

Credit Opinion

13 June 2024

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

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Taizhou Huaxin Pharmaceutical Investment Co., Ltd.

Surveillance credit rating report

CCXAP upgrades Taizhou Huaxin Pharmaceutical Investment Co., Ltd.'s long-term credit rating to BBB_g+, with stable outlook.

Summary

CCXAP has upgraded the long-term credit rating of Taizhou Huaxin Pharmaceutical Investment Co., Ltd. ("Huaxin" or the "Company") to BBB_g+

 from BBB_g, reflecting the improved comprehensive strength of Taizhou City, the good development prospect of Taizhou Medical High-Tech Industrial Development Zone (Gaogang Zone) ("Taizhou Medical Zone"), and Huaxin's good track record of receiving government supports.

The BBB_g+

 long-term credit rating of Huaxin reflects Taizhou Municipal Government's (1) very strong capacity to provide support; and (2) high willingness to provide support based on our assessment of the Company's characteristics.

Our assessment of Taizhou Municipal Government's capacity to provide support reflects its good industrial base and ongoing economic growth.

The rating also reflects the local government's willingness to provide support, based on the Company's (1) important policy role in Taizhou Medical Zone and Taizhou City; and (2) good track record of receiving government supports.

However, the rating is constrained by its (1) high exposure to commercial activities; (2) high debt leverage and weak asset liquidity; and (3) large exposure to external guarantees with contingent liability risks.

The stable outlook on Huaxin's rating reflects our expectation that the local government's capacity to provide support will remain stable, and that the Company will maintain its vital position in the Taizhou Medical Zone and continue to receive ongoing government supports.

Rating Drivers

- Important policy role in Taizhou Medical Zone and Taizhou City
- High exposure to commercial activities
- Good track record of receiving government supports
- High debt leverage and weak asset liquidity
- Access to funding channels with declining financing costs
- Large exposure to external guarantees with contingent liability risks

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) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as an expanded policy role, a significant reduction in external guarantee exposure, reduced exposure to commercial activities, or improved asset liquidity and debt management.

What could downgrade the rating?

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

Key Indicators

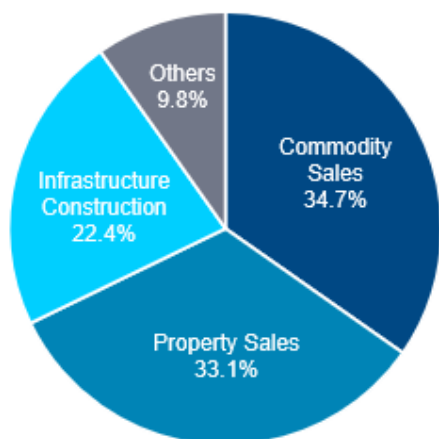
	2021FY	2022FY	2023FY	2024Q1
Total Asset (RMB billion)	85.9	89.1	94.7	95.7
Total Equity (RMB billion)	30.8	29.1	31.1	31.1
Total Revenue (RMB billion)	4.4	4.0	3.7	0.5
Total Debt/Total Capital (%)	58.8	64.6	64.5	64.4

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

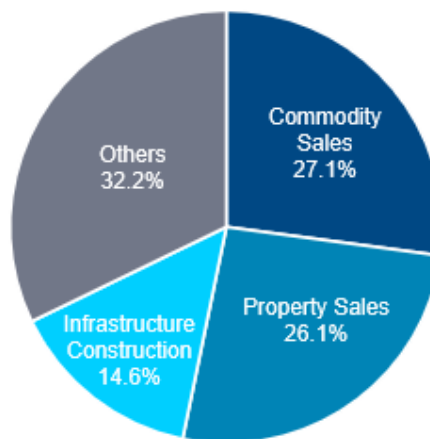
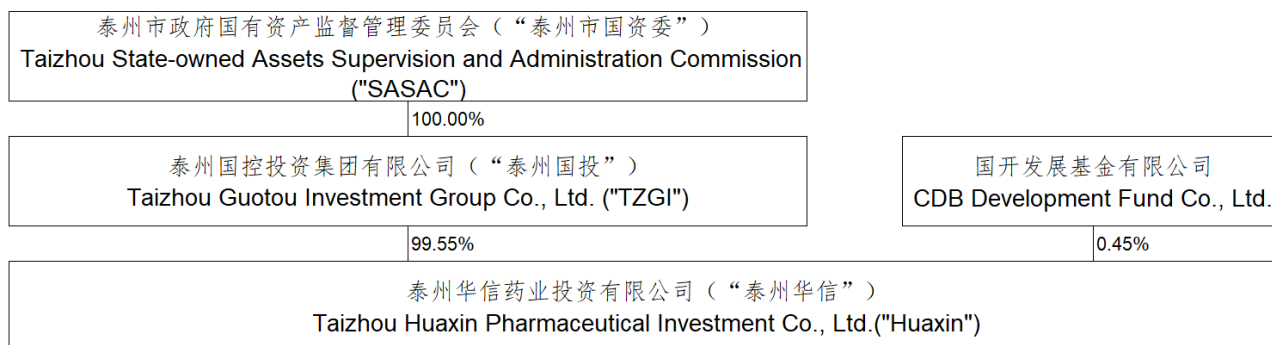
Source: Company data, CCXAP research

Corporate Profile

Founded in 2005, Huaxin is one of the most important local infrastructure investment and financing companies ("LIIFCs") in Taizhou Medical Zone in Jiangsu Province, undertaking infrastructure and resettlement housing construction and land development in the core area of the former Taizhou Pharmaceutical High-tech Zone. The Company is also engaged in sales of pharmaceutical and industrial products, sales of properties, and property leasing in Taizhou Medical Zone, which is crucial to the investment attraction and industrial development in the region. In July 2023, to optimize the layout and structure of state-owned capital, Taizhou Municipal Government transferred its 99.45% stake in Huaxin to the Taizhou Guotou Investment Group Co., Ltd. ("TZGI"), which is fully owned by the Taizhou State-owned Assets Supervision and Administration Commission ("Taizhou SASAC"), and the Company's ultimate controller, Taizhou Municipal Government, remained unchanged. In December 2023, Taizhou Municipal Government increased the Huaxin's paid-in capital by RMB1.5 billion in cash through TZGI. As of 31 March 2024, TZGI owned 99.55% shares of Huaxin, and CDB Development Fund Co., Ltd. held the remaining 0.45%.

Exhibit 1. Revenue structure in 2023

Source: Company information, CCXAP research

Exhibit 2. Gross profit structure in 2023**Exhibit 3. Shareholding chart as of 31 March 2024**

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Taizhou Municipal Government has a very strong capacity to provide support given its good industrial base and ongoing economic growth.

Jiangsu Province is one of the leading developed provinces in China. It is home to many of the world's leading electronic equipment, chemical, and textile enterprises, and is the second largest province in China by gross regional product ("GRP"), after Guangdong Province. In 2023, Jiangsu Province's total GRP amounted to RMB12.8 trillion, a year-over-year ("YoY") increase of 5.8%. The per capita GRP of the same period was RMB150,487, ranking first among all provinces in the country.

Taizhou City is a prefecture-level city located in the central region of Jiangsu Province, with pharmaceutical, electric, chemical, and shipbuilding as its pillar industries. In 2023, Taizhou City's industrial investment and fixed asset investment achieved nearly double-digit growth owing to the growth of leading industries. With the vigorous development of the industrial sector, Taizhou City has achieved sustained economic growth. In 2023, the GRP of Taizhou City was RMB673.2 billion, a YoY increase of 6.8%, and its growth rate was 1.6 percentage points higher than the national level and 1.0 percentage points higher than the provincial level. Taizhou Municipal Government's general budgetary revenue increased from RMB42.0 billion in 2021 to RMB44.0 billion in 2023. Its fiscal balance is relatively good, with a fiscal balance ratio averaging 70% for the past three years. As of end-2023, the Taizhou Municipal Government reported outstanding government debt of RMB107.1 billion,

accounting for 15.9% of the GRP. In the first quarter of 2024, Taizhou City's GDP reached RMB175.3 billion with an YoY increase of 7.3%, which is 1.1 percentage points higher than that of Jiangsu Province.

Exhibit 4. Key economic and fiscal indicators of Taizhou City

	2021FY	2022FY	2023FY
GRP (RMB billion)	602.5	640.2	673.2
GRP Growth (%)	10.1	4.4	6.8
General Budgetary Revenue (RMB billion)	42.0	41.7	44.0
General Budgetary Expenditure (RMB billion)	66.8	70.4	69.7
Local Government Debt (RMB billion)	96.6	100.1	107.1

Source: Taizhou Municipal Government, CCXAP research

Taizhou Medical Zone is the first national-level high-tech zone in the pharmaceutical field in China approved in 2009 and is a strategic region leading the development of pharmaceutical industry in Jiangsu Province. With ongoing development, it is home to more than 1,200 bio-pharmaceutical enterprises, with top companies including Yangtze River Pharmaceutical Group, AstraZeneca (Taizhou), Jiangsu Bioperfectus Technologies Co Ltd, and Nestle Health Science (China) Co Ltd. Taizhou Medical Zone ranked 9th (out of a total of 204 sample zones) in the 2022 National Biomedicine Industrial Park Comprehensive Competitiveness Ranking released by the China Biotechnology Development Center, which is the first time for Taizhou Medical Zone to enter the top ten in the ranking, indicating the strong competitiveness and good development prospect Taizhou Medical Zone especially in pharmaceutical industry. In June 2021, Taizhou Medical Zone and Taizhou Gaogang District were integrated to optimize Taizhou City's pharmaceutical industry and create a future China Medical City. After the integration, it has a relatively large planned area, about 402.9 square kilometers, with a population of 439,600 people. In addition, the economic and fiscal strength of Taizhou Medical Zone has been significantly enhanced. Its GRP increased from RMB115.3 billion in 2022 to RMB119.2 billion in 2023, and its general budget revenue increased from RMB10.1 billion to RMB10.3 billion over the same period, ranking 3rd by GRP and 1st by general budget revenue among all districts and counties in Taizhou City. Taizhou Municipal Government has introduced a series of policies, in terms of investment promotion, and talent introduction, to support the development of Taizhou Medical Zone. We expect the integration to create good prospects for the development of Taizhou Medical Zone.

Government's Willingness to Provide Support

Important policy role in Taizhou Medical Zone and Taizhou City

Huaxin is one of the most important LIIFCs in Taizhou Medical Zone by assets and acts as the important policy role in developing the pharmaceutical industry on behalf of the city. Huaxin is responsible for the major construction projects in the in the core area of the former Taizhou Pharmaceutical High-tech Zone with limited competition, including primary land development, infrastructure construction and resettlement housing construction. Huaxin is also in a leading position in the sales and distribution of pharmaceutical products, as well as the provision of land, leasing properties and service platforms in Taizhou Medical Zone, which is conducive to attracting more high-quality pharmaceutical companies to settle in and build a famous pharmaceutical city. Through strong shareholder background and capital strength, the Company is accordingly well positioned to be the primary developer of major projects within Taizhou Medical Zone. Given its important policy role and competitive position, we believe that the Company is unlikely to be replaced by other state-owned enterprises in the foreseeable future.

Huaxin has undertaken a large number of public activities in Taizhou Medical Zone with clear business model and good business stability. Under the agency construction model, Huaxin is responsible for the financing and construction of the projects, and settles with the local government after the audit. Generally, the local government will pay the construction costs to the Company within 5 years after the project is completed, and pay the Company a construction management fee of 6% of the total project completion price. As of 31 March 2024, the Company had invested more than RMB15.3 billion into the completed land consolidation and infrastructure construction projects, but with large uncollected payments from the local government due to slow pace of settlement. Meanwhile, the Company has one affordable housing project under construction, with a total estimated investment of RMB2.9 billion and an uninvested amount of RMB1.0 billion. Despite the limited project reserve, we expected a continued increase in demand for its services due to Taizhou Medical Zone's economic and industrial growth prospects.

High exposure to commercial activities

Apart from public projects, Huaxin conducts diversified commercial activities covering property development, property leasing, sales and distribution of pharmaceutical products and sales of industrial products. Although the commercial activities can bring in supplemental income and most of the business is highly related to the regional development, they may also pose higher operating and business risks to the Company compared with its infrastructure businesses. The Company's exposure to commercial businesses is high which accounted for around 30% of its total assets, by our assessment. In addition, we expect Huaxin's commercial exposure to increase as the business expands and investments continue.

Leveraging on geographical and resources advantages and strong shareholder background, Huaxin is one of the leading local pharmaceutical distribution companies in Taizhou Medical Zone. Huaxin's pharmaceutical sales business mainly refers to the sales and distribution of pharmaceutical products through the general agency and distribution model, and represents the Company's primary revenue stream. Affected by tough competition and the end of Covid-19, the pharmaceutical sales business has seen a decline in revenue since 2022. In 2023, the revenue from the segment decreased to RMB841.4 million from RMB1.1 billion in 2022. Given its high gross profit margin, which increased to 27.0% in 2023 from 21.6% in 2022, it maintains the main contributor to the Company's profitability. In addition, Huaxin also provides warehousing and logistics businesses for pharmaceutical enterprises in the zone. As of 31 March 2024, it owned three logistics warehouses with an area of 34,000 square meters.

Huaxin conducts property development and sales business in Taizhou Medical Zone. As of 31 March 2024, the Company had two property projects under development, namely Tianlu Lake and Shengya Garden, with an estimated total investment of RMB4.6 billion and an uninvested amount of RMB610.0 million. Specifically, most of Tianlu Lake has been pre-sold, with the total sale amount of RMB2.6 billion. The Company continues to face capital expenditure pressure in the property development sector, and is subject to uncertainty in the construction and destocking of the projects.

Under the guidance of the local government, Huaxin leased self-owned investment properties, such as office buildings and factories, to enterprises located in Taizhou Medical Zone at relatively low prices to attract investment. Correspondingly, the local government would compensate the Company with subsidies for the lower leasing prices. As subsidies are largely dependent on fiscal condition of the local government, the Company's rental receivables are subject to uncertainties and lags. Most of the rent preferential policies have ended in 2023 and the subsidies receivables from the local government will continue until 2028 with a stable amount of approximately RMB50.0 million each year. The high occupancy rate and the end of rent preferential policy have

contributed to the stability of the property leasing segment as a revenue supplement to the Company's total revenue. As of 31 March 2024, Huaixin had 3 leasable property projects under construction, with the total investment amount of RMB2.1 billion and the remaining investment needs of RMB742.0 million. The construction process and leasing condition are dependent on the pace of investment promotion in the region, bringing higher capital expenditure and operation uncertainty to the Company.

Huaxin is also engaged in the trading of industrial products, such as steel, light cycle oil, fuel oil, asphalt, and automotive gasoline. However, the trading business is highly concentrated in procurement and revenue has fluctuated greatly in recent years. In 2023, the procurement of industrial products from the top three suppliers accounted for 86.9% of total procurement, while sales to the top three customers accounted for 97.0% of total sales.

High debt leverage and weak asset liquidity

With the continuous financing of construction projects, Huaxin's debt leverage remains high, and its debt burden continues to increase. As of 31 March 2024, the Company's total debt had increased from RMB42.4 billion at end-2021 to RMB56.2 billion, and the total capitalization ratio was as high as 64.4%. In terms of the term structure, Huaxin is still facing certain short-term debt pressure, as indicated by its relatively high short-term debt percentage of 34.1% as of 31 March 2024. Its cash to short-term ratio was 0.1x as of the same time. Over the next 12 to 18 months, we expect the Company to continue to rely on external financing to meet its future capital needs, and its debt leverage will remain relatively high.

Huaxin's asset liquidity remains relatively weak, as its assets mainly consist of inventories, receivables, and investment properties, all of which has low liquidity. This could undermine its financial flexibility. As of 31 March 2024, inventories were mainly land development costs, receivables were uncollected payments from the local government or local state-owned enterprises, and investment properties were rental properties, and they together accounted for 88.5% of total asset. Moreover, the Company has pledged a certain amount of its assets, mainly inventories and investment properties, for loans. The pledged assets accounted for about 15.7% of total assets on 31 March 2024.

Access to funding channels with declining financing costs

Huaxin has maintained good access to fundings as reflected by its sufficient stand-by liquidity and diversified funding channels. The Company maintains good relationships with diversified large domestic banks, such as Industrial and Commercial Bank of China and China CITIC Bank. As of 31 March 2024, the Company's total credit facilities amount was RMB30.7 billion, of which the unutilized portion was RMB9.6 billion, indicating sufficient liquidity buffer. Furthermore, the Company is an active bond issuer in the debt capital markets. For example, in the first quarter of 2024, it has issued several tranches of 3-year corporate bonds with the lowest coupon rate being 3.59%. Meanwhile, since 2023, it has issued three offshore bonds, raising a total of USD156.0 million. Supported by the strong shareholder base and favorable refinancing conditions, Huaxin's financing costs continue to decline. Apart from that, Huaxin's exposure to non-standard financing products decreased in 2023, accounting for less than 10% of the total debt as of 31 March 2024.

Good track record of receiving government supports

Huaxin has a continuous track record of receiving supports from the local government in terms of capital injections, financial subsidies, and project repayments. After the integration into TZGI, the local government increased the Huaxin's paid-in capital by RMB1.5 billion in cash through TZGI in 2023, enhancing the

Company's capital strength. As one of the most important infrastructure entities in Taizhou Medical Zone, the Company has undertaken many key projects in the area and has continuously received project repayments from the local government. From 2021 to 2024Q1, the Company has received a total of RMB5.9 billion in project repayments. During the same period, the subsidies from the local government amounted to RMB704.6 million. Given the important position of Huaxin and its close relationship with the local government, we expect the Company will continue to receive strong support from the local government over the next 12 to 18 months.

Large exposure to external guarantees, with medium contingent liability risks

Huaxin's credit profile is constrained by its large external guarantees. As of 31 March 2024, Huaxin's external guarantees amounted to RMB19.5 billion, accounting for 62.8% of its net assets. Nevertheless, all external guarantees are provided to state-owned enterprises in Taizhou City, which have low credit risks. Since there are no counter-guarantee measures, when a credit event occurs, the Company may face certain contingent liability risks.

ESG Considerations

Huaxin bears environmental risks through its infrastructure projects. Such risks could be mitigated by conducting environmental studies and detailed planning before the commencement of projects, as well as close supervision during construction.

Huaxin is involved in real estate construction such as commercial property, factories, and R&D centers in Taizhou Medical Zone to help the government attract investment and develop the pharmaceutical industry. As a public service provider, the Company also faces social risks. Demographic changes, public awareness and social priorities shape the government's target for Huaxin, and may affect the government's capability to support the Company.

Huaxin'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. Major events, including strategic development, financial budgeting, and investment, require approval from the Taizhou Municipal Government.

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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