

Credit Opinion

10 May 2024

Guangdong Sanshui Development Group Co., Ltd

Initial credit rating report

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

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CCXAP assigns first-time long-term credit rating of BBB_g+

to Guangdong Sanshui Development Group Co., Ltd, with stable outlook

Summary

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

Our assessment of Sanshui District Government’s capacity to provide support reflects Sanshui District’s comprehensive strength and geographic advantage, 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 most important local infrastructure construction and utility operation entity in Sanshui District; (2) good track record of receiving government support; and (3) good access to multiple funding channels.

However, the rating is constrained by the Company’s (1) fast debt growth due to large capital expenditure; and (2) moderate asset liquidity.

The stable outlook on Sanshui Development’s rating reflects our expectation that the local government’s capacity to provide support will remain stable, and the Company will continue to serve as the most important infrastructure construction and utility operation entity in Sanshui District.

Rating Drivers

- Most important local infrastructure construction entity and utility services provider
- High sustainability for public policy businesses
- Low exposure to commercial activities
- Good track record of receiving government support
- Fast debt growth due to large capital expenditure
- Moderate asset liquidity
- Good access to multiple funding channels

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's ability to provide support strengthens; and (2) the Company's characteristics change in a way that strengthens local government's willingness to provide support, such as improved debt management and asset liquidity.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's ability to provide support weakens; or (2) the Company's characteristics change in a way that decreases the local government's willingness to provide support, such as reduced regional significance or weakened access to funding.

Key Indicators

	2021FY	2022FY	2023FY
Total Asset (RMB billion)	11.3	13.6	15.4
Total Equity (RMB billion)	5.3	6.0	6.4
Total Revenue (RMB billion)	1.1	1.4	1.6
Total Debt/Total Capital (%)	19.6	32.0	42.9

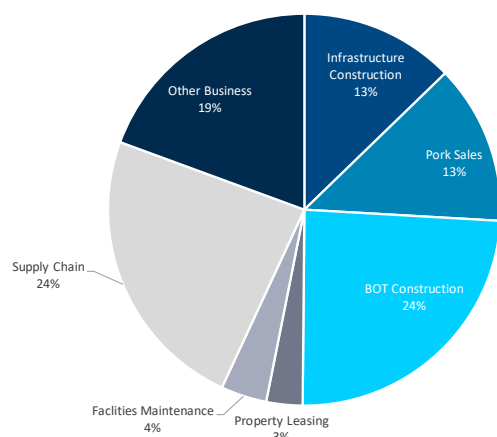
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

Corporate Profile

Founded in 2012, Sanshui Development is the largest local infrastructure investment and financing company ("LIIFC") in terms of total assets in Sanshui District, with strong regional importance. The Company is responsible for public policy projects in Sanshui District, including infrastructure construction, drainage facilities maintenance and garbage disposal. It also has several commercial businesses, including pork sale and property leasing. As of 31 December 2023, the Company was wholly owned and ultimately controlled by the State-owned Assets Supervision and Administration Commission of Sanshui District ("Sanshui SASAC").

Exhibit 1. Revenue structure in 2023



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe Sanshui District Government has strong capacity to provide support, given Sanshui District's comprehensive strength and geographic advantage, with ongoing economic growth and good fiscal balance.

Guangdong Province is one of the most economically developed provinces in China, and its comprehensive economic strength outperforms other provinces. The gross regional product ("GRP") of Guangdong Province was RMB13.6 trillion in 2023, ranking first among all provinces in China for more than 30 years, with a year-on-year ("YoY") increase of 4.8%. In 2023, its general budgetary revenue reached RMB1.4 trillion.

Foshan City is located in the central part of Guangdong Province and plays a vital role in the economic development of the Guangdong-Hong Kong-Macao Greater Bay Area. Foshan City is economically dominated by manufacturing, including advantageous industries and emerging industries. Benefited from good location of Guangdong-Hong Kong-Macao Greater Bay Area and Guangzhou-Foshan Metropolitan Area, Foshan City's total Gross Regional Product ("GRP") increased by 5% year-over-year ("YoY") to RMB1,327.6 billion in 2023, ranking 3rd in terms of GRP among all the cities in Guangdong Province. Benefited from economic recovery, Foshan City's general budgetary revenue rose from RMB79.7 billion in 2022 to RMB80.0 billion in 2023. Foshan City's budgetary self-sufficient ratio rose from 78.0% in 2022 to 81.5% in 2023. Foshan City's government debt increased from RMB227.8 billion in 2022 to RMB275.1 billion in 2023, accounting for 20.7% of its GRP.

Exhibit 2. Key Economic and Fiscal Indicators of Foshan City

	2021FY	2022FY	2023FY
GRP (RMB billion)	1,215.7	1,269.8	1,327.6
GRP Growth (%)	8.3	2.1	5.0
General Budgetary Revenue (RMB billion)	80.8	79.7	80.0
General Budgetary Expenditure (RMB billion)	107.2	102.1	98.3
Local Government Debt (RMB billion)	185.7	227.8	275.1

Source: Statistic Bureau of Foshan City, CCXAP research

Located in Guangdong-Hong Kong-Macao Greater Bay Area and Guangzhou-Foshan Metropolitan Area, Sanshui District has an area of 827.7 kilometers, with comprehensive strength and investment potential. In 2023, Sanshui District ranked 31st by comprehensive strength and 30th by investment potential among Top 100 Districts in China. Sanshui District also has sound industrial base, with pillar industries of high-end equipment manufacturing, home appliances, electronic information, and food and beverage. Sanshui District has ongoing economic growth. Its GRP increased from RMB147.2 billion in 2022 to RMB154.1 billion in 2023, ranking 4th among five administrative districts of Foshan City. Sanshui District Government's general budgetary revenue increased from RMB6.9 billion in 2022 to RMB7.0 billion in 2023 due to economic recovery. Nonetheless, its fiscal balance is good, with average fiscal balance ratio of 86.1% for the past three years. As of 31 December 2023, Sanshui District's outstanding government debt increased to RMB22.2 billion, with government debt/GRP ratio of 14.4%.

Exhibit 3. Key Economic and Fiscal Indicators of Sanshui District

	2021FY	2022FY	2023FY
GRP (RMB billion)	140.7	147.2	154.1
GRP Growth (%)	8.6	2.1	5.6
General Budgetary Revenue (RMB billion)	7.2	6.9	7.0
General Budgetary Expenditure (RMB billion)	8.2	7.9	8.4
Local Government Debt (RMB billion)	17.8	19.6	22.3

Source: Statistic Bureau of Sanshui District, CCXAP research

Government's Willingness to Provide Support**Most important local infrastructure construction entity in Sanshui District**

There are five LIIFCs in Sanshui District, each with a clear position in regional development. Among them, Sanshui Development is the largest LIIFC in terms of total asset, with the most important regional status. Besides, Foshan Sanshui Miao Cheng City Construction Investment Co., Ltd. and Foshan Sanshui Financial Investment Holding Co., Ltd., another two LIIFCs in Sanshui District, are subsidiaries controlled by Sanshui Development and managed by Sanshui SASAC. The Company is mainly responsible for major infrastructure projects in Sanshui District, including transportation, water supply facilities and public facilities maintenance, making great contributions to the economic and social development of the region. We believe that the replacement cost for the Company's role is high and will not easily be replaced by other local SOEs.

High sustainability for public policy businesses

As the most important infrastructure construction entity in Sanshui District, Sanshui Development has participated in infrastructure construction, drainage facilities maintenance and garbage disposal. There is large

amount of public policy projects in the pipeline, ensuring high business sustainability, but exerting high capital expenditure pressure.

Sanshui Development undertakes infrastructure construction projects under agent construction model. The Company enters into agent construction agreements with local government, receiving 15% markup based on total investment amount after project completion. Most of the infrastructure construction projects are transportation projects. As of 31 December 2023, the Company had completed 11 infrastructure construction projects, with total investment amount of RMB4.9 billion and had received project repayments of RMB4.1 billion from the local government. Besides, Sanshui Development had 21 infrastructure projects under construction or planning, with a total planned investment of RMB6.2 billion and uninvested amount of RMB404.0 million.

Apart from infrastructure construction, Sanshui Development newly engaged in drainage facilities maintenance business in Sanshui District in 2021. The business is operated by its subsidiary Foshan Sanshui Miaotong Drainage Engineering Co., Ltd. (“Sanshui Miaotong”). Entrusted by the local government, Sanshui Miaotong is responsible for planning, construction and maintenance for drainage facilities in the whole Sanshui District. In recent years, with Sanshui Miaotong undertaking more public facilities responsibilities, revenue from this sector increased from RMB7.0 million in 2021 to RMB60.5 million in 2023. As of 31 December 2023, Sanshui Miaotong had 3 projects under construction, with total planned investment of RMB1.8 billion and uninvested amount of RMB1.3 billion.

Sanshui Development conducts garbage disposal business under BOT model, involving garbage landfill and incineration. Authorized by Sanshui District Government, the Company is responsible for the construction of the sole garbage disposal plant in Sanshui District by self-raised funds, and has franchise for operating the garbage disposal plant until 2052, which will be transferred to the local government after expiry of the franchise. As of 31 December 2023, the Company had finished one project, with total investment of RMB1.5 billion. Besides, the Company has invested RMB505.8 million into the projects under construction, with RMB1.0 billion to be invested in the future. The Company will further expand to disposal of industry waste, which will increase its operating revenue and cash flow.

Low exposure to commercial activities

In addition to public policy business, Sanshui Development is also engaged in commercial businesses, mainly including pork sales, property leasing, and sales of alcohol and tobacco. We consider the Company’s exposure to commercial businesses to be low, accounting for around 15% of its total assets. Besides, commercial risk is manageable since sale and process of pork business has strong regional competitiveness and the scale of property leasing and sale of alcohol and tobacco businesses is small.

The sale and process of pork business involves procurement, process, and cold chain distribution of pork products. The Company’s subsidiary is the sole pig slaughtering enterprise in Sanshui District, with strong regional competitiveness. From 2021 to 2023, revenue generated from pork sales business fluctuates, and the gross profit margin was at low level.

The Company also engages in supply chain business since 2023. Supply chain business involves sale of aerated bricks, steel, sand and gravel, metal materials, hogs, medical equipment, beverages, and wine. However, those businesses make limited contributions to the Company’s revenue.

The Company also engages in property leasing business. Property leasing business involves lease of self-owned stores, office buildings, lands, and industrial plants. As of 31 December 2023, Sanshui Development had

12 projects under construction or planning, with total planned investment of RMB9.2 billion and uninvested amount of RMB7.1 billion. The Company funds those projects with its own funds. However, those businesses make limited contributions to the Company's revenue.

Good track record of receiving government support

Sanshui Development has regularly received support from the local government in the form of capital injection, asset transfer, and project payments. From 2021 to 2023, the Company totally received capital injection of about RMB1.1 billion and assets transfer of RMB42.0 million, significantly enhancing its capital strength. In 2022, Sanshui SASAC converted the Company's receivables of RMB364.0 million into capital reserve. Furthermore, the local government has regularly made project payments to the Company, which had received RMB5.4 billion for completed infrastructure projects as of 31 December 2023. Given its role as the most important local infrastructure construction entity and utility services provider, we believe that the local government will continue to provide support to the Company.

Fast debt growth due to large capital expenditure

With ongoing financing for its infrastructure construction projects, Sanshui Development has fast debt growth, which weigh on its debt servicing capability. Its total debt increased from RMB1.3 billion at end-2021 to RMB4.8 billion at end-2023, while its total capitalization ratio increased from 19.6% to 42.9% over the same period. In addition, the Company's short-term debt servicing pressure remains moderate, and the Company's short-term debt accounted for 13.6% of its total debt as of 31 December 2023. We expect that, given its large capital expenditure needs, the Company's debt burden will continue to grow in the next 12 to 18 months.

Moderate asset liquidity

Sanshui Development's asset liquidity is moderate, which may undermine its financial flexibility. The Company's assets mainly consist of inventories, other receivables, and construction in progress, all with low liquidity. The inventories and constructions in progress are development costs from construction projects, while the other receivables mainly consist of uncollected payments from the local government, totally accounting for about 60.9% of total asset at end-2023. As of 31 December 2023, there remained cash of RMB1.5 billion and cash to short-term debt ratio was 2.4x, which is sufficient to satisfy operation needs and repay short-term debt.

Good access to multiple funding channels

Sanshui Development has good access to multiple funding, including bank loans and bonds. As of 31 December 2023, bank loans and bonds accounted for about 53.8% and 42.4% of its total debt, respectively, indicating relatively high reliance on bond financing. The Company has obtained sufficient standby liquidity from diversified domestic policy banks and commercial banks. As of 31 December 2023, it obtained total credit facilities of RMB9.0 billion, with an unutilized amount of RMB6.3 billion. From July 2021 to December 2023, the Company and its subsidiary raised about RMB2.0 billion via issuance of 3 corporate bonds in the onshore bond market. Besides, the Company has no access to non-standard financing as of 31 December 2023.

ESG Considerations

Sanshui Development faces environmental risks because it has undertaken infrastructure construction projects and public services. Such risks could be moderated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

Sanshui Development bears social risks as it plays a crucial role in the social welfare of the residents in Sanshui District by providing public services. Demographic changes, public awareness and social priorities shape the Company's development targets and ultimately affect the local government's propensity to support the Company.

Sanshui Development's governance considerations are also material as the Company is subject to oversight by the Sanshui District Government and has to meet several reporting requirements, reflecting its public-policy role and status as a government-owned entity.

Structural Consideration

Sanshui Development's senior unsecured debt rating is in line with its long-term credit rating. We believe that government support will flow through the Company given its important role as the most important local infrastructure construction entity and utility services provider in Sanshui District, thereby mitigating any differences in an expected loss that could result from structural subordination.

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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