region, or whether it is guaranteed by AAA rating company. This guidance continued to control new debts of LGFVs, resulting in a slowdown in their pace of investment and financing. In addition, many LGFVs has begun to use government special bonds to raise funds for the construction projects, so the demands of external financing have also declined for LGFVs.

With Limited Onshore and Offshore Financing Channels, Outside Investment and Project Investment Had Lower Growth Rate

The main assets of LGFVs include assets formed in public policy projects (inventories), uncollected payments from counterparties (receivables), self-operating assets (investment property), investment assets formed by equity and debt investment (available-for-sale, long-term equity investment), and cash (cash and cash equivalent). Compared with enterprises from other industries, LGFV's asset structure is relatively more stable, and several important accounts take up very high proportion.

LGFV's cash has grown, but diverged greatly. With the stricter control of financing, there is limited financing channels for construction investment and working capital, and the main approved purpose is refinancing. Therefore, capital raised should mainly be used to repay the principal and interest of due debts. LGFVs located in high admin levels, with higher priority, and strong areas have relatively abundant cash reserve, and the proportion of restricted cash is relatively small. However, LGFVs with weak status and located in low fiscal revenue area suffer from great pressure.

With high pressure in fiscal profile, receivables of LGFVs have further increased, and repayment is uncertain. The growth rate of LGFV's accounts receivable is higher than that of the total assets. In recent years, LGFV's other receivables have also increased and the growth rates were 12.33%, 10.83%, 5.12% and 3.04% respectively, from 2019 to 2022H1, with narrowing growth rate every year. At the same time, with the stricter control on LGFV's external financing, LGFV's other receivables generated from lending has continued to grow, but the growth rate has dropped sharply. In addition, the counterparties of LGFVs are mainly government departments and other SOEs in the region. Therefore, repayment is greatly affected by the regional economic and fiscal profile, and the continuity of repayment remains uncertain.

Inventory is the best account reflecting the investment and construction characteristics of LGFVs. The cost of construction projects is mainly calculated through the two sub-subjects of inventory. With the tightening of investment and financing policies, construction of projects has slowed down since 2021 and the number of new projects has decreased, with slowing growth rate. LGFVs will maintain certain amounts of infrastructure construction projects while local governments are constantly improving debt management. Investment construction approvals and policies are becoming increasingly strict, and the improvement of investment processes will also slow down the growth rate.

Apart from integration of platform resources, the growth of operating assets mainly comes from the investment and construction of LGFV's self-operated projects. The best example is investment properties, which means some LGFVs have public rental housing and leasing businesses. With the continuous transformation, LGFVs will continue to construct operating assets and drive the growth of operating assets in accordance with their own positions. However, due to the impact of debt control, the growth rate of operating assets has continued to slow down since 2021, and the growth of LGFV's operating assets will continue to be limited.

Equity investment and debt investment are still the main investment assets of LGFVs. The amount and growth rate of equity investment have maintained rapid growth through integration since 2022. In practice, some LGFVs provide equity investment to enterprises operated in the industrial parks in order to meet local government’s development policy. Therefore, with the market-oriented development and diversified transformation of LGFVs, the amount of equity and debt investment has increased year by year, especially in recent years.

In conclusion, although LGFVs have maintained growth and the debt burden has continued to increase, the growth rate of LGFVs’ debt has dropped significantly since 2021. At the same time, the growth rate of some assets has also declined significantly, such as cash and inventory. However, equity investment and debt investment are still growing rapidly with the transformation of LGFVs.

Table 1：Assets Scale and Asset Growth Rate （RMB Trillion）

Administrative level	2019	2020	2021	2022.6	2019 Growth	2020 Growth	2021 Growth	2022.6 Growth	2020 Change	2021 Change	2022.6 Change
County Level	25.4	29.2	32.4	34.1	13.6%	14.9%	11.1%	5.0%	1.29	-3.81	-6.04
City Level	31.0	35.9	40.6	43.0	13.4%	15.8%	13.2%	5.8%	2.31	-2.56	-7.39
Province Level	16.0	18.3	20.0	20.9	11.4%	14.4%	9.4%	4.7%	3.02	-5.01	-4.68
Total	**72.4**	**83.3**	**93.0**	**98.0**	**13.0%**	**15.2%**	**11.6%**	**5.3%**	**2.12**	**-3.53**	**-6.32**

Data Source：Wind，CCX Research

Credit risk of LGFVs continues to diverge

Since 2021, the debt of LGFVs has continued to grow and the debt burden has continued to increase. With the deepening of debt regulation, the growth rate has dropped significantly. The regional differentiation among LGFVs increases, regions with high debt growth and regions with net financing outflows have developed into two poles and continues to diverge. LGFVs with weak status and located in low fiscal revenue area have deteriorated financial status, increasing financing costs, and higher reliance on non-standard financing methods such as trust and financial leases.

The financing channels of LGFVs mainly include bank loans, bond financing and non-standard financing. Local governments have issued documents to reduce high-cost financing since 2020. The conversion of non-standard financing to standard financing has led to a decline in the proportion of non-standard financing. However, non-standard financing is more flexible, and some LGFVs choose it to meet their cash flow needs regardless of financing costs. The proportion of non-standard financing was about 8.20% in 2021, slight decreasing from the previous year. Among them, 11 provinces, including Guizhou, Heilongjiang, Yunnan, Tianjin, Sichuan, Anhui, Shandong, Guangxi, Hubei, and Henan, have a higher proportion of non-standard financing than national average, while 15 provinces had a declining non-standard proportion, including Inner Mongolia, Shaanxi, Guizhou, Jilin, Guangxi, Shandong, Sichuan, Jiangsu, Zhejiang, and Jiangxi. Long-term and short-term loans are still the main financing channel for enterprises, accounting for about 60%. With the tightening regulation on bond issuance, the bank channel is more stable than other financing channels. In the future, LGFVs may rely more on bank loans.

The financial leverage ratio of LGFVs is rising, but with stricter regulation, the growth rate of leverage ratio has slowed down. From the perspective of provinces, the financial leverage ratio of Gansu, Guangxi, Hebei, Henan, Hubei, Jiangsu, Shandong, Shaanxi, Sichuan, Tianjin, Yunnan, and Zhejiang is relatively high.

In conclusion, LGFVs have continued to diverge in recent years. LGFVs with weak status and located in low fiscal revenue area have experienced significant decline in profitability and repayment. The debt amount of LGFVs has continued to grow but the growth rate has slowed down. The proportion of short-term debts to total debts has continued to rise, cash/short-term debts ratio has continued to drop, and short-term liquidity pressures has become more serious.

This press release does not constitute a rating action. For any CCXAP issued rating, please refer to the Rating Results page at www.ccxap.com for the latest rating action information and rating history.

A credit rating is the analytical result of current credit worthiness and forward-looking opinion on the credit risk of a rated entity or a debt issue. Credit ratings issued by CCXAP are opinions on the current and relative future credit risk of the rated entities or debt issues, but do not address any other risks, including but not limited to liquidity risk, market price risk, and interest rate risk.

Credit ratings, non-credit assessments, and other opinions included in CCXAP’s publications are not recommendations for investors to buy, sell, or hold particular securities, nor measurements of market value of the rated entities or debt issues. While obtaining information from sources it believes to be reliable, CCXAP does not perform audit and undertakes no duty of independent verification or validation of the information it receives from the rated entities or third-party sources.

All information contained herein belongs to CCXAP and is subject to change without prior notice by CCXAP. CCXAP considers the information contained herein to be accurate and reliable. However, all information is provided on an "as is" and "as available" basis and CCXAP does not guarantee accuracy, adequacy, completeness, or timeliness of the information included in CCXAP’s publications.

To the extent where legally permissible, CCXAP and its directors, officers, employees, agents and representatives disclaim liability to any person or entity (i) for any direct or compensatory losses or damages, including but not limited to by any negligence on the part of, and any contingency within or beyond the control of CCXAP or any of its directors, officers, employees, agents or representatives, arising from or in connection with the information contained herein or the use of or inability to use any such information; and (ii) for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if CCXAP or any of its directors, officers, employees, agents or representatives is advised in advance of the possibility of such losses or damages.

China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address:	Suites 1904-1909, 19/F, Jardine House, 1 Connaught Place, Central, Hong Kong
Website:	www.ccxap.com
Email:	info@ccxap.com
Tel:	+852 2860 7111
Fax:	+852 2868 0656