

Hubei Edong Urban-Rural Integration Industrial Investment Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	4 November 2024

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB’ global scale Long-term Issuer Credit Rating with Stable Outlook to Hubei Edong Urban-Rural Integration Industrial Investment Group Co., Ltd. (“HEURI” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Daye City, (“Daye government”) would provide strong support to HEURI if needed, in light of its indirect full ownership of HEURI, HEURI’s strategic importance as an important local investment and development company (“LIDC”) for rural revitalization and industrialization in Daye City (“Daye”), and the linkage between the Daye government and HEURI, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing government support, etc. In addition, the Daye government may face significant negative impact on its reputation and financing activities if HEURI encounters any operational and financial difficulties.

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

Rating Rationale

Government’s Ownership and Supervision: The Finance Bureau of Daye holds the full ownership of HEURI via Hubei New Tongdu Urban Investment and Development Group Co., Ltd. (“HNTU”, ‘BBB’/Stable), and is the company’s actual controller. The Daye government has the final decision-making authority and strong supervision over the company, including appointment and supervision of the senior management, strategic alignment and decision on its major investment and financing plan decisions. In addition, the Daye government has assessment mechanism over the company and regularly appoints auditors to review the company’s operating performance and financial position.

Strategic Importance and Strategic Alignment: HEURI is an important LIDC that is responsible for rural revitalization and industrialization, as well as the urban-rural integration in Daye. HEURI mainly undertakes recycling of renewable resources, intelligent parking, design services and other businesses. HEURI plays an important role in promoting economic and social development for the region. Its business operation and strategic planning have been aligned with the government’s development plans.

Ongoing Government Support: The Daye government provides ongoing support to HEURI, mainly in the form of asset and equity injections. In 2023 and the first half of 2024, the company received several arrays of asset injections including land, investment properties, etc. Also, the company received equity injections in the first half of 2024. These injections enlarged the company’s total asset scale. We expect the support from the Daye government to remain intact given HEURI’s strategic importance in Daye.

HEURI’s Financial and Liquidity Position: HEURI’s total assets increased significantly to RMB6.5 billion at end-June 2024 from RMB1.0 billion at end-2022, as the company continuously received injections from the Daye government. The total debt of the company

Key Figures of Daye and HEURI

(RMB billion)	2022	2023
Daye		
GDP	86.1	86.3
GDP growth rate (%)	6.5	6.2
Budgetary revenue	4.1	4.8
Government fund	8.9	3.6
Transfer payment	3.4	3.2
Budgetary expenditure	8.1	7.8
HEURI		
	2023	2024.6
Assets	3.3	6.5
Equity	2.0	4.6
Revenue	1.0	0.5

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

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Applicable Criteria

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

increased to RMB495 million at end-June 2024, compared with RMB20 million at end-2023. The company's financial leverage, as measured by debt/capitalization, remained low at 1.0% and 9.6% at end-2023 and end-June 2024, respectively, as its asset scale was strengthened following the injections from the Daye government.

HEURI's liquidity was adequate. At end-June 2024, HEURI had unrestricted cash balance of RMB106 million and unused credit facilities of RMB1,705 million, which was sufficient to cover its debt to be due within one year of RMB115 million. Moreover, HEURI has access to various financing channels, including bank loans and potential bond issuance to support its debt repayment and business operations.

Economy and Fiscal Condition of Daye: Daye is a county-level city of Hubei Province and is managed by Huangshi City. It is one of the top 100 industrial counties in China with rich mineral resources such as copper, iron and coal. Daye maintained steady economic growth during the past two years, with GDP growth rate of 6.5% and 6.2% in 2022 and 2023, respectively. The GDP of Daye reached RMB86.3 billion in 2023, which was ranked first among six Huangshi City's jurisdictions.

The budgetary revenue of the Daye government increased to RMB4.8 billion in 2023 from RMB4.1 billion in 2022. The financial self-sufficiency of Daye was weak but improving, with the budget deficit narrowing to 63.9% from 98.1% over the same period. However, the government fund income plummeted to RMB3.6 billion in 2023 from RMB8.9 billion in 2022, as the land sales remained weak amid the prolonged downturn of the property market. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, surged to 120.8% at end-2023 from 64.8% at end-2022, owing to weak government revenue and large new issuance of special purpose debts to support local public projects.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Daye

Daye is a county-level city of Hubei Province and managed by Huangshi City. Daye is one of the top 100 industrial counties in China with rich mineral resources such as copper, iron and coal, and ranked 57th in the list of Top 100 Counties in China in 2023. Daye has jurisdiction over 10 towns, 4 communities, 1 national high-tech zone and 1 state-owned farm, with a total land area of c. 1,566 square kilometers. At end-2023, Daye had an urbanization rate of 63.4%.

Daye maintained steady economic growth during the past two years, with GDP growth rate of 6.5% and 6.2% in 2022 and 2023, respectively. The GDP of Daye reached RMB86.3 billion in 2023, which was ranked first among six Huangshi City's jurisdictions. The economic growth of Daye was mainly boosted by the secondary and tertiary industries, which accounted for 53.1% and 39.9% of GDP in 2023, respectively.

Daye's GDP and Fixed Asset Investment			
(RMB billion)	2021	2022	2023
GDP	75.1	86.1	86.3
-Primary industry (%)	7.3	6.8	7.0
-Secondary industry (%)	55.5	57.7	53.1
-Tertiary industry (%)	37.3	35.5	39.9
GDP growth rate (%)	14.4	6.5	6.2
Fixed asset investment	59.5	71.1	75.1
Fixed asset investment growth rate (%)	30.7	19.5	5.6
Population (million)	0.9	0.9	0.9
<i>*Estimated data</i>			
<i>Source: Public information and Lianhe Global's calculations</i>			

Fiscal Condition of Daye

The aggregate fiscal revenue of the Daye government is mainly originated from the budget revenue and government fund income. The budgetary revenue of the Daye government increased to RMB4.8 billion in 2023 from RMB4.1 billion in 2022. The financial self-sufficiency of Daye was weak but improving, with the budget deficit narrowing to 63.9% from 98.1% over the same period. However, the government fund income plummeted to RMB3.6 billion in 2023 from RMB8.9 billion in 2022, as the land sales remained weak amid the prolonged downturn of the property market.

The outstanding debt of the Daye government kept growing in the past few years and reached RMB14.0 billion at end-2023, including RMB5.7 billion of general obligations and RMB8.3 billion of special purpose debt. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, surged to 120.8% at end-2023 from 64.8% at end-2022, owing to weak government revenue and large new issuance of special purpose debts to support local public projects.

Daye's Fiscal Condition (RMB billion)	2021	2022	2023
Budgetary revenue	4.1	4.1	4.8
Budgetary revenue growth rate (%)	50.2	9.1*	16.6
Tax revenue	3.0	3.1	3.5
Tax revenue (% of budgetary revenue)	74.8	75.3	73.0
Government fund income	5.6	8.9	3.6
Transfer payment	2.7	3.4	3.2
Aggregate revenue	12.4	16.4	11.6
Budgetary expenditure	7.9	8.1	7.8
Budget balance ¹ (%)	-95.2	-98.1	-63.9

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

*Excluding the influence of value-added tax credit refund

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

HEURI was established in May 2019. At end-June 2024, HNTU was the sole shareholder of the company. The Finance Bureau of Daye is the actual controller of the company. At end-June 2024, HEURI's registered capital was RMB500 million.

Strategic Importance and Government Linkage

Strategic Importance of HEURI to Daye

HEURI is an important LIDC that is responsible for rural revitalization and industrialization, as well as the urban-rural integration in Daye. HEURI mainly undertakes recycling of renewable resources, intelligent parking, design services and other businesses. HEURI plays an important role in promoting economic and social 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

HEURI has a strong linkage with the local government, as the Daye government holds the full ownership of HEURI via the Finance Bureau of Daye and HNTU, and the Finance Bureau of Daye is the actual controller of the company. The Daye government has the final decision-making authority and strong supervision over the company, including appointment and supervision of the senior management, strategic alignment and decision on its major investment and financing plan decisions. In addition, the Daye government has assessment mechanism over the company and regularly appoints auditors to review the company's operating performance and financial position.

Strong Government Support

The Daye government provides ongoing support to HEURI, mainly in the form of asset and equity injections. In 2023 and the first half of 2024, the company received several arrays of asset injections including land, investment properties, etc. Also, the company received equity injections in the first half of 2024. These injections enlarged the company's total asset scale. We expect the support from the Daye government to remain intact given HEURI's strategic importance in Daye.

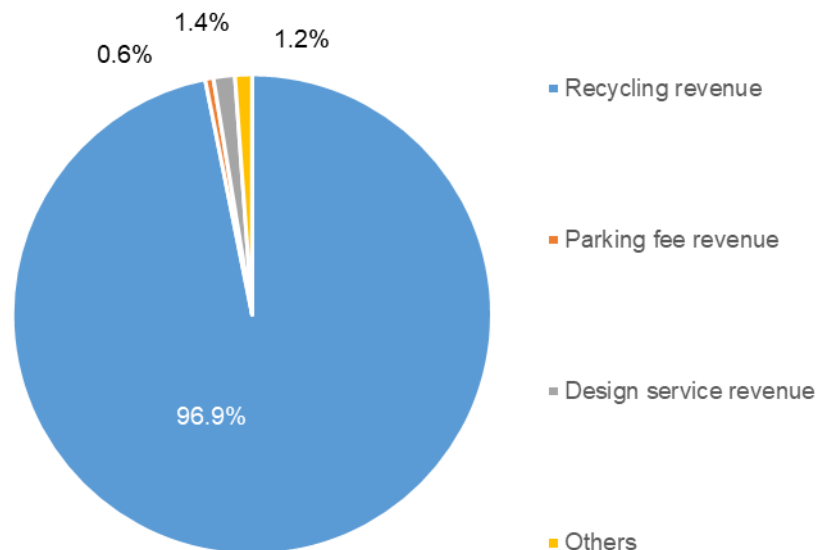
Business Profile

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

HEURI is an important LIDC that is responsible for rural revitalization and industrialization, as well as the urban-rural integration in Daye. HEURI mainly undertakes recycling of renewable resources, intelligent parking, design services and other businesses. The total revenue of HEURI was RMB453.8 million and RMB962.5 million in 2022 and 2023, respectively. The company's gross profit margin fluctuated slightly from 2022 to 2023. However, the gross profit margin improved to 1.85% in the first half of 2024, mainly due to the expansion of the design service segment and the significant increase in gross profit margin in this segment.

Revenue Breakdown

(Total revenue: RMB487.8 million for the first half of 2024)



Source: The company and Lianhe Global's Calculation

Recycling of renewable resources

It is mainly engaged in the agency trading business of scrap steel. The current varieties are mainly refined heavy scrap, mechanical crude iron, steel bars and other scrap steel. The trading business operation model is mainly based on collecting and purchasing goods from upstream suppliers and selling them to downstream customers. The major settlement method is cash.

In the first half of 2024, this segment contributed 96.9% of the total revenue. However, the gross profit margin of the segment was low, which led to a limited contribution to profit.

Intelligent Parking

The company installs smart devices in parking spaces, establishes an integrated parking backend management system and collects parking data in real time, thereby realizing the

intelligent overall management of urban parking resources and guiding vehicles to park rationally. Parking fees are charged based on the length of parking time through WeChat applets or apps.

It has been put into use since 2023, with a gross profit margin of 58.17% for the segment, which is quite considerable. However, in the first half of 2024, the company continued to deploy smart parking equipment and upgrade old parking lots in surrounding towns and other areas, coupled with the expansion of activities to promote parking services, leading to a significant decline in the gross profit margin.

Design service

It mainly undertakes urban and rural master planning, detailed planning, special planning, village planning, landscape design, planning consultation, sunshine analysis, special research and other businesses, and charges design service fees.

Although the revenue accounts for a small proportion of 1.4% of the total revenue in the first half of 2024, the gross profit margin of the segment was considerable at 55.95%.

Other Businesses

Except for the businesses mentioned above, the company operates businesses such as investment real estate management, advertising management, tourism business, and sewage treatment plant management.

Financial Profile

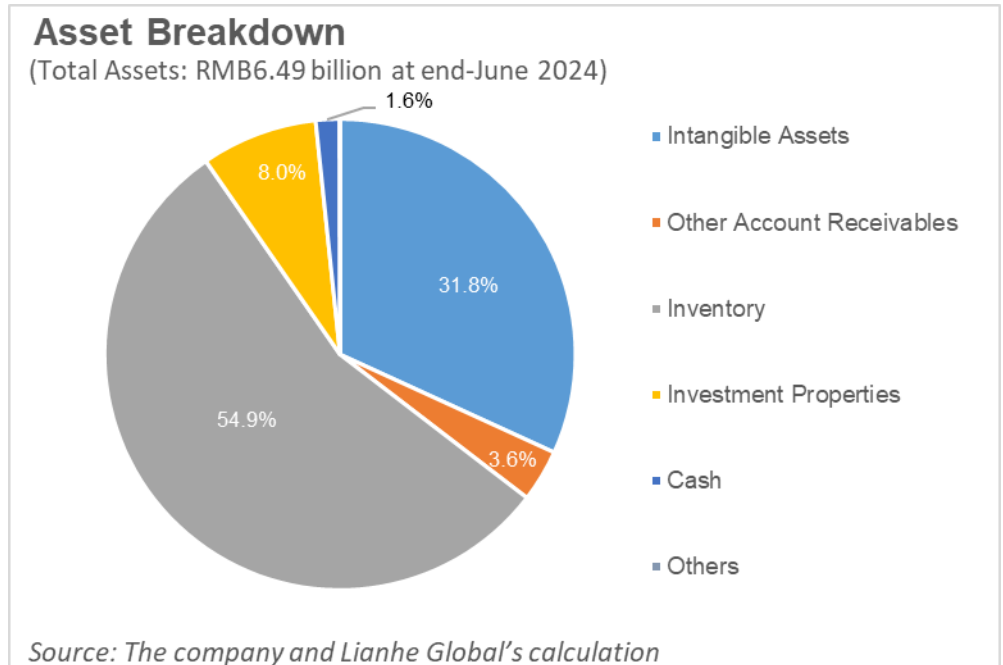
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality			
(RMB million)	2022	2023	June 2024
Total Asset	1,017	3,274	6,489
Equity	140	1,996	4,637
Debt	0	20	495
Debt / (Debt + Equity) (%)	N/A	1.0	9.6
LT Debt	0	0	380
LT Debt / (LT Debt + Equity) (%)	N/A	N/A	7.6

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

HEURI's total assets increased significantly to RMB6.5 billion at end-June 2024 from RMB1.0 billion at end-2022, as the company continuously received injections from the Daye government. The total debt of the company increased to RMB495 million at end-June 2024, compared with RMB20 million at end-2023. At end-June 2024, the short-term debt and long-term debt accounted for 23.2% and 76.8% of the total debt, respectively. The company's financial leverage, as measured by debt/capitalization, remained low at 1.0% and 9.6% at end-2023 and end-June 2024, respectively, as its asset scale was strengthened following the injections from the Daye government.

HEURI's asset quality was moderately weak. At the end-June 2024, the company's assets mainly consisted of inventories and intangibles. The inventories mainly consisted of land cost and development cost. On the other hand, intangibles mainly consisted of operating rights. These assets usually take a long time to monetize.



Debt Servicing Capability

HEURI's liquidity was adequate. At end-June 2024, HEURI had unrestricted cash balance of RMB106 million and unused credit facilities of RMB1,705 million, which was sufficient to cover its debt to be due within one year of RMB115 million. Moreover, HEURI has access to various financing channels, including bank loans and potential bond issuance to support its debt repayment and business operations.

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