

## Credit Opinion

3 November 2022

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB <sub>g</sub> +
Outlook	Stable

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

### Initial credit rating report

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub>+ to Shaoxing Shangyu State-owned Capital Investment and Operation Co., Ltd., with stable outlook.**

### Summary

The BBB<sub>g</sub>+ 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 fast 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) full and direct ownership by the local government; (2) important policy role in Shangyu District as the largest state-owned enterprise (“SOE”); (3) good access to funding; and (4) good track record of receiving government payments.

However, the rating is constrained by the Company’s (1) moderate exposure to commercial business activities; (2) moderate debt management 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 Shangyu District as the largest SOE
- Moderate exposure to commercial business activities
- Moderate debt management 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 (restated)	2021FY	2022H1
Total Asset (RMB billion)	153.2	156.7	170.6
Total Equity (RMB billion)	68.2	70.3	73.9
Total Revenue (RMB billion)	6.1	7.3	3.4
Total Debt/Total Capital (%)	53.1	52.5	54.5

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

Source: CCXAP research

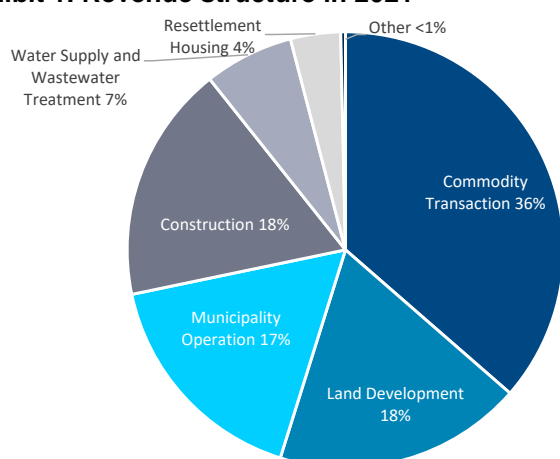
## Corporate Profile

Established in 1994, 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.

In September 2021, the local Government transferred 100% equity interest of Shaoxing Shangyu Economic Development Zone Investment Development Group Co., Ltd. and 18% of Shaoxing Shangyu Hangzhou Bay Construction and Development Co., Ltd. from the Company to Shaoxing Shangyu Hangzhou Bay Economic Zone Holdings Co., Ltd. ("Shangyu Hangzhou Bay Holdings"), and transferred 51% equity interest in Shaoxing Shangyu District Transportation Group Co., Ltd. ("Transportation Group") and 20% equity interest in Shaoxing Shangyu Hangzhou Bay Holdings to the Company. As of 30 June 2022, 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 2021



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 fast 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”) as of end-2021, in Zhejiang Province with abundant tourism resources and well-developed industries. It recorded a GRP of RMB679.5 billion with a year-over-year (“YoY”) growth rate of 8.7% 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. Supported by the growing economy, Shaoxing City Government’s general budgetary revenue increased from RMB54.4 billion in 2020 to RMB60.4 billion in 2021. The fiscal self-sufficiency was good with a fiscal balance ratio (general budgetary revenue/general budget expenditure) of 84.5% in 2021. Shaoxing City Government’s debt increased to RMB143.7 billion with an increase trend, accounting for 21.2% of GDP.

### Exhibit 2. Key economic and fiscal indicators of Shaoxing City

	2019FY	2020FY	2021FY
GRP (RMB billion)	578.6	600.1	679.5
GRP Growth (%)	7.2	3.3	8.7
General Budgetary Revenue (RMB billion)	52.8	54.4	60.4
General Budgetary Expenditure (RMB billion)	64.1	66.7	71.5
Local Government Debt (RMB billion)	103.9	124.8	143.7

Source: 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. It ranked 35<sup>th</sup> among the Top 100 Districts in China in terms of comprehensive strength in 2021. 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. In 2021, the GRP in Shangyu District reached RMB113.6, with a fast growth rate of 7.2%, ranking the 4<sup>th</sup> among six county-level districts in Shaoxing City. Shangyu District Government's fiscal strength improved with a strong economic growth. The general budgetary revenue increased from RMB9.0 billion in 2019 to RMB10.0 billion 2021. In addition, Shangyu District Government has good fiscal balance, with a fiscal balance ratio of 77.2% in 2021. Its debt amounted to RMB20.6 billion in 2021, accounting for 18.2% of GDP.

### Exhibit 3. Key economic and fiscal indicators of Shangyu District

	2019FY	2020FY	2021FY
GRP (RMB billion)	97.8	104.4	113.6
GRP Growth (%)	7.4	4.6	7.2
General Budgetary Revenue (RMB billion)	9.0	9.4	10.0
General Budgetary Expenditure (RMB billion)	10.4	12.1	13.0
Local Government Debt (RMB billion)	13.8	16.6	20.6

Source: CCXAP research

### Government's Willingness to Provide Support

#### Important policy role in Shangyu District as the largest SOE

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 undertakes various public-related activities such as water supply and wastewater treatment, land development, infrastructure construction, resettlement housing and grain storage, which significantly benefits people's livelihood and promotes the process of urbanization.

SYSC is the sole integrated water utility entity in Shangyu District, responsible for tap water supply, disposal of residential and non-residential wastewater, improvement and protection of water environment, and construction of water supply and drainage pipe network. The Company conducts such business mainly through its wholly-owned subsidiary, Shaoxing Shangyu District Water Group Co., Ltd. ("Shangyu Water"). Both the tap water price and wastewater treatment fee are determined by the Shangyu District Government. Although the utility business provides stable income to the Company, their profitability is weak. With the increasing costs of wastewater treatment and the higher depreciation costs of water supply, the business has recorded a negative gross profit in 2021. Since the Company has applied for an increase of the wastewater processing fees, we expect the gross profit of wastewater treatment business will improve upon the government approval.

SYSC is an important primary land developer in Shangyu. The Company conducts the land development business mainly through Shaoxing Shangyu City Construction Group Co., Ltd. ("Shangyu City Construction"). The scope of the business mainly focuses on the central area of Shangyu District after the Shaoxing Shangyu Economic Development Zone Investment Development Group Co., Ltd being transferred from the Company. Shangyu City Construction recognizes revenue and cost after the land transfer on the public market, therefore such business highly relies on the land market and government plans. As of 30 June 2022, the Company had

2,833 mu of land pending for transfer, which in turn promises the sustainability of the business. However, the fluctuation of local land and property markets has caused 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. It conducts the business mainly through Transportation Group and Shangyu City Construction. Under agency construction, Shangyu District Government and relevant departments commission the Company to invest in and develop urban infrastructure projects, which are mainly construction and upgrade of roads, bridges and communications. After completion and inspection of the projects, the Shangyu District Government pays the Company the project costs plus a predetermined rate of return. As of 30 June 2022, the Company had 15 agency construction projects under construction, with an estimated total investment of RMB2.4 billion and an uninvested amount of RMB1.6 billion.

SYSC is the sole 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 conducts resettlement housing business through Shangyu City Construction, mainly responsible for the development and sale of housing in Shangyu District at prices under government control. As of 30 June 2022, the Company had completed 7 resettlement housing projects, including 1 rental resettlement housing project. The Company has large capital needs for its construction projects in the pipelines. There were 2 resettlement housing projects under construction and 2 resettlement housing projects under planning as of mid-2022, with an estimated total investment of RMB9.1 billion. According to the Shangyu District Government's 14<sup>th</sup> Five-Year Plan, there will be continuous demand on resettlement housing, which guarantees the Company's business sustainability given its primary role in the provision of resettlement housing.

#### **Exhibit 4. Key public projects under construction and under planning as of 30 June 2022**

Project types	No. of projects	Budgeted	Invested	Outstanding
		amount	amount	amount
		(RMB billion)	(RMB billion)	(RMB billion)
<b>Projects Under Construction</b>				
Infrastructure Construction	15	2.4	0.8	1.6
Resettlement Housing	2	5.5	2.2	3.3
<b>Projects Under Planning</b>				
Resettlement Housing	2	3.6	-	3.6
<b>Total</b>	<b>19</b>	<b>11.5</b>	<b>3.0</b>	<b>8.5</b>

Source: Company information, CCXAP Research

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 transportation infrastructure materials and 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 15% to 20% of its total assets.

SYSC's exposure in the commodity transaction business increased since the transfer of 51.04% equity shares of Shaoxing Datong Holding Group Co., Ltd. ("Datong") from Shangyu District Government. Datong operates Datong Mall, a leading department store in the county-level cities of Zhejiang Province. In 2021, this business achieved revenue of RMB1.2 billion, with gross profit rate of 13.5%.

The Company was engaged in the sale of transportation infrastructure materials and refined oil since the consolidation of Transportation Group in 2021. The downstream clients of sale of transportation infrastructure materials were concentrated, which was considered higher business risk. In 2021, this business achieved revenue of RMB1.1 billion, but with a low gross margin of less than 1%.

The 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.

SYSC also undertakes engineering construction business through its subsidiaries, Shaoxing Shangyu District Hongda Highway Construction Co., Ltd. ("Hongda Highway Construction"), Transportation Group and Shangyu City Construction. They enter into construction contracts with relevant government departments or state-owned enterprises for projects such as infrastructure and resettlement housing, and receive construction profits for their services.

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 2021, the municipality operation business totally achieved revenue of RMB1.2 billion, with gross profit rate of 20.0%.

#### **Moderate debt management and weak asset liquidity**

SYSC's total debt increased moderately in the past three years, with high portion of short-term debt. The Company's total debt increased from RMB55.7 billion at end-2019 to RMB88.5 billion at mid-2022, with total capitalization ratio of 54.5% and short-term debt accounting for 38.7%. In addition, the liquidity profile was weak with cash to short-term debt ratio of 0.5x at mid-2022, indicating that its cash balance was insufficient to cover its short-term debt. 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, and its assets are mainly inventories and non-current assets. As of 30 June 2022, its inventories accounted for 36.9% of total assets, mainly consisting of land use right transferred by the local government and costs from the land development and agency construction businesses. In addition, the Company's non-current assets mainly comprised of long-term equity investment, intangible assets, and investment properties, accounting for 44.8% of total assets at mid-2022. The relatively high proportion of inventories with low liquidity may cause capital occupation to the Company.

#### **Good access to fundings**

SYSC has sufficient stand-by liquidity and diversified funding channels. As of 30 June 2022, the Company's total credit facilities amounted to RMB47.5 billion, of which the unutilized portion was RMB11.4 billion. They were mainly provided by diversified large domestic banks such as the Agricultural Development Bank of China and the Agricultural Bank of China Limited.

Furthermore, the Company has a proven track record of financing from both onshore and offshore debt markets. For example, during the first ten months of 2022, the Company itself raised RMB6.0 billion through the onshore debt market with coupon rates ranged from 3.07% to 3.49% and raised USD300 million with the a coupon rate of 5.2% through the offshore debt market. SYSC also has manageable non-standard financing exposure, which accounted for less than 5% of its total debts as of mid-2022. In addition, the Company has also benefited from the improving financing environment and decreasing financing costs in Shaoxing City.

### Good track record of receiving government payments

SYSC has a good track record of receiving payments from the local government in terms of capital injections, asset injections, financial subsidies, infrastructure and land development repayments. From 2020 to 2022H1, the local government totally injected cash and assets such as equity shares and use right of land of RMB32.2 billion into the Company, significantly enhancing its capital strength. Furthermore, the local government consistently provides subsidies to the Company to support its operation, with a total amount of RMB3.9 billion from 2020 to 2022H1. The visibility of payment mechanism is expected to improve as the Company has signed payment contracts with the government for infrastructure and primary land development projects, with greater transparency in total and annual payment. 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.

#### Exhibit 5. Track record of government payments from 2020 to 2022H1

(RMB billion)	2020	2021	2022H1
Cash Injections	-	4.6	-
Asset Injections	15.5	11.9	0.2
Financial Subsidies	1.1	1.5	0.9
<b>Total</b>	<b>16.6</b>	<b>18.2</b>	<b>1.1</b>

Source: Company information, CCXAP Research

### Moderate exposure to contingent liabilities

SYSC had moderate exposure to contingent liabilities as its external guarantees were 25.6% relative to total equity as of 30 June 2022. The external guarantees amounted to RMB19.7 billion, all of which were provided to bank borrowings or bond issuance from state-owned enterprises in Shangyu District and Zhejiang Province. In case a credit event occurs, the Company may face certain contingent liability risks and cross default risks, which could negatively impact its credit quality.

### 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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