

## Shenyang Heping District State-owned Assets Operations Co., Ltd.

Hong Kong

Category:	Corporate Rating
Rating Type:	Solicited Rating
Industry:	Local Government Financing Vehicles
Long-term Credit Rating:	BBB <sub>g</sub>
Rating Outlook:	Stable

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### Key Indicators

Shenyang Heping District State-owned Assets Operations Co., Ltd. <sup>[1]</sup>	2017Q3	2016	2015	2014
Total Assets (RMB million)	25,916.3	24,789.5	23,345.5	20,269.9
Total Assets (USD million) <sup>[2]</sup>	3,904.9	3,573.5	3,595.2	3,312.6
Net Assets (RMB million)	8,015.2	7,975.3	7,752.1	7,337.2
Net Assets (USD million) <sup>[2]</sup>	1,207.7	1,149.7	1,193.8	1,199.1
Total Revenue (RMB million)	325.9	878.8	2,175.1	2,836.3
Total Revenue (USD million) <sup>[2]</sup>	49.1	126.7	335.0	463.5
Net Profit (RMB million)	39.9	217.3	381.4	271.6
Net Profit (USD million) <sup>[2]</sup>	6.0	31.3	58.7	44.4
Gross Margin (%)	10.7	12.0	10.8	5.4
Return on Equity (%)	0.5	2.8	5.1	3.8
Total Debt / Total Capital (%)	54.9	52.4	51.8	48.0
Total Liabilities / Total Assets (%)	69.1	67.8	66.8	63.8
Total Debt / EBITDA (x)	-	26.6	19.0	20.8
EBITDA / Interest (x)	-	0.7	0.6	0.7

[1] Consolidated financial statements in accordance with PRC GAAP audited by HuaPu TianJian CPA LLP. 2017Q3 figures denote for the nine months ended 30 September 2017 from unaudited results.

[2] Exchange rates for 2014 (1 USD = 6.1190 CNY), 2015 (1 USD = 6.4936 CNY), 2016 (1 USD = 6.9370 CNY), and 2017Q3 (1 USD = 6.6369 CNY) announced by PBOC

Source: Company data, CCXAP research

## Rating Drivers

- Strong fiscal capacity and self-sufficiency of Heping District
- High level of government support provided to the Company
- Notable drop in primary land development revenue over the years past, yet steady increase in land supplies to generate land sales proceeds over the years to come
- Weakening credit metrics with sizable debt due by the end of 2018

## Rating Rationale

The BBB<sub>g</sub> rating of Shenyang Heping District State-owned Assets Operations Co., Ltd. (“SHDSAO” or the “Company”) is underpinned by (1) politically and strategically important role of Shenyang City and strong fiscal capacity of Heping District; (2) high level of government support given the Company’s monopoly position as the primary land developer in the district. However, the rating is also constrained by the Company’s (1) notable drop in revenue and relatively low operating profitability; and (2) growing debt level coupled with weakening debt structure and liquidity position, which may impose liquidity pressure in the coming 12-18 months.

## Rating Outlook

The stable outlook on SHDSAO’s rating reflects its role as the sole provider of primary land development and city construction service in Heping District with high level of support from the government. We expect that the Company will maintain its strategically important position and further develop given its strong access to project resources.

### What could upgrade the rating?

The rating could be upgraded if (1) the Company would be granted with more favorable policy support; (2) the Company improves its profitability and credit metrics.

### What could downgrade the rating?

The rating could be downgraded if (1) there is reduced support from the Heping District Government; (2) the Company records weakening credit metrics in the future; (3) there are substantial constraints on the Company’s refinancing capability.

## Corporate Profile

SHDSAO was founded by State-owned Assets Supervision and Administration Commission of Heping District in 2002. As at 2017Q3, the Company is wholly owned by the Shenyang Heping District State-owned Assets Supervision and Administration Bureau.

The Company has a monopoly position in Heping District, Shenyang City. It is mainly engaged in primary land development in Changbai Island and Manrong Economic Zone, infrastructure construction, real estate development and operation & management of state-owned assets.

As of 30 September 2017, SHDSAO reported total assets of RMB 25.9 billion and total equity of RMB 8.0 billion. For the nine months ended 30 September 2017, the Company recorded total revenue of RMB 325.9 million and net profit of RMB 39.9 million.

**Exhibit 1. Shareholding Structure of SHDSAO as of 31 December 2017**


Source: Company information, CCXAP research

## Detailed Rating Considerations

### 1. Strong fiscal capacity and high self-sufficiency of Heping District, yet with relatively high debt ratio

As provincial capital city of Liaoning Province, Shenyang is one of the most economically developed cities in Northern China. Shenyang's GDP amounted to RMB 546.0 billion in 2016, with a YoY decrease of 24.9%. Shenyang has a track record of industrial development, and its key industries include equipment manufacturing, auto parts manufacturing and agricultural products processing. In recent years, service sector has accelerated its growth pace, indicating an improvement in economic structure. Shenyang is also a politically important city. According to the national urban planning by the State Council, Shenyang is positioned as central city of Northeast area. Fiscal revenue of Shenyang in 2016 totaled RMB 114.4 billion. Proportion of tax revenue in general budget revenue has mildly increased since 2015 to 82.4%. In terms of government debt, as at end-2016, debt balance stood at RMB 172.2 billion, which was 10.6% below local government debt ceiling. In the meanwhile, the debt ratio (outstanding debt/fiscal revenue) reached a relative high level of 151.0%.

Heping District is located in the heart of Shenyang City as an economic and cultural center. Heping District's GDP constantly ranks top 3 among all districts of Shenyang. Its GDP was estimated at RMB 70.2 billion in 2016 with a comparable YoY GDP growth of 3.6%. In terms of economic structure, service sector is the key industry. In 2016, service sector accounted for 83.0% of total GDP while industrial sector took up 17.0%. Finance, information technology and trading industries are the primary growth drivers. These three industries contributed approximately 16.3%, 11.0% and 12.1% of Heping District's 2016 GDP, respectively. Heping District has a long history as a strategically important district in the urban modernization of Shenyang City and the recent development in cultural tourism and information technology.

According to preliminary data, fiscal revenue of Heping District increased YoY by 5.0% to RMB 10,291.4 million in 2017, while general public budget revenue rose to RMB 8,940.0 million. Tax revenue accounted for 91.4% of total budget revenue, implying a highly stable composition of fiscal revenue. In 2016, major tax payers of Heping District included Shengjing Bank, State Grid Liaoning

Electric Power Supply Co. Ltd., New World (Shenyang) Property Development Ltd. and etc. On the other hand, land sales have declined significantly since 2015 and currently there is no sign of change in the downward trend, leading to continued drop in government-managed fund revenue. Fiscal expenditure of Heping District moderately increased to RMB 5,077.6 million in 2017. The self-sufficient ratio (fiscal revenue/fiscal expenditure) was above 200.0% during 2015 to 2017, suggesting a track record of strong fiscal capacity.

#### **Exhibit 2. Fiscal data of Heping District Government in 2014-2017**

<b>(RMB million)</b>	<b>2017*</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
General public budget revenue	8,940.0	8,505.4	8,135.3	9,822.0
In which: Tax revenue	8,170.9	8,311.2	7,886.5	8,584.0
Non-tax revenue	769.1	194.2	248.8	1,238.0
Government-managed funds revenue	358.8	276.2	366.9	3,635.0
Transfer payments from superior government	992.6	1,020.8	1,048.6	890.4
<b>Fiscal revenue</b>	<b>10,291.4</b>	<b>9,802.3</b>	<b>9,550.8</b>	<b>14,347.4</b>
General public budget expenditure	4,596.9	4,085.2	3,945.0	4,759.1
Government-managed funds expenditure	480.7	384.4	387.3	3,772.5
<b>Fiscal expenditure</b>	<b>5,077.6</b>	<b>4,469.6</b>	<b>4,332.3</b>	<b>8,531.6</b>
<b>Self-sufficient rate (%)</b>	<b>202.7</b>	<b>219.3</b>	<b>220.5</b>	<b>168.2</b>

Note: \*Based on preliminary announced data

Source: Government data, CCXAP research

At end-2017, outstanding debt of Heping District Government totaled RMB 11,280.6 million, moderately below its debt ceiling. General debt amounted to RMB 5,768.7 million and special debt amounted to RMB 5,511.9 million. The debt ratio (outstanding debt/fiscal revenue) stood at 109.6% which showed an improvement from 2016 data, yet still at a relatively high level. Overall, Heping District had strong fiscal capacity and healthy revenue composition, yet with a relatively large amount of outstanding government debt.

## **2. Track record of strong support from Heping District Government**

As the only investment and construction platform of Heping District, the Company is mainly engaged in primary land development and city construction in Changbai Island and Manrong Economic Zone. Due to its monopoly position and important role in city construction, Heping District Government has demonstrated strong support to the Company.

During 2014-2016, the Company received financial subsidies from Heping District Government with amount at around RMB 300 million each year, which suggested track record of stable and continuous financial support from the local government.

#### **Exhibit 3. Financial support received from Heping District Government in 2014-2017Q3**

<b>(RMB million)</b>	<b>2017Q3*</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Financial subsidies	111.9	294.8	293.2	280.9
Debt swap	494.8	1,279.8	2,530.0	-

Note: \*Debt swap amount totaled RMB 1,913 million for 2017FY

Source: Company data, CCXAP research

SHDSAO's gross debt amount of RMB 5,723 million has been recognized as local government debt during debt screening in 2014. The Company received the amount of RMB 2,530 million in 2015,

RMB 1,280 million in 2016 and RMB 1,913 million in 2017 through the local government debt swap programme. The debt swap has been completed by the end of 2017.

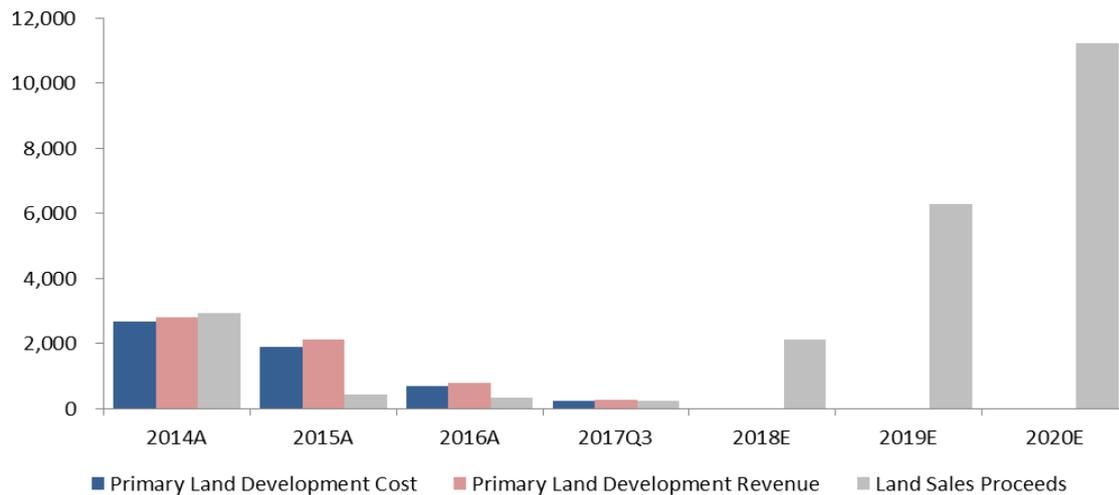
In terms of project resources, as the only entity for city construction in Heping District, the Company has undertaken important infrastructure construction projects in the district, such as Mazong Garden project, the Old North-market Cultural Park project and Heping District National Fitness Center project, all of which were key projects of Heping District since initiation. For example, the National Fitness Center, which is currently under construction, was introduced under 2016-2020 Shenyang National Fitness Program with strong policy support.

SHDSAO has also engaged in several key investment promotion projects in 2017, such as TusPark project, Inspur Big Data project and Jiuwu Cultural City project, which are all key projects of Heping District that are granted with good government support and possess sound growth potential. Extended access to key projects shows SHDSAO's position as a strategically important entity to the local government.

### **3. Noticeable decline in primary land development proceeds in past few years with several large land sales expected in the years to come**

SHDSAO is mainly engaged in primary land development in Changbai Island and Manrong Economic Zone. Revenue from primary land development revenue includes primary land development and infrastructure construction. The Company applies government procurement model which generally charge a service fee around 8%~15% of relevant costs for land leveling and pipeline installation work. After lands are sold through open auctions, the local government would settle the amount with the Company. Revenue from primary land development has been on the decline since 2015 and the trend accelerated in years followed. For the nine months ended 30 September 2017, revenue from primary land development decreased by 53.2% YoY to RMB 273.0 million. Decline in the Company's primary land development revenue was in line with decline in Heping District's land sales which was indicated by reduced government-managed fund since 2015. Land plots in Manrong are planned to be put to auction market in 2018 which are expected to provide primary land sales proceeds of around RMB 2,133.3 million, yet there would usually be some time lag before the Company could recognize revenue and receive cash inflows.

The Company's future focus of primary land development would be on Manrong Economic Zone. Subsequent projects would bring in large primary land development revenue, yet future cash inflows could be affected by various factors such as land sales schedule and real estate prices. CCXAP would continue to monitor future development in the Company's primary land sales and cash inflows.

**Exhibit 4. Historical and expected primary land development activities (RMB million)**


Source: Company data, CCXAP research

#### 4. Primary land development in Manrong Economic Zone and real estate segment are the Company's major development areas in the future

Revenue recognized in 2017 and before was all related to primary land development projects in Changbai Island. As at 2017Q3, most of the projects in that area were completed, and the only major project under construction was Changbai 1st Street project, road construction of which was about 90% completed. It's believed that Changbai Island would not have many primary land projects in the future.

SHDSAO's future focus of primary land development and infrastructure construction will be put on Manrong Economic Zone. Primary projects the Company engaged in Manrong includes primary land development for Shenyang Manrong international community. The project has a gross investment amount of RMB 6,000 million, of which RMB 1,500 million being internal capital of the Company and RMB 4,500 million being loan borrowings from China Development Bank, Liaoning Branch. As at 2017Q3, the project was approximately 10.2% completed with RMB 611 million invested. Payback of investment of the project and future subsidies have been agreed to be included in fiscal budgets in years followed. With sizable primary land in the area, the Company is expected to have large capital investment in Manrong Economic Zone in the future.

**Exhibit 5. Key projects under construction and planning as of 30 September 2017**

No.	Project	Construction period	Gross investment (RMB mn)	Amount invested (RMB mn)
<b>Projects under Construction</b>				
1	Ma Zong Garden	2013-2018	2,200	1,997
2	Hejingjiayuan	2015-2018	1,470	690
3	Pheonix Building	2007.8-2018	1,213	1,189
4	Northeast Auto Parts Trade Center	2007.8-2018	686	617
5	North-market Commercial and Cultural District project	2013-2020	930	636
6	Xingfu Garden	2013.8-2018	630	459
7	Blue Ocean Productivity Center (Phase 1)	2012-2019	498	420

No.	Project	Construction period	Gross investment (RMB mn)	Amount invested (RMB mn)
<b>Projects under Planning</b>				
1	Minzu North Street Commercial Project	-	200	-
2	Taiyuan North Street Commercial Project	-	218	-
3	Huaguang Bulb Factory Refurbishment project	-	660	-
4	Changbai Island International School	-	430	-
5	Tianhe Jiayuan Primary School	-	180	-
6	South 11th Road	-	235	-

Source: Company data, CCXAP research

Real estate segment is one of the key segments that the Company intends to develop. The Company mainly takes on affordable housing and shantytown renovation projects in this segment, while it would also carry out some residential and commercial property development projects. Most of the projects would be paid back through government repurchases or subsidies. Major projects under construction include Ma Zong Garden, which is an affordable housing project launched in 2013. Ma Zong Garden has a planned gross investment amount of RMB 2,200 million and target gross repurchase consideration of RMB 2,600 million. According to the repurchase agreement, the Company is entitled to annual payment of RMB 360 million starting from year 2012. As of 2017Q3, Ma Zong Garden project was nearly completed. Apart from Ma Zong Garden, the Company also has several other shantytown renovation projects and affordable housing projects such as Xingfu Garden and some properties built under BT model. Residential and commercial property development projects mainly include Hejingjiayuan, which is an urban complex project, partially built under repurchase agreement and partially built as residential and commercial properties for sales or leasing. The Company is expected to recognize sales revenue on Hejingjiayuan project in 2018.

SHDSAO will continue to focus on primary land development business in Heping District, and in the meanwhile target to obtain more property development contracts by leveraging its access to quality projects through primary land development.

## 5. Low profitability and weak cash generating ability

Apart from primary land development, the Company is also engaged in other businesses including real estate, exhibition, property management and security services. Starting from 2015, due to tighter constraints on primary land development businesses from policy changes, proportion of other segments in total revenue has been on the increase since, yet in aggregate their shares were still relatively small. As primary land development business still generated the highest part of total revenue, the Company's operation revenue has been declining along with decrease in primary land development business.

### Exhibit 6. Revenue breakdown and gross margin by segment in 2014-2017Q3

	Revenue (RMB million)				Gross Profit Margin (%)			
	2017Q3	2016	2015	2014	2017Q3	2016	2015	2014
Primary land development	273.0	795.2	2,103.0	2,805.9	14.1	12.3	9.9	5.0
Real estate	10.0	0.4	1.2	3.3	-24.5	42.4	41.1	36.2
Exhibition	2.6	2.0	0.5	2.3	-63.3	-193.3	-399.0	32.7

	Revenue (RMB million)				Gross Profit Margin (%)			
	2017Q3	2016	2015	2014	2017Q3	2016	2015	2014
Property management	13.5	16.8	16.0	13.6	10.3	14.4	14.8	7.7
Security services	26.7	35.3	18.2	-	-3.2	7.0	26.3	-
Others	-	29.1	36.2	11.2	-	22.3	56.7	77.2
<b>Total</b>	<b>325.9</b>	<b>878.8</b>	<b>2,175.1</b>	<b>2,836.3</b>	<b>12.0</b>	<b>12.0</b>	<b>10.8</b>	<b>5.4</b>

Source: Company data, CCXAP Research

Under the new Budget Law, the Company is also engaged in projects ranging from real estate, investment and cultural tourism. Apart from self-managed projects, it also jointly invested with third parties on key projects of Heping District which received constant support from the government and were of sound outlook. CCXAP expects that equity investments in projects managed by third parties would be one of the major growth strategies for the Company, yet in the meanwhile considering that these projects are capital intensive with relatively long payback period, in the short-term they would further impose pressure on cash flow of the Company while its impact on profit would be minimal.

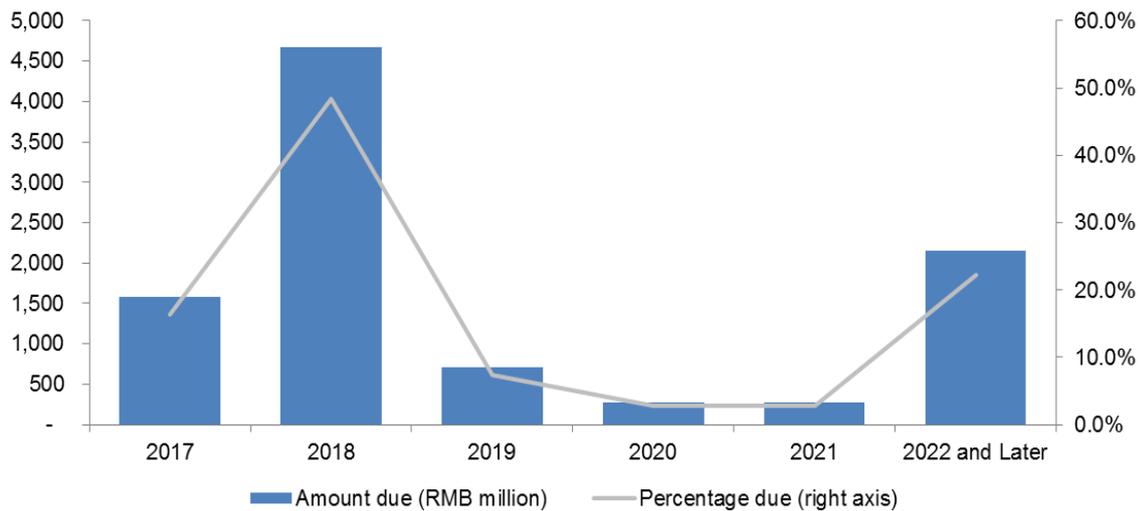
In terms of gross profit margin, despite the fact that the Company possesses diversified revenue streams, most of the business segments had low profitability. The Company's gross profit margin was 5.4% in 2014, 10.8% in 2015, and it slightly improved to 12.0% in 2016 and 10.7% in 2017Q3. Primary land development segment generated a stable profit margin, which was usually at around 10.0%. Real estate segment generated relatively high profit margin at around 40.0% since 2014.

CCXAP also noticed a rapid increase in finance expenses. In 2016, the Company had finance expenses equaled RMB 69.2 million, which was three times that of 2015. The increase in finance expenses was mainly due to a number of debts incurred near the end of 2015, including a private placement bond of RMB 1,500 million with coupon rate of 6.4%. Considering that the Company increased its financing activities in 2017, we expect the company would undergo elevated finance expenses in the future.

Due to the above factors, the Company has noted relatively weak profitability. The ROE ratio for the nine months ended 2017Q3 stood at 0.5%, 2.3 percentage points lower than that of 2016. In the meanwhile, the Company has relatively weak cash generating ability as it noted negative cash flow from operation activities in the year 2014, 2015 and for the nine months ended 30 September 2017.

## **6. Slight increase in debt leverage with large portion of debt due before end-2018**

The Company noted a relatively higher leverage ratio as of 2017Q3 compared with that of end-2016. At 2017Q3, the Company reported interest-bearing debt of RMB 9,647.7 million, increased by 11.4% compared with that of end-2016. Total capitalization ratio reached 54.9% at 2017Q3 as a result of steady increase in total debt amount since 2014. Short-term debt/long-term debt was 0.46x at 2017Q3 compared with 0.25x at end-2016, which suggested a weakening debt structure. The Company would see majority of its debt come due in 2018 with relatively tight maturity profile.

**Exhibit 7: Summary of debt maturity schedule as of 30 September 2017**


Source: Company data, CCXAP Research

The Company's total debt/EBITDA was 26.6x at end-2016, indicating large increases compared with 19.0x as of 2015 and 20.8x as of 2014, suggesting a relatively high leverage with regard to profitability. The Company registered modest EBITDA interest coverage of around 0.8x since 2014, indicating a relatively low coverage of interest payments.

On 30 November 2017, SHDSAO redeemed its bond listed on the Inter-bank Bond Market and Shanghai Stock Exchange through local government debt swap programme. The redeemed bond had coupon rate of 6.85%, original principle of RMB 1,200 million and residual principle of RMB 480 million. Through the earlier redemption, the Company reduced outstanding debt amount.

## 7. Weakening liquidity position with diversified financing channels

The Company has a comparatively weak liquidity position. In terms of cash balance, cash/short-term debt equaled 0.3x as at 2017Q3, as compared to 0.6x at end-2016. The ratio has been on the decline over the years since 2014 when it was 1.2x. The decline was mainly caused by reduction in cash and rise in outstanding debt. In terms of cash flow, EBITDA/short-term debt equaled 0.2x for 2016, indicating that the Company's short-term debt size was relatively large compared with its cash generating capacities from operations.

Nevertheless, the Company has good access to diversified financing channels. As at 2017Q3, apart from bank borrowings, it also had trust loan, private placement bond, and enterprise bond on its balance sheet. On 6 July 2017, the Company issued a 360-day private placement note of USD 200 million with coupon rate of 5.75% in the offshore bond market. However, given the short-term nature of the Company's debt structure, this might exert refinancing pressure on the Company. CCXAP will closely monitor the Company's liquidity position and refinancing capacity.

## Appendix. CCXAP's Credit Rating Symbols and their Meaning

China Chengxin (Asia Pacific) Credit Ratings Company Limited uses simple, consistent, and comparable rating symbols expressed in letters to represent the credit worthiness of rated entities and rated debt issues.

### A. Long-Term Credit Ratings

A long-term credit rating refers to a rating for a period of more than 12 months.

Rating Symbol	Definition
<b>AAAg</b>	Capacity to meet commitments on short-term and long-term debts is extremely strong. Business is operated in a virtuous circle. The foreseeable uncertainty on business operations is minimal.
<b>AAg+</b> <b>AAg</b> <b>AAg-</b>	Capacity to meet short-term and long-term financial commitments is very strong. Business is operated in a virtuous circle. Foreseeable uncertainty in business operations is relatively low.
<b>Ag+</b> <b>Ag</b> <b>Ag-</b>	Capacity to meet short-term and long-term commitments is strong. Business is operated in a virtuous circle. Business operation and development may be affected by internal uncertain factors, which may create fluctuations in profitability and solvency of the issuer.
<b>BBBg+</b> <b>BBBg</b> <b>BBBg-</b>	Capacity to meet financial commitment is considered adequate and capacity to meet short-term and long-term commitments is satisfactory. Business is operated in a virtuous circle. Business is affected by internal and external uncertainties. Profitability and solvency may experience significant fluctuation. Principal and interest may not be sufficiently protected by the terms of agreement.
<b>BBg+</b> <b>BBg</b> <b>BBg-</b>	Capacity to meet short-term and long-term financial commitment is relatively weak. Financial commitment towards short-term and long-term debts is below average. Status of business operations and development is not good. Solvency is unstable and subject to sustainable risk.
<b>Bg+</b> <b>Bg</b> <b>Bg-</b>	Financial commitment towards short-term and long-term debts is bad. Business is affected by internal and external uncertain factors. There are difficulties in business operations. Solvency is uncertain and subject to high credit risk.
<b>CCCG</b>	Financial commitment towards short-term and long-term debts is very bad. Business is affected by internal and external uncertain factors. There are difficulties in business operations. Poor solvency with very high credit risk.
<b>CCg</b>	Financial commitment towards short-term and long-term debts is extremely bad. Business operations are poor. There are very limited positive internal and external factors to support business operation and development. Extremely high credit risk is found.
<b>Cg</b>	Financial commitment towards short-term and long-term debts is insolvent. Business falls into a vicious circle. Very limited positive internal and external factors are found to support business operations and development in positive cycle. Extremely high credit risk is seen and is near default.
<b>Dg</b>	Unable to meet financial commitments. Default is confirmed.

### B. Long-term Credit Rating Outlook

A rating outlook is the medium- and long-term trend of the credit rating of a rated entity. In formulating a rating outlook, CCXAP considers the potential change in economic and commercial factors from a medium- and long-term perspective for a period of 12 to 18 months.

<b>Positive</b>	Indicates a rating with an ascending trend
<b>Negative</b>	Indicates a rating with a descending trend
<b>Stable</b>	Indicates the rating is likely to be stable

### C. Short-term Credit Ratings

A short-term credit rating refers to a rating for a period of less than 12 months.

Rating Symbol	Definition
<b>Ag-1</b>	Capacity to meet short-term financial commitments is extremely strong with a high level of safety.
<b>Ag-2</b>	Capacity to meet short-term financial commitments is strong with a high level of safety.
<b>Ag-3</b>	Capacity to meet short-term financial commitments is average but the safety may be easily affected by adverse business, financial, or economic conditions.
<b>Bg</b>	Capacity to meet short-term financial commitments is weak with a high probability of default.
<b>Cg</b>	Capacity to meet short-term financial commitments is very weak and the probability of default is very high.
<b>Dg</b>	Unable to meet financial commitments. Default is confirmed.

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