

Credit Opinion

7 December 2023

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB _g +
Outlook	Stable

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Shaoxing Shangyu State-owned Capital Investment and Operation Co., Ltd.

Surveillance credit rating report

CCXAP affirms Shaoxing Shangyu State-owned Capital Investment and Operation Co., Ltd.'s BBB_g+ long-term credit rating, with stable outlook.

Summary

The BBB_g+ long-term credit rating of Shaoxing Shangyu State-owned Capital Investment and Operation Co., Ltd. ("SYSC" or the "Company") reflects (1) Shangyu District Government's strong capacity to provide support; and (2) the local government's extremely high willingness to provide support, based on our assessment of the Company's characteristics.

Our assessment of Shangyu District Government's capacity to provide support reflects the Shangyu District's relatively good comprehensive strength, with ongoing economic growth and good fiscal balance.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) status as the core state-owned platform in Shangyu District with important policy role in the urban construction and land development; (2) good access to funding; and (3) good track record of receiving government payments.

However, the rating is constrained by the Company's (1) moderate exposure to commercial business activities; (2) increasing debt leverage and weak asset liquidity; and (3) moderate exposure to contingent liabilities.

The stable outlook on SYSC's rating reflects our expectation that Shangyu District Government's capacity to provide support will remain stable, and the Company will maintain its vital position in Shangyu District.

Rating Drivers

- Important policy role in the urban construction and land development of Shangyu District
- Moderate exposure to commercial business activities
- Increasing debt leverage and weak asset liquidity
- Good access to funding
- Good track record of receiving government payments
- Moderate exposure to contingent liabilities

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Shangyu District Government's capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as a substantial reduction in external guarantees or improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Shangyu District Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to support, such as a reduction in importance of its policy role, a substantial reduction in government payments, or deteriorated debt management.

Key Indicators

	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	153.2	156.7	177.8	194.4
Total Equity (RMB billion)	68.2	70.3	72.5	71.6
Total Revenue (RMB billion)	6.1	7.3	6.6	3.6
Total Debt/Total Capital (%)	53.1	52.5	56.4	61.0

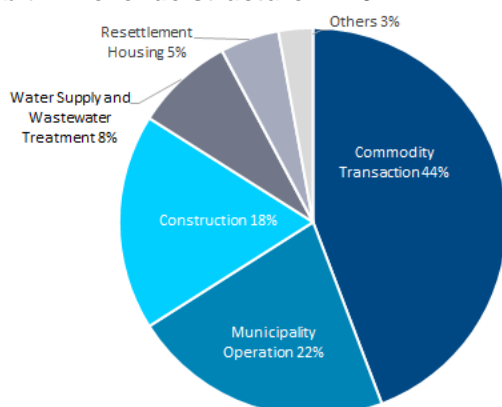
All ratios and figures are calculated using CCXAP's adjustments.

Source: CCXAP research

Corporate Profile

Established in 2015, SYSC is the largest local infrastructure investment and financing company ("LIIFC") in Shangyu District, Shaoxing City in terms of total assets. As the main operator and developer in Shangyu District, the Company engages in diversified businesses, including water supply and wastewater treatment, land development, construction, resettlement housing, municipality operation, and commodity transaction businesses. As of 30 June 2023, the Company was wholly owned and directly controlled by State-owned Assets Supervision and Administration Commission of Shaoxing City Shangyu District ("Shangyu SASAC").

Exhibit 1. Revenue structure in 2022



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Shangyu District Government has a strong capacity to provide support, based on its relatively good comprehensive strength, with ongoing economic growth and good fiscal balance.

Shangyu District is a riverside city located in the eastern of Shaoxing City and in the center of the Yangtze River Delta Economic Zone. Shaoxing City was the fourth largest prefecture-level city in terms of gross regional product ("GRP") in Zhejiang Province with abundant tourism resources and well-developed industries. In 2022, Shaoxing City recorded a GRP of RMB735.1 billion with a year-over-year ("YoY") growth rate of 4.4% which higher than provincial level. Shaoxing City has already developed textile, machinery, and food industry as its pillar industries. Currently, new industries such as modern equipment, modern medicine, electronic information, and new materials also grow rapidly. Affected by the tax refund policy, Shaoxing Municipal Government's general budgetary revenue decreased from RMB60.4 billion in 2021 to RMB54.9 billion in 2022. The fiscal self-sufficiency was relatively good with an average fiscal balance ratio (general budgetary revenue/general budget expenditure) of 77.7% over the past three years. As of end-2022, Shaoxing Municipal Government's outstanding debt increased to RMB168.0 billion, accounting for 22.9% of GDP.

Exhibit 2. Key economic and fiscal indicators of Shaoxing City

	2020FY	2021FY	2022FY
GRP (RMB billion)	600.1	679.5	735.1
GRP Growth (%)	3.3	8.7	4.4
General Budgetary Revenue (RMB billion)	54.4	60.4	54.0
General Budgetary Expenditure (RMB billion)	66.7	71.5	80.5
Local Government Debt (RMB billion)	124.8	143.7	168.0

Source: Statistic Bureau of Shaoxing City, CCXAP research

Supported by its good transportation network and geographical location, Shangyu District is one of the business centers in Shaoxing City and an important regional transportation hub center in Zhejiang Province. Shangyu District has a relatively good comprehensive strength. In 2023, Shangyu District ranked 29th in terms of comprehensive strength among the Top 100 Districts in China. Various pillar industries including mechanical equipment, pharmaceutical chemical, textile, and lighting appliance are well developed. Shaoxing District has improved its industrial structure by strategically promoting emerging industries, such as new material, modern

medical and green lighting. Shangyu District has demonstrated ongoing economic growth in recent years. The GRP in Shangyu District increased from RMB113.6 billion in 2021 to RMB124.2 billion in 2022, accounting for about 17% of GRP of Shaoxing City. The general budgetary revenue increased by 1.2% YoY (excluding the tax refund factor) to RMB9.1 billion in 2022. In addition, Shangyu District's fiscal balance ratio decreased from 77.2% in 2021 to 66.3% in 2022. Its outstanding government debt amounted to RMB24.9 billion with an increasing trend, accounting for 20% of its GRP in 2022. In the first nine months of 2023, Shangyu District recorded a GRP of RMB93.9 billion, with a YoY growth rate of 7.4%; while its general budgetary revenue increased by 2.6% YoY to RMB8.9 billion.

Exhibit 3. Key economic and fiscal indicators of Shangyu District

	2020FY	2021FY	2022FY
GRP (RMB billion)	104.4	113.6	124.2
GRP Growth (%)	4.6	7.2	4.7
General Budgetary Revenue (RMB billion)	9.4	10.0	9.1
General Budgetary Expenditure (RMB billion)	12.1	13.0	13.7
Local Government Debt (RMB billion)	16.6	20.6	24.9

Source: Statistic Bureau of Shangyu District, CCXAP research

Government's Willingness to Provide Support

Important policy role in the urban construction and land development of Shangyu District

SYSC is the largest LIIFC in terms of total assets in Shangyu District and the primary LIIFC wholly owned and effectively controlled by the Shangyu District Government to participate in the operation and development of Shangyu District. Positioned as the main developer in Shangyu District, SYSC continues to undertake various public-related activities such as land development, infrastructure construction, resettlement housing, water supply and wastewater treatment, and grain storage, which significantly benefits people's livelihood and promotes the process of urbanization.

SYSC is the largest primary land developer in Shangyu District, conducting the land development business through subsidiaries. The scope of the business mainly focuses on the central area of Shangyu District and Highspeed Railway New City. As of 30 June 2023, the Company had 7 land projects under development, with total estimate investment of RMB11.0 billion and uninvested amount of RMB2.9 billion. Overall, the Company has about 2,000 mu of land pending for transfer, which in turn promises the sustainability of the business. However, such business highly relies on the local land market and government plans, resulting in a degree of uncertainty to the Company's land transfer income.

SYSC is the largest agency construction entity in the municipal area in Shangyu District, with dominant presence in highway maintenance, pipe network construction and infrastructure construction in the region. The Company continues to conduct infrastructure construction projects under agency construction model. As of 30 June 2023, the Company had 9 agency construction projects under construction, with an estimated total investment of RMB550.1 million and an uninvested amount of RMB263.0 million.

SYSC is the key resettlement housing developer in Shangyu District to implement the local government's housing policies and improve the housing conditions for low-income households. The Company is responsible for the development and sale of resettlement housing in Shangyu District at prices under government control. The Company has large capital needs for its construction projects in the pipelines. As of mid-2023, there were 5 resettlement housing projects under construction or planning, with an estimated total investment of RMB12.4

billion and an outstanding amount of 7.0 billion. The large number of projects in the pipeline can ensure the sustainability of the resettlement housing business, but also exert high capital expenditure pressure on the Company.

SYSC is the sole integrated water utility entity in Shangyu District, providing water supply and wastewater treatment services to around 800,000 local residents through its wholly-owned subsidiary, Shaoxing Shangyu District Water Group Co., Ltd. (“Shangyu Water”). As of 30 June 2023, Shangyu Water had 5 water supply plants and 1 wastewater treatment plant in operation. Benefiting from the decreased depreciation costs, the gross profit margin of water utility business improved from -18.2% in 2021 to -2.0% in 2022. Given the wastewater processing fees has increased since May 2023, we expect the gross profit of wastewater treatment business will improve.

SYSC also engages in policy-oriented grain storage business involving the purchase, storage, transfer, wholesale and import and export of grain and oil. It receives national government grants and subsidies compensated for operating losses.

Moderate exposure to commercial business activities

SYSC also engages in commercial business activities, including commodity transaction, sales of refined oil, engineering construction and municipality operation, which generate supplementary revenue and profit to the Company. We estimate that SYSC had moderate commercial exposure, with the assets of commercial businesses accounting for around 20% of its total assets.

SYSC’s conducts commodity transaction business mainly through its subsidiaries Shaoxing Datong Holding Group Co., Ltd. (“Datong”) and Shangyu Water. Datong operates Datong Mall, a leading department store in the county-level cities of Zhejiang Province. Shangyu Water is mainly responsible for the sales water supply and drainage instruments, pipes, and building materials. In 2022, this business achieved revenue of RMB1.4 billion, with a gross profit margin of 10.0%.

The sale of transportation infrastructure materials business involves trading of asphalt, steel, electrolytic, copper, bulk materials, vehicle inspection equipment, cement, office supplies. The downstream and upstream of the transportation infrastructure materials business remain concentrated, posing higher business risk. Due to the reduction of business scale, the revenue of the business decreased by 27.5% to RMB765.7 billion, with a low gross margin of 1.2%

The sale of refined oil business adopts the “procurement-stock-retail” model, under which refined oil will be purchased from upstream refined oil suppliers and transported to the gas station for underground safety storage, and then retailed to customers. The upstream of the business is highly concentrated and occupy a monopoly position in the industry, indicating the Company’s relatively weak bargaining power. In 2022, the sale of refined oil business achieved revenue of RMB363.9 million, with gross profit margin of 6.2%.

SYSC also undertakes engineering construction business through its subsidiaries, responsible for carrying out the construction phase of a project. They enter into construction contracts with relevant government departments or state-owned enterprises for projects such as infrastructure and resettlement housing, and receive engineering construction profits for their services. In 2022, this business achieved revenue of RMB810.8 million, with a gross profit margin of 9.6%.

SYSC is the largest municipality operation provider in Shangyu District, primarily conducting services business and logistics business. The services business includes labor agency services, sanitation services, leasing

services and tourism services, while the logistic business includes transportation, warehousing, logistic information services, administrative management and auxiliary logistic services. The strong shareholder background of the Company made regional competitive advantages in the provision of such services. In 2022, the municipality operation business totally achieved revenue of RMB1.4 billion, with gross profit margin of 18.1%.

Increasing debt leverage and weak asset liquidity

SYSC's total debt and debt leverage increased moderately in the past three years. The Company's total debt increased from RMB77.6 billion at end-2021 to RMB112.0 billion at mid-2023, while its total capitalization ratio increased from 52.5% to 61.0% over the same period. In addition, the Company also has high short-term debt repayment pressure. As of 30 June 2023, its short-term debt accounted for 41.2% of the total debt, and cash to short-term debt ratio was 0.4x, indicating that its debt structure needs to be improved. Given the large capital needs from construction projects, we expect the debt leverage of the Company to remain at a relatively high level in the next 12 to 18 months.

SYSC's asset liquidity is relatively weak, which may undermine its financial flexibility. As of 30 June 2023, the Company's inventories accounted for 35.6% of total assets, mainly consisting of land use right transferred by the local government and costs from the land development and agency construction businesses; its non-current assets accounted for 46.9% of total assets, mainly comprised of long-term equity investment, intangible assets, and investment properties.

Good access to fundings

SYSC has sufficient stand-by liquidity and access to bond markets. The Company has good relationship with diversified large domestic commercial and policy banks, such as the Bank of China Limited and the Agricultural Development Bank. As of 31 June 2023, the Company's total credit facilities amounted to RMB73.8 billion, of which the unutilized portion was RMB30.9 billion. Furthermore, the Company continues to have smooth access to financing from both onshore and offshore bond markets. For example, during the first ten months of 2023, the Company itself raised RMB10.3 billion through onshore and offshore bond market with coupon rates ranging from 2.85% to 4.95%. SYSC also has manageable non-standard financing exposure, which accounted for around 7% of its total debts at mid-2023.

Good track record of receiving government payments

SYSC continues to receive payment support from the local government in terms of capital injections, asset injections, financial subsidies. In 2022, the local government injected a large amount of cash and assets into the Company, significantly increasing the capital reserves of RMB2.7 billion. Furthermore, the local government consistently provides subsidies to the Company to support its operation, with a total amount of RMB3.5 billion from 2022 to 2023H1. Considering SYSC's important position and tight relationship with the local government, we expect the local government will continue to support SYSC by providing payments over the next 12 to 18 months.

Moderate exposure to contingent liabilities

SYSC has moderate exposure to contingent liabilities as reflected by its large amount of external guarantees. As of 30 June 2023, the Company's external guarantees amounted to RMB17.9 billion, 25.1% relative to total equity. Although all external guarantees are provided to bank borrowings or bond issuance of the local state-owned enterprises in Shangyu District and Zhejiang Province, the Company may face certain contingent liability risks and cross default risks should a credit event occurs.

ESG Considerations

SYSC is exposed to environmental risks because it has undertaken infrastructure construction and utility projects. Such risks could be moderated by conducting environmental studies and planning before the commencement of projects, and close supervision during the construction phase.

The Company is also exposed to social risks as a public services provider in Shangyu District. Demographic changes, public awareness and social priorities shape government's target for SYSC, or affect the government's propensity to support the Company.

SYSC's governance considerations are also material as the Company is subject to oversight and reporting requirements to the local government, reflecting its public-policy role and status as a government-owned entity.

Rating Methodology

The methodology used in this rating is the Rating Methodology for [China's Local Infrastructure Investment and Financing Companies \(July 2022\)](#).

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