

## Credit Opinion

10 May 2023

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

### Analyst Contacts

Kelly Liang +852-2860 7127  
Credit Analyst  
[kelly\\_liang@ccxap.com](mailto:kelly_liang@ccxap.com)

Christy Liu +852-2860 7130  
Credit Analyst  
[christy\\_liu@ccxap.com](mailto:christy_liu@ccxap.com)

Elle Hu +852-2860 7120  
Executive Director of Credit Ratings  
[elle\\_hu@ccxap.com](mailto:elle_hu@ccxap.com)

*\*The first name above is the lead analyst for this rating and the last name above is the person primarily responsible for approving this rating.*

### Client Services

Hong Kong +852-2860 7111

## Sheyang State-owned Assets Investment Group Co., Ltd.

### Initial credit rating report

**CCXAP assigns first time long-term credit rating of BBB<sub>g</sub>- to Sheyang State-owned Assets Investment Group Co., Ltd., with stable outlook.**

### Summary

The BBB<sub>g</sub>- long-term credit rating of Sheyang State-owned Assets Investment Group Co., Ltd. (“SYSI” or the “Company”) reflects (1) the Sheyang County Government’s relatively 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 Sheyang County Government’s capacity to provide support reflects Sheyang County’s status as one of the CCID Top 100 Counties in China, while its fiscal profile was modest.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) full ownership by the Sheyang County Government; (2) key role in infrastructure construction in Sheyang County; and (3) track record of receiving government support.

However, the rating is constrained by the Company’s (1) medium risk exposure to commercial activities such as property development and photovoltaic power generation; (2) high reliance on bank borrowing and non-standard financing; and (3) medium level of contingent risk.

The stable outlook on SYSI’s rating reflects our expectation that Sheyang County Government’s capacity to provide support will remain stable, and the Company will maintain its important position in Sheyang County over the next 12-18 months.

## Rating Drivers

- Key role in infrastructure construction in Sheyang County
- Medium risk exposure to commercial activities
- Track record of receiving government support
- High reliance on bank borrowing and non-standard financing
- Medium level of contingent risk

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) Sheyang County Government's ability 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 improved financing ability and reduction in exposure to external guarantees.

### What could downgrade the rating?

The rating could be downgraded if (1) Sheyang County 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 policy significance or significantly increased exposure to risky commercial activities.

## Key Indicators

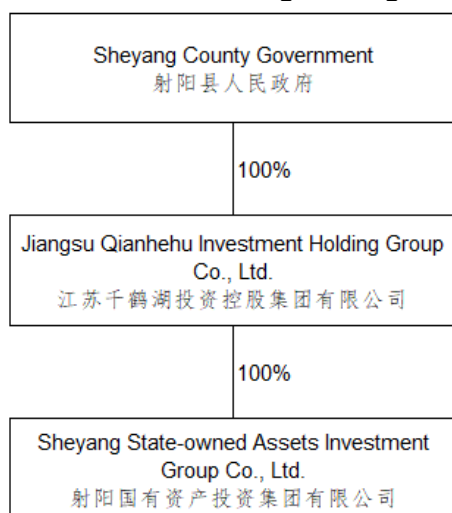
	2019FY	2020FY	2021FY	2022Q3
Total Asset (RMB billion)	9.5	14.1	15.9	16.4
Total Equity (RMB billion)	4.3	5.4	6.5	6.7
Total Revenue (RMB billion)	0.5	1.5	1.6	1.0
Total Debt/Total Capital (%)	38.8	47.7	47.3	53.5

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

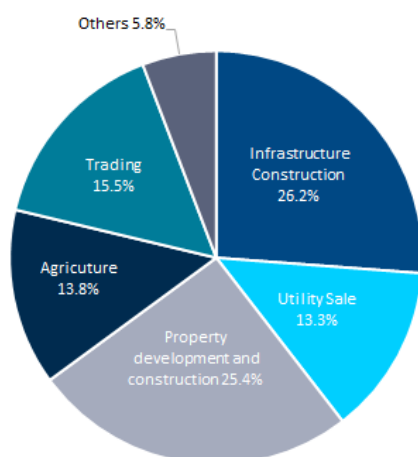
Source: CCXAP research

## Corporate Profile

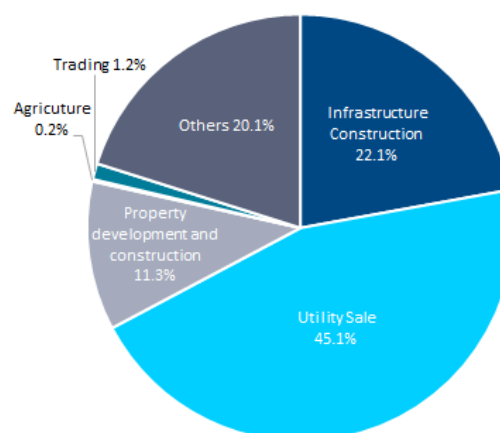
Founded in 2015, SYSI is one of the key local infrastructure investment and financing companies ("LIIFCs") in Sheyang County, focusing on medical and cultural infrastructure construction such as hospitals and schools. SYSI has a diversified business scope including infrastructure construction, photovoltaic power, property development, and trading. As of 30 April 2023, Sheyang County Government ultimately controlled the Company and indirectly held 100% shares of the Company through Jiangsu Qianhehu Investment Holding Group Co., Ltd. ("QHHI").

**Exhibit 1. Shareholding and organization chart as of 30 April 2023**

Source: Company information, CCXAP research

**Exhibit 2. Revenue structure in 2021**

Source: Company information, CCXAP research

**Exhibit 3. Gross profit structure in 2021****Rating Considerations****Government's Capacity to Provide Support**

We believe that the Sheyang County Government has a relatively strong capacity to provide support to the Company, given its status as one of the CCID Top 100 Counties in China. However, its fiscal profile was modest and debt ratio was high among county-level districts in Yancheng City.

Jiangsu Province is one of the leading and well-developed provinces in China. It is home to many of the world leading enterprises of electronic equipment, chemicals, and textiles. Jiangsu Province is the second largest province in China by GRP, after Guangdong Province. In 2022, its total gross regional product ("GRP") amounted to RMB12.3 trillion, grew by 2.8% year-over-year ("YoY"). The GRP per capital was RMB144,390 for the same period, which was the highest one among all provinces in China.

Yancheng City is a prefecture-level city in Jiangsu Province, with a good economic foundation. Its pillar industries include auto parts, machinery, textiles, and chemical industry. Yancheng City is undergoing an economic transition and is developing emerging industries such as high-tech electronic manufacturing, big data, new energy, and intelligent manufacturing, which will help support sustainable economic growth in the long run. In 2022, Yancheng City recorded a GRP of RMB708.0 billion, ranking 8<sup>th</sup> among 13 municipals in Jiangsu Province. At the same time, the Yancheng Municipal Government reported a general budgetary revenue of RMB45.3 billion, of which taxes income accounted for around 65.6%. However, the fiscal balance ratio (calculated by general budgetary revenue over general budgetary expenditure) was at a moderate level of 40.5%. The local government's outstanding debt amounted to RMB153.5 billion as of the end of 2022, accounting for about 21.7% of GRP.

#### Exhibit 4. Key economic and fiscal indicators of Yancheng City

	2020FY	2021FY	2022FY
GRP (RMB billion)	595.3	661.7	708.1
GRP Growth (%)	3.5	7.7	4.6
General Budgetary Revenue (RMB billion)	40.0	45.1	45.3
General Budgetary Expenditure (RMB billion)	97.4	105.3	111.8
Local Government Debt (RMB billion)	137.0	147.3	153.5

Source: Statistics Bureau of Yancheng City, CCXAP research

Sheyang County is a county-level city under the jurisdiction of Yancheng City. Sheyang County is one of the Top 100 counties in China released by the CCID Consulting County Economic Research Center, and is also the county with the largest sea area in Jiangsu Province. Sheyang County has developed several core industries, including new energy and equipment, electronic information, and high-end textiles. From 2019 to 2021, Sheyang County's economic strength improved steadily with GRP increasing from RMB56.4 billion to RMB66.3 billion. According to preliminary statistical results, its GRP reached RMB71.0 billion in 2022, representing a YoY growth of 4.1%. In 2022, affected by the COVID-19 pandemic and the tax rebate policy from the government, Sheyang County Government's general budgetary revenue and tax revenue decreased by around 9.2% and 26.2% from 2021 to RMB3.1 billion and RMB2.0 billion, respectively. Government fund revenue is an important replenishment to its fiscal revenue but was influenced significantly by the land transaction market and fluctuated over the past three years. However, Sheyang County Government's fiscal balance ratio is relatively low of 30.3% in 2022, reflecting a high reliance on fiscal support from the upper-tier government and land sales proceeds to balance its fiscal budget. Its outstanding government debt amounted to RMB17.7 billion at end-2022, accounting for about 24.9% of GRP.

#### Exhibit 5. Key economic and fiscal indicators of Sheyang County

	2020FY	2021FY	2022FY
GRP (RMB billion)	59.2	66.3	71.0
GRP Growth (%)	4.1	8.1	4.1
General Budgetary Revenue (RMB billion)	3.1	3.4	3.1
General Budgetary Expenditure (RMB billion)	9.6	10.3	10.2
Local Government Debt (RMB billion)	16.3	17.5	17.7

Source: Statistics Bureau of Sheyang County, CCXAP research

## **Government’s Willingness to Provide Support**

### **Key role in infrastructure construction in Sheyang County**

SYSI is one of the key LIIFCs in Sheyang County, responsible for local infrastructure construction particularly in medical and cultural fields. SYSI undertakes infrastructure construction in Sheyang County by signing construction agreements with the local government and carrying out the construction work accordingly. The local government would make payments to the Company based on the actual cost plus a markup in return upon completion, generally around 15%. SYSI has completed 7 key construction projects with a total investment of RMB2.5 billion, including Sheyang County People’s Hospital Xingang City Branch, Maternal and Child Health Hospital, and Cultural Palace. Such infrastructure helps improve the level of medical and health services in the city. As of 30 September 2022, the Company was constructing a public health clinical center, with a total planned investment of RMB550 million and an outstanding amount of RMB450 million. In addition, there was a project under planning with a total investment of RMB170 million.

The local government consolidated its state-owned assets in 2023 by forming QHHI, and transferred the holdings of some LIIFCs, including SYSI, into QHHI. QHHI became one of the largest state-owned enterprises in terms of assets in Sheyang County, while the Sheyang County Government is still the ultimate controller of SYSI and directly supervises the Company. The Company’s position as the key LIIFC for medical and cultural infrastructure remained unchanged. Moreover, SYSI’s management team is also responsible for the operation and management of another LIIFC in Sheyang County, namely Sheyang Urban Investment Development Co., Ltd (“SYUI”). SYSI will continue undertaking infrastructure construction projects according to the planning of the local government after the consolidation of state-owned enterprises, but the business sustainability is affected by its small project reserves.

### **Medium risk exposure to commercial activities**

After years of development, SYSI has developed diversified businesses such as property development, trading, and photovoltaic power. Some of such commercial activities are policy-driven such as photovoltaic power in order to promote the development of local industries. Based on our estimation, the Company had medium risk exposure to commercial activities.

SYSI’s property development business mainly involves the development of commercial housing and generates income through sales. The property development business may expose the Company to certain business risk and the local government seldom provides direct support for these activities. As of 30 September 2022, the Company has completed Julongfu North Garden and Haidu Yaju, of which most of the commercial housing has been sold and the wet market located in Haidu Yaju is run by the Company itself. In the future, the Company will invest around RMB1.1 billion in property development projects that are under construction or planning. Considering its ongoing investments in property development, the Company may face a certain capital expenditure burden. During the period of downturn in the recent real estate market, it may bring more uncertainties to the sales of these properties as well.

SYSI engages in the photovoltaic power generation business through its holding subsidiary, which generates sound income and gross profit over the years. As of 30 September 2022, the subsidiary held 37 photovoltaic power stations in Jiangsu, Shanxi, and Liaoning Province, most of which enjoyed national subsidies when selling electricity to State Grid Corporate of China, leading to a high gross profit margin in this business sector. Under the national “double carbon” goal, Sheyang County becomes one of the pilot counties promoting distributed photovoltaics industry in Jiangsu Province. As the main entity to develop the energy business in Sheyang County, SYSI is expected to increase investment in distributed photovoltaics. However, national subsidies are easily

affected by government policies, and photovoltaic power stations the Company newly constructed do not enjoy national subsidies, therefore the high gross profit margin may not be able to maintain in the future.

SYSI used to buy coal and sell it to power plants across the country. However, the Company has stopped the coal trading business since February 2022 because its downstream clients experienced operating difficulties. In addition, as of 30 September 2022, there were overdue receivables of RMB131 million, particularly from Xingyi Shangcheng Power Generation Co., Ltd. (“XYPG”), a state-owned enterprise in Qianxinan Prefecture. As XYPG and its shareholders are involved in multiple sales contract disputes and loan contract litigations, there is a credit contagion risk for the Company as some portion of the receivables may become bad debt.

### **Track record of receiving government support**

SYSI serves an important public policy function in medical and cultural infrastructure construction and is important to the economic and social development of Sheyang County. The Company has received ongoing support from the Sheyang County Government, in terms of capital injections, debt exemption, and operating subsidies. The local government injected capital of RMB120 million in cash into the Company in 2021, which substantially enhanced the capital strength of the Company. Moreover, the Company received assets such as the Maternal and Child Health Hospital, and land from the government.

From 2019 to 2021, the Company received RMB1.5 billion of debt exemption from Sheyang County Government. Apart from that, the Company received a total of RMB369.5 million in operating subsidies over the same period. The Company is also expected to receive electricity subsidies from the government in the future. However, as the Company’s shareholding of Jiangsu Sheyang Rice Group Co., Ltd. transferred to SYUI in April 2023, the Company’s subsidies for agricultural business from the local government will decrease in the future.

### **High reliance on bank borrowing and non-standard financing**

SYSI reported fast debt growth and a high reliance on bank borrowing and non-standard financing for its capital expenditure and debt repayment. As of 30 September 2022, the Company’s total debt increased to RMB7.7 billion from RMB2.7 billion at end-2019, and the capitalization ratio, as measured by total debt to total capital, increased to 53.5%. The total debt mainly consists of bank loans and non-standard financing and most of the loans were secured by assets or guaranteed by other state-owned enterprises in Sheyang County. Non-standard financing accounted for more than 40% of total debts with long terms but relatively high costs, and they were mainly trust and finance leases.

As of 30 September 2022, the Company has obtained total credit facilities of RMB3.2 billion from banks, with an unutilized amount of RMB118 million. At the same time, the short-term debt was high which represented 57.2% of the total debt, and the cash-to-short-term debt ratio was 0.7x. With the slow payment process from the local government and ongoing investment activities such in infrastructure and photovoltaic power, the Company is expected to rely on external financing, and the debt structure and funding channels need to be improved and expanded.

### **Medium level of contingent risk**

SYSI’s credit profile is constrained by its external guarantees, which could potentially increase its repayment obligations. As of 30 September 2022, the Company had external guarantees of RMB1.6 billion, accounting for around 24.6% of its net assets, which exposes the Company to substantial contingent liabilities. The guarantees are provided to other state-owned enterprises within Sheyang County. If a credit event occurs in Sheyang County, it may lead to large-scale cross-effects. However, we believe that the contingent risk of the external

guarantee is moderately controllable, considering the state-owned enterprises' important strategic position in their respective regions with the local government's support in a timely manner.

## ESG Considerations

SYSI faces environmental risks because it has undertaken infrastructure construction projects. 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.

SYSI bears social risks as it implements public policy initiatives by building public infrastructure in Sheyang County. 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.

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

## Structural Consideration

SYSI's senior unsecured debt rating is equivalent to its long-term credit rating. We believe that government support will flow through the Company given its important position in Sheyang County, 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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**China Chengxin (Asia Pacific) Credit Ratings Company Limited**

Address: Suites 1904-1909, 19/F, Jardine House,  
1 Connaught Place, Central, Hong Kong

Website: [www.ccxap.com](http://www.ccxap.com)

Email: [info@ccxap.com](mailto:info@ccxap.com)

Tel: +852-2860 7111

Fax: +852-2868 0656