

# Suqian Yunhe Port Area Development Group Co., Ltd.

## Initial Issuer Report

### Summary

|               |  |
|---------------|--|
| Issuer Rating | BBB-                                       |
| Outlook       | Stable                                     |
| Location      | China                                      |
| Industry      | Local Investment and Development Companies |
| Date          | 25 May 2023                                |

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Suqian Yunhe Port Area Development Group Co., Ltd. (“SYPAD” or “the company”)

### Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Sucheng District, Suqian City (“Sucheng government”) would provide strong support to SYPAD if needed, in light of its indirect ownership of SYPAD, SYPAD’s strategic importance as the key local investment and development company (“LIDC”) that is responsible for infrastructure construction, land development and project investment in supporting facilities in Sucheng District, Suqian City (“Sucheng”), especially in the Suqian Canal Port Area (“Port Area”), and the linkage between the Sucheng government and SYPAD, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing operational and financial support. In addition, the Sucheng government may face significant negative impact on its reputation and financing activities if SYPAD encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that SYPAD’s strategic importance would remain intact while the Sucheng government will continue to ensure SYPAD’s stable operation.

### Rating Rationale

**Sucheng Government’s Ownership and Supervision:** The Sucheng government indirectly holds 49% ownership of SYPAD through Suqian Huinong Industry Development Co. Ltd. (“SHID”), via the Sucheng State-owned Assets Management Center (“Sucheng SAMC”), and is the actual controller of the company. The remaining 51% ownership of SYPAD is held by the People’s Government of Suqian City (“Suqian government”), via Suqian Industrial Development Group Co. Ltd. (“SIDG”). The Sucheng government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Sucheng government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

**Strategic Importance to Sucheng and Strategic Alignment:** SYPAD, as the sole LIDC in the Port Area, is primarily responsible for infrastructure construction, land development and project investment in supporting facilities within the region with strong franchised advantages. The company is responsible for the demolition, land consolidation, municipal projects construction and utility network development in the Port Area. In addition, in order to attract business and investment in the Port Area, the company invests in the construction of industrial factories and other supporting facilities for enterprises settling in the area. SYPAD plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government’s development plans.

**Ongoing Government Support:** SYPAD received operational and financial support from the government. SYPAD received a total subsidy amount of c. RMB283.5 million from 2020

### Key Figures of Sucheng and SYPAD

| (RMB billion)         | 2021 | 2022 |
|-----------------------|------|------|
| <b>Sucheng</b>        |      |      |
| GDP                   | 46.4 | 52.5 |
| GDP growth rate (%)   | 9.5  | 3.3  |
| Budgetary revenue     | 3.0  | 4.1  |
| Government fund       | 4.4  | 2.3  |
| Transfer payment      | 0.2  | 1.1  |
| Budgetary expenditure | 5.4  | 5.8  |
| <b>SYPAD</b>          |      |      |
| Assets                | 11.5 | 14.4 |
| Equity                | 4.7  | 4.8  |
| Revenue               | 0.8  | 0.8  |

Source: Public information, SYPAD and Lianhe Global’s calculations

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### Applicable Criteria

China Local Investment and Development Companies Criteria (5 December 2022)

to 2022, mainly including operating subsidies. The Sucheng government also injected special fund to the company, which served as state-owned capital investment for the company's infrastructure projects. The Sucheng government will repurchase some infrastructure projects and provide policy supports to SYPAD to ensure its business operation. Given the franchised advantages in infrastructure construction and land development in Sucheng, especially in the Port Area, SYPAD has advantage to obtain major projects. We believe SYPAD is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

**SYPAD's Financial Matrix and Liquidity Position:** SYPAD's total assets showed a continuous growth trend in the past years and reached RMB14.4 billion at end-2022, mainly due to its inventories, which has steadily increased in tandem with the company's infrastructure construction projects. The current assets of SYPAD accounted for c. 72.8% of the total assets at end-2022, but the overall assets were less liquid. SYPAD's financial leverage (total liabilities to total assets) was 66.7% and its adjusted debt increased to c. RMB8.3 billion at end-2022. The liquidity of SYPAD was tight. SYPAD had an unrestricted cash balance and unused credit facilities of c. RMB149.3 million and RMB1.1 billion at end-2022, respectively, compared with its debt due within one year of c. RMB2.9 billion. Besides, SYPAD has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

**Economy and Fiscal Condition of Sucheng:** Sucheng is an administrative district located in the western part of the central of Suqian City, Jiangsu Province ("Suqian") with a total land area of c. 854 square kilometers. Sucheng recorded an economic growth in 2022, achieving a GDP of c. RMB52.5 billion, with a year-on-year growth of 3.3%. The growth rate has slowed down compared to previous years, due to the impact from COVID-19. The aggregate fiscal revenue of the Sucheng government was mainly derived from the budgetary revenue and government fund income. In 2022, the budgetary revenue of the Sucheng government reached c. RMB4.1 billion, with a year-on-year increase of 11.9%, primarily driven by a 32.7% growth in tax revenue. At the same time, the government fund income was cut by almost half in 2022, amounting to RMB2.3 billion. The budget deficit of the Sucheng government was c. -43.4% at end-2022, while the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Sucheng government was relatively high, reaching 108.3% at end-2022.

### Rating Sensitivities

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

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

### Operating Environment

#### Economic Condition of Sucheng

Sucheng is an administrative district of Suqian, located in the western part of the central city of Suqian. Sucheng has jurisdiction over 8 towns, 7 streets, 1 economic development zone

and 1 modern agricultural development zone, with a total land area of 854 square kilometers. Sucheng had a residential population of 0.8 million at end-2022, with an urbanization rate of c. 66%.

The economic growth of Sucheng slowed down to 3.3% in 2022, with the GDP amounting to RMB 52.5 billion, ranking 4<sup>th</sup> out of all districts and counties of Suqian. Sucheng's economy was mainly fueled by the secondary and tertiary industries in 2022, which explained 28.6% and 65.6% of its GDP correspondingly.

The Port Area was established in October 2013 to utilize the canal's resources and develop the industrial belt. It covers a planned area of 49.10 square kilometers. The area is divided into functional zones, including port logistics, green building materials, electronic information, etc.

#### Sucheng's GDP and Fixed Asset Investment

| (RMB billion)                          | 2020 | 2021 | 2022 |
|--|------|------|------|
| GDP                                    | 40.3 | 46.4 | 52.5 |
| -Primary industry (%)                  | 6.8  | 6.8  | 5.8  |
| -Secondary industry (%)                | 25.4 | 26.9 | 28.6 |
| -Tertiary industry (%)                 | 67.8 | 66.3 | 65.6 |
| GDP growth rate (%)                    | 4.5  | 9.5  | 3.3  |
| Fixed asset investment                 | 32.4 | 35.2 | 37.2 |
| Fixed asset investment growth rate (%) | 13.0 | 8.7  | 5.6  |
| Population (million)                   | 0.7  | 0.7  | 0.8  |

Source: Public information and Lianhe Global's calculations

#### Fiscal Condition of Sucheng

The Sucheng government's aggregate fiscal revenue was mainly derived from the budgetary revenue and government fund income. As the tax revenue increased by 32.7% to RMB 3.8 billion, the budgetary revenue represented a year-on-year growth rate of 11.9% and reached RMB 4.1 billion in 2022. The government fund income was cut by almost half in 2022 in contrast to 2021, which totaled RMB 2.3 billion. The financial self-sufficiency rate of Sucheng was inadequate, as it experienced deficit for three consecutive years, and the budget deficit rate was recorded at -43.4% in 2022. The transfer payment received from the higher government increased significantly, nearly fourfold compared to that in 2021.

The outstanding amount of government debt expanded in the past three years. At end-2022, the outstanding government debt amounted to RMB 8.0 billion, and the debt ratio (i.e., total government debt divided by aggregate revenue) of the Sucheng government surged to 108.3%, indicating a considerable growth.

#### Sucheng's Fiscal Condition

| (RMB billion)                        | 2020       | 2021       | 2022       |
|--------------------------------------|------------|------------|------------|
| Budgetary revenue                    | 2.1        | 3.0        | 4.1        |
| Budgetary revenue growth rate (%)    | 3.7        | 44.6       | 11.9       |
| Tax revenue                          | 1.8        | 2.9        | 3.8        |
| Tax revenue (% of budgetary revenue) | 89.0       | 95.6       | 94.0       |
| Government fund income               | 3.1        | 4.4        | 2.3        |
| Transfer payment                     | 2.4        | 0.2        | 1.1        |
| <b>Aggregate revenue</b>             | <b>7.6</b> | <b>7.7</b> | <b>7.4</b> |
| Budgetary expenditure                | 5.6        | 5.4        | 5.8        |
| Budget deficit <sup>1</sup> (%)      | -168.0     | -79.3      | -43.4      |

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

Source: Public information and Lianhe Global's calculations

## Ownership Structure

### Government's Ownership

SYPAD was established in January 2013 with an initial registered capital of RMB0.3 billion, co-funded by SIDG and SHID. At end-2022, the company's registered and paid-in capital were both RMB0.3 billion. The company has a shareholding structure in which the SIDG held 51% of the company's equity and the remaining 49% equity was held by SHID. At end-2022, SIDG was fully owned by the Suqian government, while SHID was fully owned by the Sucheng government through Jiangsu Suxiang State-owned Assets Management Co. Ltd. and the Sucheng SAMC.

Per management, SIDG holds shares in SYPAD purely as a financial investment and does not participate in the company's daily operations, development strategies, management or financing decisions. The Sucheng government, as the actual controller of the company, has the final decision-making authority and supervises the company.

## Strategic Importance and Government Linkage

### Strategic Importance of SYPAD to Sucheng

SYPAD, as the sole LIDC in the Port Area, is primarily responsible for infrastructure construction, land development and project investment in supporting facilities within the region with strong franchised advantages. The company is responsible for the demolition, land consolidation, municipal projects construction and utility network development in the Port Area. In addition, in order to attract business and investment in the Port Area, the company invests in the construction of industrial factories and other supporting facilities for enterprises settling in the area. SYPAD plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government's development plans.

### Strong Linkage with the Local Government

SYPAD's linkage with the local government is strong as the Sucheng government indirectly holds 49% ownership of SYPAD through SHID, via the Sucheng SAMC. The remaining 51% ownership of SYPAD is held by the Suqian government through SIDG. The Sucheng government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Sucheng government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

### Government Support

SYPAD continued to receive financial subsidies, mainly including operating subsidies, from the local government to maintain its business operation. SYPAD received subsidies of c. RMB108.7 million, RMB111.2 million and RMB63.6 million in 2020, 2021 and 2022, respectively. In 2020, the Sucheng government allocated RMB1.2 billion to the company as a special fund that served as state-owned capital investment for the company's infrastructure projects. The Sucheng government will repurchase some infrastructure projects and provide policy supports to SYPAD to ensure its business operation. Given the franchised advantages in infrastructure construction and land development in Sucheng, especially in

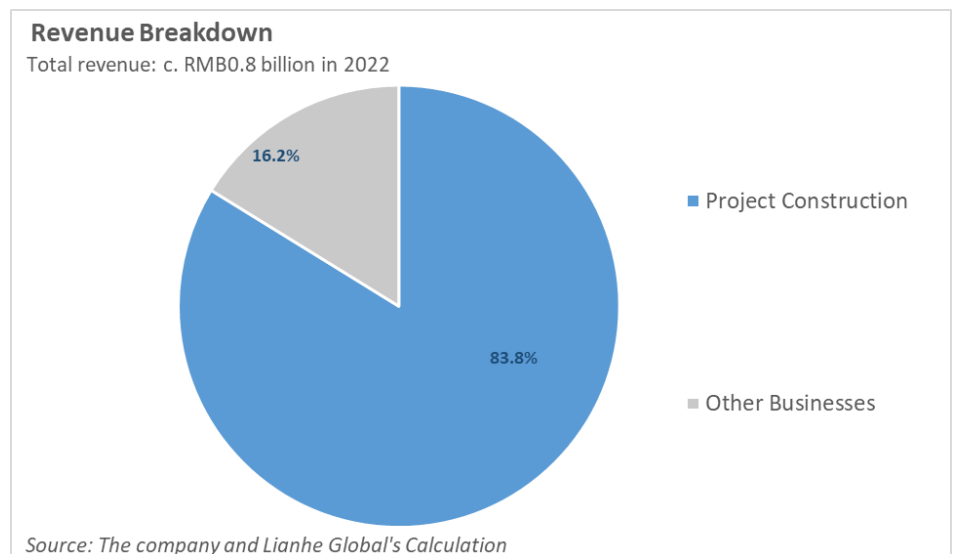
the Port Area, SYPAD has advantage to obtain major projects. We believe SYPAD is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

### Business Profile

#### The Sole Entity Responsible for Infrastructure Construction in the Port Area

SYPAD, as an important LIDC in port area, is mainly responsible for infrastructure construction within the port area, including demolition, land development, road construction, pipe line construction, etc. In addition, the company is also responsible for the construction of support facilities (i.e., standard factories for enterprises settled in the port area) to help attracting businesses and investment for the port area. The company has a strong franchised advantage and its business scope does not overlap with other LIDCs in Sucheng.

The primary sources of operating revenue for the company are project construction, while it also engaged in handling and transportation, leasing, etc. The company's total revenue reached c. RMB0.77 billion, RMB0.79 billion, and RMB0.77 billion in 2020, 2021 and 2022, respectively, representing a steady trend. The overall gross profit margin of the company remained stable at c. 17%-19% from 2020 to 2022. In general, the company's business was relatively concentrated, and it has regional advantages in its major businesses.



### Project Construction

The company's project construction business is divided into two models: self-built model and agent construction model. Self-built projects are financed by the company's own funds and project loans, and are self-owned or partially sold after completion. Under the agent construction model, the company is entrusted by Suqian Yunhe Port Industrial Park Administration Committee ("Suqian Port AC") and other government agencies to undertake the infrastructure construction business within the Port Area, including demolition, land development, road construction, pipe line construction, etc. The revenue recognition includes construction costs incurred plus an additional margin of 20% (including value-added tax). Its revenue in this segment reached c. RMB0.69 billion, RMB0.70 billion and

RMB0.64 billion in 2020, 2021 and 2022, respectively, with the gross profit margin remaining stable at 14.2%. Currently, the company is working on several large-scale projects, thus it incurs high capital expenditure pressure.

### Other Businesses

Other businesses of the company include handling and transportation, leasing, etc. Among them, handling and transportation and leasing businesses play a larger role, while other segments account for a relatively small proportion of the company's total revenue. Other businesses mainly play the role of supplementing the revenue of the main business and make the revenue structure more diversified.

## Financial Profile

### Balance Sheet Structure and Quality

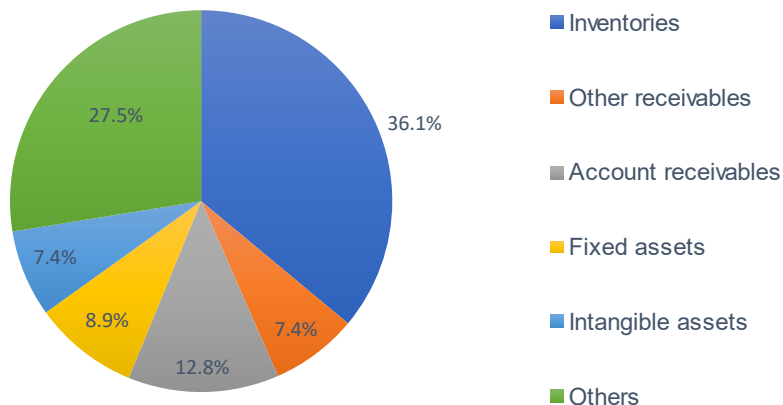
| <b>Balance Sheet Structure and Quality</b> |             |             |             |
|--|-------------|-------------|-------------|
| <b>(RMB million)</b>                       | <b>2020</b> | <b>2021</b> | <b>2022</b> |
| Total Asset                                | 10,633      | 11,457      | 14,406      |
| Equity                                     | 4,860       | 4,713       | 4,791       |
| Debt                                       | 4,037       | 6,106       | 8,344       |
| Debt / (Debt + Equity) (%)                 | 45.4        | 56.4        | 63.5        |
| LT Debt                                    | 2,525       | 3,264       | 5,197       |
| LT Debt / (LT Debt + Equity) (%)           | 34.2        | 40.9        | 52.0        |

*Source: Company information and Lianhe Global's calculations*

SYPAD's total assets showed a continuous growth in the past few years, with a growth rate of 7.7% and 25.7% at end-2021 and end-2022, respectively, and reached RMB14.4 billion at end-2022. The increase of SYPAD's total assets in 2022 was largely due to its inventories, which has steadily increased in tandem with the company's infrastructure construction projects. SYPAD's assets mainly consisted of inventories, other receivables, account receivables, fixed assets and intangible assets. Inventories mainly included costs incurred to fulfill the contract, which were associated with SYPAD's core business operations, such as infrastructure construction. Other receivables and account receivables were mainly transactions with Suqian Port AC, other LIDCs and other government agencies in Sucheng, which had an aging period of mostly 1-3 years, with controllable counterparty risk and low bad debt provision. Having said that, the overall process of payments collection related to the company's agent construction business was relatively weak. Fixed assets primarily comprised of houses and buildings related to its operation business (e.g., self-operation construction projects). Intangible assets mainly consisted of land use right. Though SYPAD had large proportion of current assets (72.8% at end-2022), its assets were illiquid, primarily due to the significant proportion of costs associated with construction projects and receivables.

### Asset Breakdown

(Total assets: RMB14.4 billion at end-2022)



Source: The company and Lianhe Global's calculation

SYPAD's financial leverage (total liabilities to assets) reached 54.3%, 58.9% and 66.7% at end-2020, end-2021 and end-2022, respectively, representing an upward trend due to the increasing long-term borrowings. SYPAD's total adjusted debt increased significantly from c. RMB4.0 billion at end-2020 to c. RMB8.3 billion at end-2022, with short-term debt accounting for c. 37.7% of the total debt. There was no significant change in the ownership equity structure of SYPAD at end-2022, compared with that at end-2020. SYPAD mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure related projects under construction and to be constructed in the future.

### Debt Servicing Capability

The liquidity of SYPAD was tight. At end-2022, SYPAD had a cash balance and unused credit facilities of c. RMB329.4 million and RMB1.1 billion, respectively, but a relatively high proportion of cash of RMB180.1 million was restricted, compared with its debt due within one year of c. RMB2.9 billion at the same time. Besides, SYPAD has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

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