Credit Opinion

8 July 2024

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB_g
Outlook	Stable

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Shaoyang Industrial Development Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g to Shaoyang Industrial Development Group Co., Ltd., with stable outlook.

Summary

The BBB_g long-term credit rating of Shaoyang Industrial Development Group Co., Ltd. (“SYIG” or the “Company”) reflects the Shaoyang Municipal Government’s (1) strong capacity to provide support; and (2) very high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of the Shaoyang Municipal Government’s capacity to provide support reflects its status as the first ranking by GRP in western Hunan Province, with steady economic growth, but constrained by its modest fiscal profile.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) strategic role as the primary state-owned assets operation entity in Shaoyang City with strong regional franchise advantages in developing Shaoyang ETDZ; (2) good sustainability of public policy businesses; and (3) solid track record of receiving government payments.

However, the rating is constrained by the Company’s (1) medium exposure to commercial activities with poor industrial investment return; (2) fast-growing debt from large development pipelines; and (3) medium exposure to contingent risk.

The stable outlook on SYIG’s rating reflects our expectation that the local government’s capacity to support the Company will remain stable, and the Company will maintain its strategic role in Shaoyang City as the sole infrastructure construction platform in Shaoyang ETDZ.

Rating Drivers

- Strategic role as the primary state-owned assets operation entity in Shaoyang City with strong regional franchise advantages in developing Shaoyang ETDZ
- Good sustainability of public policy businesses
- Solid track record of receiving government payments
- Medium exposure to commercial activities with poor industrial investment return
- Fast-growing debt from large development pipelines
- Moderate asset liquidity as most assets are composed of land and construction projects
- Diversified access to funding channels
- Medium exposure to contingent risk

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government’s capacity to provide support strengthens; and (2) changes in Company's characteristics enhance local government’s willingness to provide support, such as enhanced regional significance and reduced exposure to commercial activities.

What could downgrade the rating?

The rating could be downgraded if (1) the local government’s capacity to provide support weakens; or (2) changes in Company characteristics decrease the local government’s willingness to provide support, such as reduced regional significance and worsen debt management.

Key Indicators

	2021FY	2022FY	2023FY	2024Q1
Total Asset (RMB billion)	40.1	48.0	49.4	49.8
Total Equity (RMB billion)	19.2	24.8	25.1	25.1
Total Revenue (RMB billion)	2.3	2.2	2.3	0.2
Total Debt/Total Capital (%)	48.4	42.2	45.2	45.9

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

Source: Company data, CCXAP research

Corporate Profile

Established in 2013, SYIG, formerly known as Shaoyang State-owned Assets Investment and Operation Co., Ltd., became one of the key local infrastructure investment and financing Companies (“LIIFCs”) in Shaoyang City after equity transfer since 2021. The Company is mainly responsible for restructuring of state-owned enterprises in Shaoyang City, land consolidation, and infrastructure construction in Shaoyang ETDZ. It also engages in several commercial activities, including property sales and leasing and industrial investment. As of 31 March 2024, the State-owned Assets Supervision and Administration Commission of Shaoyang City (“Shaoyang SASAC”) was the ultimate controller of the Company, directly holding 100% stakes of the Company.

Exhibit 1. Revenue structure in 2023

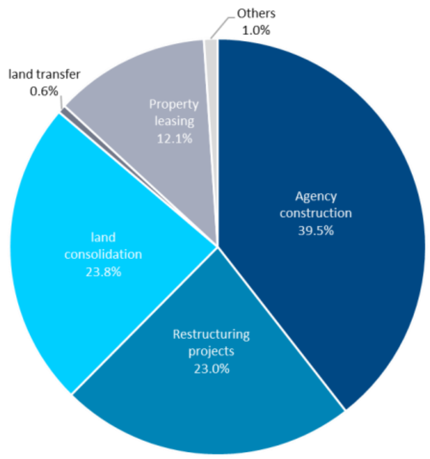
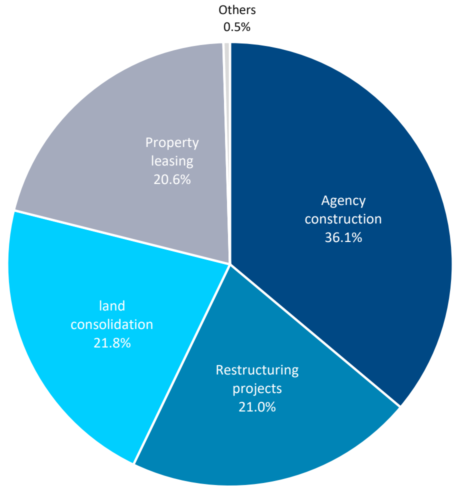


Exhibit 2. Gross profit structure in 2023



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Shaoyang Municipal Government has a strong capacity to provide support to the Company, given its economic importance in western Hunan Province, with steady economic growth, but constrained by its modest fiscal profile.

Located in the central part of China, Hunan Province serves as important grain production base, energy and raw material base, modern equipment manufacturing and high-tech industrial base and comprehensive transportation hub in China. With the good transportation and resource advantages, Hunan Province's economic strength improved steadily with general regional product ("GRP") increasing from RMB4.6 trillion to RMB5.0 trillion from 2021 to 2023, ranking 9th among all provinces in China and the third among 6 provinces in central China. From 2021 to 2023, its general budgetary revenue increased from RMB325.1 billion to RMB336.1 billion with a CAGR of 1.1%, and the tax revenue accounted for over 64.0% of its general public budget revenue in consecutive 3 years, indicating a stable growth. Meanwhile, Hunan Province Government has a relatively large debt burden. In 2023, Hunan Province had an outstanding direct government debt balance of RMB1.8 trillion, accounting for 36.4% of the Hunan Province's GRP.

Shaoyang City is a regional central city in the west part of Hunan Province and a strategic node city connecting the Changsha-Zhuzhou-Xiangtan metropolitan area with western Hunan. Shaoyang City has formed preliminary pillar industries, including mechanical manufacturing, new energy, electronic information, biomedicine, light industry, traditional Chinese medicine industry, and agricultural specialty industry, developing a solid foundation for industrial upgrading. Shaoyang City's economy has demonstrated a stable growth trend over the past years. Benefiting from the ongoing industrial development, Shaoyang City's GRP increased from RMB246.2 billion to RMB273.1 billion in 2023, ranking 8th among 14 prefecture-level cities in Hunan Province and ranking the first in western Hunan, including 5 prefecture-level cities. The general budgetary revenue of Shaoyang City increased to RMB13.4 billion in 2023 from RMB11.9 billion in 2021, representing a 4.1% CAGR. It has moderate fiscal stability with tax income contributing to over 64% of the general budgetary revenue over the past three years. However, its fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was 19.8% in 2023, which was at a relatively weak level. At the end of 2023, the outstanding direct government debt balance of Shaoyang Municipal Government amounted to RMB96.0 billion, accounting for 35.0% of its GRP for that year.

Exhibit 3. Key Economic and Fiscal Indicators of Shaoyang City

	2021FY	2022FY	2023FY
GRP (RMB billion)	246.2	260.0	273.1
GRP Growth (%)	8.5	4.7	4.8
General Budgetary Revenue (RMB billion)	11.9	12.8	13.4
General Budgetary Expenditure (RMB billion)	56.0	63.7	67.7
Local Government Debt (RMB billion)	66.9	77.4	95.7

Source: Statistic Bureau of Shaoyang City, CCXAP research

Shaoyang ETDZ was established in 1996 and promoted to a National Economic and Technical Development Zone in 2021. It covers an area of 29.2 square kilometers (“km^2”), with planning built-up industrial area of 60 km^2. Shaoyang ETDZ has formed a “2+1” industrial pattern, including advanced equipment manufacturing, smart home appliances, and new display materials industries. Thanks to rapid development of pillar industries, Shaoyang ETDZ achieved fast economic growth in recent years. From 2021 to 2023, Shaoyang ETDZ’s general budgetary revenue increased from RMB0.8 billion to RMB1.0 billion. As the sole development and construction entity in Shaoyang ETDZ, SYIG has great development opportunities in the development of infrastructure and supporting facilities.

Government’s Willingness to Provide Support

Strategic role as the primary state-owned assets operation entity in Shaoyang City with strong regional franchise advantages in developing Shaoyang ETDZ

There are two key LIIFCs in Shaoyang City, which are Shaoyang Urban Construction Investment and Operation Group Co., Ltd. (“SYUC”) and the Company, each with clear positioning in the development of the region. SYUC is the largest and most important infrastructure construction entity in the region, and undertakes important functions such as urban infrastructure construction and land development, water supply and gas supply in Shaoyang City. Meanwhile, SYIG plays a vital role in public policy businesses, such as conducting land consolidation and infrastructure construction projects, especially in Shaoyang ETDZ, with strong regional franchise advantages. Besides, it is also responsible for restructuring of state-owned enterprises and industrial investment in Shaoyang City. The Company has made strong contributions to the local social and economic development. Considering its strategic importance in undertaking public policy projects in the region, we believe the Company will not be easily replaced by other local state-owned enterprises in the foreseeable future.

Good sustainability of public policy businesses

As an important state-owned asset operation and infrastructure construction entity in Shaoyang City and Shaoyang ETDZ, SYIG’s infrastructure construction, land consolidation and state-owned enterprises restructuring businesses are crucial to local social and economic development. We believe SYIG's large pipeline of public policy projects assigned by the local government has demonstrated its leading position in the development of Shaoyang City and Shaoyang ETDZ, ensuring its sustainability of public policy businesses but exerting certain capital expenditure pressure. Nevertheless, funding from policy banks and special government bonds can alleviate part of the investment pressure.

As the main urban developer in Shaoyang ETDZ, the Company is entrusted by the local government to undertake land consolidation and infrastructure construction. The Company conducts infrastructure construction business mainly through agency construction and government repurchase models. Under the agency construction model, SYIG enters into an agency construction agreement with the related departments of the

Shaoyang Municipal Government and the related departments will pay the total cost plus 20% markups to the Company within 3 to 5 years. Under the government repurchase model, the local government would repurchase the infrastructure construction projects and pay the total cost plus 20% markups to the Company after examination of the projects. From the perspective of project reserves, as of the end of 2023, the Company had 10 key infrastructure construction projects under construction, such as road and resettlement housing construction projects, with a total investment of RMB2.9 billion and an uninvested amount of RMB826 million. In the meantime, the Company had 3 infrastructure construction projects under planning, with a total planned investment of RMB160 million.

The Company engages in land development business through its subsidiary, involving land acquisition, demolition, compensation and consolidation within the planned area. The local government would pay the Company based on the cost of land consolidation plus 20% markup after completion of the land consolidation within 3 to 5 years. The income of land consolidation business shows a downward trend these years, decreasing from RMB681.6 million in 2021 to RMB545.8 million in 2023, mainly due to the downturn of the land market. As of 31 December 2023, the Company had 21 land development projects under construction with a total investment amount of RMB3.8 billion and an outstanding amount of RMB1.4 billion. Moreover, the Company's 2 planned land consolidation projects required a total planned investment of RMB258 million. The large scale of land consolidation ensures the sustainability of the business. However, the income from land development is largely susceptible to the land market conditions and government policies.

Besides, entrusted by the Shaoyang SASAC, the Company takes part in restructuring of state-owned enterprises business and is responsible for staff resettlement and assets collection through self-financing restructuring costs. The Shaoyang SASAC would pay the total cost plus 20% markups to the Company after examination of the restructuring projects. As of the end of 2023, the Company had restructured and settled 58 state-owned enterprises, with an invested amount of RMB4.0 billion. The Company has sufficient reserves of state-owned enterprise restructuring projects, indicating good business sustainability. As of 31 December 2023, there were 25 enterprises under restructuring, with a total investment of RMB2.6 billion and an outstanding amount of RMB536 million, and 3 restructuring projects under planning with an estimated investment of RMB219 million. The revenue of restructuring of state-owned enterprises business has a steady growth, but it is subject to relatively long restructuring period of the projects (up to 10 years) and government settlement progress.

Medium exposure to commercial activities with poor industrial investment return

In addition to public activities, SYIG also engages in various commercial activities, such as property leasing and sales, industrial investment and self-operated project construction. We consider SYIG's commercial business exposure to be medium, as its market-driven businesses accounted for around 25-30% of its total assets at the end of March 2024. We expect these activities have been a good supplement to the Company's revenue but could exert certain funding pressure and business risks.

The Company is undertaking several self-operated construction projects, including standard factories projects and technology park projects. After these projects are completed, the Company generates profits from property leasing and sales for fund balance. At the end of 2023, the Company had 16 self-operated projects under construction, with an invested amount of RMB2.1 billion. Moreover, the income of the Company's property leasing and sale business mainly comes from leasing and sale of self-operated projects, which are highly subject to local industrial development and investment promotion policy. From 2021 to 2023, the Company's property leasing and sales amounted to RMB105 million, RMB124 million and RMB278 million, respectively, with limited contribution to the Company's overall income because of its relatively slow construction progress of self-operated projects. Considering the relatively large scale of capital expenditure and lower-than-expected return from self-construction projects, as well as the slow progress of project construction, there is uncertainties with regard to the subsequent fund balancing of these projects.

SYIC also engages in industrial investment business in Shaoyang ETDZ in the form of equity investment, focusing on local emerging industries such as new materials, asset acquisition and glassmaking, to promote the local industrial development. As of 31 December 2023, the Company had mainly invested in 5 equity investment projects, with a total investment of RMB1.3 billion. However, the Company endured a loss of 12.5% from investments in 2 key targets which are Hunan Shaohong Special Glass Co., Ltd. ("Shaohong Special Glass") and Rainbow Group (Shaoyang) Special Glass Co., Ltd. ("Rainbow Special Glass"), accounting for 85.6% of the Company's total investment at end-2023. Both Shaohong Special Glass and Rainbow Special Glass operate in special glass sector and face challenges of insufficient productivity within competitive industry environment monopolized by international giants with high technical barriers. Considering the process to achieve technological breakthroughs is time-consuming and capital-intensive, the investment cycle is prolonged and the dividend income is susceptible to the industry policies and market conditions, causing uncertainty in the investment return of SYIC's industrial investment business.

Solid track record of receiving government payments

In recognition of its importance as an infrastructure construction platform and state-owned assets operator in Shaoyang City, SYIG has received recurring financial support, including financial subsidies, asset and capital injection from the Shaoyang Municipal Government. From 2021 to 2023, the local government transferred assets with total value of about RMB0.7 billion, including lands and properties to the Company without compensation, enhancing its capital strength and broadening its business scope. In 2022, the Company's debt rights of RMB4.6 billion were converted into capital reserves, significantly reducing its debt burden. The Company also received sizeable government subsidies of RMB1.0 billion, special refinancing bonds of around RMB909 million and special bonds of around RMB1.8 billion from 2021 to 2023, facilitating its capital-intensive investments and debt repayments. Given SYIG's important strategic role in the region, we expect the Company will continue to receive support from the government in the future.

Fast-growing debt from large development pipelines

SYIG's total debt has grown rapidly owing to its debt-driven business expansion over the past years. The Company's total debt had increased from RMB18.0 billion at end-2021 to RMB21.3 billion as of 31 March 2024, with a relatively high total capitalization ratio of 45.9%. In addition, as of 31 March 2024, its short-term debt accounted for about 31.7% of its total debt, and cash to short-term debt ratio was 0.5x, indicating certain short term debt servicing pressure. Considering its ongoing investment needs and slow project repayments progress, we expect the Company will maintain a relatively fast debt growth for the next 12-18 months.

Moderate asset liquidity as most assets are composed of land and construction projects

SYIG's asset liquidity is moderate, which may undermine its financial flexibility. The Company's total asset mainly consists of inventories and investment properties, which accounted for 71.6% of its total assets as of 31 March 2024. Inventories are mainly land assets and investment costs for infrastructure construction projects and state-owned enterprise restructuring projects, which are considered low liquidity. However, the investment properties, mainly standard factories, office buildings, customs buildings, can provide supplementary income and cash flow to the Company, although their scale are relatively small. As of 31 March 2024, the Company had investment properties of RMB9.6 billion, accounting for 19.4% of total assets.

In addition, as of 31 March 2024, the Company's restricted assets amounted to RMB10.1 billion, representing around 20.3% of its total assets and mainly consisting of land and properties.

Diversified access to funding channels

The Company has access to various sources of funding, including bank loans, onshore bond financing and non-standard financing. As of 31 March 2024, around 80.0% of the Company's debt financing was provided by domestic banks, with total credit facilities of RMB31.8 billion and available credit facilities of RMB14.0 billion, indicating a sufficient liquidity buffer. The Company is also able to access the onshore debt market by issuing a tranche of five-year private corporate bond to raise around RMB274.0 million in June 2024 and the Company's subsidiary had raised RMB4.8 billion from the onshore bond market from 2016 to 2022. In addition, the Company has a low exposure to non-standard financing, such as financial leasing, which accounted for less than 5.0% of its total debt. We consider the Company's diversified funding channel can largely fulfill its future capital expenditure.

Medium exposure to contingent risk

The Company bears moderate contingent risk resulting from relatively large external guarantees, which could potentially increase its repayment obligations. As of 31 March 2024, the Company's external guarantees amounted to RMB6.3 billion, accounting for 25.0% of its net assets. All of the external guarantees are provided to other local state-owned enterprises. We believe that the credit risk of the guarantee is controllable, taking into account the government's support to local state-owned enterprises.

ESG Considerations

The Company is subject to environmental laws and regulations governing air pollution, noise emissions, hazardous substances, water and waste discharge and other environmental matters issued by the national governmental authorities. SYIG assumes environmental risks for its infrastructure projects. Such risks could be mitigated by conducting environmental studies and detailed planning prior to the commencement of projects and close supervision during construction.

SYIG is also exposed to social risks as it implements public-policy initiatives by building public infrastructure in Shaoyang City. Demographic changes, public awareness and social priorities shape government's development strategy, and it will affect the government's propensity to support the Company.

The Company's governance considerations are also material as it is subject to oversight and reporting requirements to the local government, reflecting its public-policy role and status as a government-owned entity. SYIG believes that it is in compliance in all material respects with the applicable governmental regulations, rules and executive orders in each jurisdiction in which it operates. The Company maintains regular communication with local governments and regulatory authorities through its management team or representatives, ensuring compliance with the requirements and conditions for obtaining and maintaining the licenses, concessions, permits, or certificates.

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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