

# RatingsDirect®

---

## Research Update:

# Jiangsu New Headline Development Group Co. Ltd. And HK Zhiyuan Group Ltd. Outlooks Revised To Negative; Ratings Affirmed

### Primary Credit Analyst:

Apple Li, CPA, Hong Kong (852) 2533-3512; apple.li@spglobal.com

### Secondary Contacts:

Susan Chu, Taipei (8862) 8722-5813; susan.chu@taiwanratings.com.tw

Yao Liu, Singapore +65 6216-1145; angie.liu@spglobal.com

YeeFarn Phua, Singapore (65) 6239-6341; yeefarn.phua@spglobal.com

## Table Of Contents

---

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

## Research Update:

# Jiangsu New Headline Development Group Co. Ltd. And HK Zhiyuan Group Ltd. Outlooks Revised To Negative; Ratings Affirmed

## Overview

- We continue to see an extremely high likelihood that NHL will receive timely and sufficient extraordinary support if needed from its owner, the Lianyungang government; but the government's debt burden and contingent liabilities will increasingly strain the municipal's credit quality.
- We are revising our rating outlooks on NHL and Zhiyuan to negative from stable. We are therefore lowering the long-term Greater China regional scale ratings on NHL to 'cnBBB' from 'cnBBB+' and on Zhiyuan to 'cnBB+' from 'cnBBB-'.
- We are also affirming our 'BB+' long-term corporate credit rating on NHL and 'BB' long-term corporate credit rating on Zhiyuan.
- The negative outlook on NHL reflects our view of the credit profile of the Lianyungang government. In our view, the company will receive extraordinary support from the government if needed over the next 12 months and Zhiyuan will remain highly strategic to NHL.

## Rating Action

On Sept. 13, 2016, S&P Global Ratings revised its rating outlook on Jiangsu New Headline Development Group Co. Ltd. (NHL) to negative from stable. At the same time, we affirmed our 'BB+' long-term corporate credit rating on the company. In line with the outlook revision, we lowered our long-term Greater China regional scale rating on NHL to 'cnBBB' from 'cnBBB+'.

In addition, we revised our rating outlook on HK Zhiyuan Group Ltd. (Zhiyuan) to negative from stable. At the same time, we affirmed our 'BB' long-term corporate credit rating on Zhiyuan. In line with the outlook revision, we lowered our long-term Greater China regional scale rating on Zhiyuan to 'cnBB+' from 'cnBBB-'.

We also lowered our long-term Greater China regional scale rating on the U.S. dollar-denominated senior unsecured notes issued by ZHIYUAN Group (BVI) Co. Ltd., a special purpose vehicle, to 'cnBB+' from 'cnBBB-'. Zhiyuan unconditionally and irrevocably guarantees the notes. At the same time, we affirmed the 'BB' long-term issue rating on the notes.

NHL is a construction services provider and one of the largest financing and investment companies of the Lianyungang municipal government. Zhiyuan is NHL's fully owned subsidiary, primarily positioned as the group's sole funding

vehicle offshore.

## **Rationale**

We revised the outlooks on NHL and Zhiyuan because we believe the credit quality of the Lianyungang municipal government has weakened; the government owns 100% of NHL. In our view, Lianyungang's financial capacity to provide extraordinary support to NHL, if required, is likely to diminish further over the next 12 months.

Lianyungang's debt burden and contingent liabilities are likely to increasingly strain the municipal's credit quality, in our view. The city is exposed to traditional sectors such as salt production and steel that have overcapacity issues. In the first half of 2016, economic growth slowed considerably, placing substantial pressure on the municipal's budgetary performance.

We expect the government's tax-supported debt to rise to around 200% of its operating revenues in 2018 from our estimate of 140% at year-end 2015. Our view is based on the economic slowdown, which has hampered previous double-digit fiscal revenue growth and made countercyclical spending more necessary.

The rating on NHL reflects the credit profile of the Lianyungang government. In our opinion, NHL has an extremely high likelihood of receiving timely and sufficient extraordinary government support if it comes under financial stress. The rating on NHL is four notches above the company's stand-alone credit profile (SACP) of 'b'.

Our assessment of extraordinary government support reflects the following characteristics of NHL:

- Very important role to the government. NHL undertakes construction services on behalf of the Lianyungang government and develops infrastructure projects on a build-and-transfer basis, particularly for the Lianyungang Economic and Technological Development Zone, an important economic region for the city. The zone contributed 24% to the city's GDP in 2014 and 19% of its fiscal income, and NHL is the sole construction operator in the zone. Most of NHL's businesses are not commercial in nature and it performs these mainly for public service, such as urban roads and public housing. Still, we do not consider NHL as having a critical role to the government. This is given that the company's construction and infrastructure development activity can be replaced by other providers whenever necessary, although that won't be so easy considering NHL's dominant position in the city.
- Integral link with the government. The municipal government owns 100% of NHL, and we do not expect it to reduce its stake because the company will continue to undertake a public service for the government. The government appoints NHL's senior management, drives the company's business strategy,

and directly controls it through a commission such that we believe it has direct control over its operations. A substantial portion of NHL's debt is considered government debt and consolidated into the government's fiscal budget. We believe the severability of non-government debt from government debt is limited.

## **Liquidity**

We estimate that NHL has adequate liquidity on a stand-alone basis. We expect the company's ratio of liquidity sources to liquidity uses to be more than 1.2x over the next 12 months.

Principal liquidity sources include:

- Cash and short-term investments of Chinese renminbi (RMB) 1.3 billion at the end of 2015.
- Ongoing government support through bank facilities of RMB4.0 billion-RMB6.0 billion during this time. A sizable portion of NHL's debt is classified as government debt, which is borne and repayable by the government.

Principal liquidity uses include:

- Debt repayment of RMB4.0 billion-RMB5.0 billion over the coming 12 months.
- Marginally negative funds from operations in the coming 12 months.
- Working capital outflow of about RMB1.5 billion during this time.
- Capital expenditure of about RMB200 million over the same period.

NHL's liquidity sources should exceed liquidity uses even if our forecast EBITDA declines by 15%. In addition, the company's state-owned enterprise link allows it to maintain good relationships with banks, as shown by its wide bank connections and sufficient bank facilities for use. NHL has no financial covenants on its existing borrowings.

## **Outlook**

The negative outlook on NHL reflects our view on the Lianyungang municipal government. At the same time, we continue to see an extremely high likelihood that the company will receive extraordinary support from the government over the next 12 months.

The negative outlook on Zhiyuan reflects the outlook on NHL and our view that Zhiyuan will remain highly strategic to its parent over the next 12 months. The rating on Zhiyuan will move in tandem with the rating on NHL (with a one-notch differential) unless we reassess Zhiyuan's group status.

## **Downside scenario**

We could lower the rating on NHL and Zhiyuan if we believe the creditworthiness of the Lianyungang government will further deteriorate. The ratings on NHL and Zhiyuan may be lowered if the city's tax-supported debt continues to grow significantly faster than operating revenues. We anticipate

such a scenario should the government embark on large-scale stimulus spending while supply-side reforms in Lianyungang's manufacturing sector continue without an improvement in economic growth. In such a scenario, the municipal's debt ratios will likely exceed 270% of operating revenues.

Alternatively, we could lower the ratings on NHL if we believe the likelihood of extraordinary government support has materially diminished.

### **Upside scenario**

We could revise our outlook on NHL and Zhiyuan to stable if we believe the creditworthiness of the Lianyungang government has significantly improved. This could occur if Lianyungang mitigates its debt burden by containing its tax-supported debt growth, operating revenues pick up through further economic growth, and reforms in its state-owned enterprise sector result in lower contingent liabilities.

## **Ratings Score Snapshot**

Corporate Credit Rating: BB+/Negative/--

Business risk: Weak

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: b

- Likelihood of government support: Extremely high (+4 notches from SACP)

## **Related Criteria And Research**

### **Related Criteria**

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014
- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings - October 24, 2013

- Legal Criteria: Guarantee Criteria--Structured Finance - May 07, 2013
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - June 01, 2016
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue - April 15, 2008
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Group Rating Methodology - November 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Engineering And Construction Industry - November 19, 2013

## Related Research

- Jiangsu New Headline Development Group Co. Ltd., Jan. 5 2016

## Ratings List

### Ratings Affirmed; Outlook Action

	To	From
Jiangsu New Headline Development Group Co. Ltd. Corporate Credit Rating	BB+/Negative/--	BB+/Stable/--
HK Zhiyuan Group Ltd. Corporate Credit Rating	BB/Negative/--	BB/Stable/--

### Ratings Affirmed

ZHIYUAN Group (BVI) Co. Ltd. Senior Unsecured	BB
--	----

### Downgraded

To	From
----	------

Jiangsu New Headline Development Group Co. Ltd.		
Greater China Regional Scale Rating	cnBBB	cnBBB+
HK Zhiyuan Group Ltd.		
Greater China Regional Scale Rating	cnBB+	cnBBB-
ZHIYUAN Group (BVI) Co. Ltd.		
Senior Unsecured	cnBB+	cnBBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [www.spcapitaliq.com](http://www.spcapitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

Copyright © 2016 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription) and [www.spcapitaliq.com](http://www.spcapitaliq.com) (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.