

Suqian Yufeng Industrial Investment Development Management Group Co., Ltd.

Initial Issuer Report

Summary

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|---------------|--|
| Issuer Rating | BBB- |
| Outlook | Stable |
| Location | China |
| Industry | Local Investment and Development Companies |
| Date | 19 August 2024 |

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'BBB-' global scale Long-term Issuer Credit Rating with Stable Outlook to Suqian Yufeng Industrial Investment Development Management Group Co., Ltd. ("SYII" or "the company")

Summary

The Issuer Credit Rating reflects a high possibility that the People's Government of Suyu District of Suqian City ("Suyu government") would provide strong support to SYII if needed, in light of its indirectly full ownership of SYII, SYII's strategic importance as an important local investment and development company ("LIDC") for infrastructure construction and state-owned assets operation in Suyu District ("Suyu"), and the linkage between the Suyu government and SYII, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing government support, etc. In addition, the Suyu government may face significant negative impact on its reputation and financing activities if SYII encounters any operational and financial difficulties.

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

Rating Rationale

Government's Ownership and Supervision: The Suyu government indirectly holds 100% ownership of SYII through the State-owned Assets Supervision and Administration Office of the Suyu government ("Suyu SASAO") and via Jiangsu Yundong Holding Group Co., Ltd. ("Yundong Group"), a state-owned entity wholly owned by the Suyu SASAO. The actual controller of the company was the Suyu SASAO. The Suyu government has strong supervision over SYII, including appointment and supervision of the senior management, strategy alignment and major investment and financing plan decisions. In addition, the Suyu government has formulated a performance appraisal policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

Strategic Importance and Strategic Alignment: SYII is an important LIDC for infrastructure construction and state-owned assets operation in Suyu. SYII mainly undertakes Suyu's municipal projects construction, including water conservancy projects and road renovation projects. The company also engages in affordable housing construction and sales within the region. SYII is in a dominant position in the urban infrastructure industry of Suyu, playing an important role in the urban construction and economic development for the region. Its business operation and strategic planning have been aligned with the government's development plans.

Strong Government Support: The Suyu government provides strong support to SYII. In 2020, the registered capital of the company increased from the initial of RMB100 million to RMB500 million, mainly increased by capital and physical assets injection from shareholder. Between 2021 and 2022, the company received asset injections from the Suyu government mainly in the form of cash, which reached about RMB322.0 million. Between 2020 and 2023, SYII received financial subsidies with the total amount of RMB138.2 million from the Suyu

Key Figures of Suyu and SYII

| (RMB billion) | 2022 | 2023 |
|-----------------------|-------------|-------------|
| Suyu District | | |
| GDP | 43.0 | 46.4 |
| GDP growth rate (%) | 3.3 | 8.1 |
| Budgetary revenue | 3.5 | 4.0 |
| Government fund | 3.0 | 2.2 |
| Transfer payment | 4.3 | 2.9 |
| Budgetary expenditure | 6.4 | 6.7 |
| SYII | 2022 | 2023 |
| Assets | 25.8 | 28.7 |
| Equity | 9.8 | 9.7 |
| Revenue | 1.2 | 2.1 |

Source: Public information, SYII and Lianhe Global's calculations

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Applicable Criteria

China Local Investment and Development Companies Criteria (31 July 2024)

government. We expect the support from the local government to remain intact given SYII's strategic importance in Suyu.

SYII's Financial and Liquidity Position: SYII's total assets increased steadily to RMB28.7 billion at end-2023 from RMB23.7 billion at end-2021, as the company actively participated in affordable housing and infrastructure project development in Suyu. The total debt of the company increased to RMB12.6 billion at end-2023, compared with that at end-2021 (RMB9.9 billion), indicating the reliance on debt financing of SYII was heavier at end-2023 compared to that at end-2021. At end-2023, the short-term debt and long-term debt accounted for 30.0% and 70.0% of the total debt, respectively. The company's financial leverage, as measured by debt/capitalization, ranged between 52.7% and 56.6% in 2021-2023.

SYII's liquidity was moderately weak. At end-2023, SYII had unrestricted cash balance of RMB450.3 million, compared with its debt to be due within one year of RMB3,790.4 million. However, SYII has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations. At end-2023, the company had unused credit facilities of RMB7,747.0 million.

Economy and Fiscal Condition of Suyu: Suyu is a district under the jurisdiction of Suqian City of Jiangsu Province ("Jiangsu"), and it is located in the north of Jiangsu. In 2023, the economic growth of Suyu accelerated, and its GDP was RMB46.4 billion, representing a year-on-year growth rate of 8.1%, up from 3.3% recorded in 2022. The budgetary revenue increased to RMB4.0 billion in 2023 from RMB3.5 billion in 2022, and the contribution of tax revenue increased to 90.0% from 82.0% over the same period. The fiscal self-sufficiency of the Suyu government was relatively weak but improving, with the budget deficit narrowing to 66.2% in 2023 from 83.6% in 2022. The transfer payment received from the higher government dropped to RMB2.9 billion in 2023 from RMB4.3 billion in 2022. The government fund income, most of which was derived from land use rights revenue, declined to RMB2.2 billion in 2023 from RMB3.0 billion in 2022, owing to weak property market. The fiscal debt ratio (total government debt outstanding/aggregate revenue) of the Suyu government rose to 100.1% at end-2023 from 79.6% at end-2022.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Suyu

Suyu is a district under the jurisdiction of Suqian City of Jiangsu, and it is located in the northern part of Jiangsu. Suyu has jurisdiction over 3 towns, 6 streets and 1 national high-tech industrial development zone (Suqian National High-tech Industrial Development Zone), with a total area of 1,252.6 square kilometers. At end-2023, Suyu had a residential population of 448 thousand with an urbanization rate of 69.5%.

In 2023, the economic growth of Suyu accelerated, and its GDP was RMB46.4 billion, representing a year-on-year growth rate of 8.1%, up from 3.3% recorded in 2022. In terms of industrial structure, the economy of Suyu was mainly dominated by the secondary industry and the tertiary industry, which accounted for 47.1% and 44.7% of the GDP in 2023, respectively. The fixed asset investment of Suyu maintained a rapid growth in 2023, up by 9.2% compared with that in 2022.

| Suyu's GDP and Fixed Asset Investment | | | |
|--|-------------|-------------|-------------|
| (RMB billion) | 2021 | 2022 | 2023 |
| GDP | 38.3 | 43.0 | 46.4 |
| -Primary industry (%) | 8.9 | 9.2 | 9.2 |
| -Secondary industry (%) | 44.4 | 46.7 | 47.1 |
| -Tertiary industry (%) | 46.7 | 44.1 | 44.4 |
| GDP growth rate (%) | 9.3 | 3.3 | 8.1 |
| Fixed asset investment | 36.1 | 39.5 | 43.2 |
| Fixed asset investment growth rate (%) | 6.1 | 9.6 | 9.2 |
| Population (million) | 0.4 | 0.4 | 0.4 |
| <i>Source: Public information and Lianhe Global's calculations</i> | | | |

Fiscal Condition of Suyu

The aggregate fiscal revenue of the Suyu government is mainly derived from budgetary revenue and transfer payment from the higher government. The budgetary revenue increased to RMB4.0 billion in 2023 from RMB3.5 billion in 2022, and the contribution of tax revenue increased to 90.0% from 82.0% over the same period. The fiscal self-sufficiency of the Suyu government was relatively weak but improving, with the budget deficit narrowing to 66.2% in 2023 from 83.6% in 2022. The transfer payment received from the higher government dropped to RMB2.9 billion in 2023 from RMB4.3 billion in 2022. The government fund income, most of which was derived from land use rights revenue, declined to RMB2.2 billion in 2023 from RMB3.0 billion in 2022, owing to weak property market.

The outstanding debt of the Suyu government increased from RMB8.6 billion at end-2022 to RMB9.2 billion at end-2023. The general obligations stayed almost the same while the special debts increased to RMB5.8 billion at end-2023 from RMB5.2 billion at end-2022. The fiscal debt ratio (total government debt outstanding/aggregate revenue) of the Suyu government rose to 100.1% at end-2023 from 79.6% at end-2022.

| Suyu's Fiscal Condition (RMB billion) | 2021 | 2022 | 2023 |
|---|-------------|-------------|-------------|
| Budgetary revenue | 3.5 | 3.5 | 4.0 |
| Budgetary revenue growth rate (%) | 26.0 | 0.4 | 14.5 |
| Tax revenue | 3.1 | 2.9 | 3.6 |
| Tax revenue (% of budgetary revenue) | 89.0 | 82.0 | 90.0 |
| Government fund income | 4.2 | 3.0 | 2.2 |
| Transfer payment | 2.8 | 4.3 | 2.9 |
| Aggregate revenue | 10.5 | 10.8 | 9.2 |
| Budgetary expenditure | 5.9 | 6.4 | 6.7 |
| Budget deficit ¹ (%) | -69.3 | -83.6 | -66.2 |

¹ Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

SYII was established in February 2009, with an initial registered capital of RMB100 million. In February 2023, the controlling shareholder of the company changed to Yundong Group, a state-owned entity wholly owned by the Suyu SASAO. At end-2023, SYII's registered capital and paid-in capital were both RMB500 million after several capital injections. The actual controller of the company was the Suyu SASAO.

Strategic Importance and Government Linkage

Strategic Importance of SYII to Suyu

SYII is an important LIDC for infrastructure construction and state-owned assets operation in Suyu. SYII mainly undertakes Suyu's municipal projects construction, including water conservancy projects and road renovation projects. The company also engages in affordable housing construction and sales within the region. SYII is in a dominant position in the urban infrastructure industry of Suyu, playing an important role in the urban construction and economic development for the region. Its business operation and strategic planning have been aligned with the government's development plans.

Strong Linkage with the Local Government

SYII has a strong linkage with the local government, as the the Suyu government indirectly holds 100% ownership of SYII through the Suyu SASAO and via Yundong Group. The actual controller of the company was the Suyu SASAO. The Suyu government has strong supervision over SYII, including appointment and supervision of the senior management, strategy alignment and major investment and financing plan decisions. In addition, the Suyu government has formulated a performance appraisal policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

Strong Government Support

The Suyu government provides strong support to SYII. In 2020, the registered capital of the company increased from the initial of RMB100 million to RMB500 million, mainly increased by capital and physical assets injection from shareholder. Between 2021 and 2022, the company received asset injections from the Suyu government mainly in the form of cash, which reached about RMB322.0 million. Between 2020 and 2023, SYII received financial subsidies with the total amount of RMB138.2 million from the Suyu government. We expect

the support from the local government to remain intact given SYII's strategic importance in Suyu.

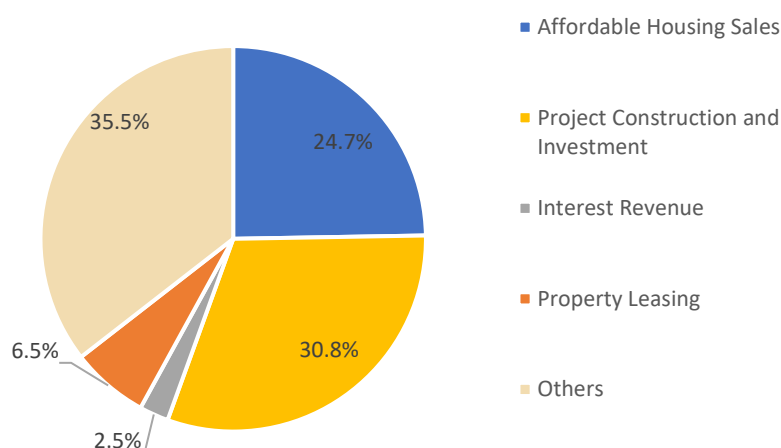
Business Profile

The Important LIDC Responsible for Infrastructure Construction and State-owned Assets Operation in Suyu

The company is an important entity for infrastructure construction and state-owned assets operation in Suyu. The major revenue sources of the company include project construction and investment, affordable housing sales, property leasing, interest revenue and other businesses. The total operating revenue of SYII was RMB1,110.0 million, RMB1,161.4 million and RMB2,057.5million in 2021, 2022 and 2023, respectively. The gross profit margin decreased from 32.9% in 2021 to 18.2% in 2023, mainly due to higher costs in property leasing and other businesses.

Revenue Breakdown

(Total revenue: RMB2,057.5 million in 2023)



Source: The company and Lianhe Global's calculations

Affordable Housing Sales

The company's affordable housing sales business mainly involves the investment, development and sales of affordable housing projects in Suyu. This segment is operated under both agent construction and self-operated models. Under the self-operated model, the company acquires land through auction and constructs affordable housing, and sells to the relocated households at a price lower than the market level. Under the agent construction model, the company designated by the local government to invest in and construct the affordable housing project, and the company sells directly to the relocated households after projects are completed.

Project Construction and Investment

The company is mainly responsible for the construction of water conservancy projects, road renovation projects and other infrastructure projects in Suyu. This segment is operated under both agent construction and self-operated models. Under the agent construction model, the company signs the agent construction agreements with the local government agencies or state-owned enterprises and is responsible for construction of projects. The

company settles construction costs plus a markup of c. 20% with the entrusting parties upon the completion of the projects. Under the self-operated model, the company constructs the projects and sells or operates them for income upon completion. Currently, projects under construction and to be constructed still require a large scale of investment, thus it incurs high pressure on capital expenditure.

Property Leasing

The company mainly leases its own factory buildings, office buildings and shops to enterprises and other tenants, generating a certain amount of rental income each year. The income derived from this segment was RMB5.1 million, RMB35.9 million, and RMB133.8 million in 2021, 2022 and 2023, respectively. The gross profit margin of this segment was 100%, 22.2% and 48.2% over the same period.

Interest Revenue and Other Businesses

Except for the businesses mentioned above, the company also operates in other businesses to supplement its operating income, such as interest income, service fee income, commodity sales income and property management income, etc. Interest income mainly refers to the income generated by the company's lending its funds to other institutions in the region.

Financial Profile

Balance Sheet Structure and Quality

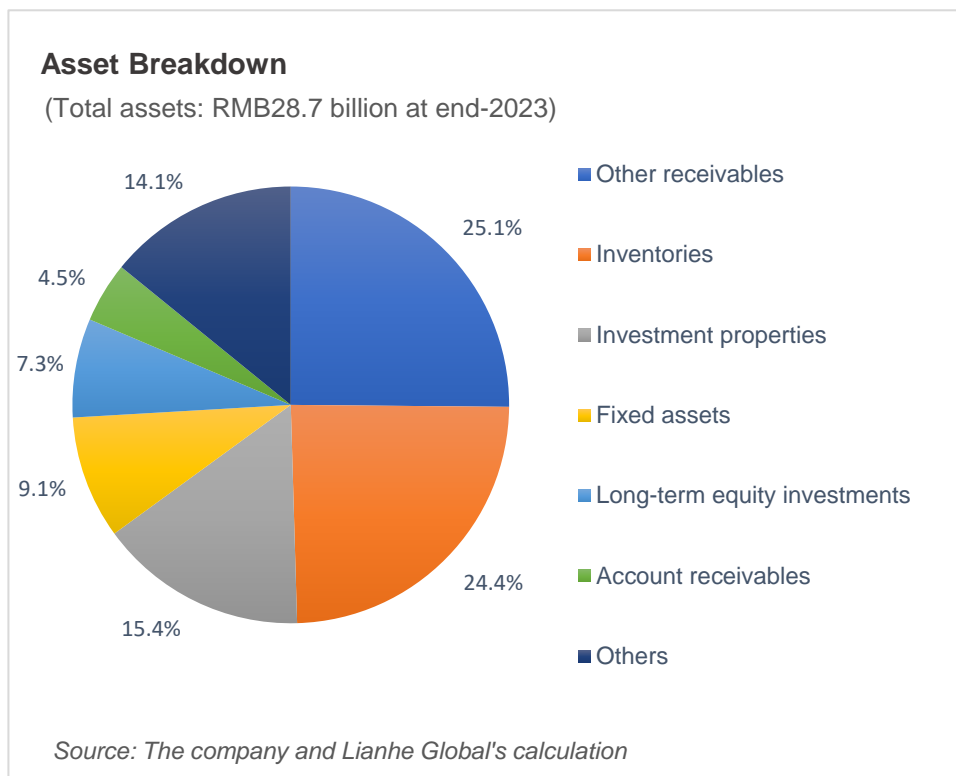
| Balance Sheet Structure and Quality | | | |
|--|-------------|-------------|-------------|
| (RMB million) | 2021 | 2022 | 2023 |
| Total Asset | 23,686 | 25,787 | 28,656 |
| Equity | 8,486 | 9,752 | 9,668 |
| Debt | 9,926 | 10,849 | 12,631 |
| Debt / (Debt + Equity) (%) | 53.9 | 52.7 | 56.6 |
| LT Debt | 6,603 | 6,335 | 8,840 |
| LT Debt / (LT Debt + Equity) (%) | 43.8 | 39.4 | 47.8 |

Source: The company's financial reports and Lianhe Global's calculations

SYII's total assets increased steadily to RMB28.7 billion at end-2023 from RMB23.7 billion at end-2021, as the company actively participated in affordable housing and infrastructure project development in Suyu. The total debt of the company increased to RMB12.6 billion at end-2023, compared with that at end-2021 (RMB9.9 billion), indicating the reliance on debt financing of SYII was heavier at end-2023 compared to that at end-2021. At end-2023, the short-term debt and long-term debt accounted for 30.0% and 70.0% of the total debt, respectively. The company's financial leverage, as measured by debt/capitalization, ranged between 52.7% and 56.6% in 2021-2023.

SYII's asset quality was moderately weak. At the end-2023, the company's assets mainly consisted of inventory, investment properties, receivables, fixed assets, long-term equity investment and others. The company's project construction activities accumulated sizeable inventories, which mainly constituted of development cost of infrastructure construction and land use rights. These assets usually take a long time to monetize. In addition, the company had a large number of account receivables and other receivables, primarily due from government agencies and state-owned enterprises, which had an aging period of mostly 1-

3 years. The company's investment properties were calculated at cost and may be subject to the impact of market value fluctuations, which may require the provision for impairment.



Debt Servicing Capability

SYII's liquidity was moderately weak. At end-2023, SYII had unrestricted cash balance of RMB450.3 million, compared with its debt to be due within one year of RMB3,790.4 million. However, SYII has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations. At end-2023, the company had unused credit facilities of RMB7,747.0 million.

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