

# Yangzhou Jianghuai Construction Development Co., Ltd.

## Initial Issuer Report

### Summary

<b>Issuer Rating</b>	BBB
<b>Outlook</b>	Stable
<b>Location</b>	China
<b>Industry</b>	Local Government Financing Vehicle
<b>Date</b>	1 December 2022

Lianhe Global has assigned 'BBB' global scale Long-term Issuer Credit Rating with Stable Outlook to Yangzhou Jianghuai Construction Development Co., Ltd. ("YJCD" or "the company")

### Summary

The Issuer Credit Rating reflects a high possibility that the people's government of Jiangdu District ("the Jiangdu government") would provide strong support to YJCD if needed. This mainly considers the Jiangdu government's 100% ownership of YJCD, YJCD's strategic position as a flagship LGFV within Jiangdu District, as well as the strong linkage between the Jiangdu government and YJCD, including management supervision, strategic alignment, and ongoing operational and financial support. In addition, the Jiangdu government may face significant negative impact on its reputation and financing activities should YJCD encounter any operational or financial difficulties.

The Stable Outlook reflects our expectation that YJCD's strategic importance would remain intact while the Jiangdu government will continue to ensure YJCD's stable operation.

### Key Rating Rationales

**Full Government Ownership and Strong Linkage and with the Government:** Jiangdu Government has 100% ownership of YJCD. It also has strong control and supervision over YJCD, including control of the board of directors, senior management appointments, as well as major strategic, investment and financing planning. In addition, Jiangdu Government has comprehensive performance assessment policies for YJCD.

**High Strategic Importance:** As 100% ownership of Yangzhou Longchuan Holding Group Co., Ltd. ("YLHG"), the largest infrastructure construction and city operation entity in Jiangdu District, was transferred to YJCD free of charge under the instruction of the Jiangdu government in August 2022, the company has become the most important LGFV in Jiangdu District.

YJCD carries out major construction projects, including roads and bridges, public facilities, as well as resettlement houses designated by the Jiangdu government. YJCD is also engaged in water supply, grain collection and storage, as well as security service activities in Jiangdu District. YJCD's strategic planning and development have been aligned with the local government's economic and social policies.

**Ongoing Government Support:** YJCD received substantial support, including capital injections and operational subsidies from the Jiangdu government in the past three years. The company received two rounds of cash capital injections, amounting to RMB2,430 million and RMB1,000 million in 2020 and 2021, respectively. The Jiangdu government also provided financial subsidies to support YJCD's activities relating to supplying public goods and services. We expect YJCD to receive ongoing financial support in the future. Yet the amount of operational subsidies has shown a decreasing trend, which were

### Key Figures of Jiangdu District and YJCD

(RMB billion)	2020	2021
<b>Jiangdu District</b>		
GDP	111.5	122.1
GDP growth rate (%)	3.0	8.0
Budgetary revenue	5.6	5.7
Government fund	8.0	10.0
Transfer payment	3.6	2.9
Budgetary expenditure	11.7	11.1
<b>YJCD</b>		
Total Asset	73.5	79.0
Equity	23.3	24.8
Revenue	14.4	20.6

Source: Finance Bureau of Jiangdu District, Statistical Bureau of Jiangdu District, YJCD and Lianhe Global's calculations

### Analysts

Roy Luo  
(852) 3462 9582  
[roy.luo@lhratingsglobal.com](mailto:roy.luo@lhratingsglobal.com)

Toni Ho  
(852) 3462 9578  
[toni.ho@lhratingsglobal.com](mailto:toni.ho@lhratingsglobal.com)

### Applicable Criteria

China Local Government Financing Vehicle Criteria (31 December 2021)



RMB535 million, 506 million, 474 million and 180 million in 2019, 2020, 2021 and the first half of 2022, respectively.

**Economic and Fiscal Conditions of Jiangdu District:** Jiangdu District's economic growth rebounded in 2021, realizing year-on-year growth of 8%, up from 3% in 2020. Its fixed asset investment decreased significantly by 22.5% due to the impact of Covid-19. It then grew slightly by 0.3% to RMB63.4 billion in 2021.

Leveraging the Jiangdu Economic Development Zone, a provincial-level economic development zone established in 1993, Jiangdu District is developing itself as a manufacturing base, mainly covering shipbuilding, machinery, equipment, special steel and car parts. As a result, the secondary industry contributed c. 50% to Jiangdu District's GDP in the past three years.

The Jiangdu government's budgetary revenue grew steadily in the past three years, with a moderate compound annual growth rate ("CAGR") of 3.7% from 2019 to 2021. However, its aggregate revenue increasingly depended on the government-managed fund, which contribution increased to 53.5% in 2021 from 43.4% in 2019. That makes it vulnerable to the recent property market downturn.

**Moderately Weak Financial of YJCD; High Contingent Liability:** YJCD's financial leverage was moderately high but stable in the past three years. Its total liability/total asset ratio was maintained at c.68%-69% level, and the total debt to capitalization ratio was maintained at c.63%-65% level. This was because the company simultaneously relied on capital injections and borrowings to fund its asset expansion.

YJCD's asset liquidity was relatively weak. Its infrastructure and resettlement house construction activities generated sizeable inventory (mainly construction costs) and account receivable, which could take a long time (usually 2 to 3 years) to convert to cash in practice. In addition, YJCD had sizeable other receivables due from government agencies, LGFVs and SOEs in Jiangdu District, and a large portion was technically loaned to them. YJCD usually takes 3 to 5 years to recover these other receivables. YJCD also made sizeable equity investments in non-listed companies within Jiangdu District to support local industry development. However, these investments usually don't have a specified exit plan.

YJCD's contingent liability risk was high, as it had provided financing guarantees of RMB31 billion to external parties at end-June 2022, representing 123.1% of the company's equity. The company has a comprehensive policy regarding financing guarantees to external parties, and guaranteed parties were mainly other LGFVs and SOEs in Jiangdu District.

## Rating Sensitivities

We would consider downgrading YJCD's rating if (1) there is perceived weakening in support from the Jiangdu government, particularly due to its reduced strategic importance with diminished government functions, or (2) there is a significant reduction of the Jiangdu government's ownership of YJCD, or (3) there is a downgrade in our internal credit assessment on the Jiangdu government.

We would consider upgrading YJCD's rating if (1) there is strengthened support from the Jiangdu government, or (2) there is an upgrade in our internal credit assessment on the Jiangdu government.



## Operating Environment

### Economy and Fiscal Condition of Jiangdu District

Jiangdu District is a district administered by Yangzhou with a land area of 1,333 square kilometers, a residential population of 0.93 million, and an urbanization rate was 61.2% at end-2021. Leveraging the Jiangdu Economic Development Zone, a provincial-level economic development zone established in 1993, Jiangdu District is developing itself as a manufacturing base, mainly covering shipbuilding, machinery, equipment, special steel and car parts. As a result, the secondary industry contributed c. 50% to Jiangdu District's GDP in the past three years, while the primary and tertiary industries contributed c. 6% and c. 44%, respectively.

Jiangdu District's economic growth rebounded in 2021, realizing a GDP of RMB122.1 billion and representing year-on-year growth of 8%, up from 3% in 2020. Nevertheless, Jiangdu's fixed asset investment decreased significantly by 22.5% to RMB63.2 billion in 2020 from RMB81.5 billion in 2019, due to the impact of Covid-19. It then grew slightly by 0.3% to RMB63.4 billion in 2021.

#### Jiangdu District's GDP and Fixed Asset Investment

(RMB billion)	2019	2020	2021
GDP	109.2	111.5	122.1
-Primary industry (%)	6.4	6.4	6.1
-Secondary industry (%)	50.3	48.9	50.7
-Tertiary industry (%)	43.3	44.5	43.1
GDP growth rate (%)	6.0	3.0	8.0
Fixed asset investment	81.5	63.2	63.4
Fixed asset investment growth rate (%)	0.2	(22.5)	0.3
Residential population (million)	1.0	0.9	0.9

Source: Statistical Bureau of Jiangdu District and Lianhe Global's calculation

The Jiangdu government's budgetary revenue grew steadily in the past three years, with a moderate CAGR of 3.7% from 2019 to 2021. The budgetary revenue increased to RMB5.7 billion in 2021, up from RMB5.3 billion in 2019. Nevertheless, the Jiangdu government's aggregate revenue increasingly depended on the government-managed fund, which contribution increased to 53.5% in 2021 from 43.4% in 2019. That makes it vulnerable to the recent property market downturn.

The Jiangdu government's budgetary balance was moderately weak but improving, as evidenced by its budget deficit decreased to 95.1% in 2021 from 112% in 2019. Its government debt was manageable. The government debt ratio, as measured by total debt outstanding/aggregate revenue, decreased to 50.9% from 62.0% over the same period.

#### Jiangdu Government's Fiscal Conditions

(RMB billion)	2019	2020	2021
Budgetary revenue	5.3	5.6	5.7
Budgetary revenue growth rate (%)	0.2	5.1	2.2
-Tax revenue	4.4	4.4	4.7
-Tax revenue (% of budgetary revenue)	83.0	79.8	82.2
Government fund income	6.6	8.0	10.0
Transfer payment	3.3	3.6	3.0
Aggregate revenue	15.3	17.2	18.6
Budgetary expenditure	11.2	11.7	11.1
Budget deficit <sup>1</sup> (%)	-112.0	-109.6	-95.1

<sup>1</sup> Budget deficit = (1 - budgetary expenditure / budgetary revenue) \* 100%

Source: Finance Bureau of Jiangdu District and Lianhe Global's calculations

## Ownership Structure and Profile

### Full Government Ownership

YJCD was established in October 2017 by the State-owned Assets Supervision and Administration Office of Jiangdu District (“Jiangdu SASAO”). In August 2022, Yangzhou Jiangdu District State-owned Capital Investment and Operation Group Co., Ltd. transferred 100% ownership of YLHG to YJCD free of charge under the instruction of the Jiangdu government. YLHG was the most important infrastructure construction and city operation entity in Jiangdu District.

After the equity transfer, YJCD became the largest LGFV in asset size directly under the Jiangdu government. Currently, YJCD merely serves as a holding company; YLHG continues undertaking its projects and operating existing businesses. YJCD and YLHG’s connection is strong. Mr. Gao Peng, the chairman of YJCD, serves as YLHG’s director and general manager. Two companies also share the same work team.

## Strategic Importance and Government Linkage

### High Strategic Importance of YJCD to the Jiangdu Government

As 100% ownership of YLHG was transferred to YJCD in 2022, the company has become the most important LGFV in Jiangdu District. We believe that the Jiangdu government is willing to extend strong support to YJCD in view of its strategic important role in Jiangdu District’s infrastructure construction and city operation. It carries out major construction projects, including roads and bridges, public facilities, as well as resettlement houses designated by the Jiangdu government. YJCD is also engaged in water supply, grain collection and storage, as well as security service activities in Jiangdu District. YJCD’s strategic planning and development have been aligned with the local government’s economic and social policies.

### Strong Linkage with the Jiangdu Government

YJCD’s linkage with the local government is strong as it is wholly owned and managed by the Jiangdu government through Jiangdu SASAO. The Jiangdu government has strong control and supervision over YJCD, including control of the board of directors, senior management appointments as well as investment and financing planning. In addition, the Jiangdu government has comprehensive performance assessment policies for YJCD.

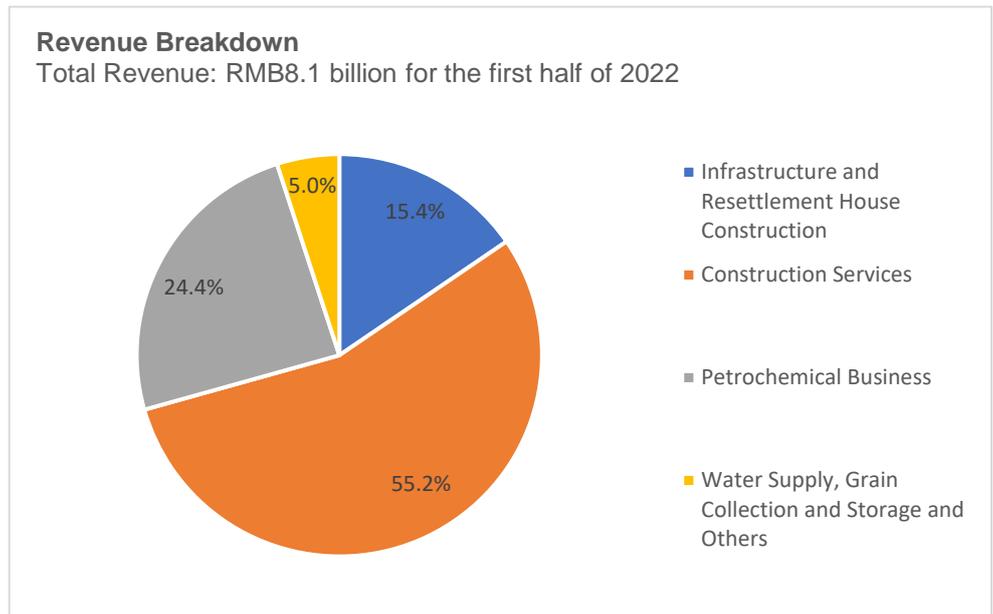
### Ongoing Government Support including Capital Injections and Operational Subsidies

YJCD received substantial financial support, including capital injections and operational subsidies from the Jiangdu government in the past three years. The company received two rounds of cash capital injections, amounting to RMB2,430 million and RMB1,000 million in 2020 and 2021, respectively. The Jiangdu government also provided operational support amounting to RMB535 million, 506 million, 474 million and 180 million in 2019, 2020, 2021 and the first half of 2022, respectively. We expect YJCD to receive ongoing financial support in the future. Yet the amount of operational subsidies has shown a decreasing trend since 2019.

## Business Profile

### Flagship LGFV Responsible for Infrastructure Construction and City Operation in Jiangdu District

YJCD undertakes major urban development projects designated by the Jiangdu government. The project scope mainly includes roads and bridges, public facilities, as well as resettlement houses. YJCD is also engaged in water supply, as well as grain collection and storage activities. In addition, the company participates in construction services and petrochemical businesses through its non-wholly and independently operating subsidiaries.



Source: YJCD's 2022 unaudited interim report

### Infrastructure and Resettlement House Construction

YJCD enters into agent construction agreements with the government agencies in Jiangdu District. According to these agreements, YJCD is responsible for entrusted projects' fundraising and construction. The company confirms the project progress with entrusting parties annually, and recognizes construction costs plus a certain margin (depending on project type) as revenue.

Revenue generated by this segment dropped to RMB1,288 million in 2020 from RMB1,892 million, owing to Covid-19's impact, then it rebounded to RMB1,825 million in 2021. The segment's gross margin fluctuated between 12% and 18% in the past three years due to different types of projects delivered each year. The segment recorded revenue of RMB1,247 million in the first half of 2022.

At end-June 2022, YJCD had three major infrastructure projects and four resettlement house projects under construction with a total investment of c. RMB10 billion, and RMB3.1 billion to be invested. Also, YJCD plans to invest in seven infrastructure projects and one resettlement house project with a total investment of RMB6.2 billion, of which four infrastructure projects are to be held for leasing, and the rest are under agent construction agreements. These projects can support the segment's revenue growth in the next three years.



### Construction Services

YJCD has participated in construction services through a non-wholly owned subsidiary, Jiangsu Jiangdu Construction Group Co., Ltd. (“Jiangdu Construction”) since 2019, when YJCD acquired 35% shares of Jiangdu Construction, and became its largest shareholder. Jiangdu Construction acquires projects through open tendering, and receives payments based on the progress of projects. Most projects under construction were entrusted by property developers.

The construction services segment recorded revenue of c. RMB14 billion in 2021, up from c. RMB6.2 billion in 2019, representing a high CAGR of 49.9%. It became YJCD’s most crucial source of revenue, contributing 68.1% to the company’s total revenue in 2021. Over the same period, the segment’s gross margin stood at c. 3% level.

Nevertheless, the impact of Covid-19 and the property market downturn hampered the construction services segment’s performance. As a result, in the first half of 2022, the segment recorded revenue of RMB4.5 billion, representing 55.2% of the total revenue. In addition, the total value of newly acquired projects has been decreasing, which were RMB16.6 billion, 13.5 billion, 10.4 billion and 3.8 billion in 2019, 2020, 2021 and the first half of 2022, respectively.

### Petrochemical Business

YJCD consolidated Yangzhou Petrochemical Co., Ltd. (“Yangzhou Petrochemical”) in 2021 by acquiring an additional 10.47% of its share, lifting the total shareholding to 51%; Sinopec holds the rest 49% share. Yangzhou Petrochemical mainly produces refined oil, chemical fiber, polypropylene and other petrochemical products. The petrochemical segment realized revenue of RMB2.2 billion and RMB1.9 billion with a gross margin of 19.8% and 15.7% in 2021 and the first half of 2022, respectively, becoming a significant income source for YJCD.

### Water Supply, Grain Collection and Storage and Others

YJCD is also responsible for water supply as well as grain collection and storage in Jiangdu District. Although these activities have a thin or negative gross margin, they enhance the company’s strategic importance to some extent by providing public goods and serving social functions.

YJCD’s other businesses include security services, car park leasing, property management, etc., contributing a small fraction to the company’s total revenue in the past three years.

## Financial Profile

### Balance Sheet Structure and Quality

#### Balance Sheet Structure and Quality

(RMB million)	2019	2020	2021	June 2022	* June 2022 (Adjusted)
Total Asset	63,582	73,530	79,036	82,025	82,025
Equity	20,397	23,336	24,752	25,141	23,459
Debt	36,531	40,567	42,626	45,130	46,813
Debt/ (Debt+Equity) (%)	64.2%	63.5%	63.3%	64.2%	66.6%



LT Debt	23,931	23,947	26,669	26,682	28,364
LT Debt/ (LT Debt +Equity) %	54.0%	50.6%	51.9%	51.5%	54.7%

Source: YJCD's 2022 unaudited interim report, 2019-2022 audited proforma report and Lianhe Global's calculations

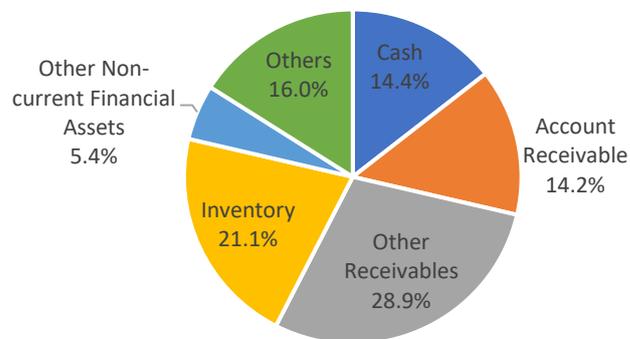
\*Note: Adjusted numbers and ratios reflect the perpetual bonds reallocating to long-term debt and total debt from equity.

YJCD's total assets increased by 29.0% to RMB82.0 billion at end-June 2022 from RMB63.6 billion at end-2019, as the company actively participated in project construction activities in the past three years. It also invested heavily in equities of non-listed companies to support local industry development. In addition, other receivables due from government agencies, LGFVs and SOEs in Jiangdu District increased significantly over the same period.

Nevertheless, YJCD's balance sheet structure was largely stable in the past three years as the company simultaneously relied on capital injections and borrowings to fund its asset' expansion. YJCD's total debt increased by 23.6% to RMB45.1 billion at end-June 2022 from RMB36.5 billion at end-2019. The Jiangdu government injected cash of RMB2.4 billion in 2020 and RMB1 billion in 2021. Also, YJCD deconsolidated several subsidiaries with high leverage under the instruction of the Jiangdu government. As a result, the company's financial leverage was moderately high but stable in the past three years. Its total liability/total asset ratio was maintained at c.68%-69% level, and the total debt to capitalization ratio was maintained at c.63%-65% level.

#### Asset Breakdown

Total Assets:RMB82.0 billion at end-June 2022



Source: YJCD's 2022 unaudited interim report and Lianhe Global's calculations

YJCD's asset liquidity was relatively weak. Its infrastructure and resettlement house construction activities generated sizeable inventory (mainly construction costs) and account receivable, which could take a long time (usually 2 to 3 years) to convert to cash in practice. At end-June 2022, YJCD had an inventory of RMB17.3 billion and account receivable of RMB11.7 billion, representing 21.1% and 14.2% of the company's total asset.

In addition, YJCD had other receivables of RMB23.7 billion at end-June 2022, up from RMB16.8 billion at end-2019. These receivables were mainly due from government agencies, LGFVs and SOEs in Jiangdu District, and a substantial part was technically loaned to them. YJCD usually takes 3 to 5 years to recover its other receivables. Also, YJCD had other non-current financial assets of RMB4.4 billion, mainly equity investments



in non-listed companies within Jiangdu District to support local industry development. Yet these investments usually don't have a specified exit plan.

### Cash Flow

<b>Cash Flow</b> (RMB million)	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>6M2022</b>
Cash Inflows from Operation	11,570	22,001	30,117	16,688
Cash Outflows from Operation	15,561	19,017	33,043	17,064
<b>Net CF from Operation</b>	<b>-3,991</b>	<b>2,984</b>	<b>-2,925</b>	<b>-377</b>
Cash Inflows from Investment	412	182	1,233	35
Cash Outflows from Investment	4,348	3,379	3,228	1,009
<b>Net CF from Investment</b>	<b>-3,936</b>	<b>-3,197</b>	<b>-1,995</b>	<b>-974</b>
Cash Inflows from Financing	24,633	24,421	32,327	18,953
Cash Outflows from Financing	14,152	22,896	30,254	14,712
<b>Net CF from Financing</b>	<b>10,481</b>	<b>1,526</b>	<b>2,073</b>	<b>4,241</b>
Net Increase in Cash and cash equivalent	2,554	1,312	-2,848	2,890

*Source: YJCD's 2022 unaudited interim report, 2019-2022 audited proforma report and Lianhe Global's calculations*

### Debt Servicing Capability

YJCD's short-term debts were manageable. At end-June 2022, YJCD had short-term debt of RMB18.4 billion. At the same time, YJCD had cash of RMB11.8 billion (including restricted cash of RMB4.3 billion), covering 64.1% of its short-term maturities. In addition, YJCD has access to multiple financing channels, including bank borrowings, non-traditional borrowings, as well as onshore and offshore bond issuances, etc. to support its debt repayments and business operations. The company had a total credit line of c. RMB38.4 billion, of which RMB8.8 billion was unused, and available bond issuance quotas of RMB1.5 billion at end-June 2022.

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