Credit Opinion

11 June 2024

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	A_g
Outlook	Stable

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Yiwu State-owned Capital Operation Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of A_g to Yiwu State-owned Capital Operation Co., Ltd., with stable outlook.

Summary

The A_g long-term credit rating of Yiwu State-owned Capital Operation Co., Ltd. ("YSCO" or the "Company") reflects Yiwu City Government's very strong capacity to provide support, and extremely high willingness to provide support to the Company based on our assessment of the Company's characteristics.

Our assessment of Yiwu City Government's capacity to provide support reflects its position as the world's largest small commodity export base with ongoing economic growth.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) leading role in the infrastructure construction and state-owned asset operation in Yiwu City; (2) dominant role in providing essential public services with high sustainability; (3) good track record of receiving government payments; and (4) strong access to funding from commercial banks and bond markets.

However, the rating is constrained by the Company's (1) large capital expenditure pressure and increasing debt burden; (2) operating risk arising from medium commercial business exposure; and (3) medium contingent liability risk associated with external guarantees.

The stable outlook on YSCO's rating reflects our expectation that the local government's capacity to support the Company will remain stable, and that the Company will maintain its leading role in the infrastructure construction and state-owned asset operation in Yiwu City.

Rating Drivers

- Leading role in infrastructure construction and state-owned asset operation in Yiwu City
- High sustainability in public services business
- Good track record of receiving government payments
- Operating risk arising from medium commercial business exposure
- Increasing debt burden and moderate asset liquidity
- Strong access to funding from commercial banks and bond markets
- Medium contingent liability risk associated with external guarantees

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government’s capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government’s willingness to support, such as improvement in debt management and asset quality.

What could downgrade the rating?

The rating could be downgraded if (1) the local government’s capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government’s willingness to support, such as decrease in its strategic significance; decrease in government payments; or increase in exposure to commercial activities.

Key Indicators

	2021FY	2022FY	2023FY	2024Q1
Total Asset (RMB billion)	220.0	232.9	252.9	260.1
Total Equity (RMB billion)	51.1	54.6	60.1	61.6
Total Revenue (RMB billion)	29.1	26.7	36.2	5.6
Total Debt/Total Capital (%)	69.8	69.8	68.9	69.4

All ratios and figures are calculated using CCXAP’s adjustments.

Source: Company data, CCXAP research

Corporate Profile

Established in 2013, YSCO is now the most important and largest Local Infrastructure Investment and Financing Company (“LIIFC”) in Yiwu City by asset size, undertaking public service business including infrastructure construction, affordable housing projects, as well as public transportation and urban utility services. In addition, the Company also engages in commercial business such as property development, commodity trading, and market operation business. As of 31 March 2024, it is ultimately controlled by the Yiwu State-owned Asset Supervision and Administration Office (“Yiwu SASAO”). Yiwu SASAO directly held 85.6% of the Company’s shares and indirectly held 5% of the Company’s shares via Yiwu Shuzhi Industry Development Group Co., Ltd. Zhejiang Financial Development Co., Ltd held the rest 9.4% of the Company’s shares.

Exhibit 1. Revenue structure in 2023

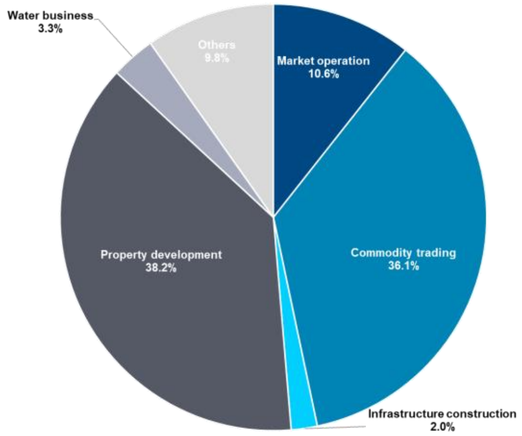
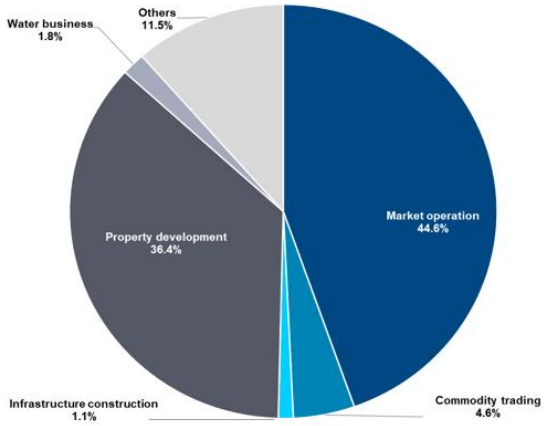
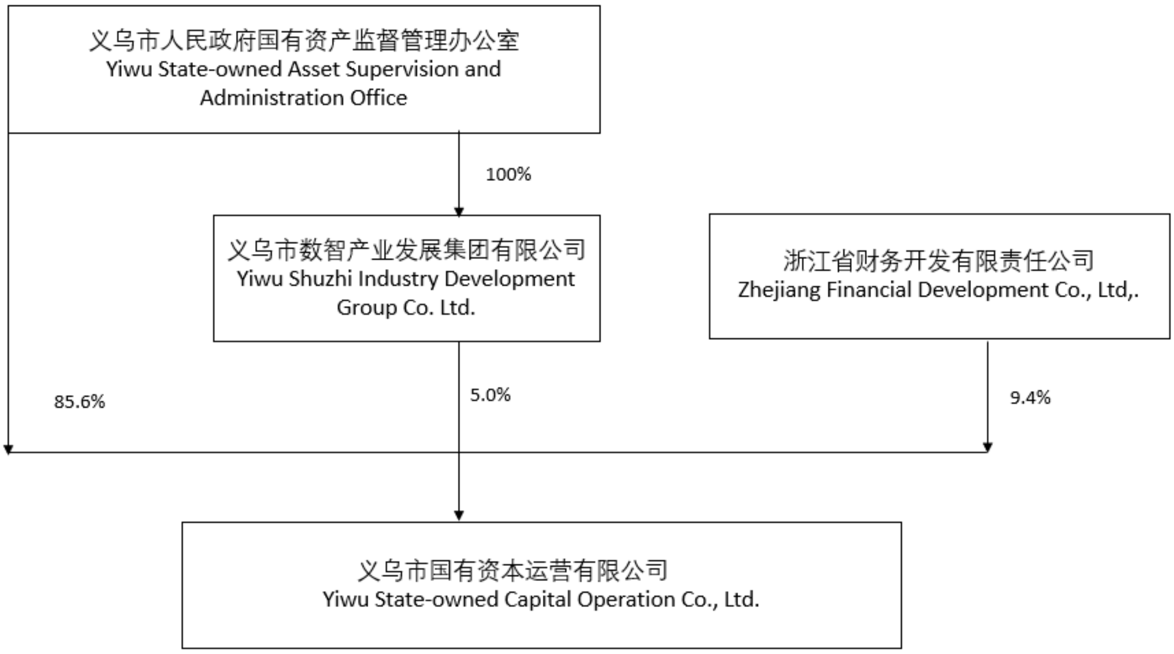


Exhibit 2. Gross profit structure in 2023



Source: Company information, CCXAP research

Exhibit 3. Shareholding Chart as of 31 March 2024



Source: Company information, CCXAP research

Rating Considerations

Government Capacity to Provide Support

We believe that Yiwu City Government has a very strong capacity to provide support as reflected by its position as the world's largest small commodity export base and ongoing economic growth.

Located in the central part of Zhejiang Province, Jinhua City is a well-known economically developed city in the province. After years of development, Jinhua City has formed traditional industries such as metal products, pharmaceutical manufacturing, electrical machinery and equipment manufacturing, textiles and clothing, and automobile manufacturing. In recent years, in addition to traditional industries, Jinhua City has started to promote industrial transformation and put great effort into the development of a network economy, smart logistics, film and television culture. In 2023, its gross regional product ("GRP") recorded RMB601.1 billion with a GRP growth rate of 6.8% year-on-year ("YoY"), compared with RMB556.2 billion in 2022. Jinhua Municipal Government's general budgetary revenue showed an increase from RMB48.9 billion in 2022 to RMB52.6 billion in 2023, mainly due to the strong regional economic recovery. Its fiscal balance is at a moderate level, with an average general budgetary revenue to general budgetary expenditure ratio of 61.0% over the past three years. It has good fiscal quality, with tax income accounting for over 80% of its general budgetary revenue for the past three years. However, the debt scale of Jinhua Municipal Government continues to grow. In 2023, the outstanding government debt of Jinhua City rose to RMB169.1 billion from RMB137.9 billion in 2022, representing a YoY increase of 22.6%. As of 2023, its government debt accounts for 28.1% of its GRP and 104.5% of fiscal revenue.

Exhibit 4. Key Economic and Fiscal Indicators of Jinhua City

	2021FY	2022FY	2023FY
GRP (RMB billion)	535.6	556.2	601.1
GRP Growth (%)	9.8	2.5	6.8
General Budgetary Revenue (RMB billion)	49.2	48.9	52.6
General Budgetary Expenditure (RMB billion)	79.1	83.0	84.8
Local Government Debt (RMB billion)	116.7	137.9	169.1

Source: Statistics Bureau of Jinhua City, CCXAP research

Yiwu is the world's largest small commodity export base, known as the world's "Capital of Small Commodity". It is also the first county-level national international trade comprehensive reform pilot zone. According to CCID Consulting Co. Ltd, Yiwu City ranked 9th on the "2023 National Top 100 Counties with Development Potential" list. The Yiwu Small Commodity Market, developed and managed by YSCO, is the first 4A tourism spot and is recognized as the largest global small commodity retail market by a number of supranational institutions. Relying on the advantages of the small commodity trade, the light industry dominated the local industry structure, including clothing, accessories, and toys. Besides, the international logistics infrastructure has expanded substantially in recent years, with many newly-built projects such as Yongjin Railway (connecting Ningbo and Jinhua), providing important support for the economic development of Yiwu City. In 2023, Yiwu City recorded a GRP of RMB205.6 billion, increasing by 8.0% YoY, accounting for 34.2% of the GRP of Jinhua City. Benefiting from a strong recovery in international trade and showing exceptional resilience to withstand the pandemic shock, its general budgetary revenue increased from RMB13.3 billion in 2022 to RMB14.4 billion in 2023. Government fund revenue is an important supplementary income of Yiwu City, but it is largely affected by the land market conditions. The government funds recorded a substantial drop since 2021, from RMB73.8 billion in 2021 to RMB27.4 billion in 2023. The fiscal balance of Yiwu City is good, with an average general budgetary revenue/general budgetary expenditure ratio of 84.7% from 2021 to 2023. In addition, Yiwu City's debt burden is low. In 2023, Yiwu City's governmental debt was 29.7 billion, representing 14.4% of GRP and 55.0% of total fiscal revenue.

Exhibit 5. Key Economic and Fiscal Indicators of Yiwu City

	2021FY	2022FY	2023FY
GRP (RMB billion)	173.0	183.6	205.6
GRP Growth (%)	11.6	4.6	8.0
General Budgetary Revenue (RMB billion)	12.7	13.3	14.4
General Budgetary Expenditure (RMB billion)	15.4	16.0	16.3
Local Government Debt (RMB billion)	20.0	23.6	29.7

Source: Statistics Bureau of Yiwu City, CCXAP research

Government Willingness to Provide Support

Leading role in infrastructure construction and state-owned asset operation in Yiwu City, with high sustainability in public services business

As the largest state-owned enterprise by asset size in Yiwu City, YSCO manages or operates around 90% of the city's state-owned assets. The Company conducts public service business including infrastructure projects, affordable housing, water-related business and public transportation via different functional subsidiaries. Considering the Company’s extremely high strategic significance to the development of Yiwu City, we believe the Company will not be easily replaced by other local state-owned enterprises in the foreseeable future.

In terms of the infrastructure construction segment, the Company enters into agreements with the Yiwu government which will make payments to the Company annually based on the progress of construction. The types of infrastructure projects include municipal projects, road construction and maintenance, and logistics-related facilities. As of 31 March 2024, the Company has completed 29 projects, with invested amounts of RMB12.6 billion and collected payments of RMB9.9 billion. Meanwhile, the Company has 34 projects under construction or planning, with a total estimated investment of RMB33.1 billion and an uninvested amount of RMB20.5 billion, indicating a large capital expenditure in the future.

The Company also engages in the affordable housing business, which is mainly aimed at transforming rural areas into modern communities. The affordable house was sold to resettlement households at a government guidance price (lower than the market price), and the loss is compensated in several ways, including government subsidies, government purchase payments, and agency construction repayments. As of 31 March 2024, the total investment of completed affordable housing projects was RMB27.1 billion, with total sales and cash payment collection of RMB21.7 billion and RMB20.1 billion, respectively; and the Company had 14 major affordable housing projects under construction, with a total investment amount of RMB19.2 billion and an uninvested amount of RMB8.0 billion. Thus, the Company will continue to undertake the construction of affordable housing in Yiwu City, with strong business sustainability, but facing certain investment pressure.

The Company is the sole water business provider in Yiwu City. The water segment includes water supply, sewage treatment, pipeline construction, and water conservancy projects. As of 31 March 2024, the Company has a daily water processing capacity (water supply and sewage treatment) of 1.5 million tons per day through 8 water supply plants and 10 sewage treatment plants, which is higher than most of its county-level peers in China. The gross margin of the water business remained positive over the past three years. Due to YSCO’s monopolistic position in the water business in Yiwu City, the business has strong stability and sustainability.

The public business conducted by the Company also includes warehouse and logistic facilities, as well as public transportation, but these business segments contribute little to the Company’s overall revenue, accounting for around 2.3% of its total revenue in 2023. The business segment of public transportation involves buses, cabs, long-distance passenger transportation, and the operation of passenger terminals. In recent years. the rise of private cars, airplanes, and high-speed rail has intensified competition in the business. The public transportation business remained non-profitable, requiring government subsidies to support its operations. Its gross profit margins remained negative, dragging down the Company's overall profitability. In addition, in line with the national “One Belt, One Road” strategy, the Company vigorously develops supporting logistics terminals and warehousing facilities. As of 31 March 2024, there was a logistics park under construction, with a total investment amount of RMB7.6 billion.

Operating risk arising from medium commercial business exposure

YSCO engages in commercial business such as property development, commodity trading, as well as its well-known market operation business based on its small commodities trading centres. We estimate that the Company had medium commercial exposure with the proportion of commercial business assets being around 35% of its total assets. We believe the Company's commercial businesses are complementary to its existing policy mandates with manageable risk.

The market operation business is the core business and the largest contributor to the Company's gross profit. It is mainly operated by the Company's owned subsidiary and its holding subsidiary Zhejiang China Commodity City Group Company Ltd ("CCC Group", Stock Code: 600415. SH). The Company possesses different small commodity trading centers, notably the Yiwu Small Commodity Market, which comprises the Yiwu International Trade City, the Huangyuan Garment Market and the Yiwu Production Material Market, and achieves profit by rental income paid by numerous small tenants, which mainly engaged in consumer staples such toys and clothing. This segment has shown extraordinary resilience over the past few years, as the occupancy rate of stores has been maintained at over 90%. Meanwhile, given that the Company has adopted the business model of collecting leasing fees 1 to 5 years in advance, coupled with the Company's monopoly advantage in the local market, this business has a guaranteed source of income and strong business competitiveness. Though the market operation business saw a drop in gross profit in 2022 due to the one-off rental-free policy supporting the tenants, it rebounded strongly in 2023, with gross profit reaching RMB2.4 billion, up by 26.6% from 2021. The Company is also constructing the Global Digital Trade Center, with a total investment amount of RMB8.3 billion. The Company plans to achieve revenues primarily through leasing, sales, property management, and advertising upon completion of the project.

The Company's property development business is mainly operated via a self-development model and joint-development model. The Company uses self-raised funds to purchase lands and constructs property projects for market-oriented sales. The projects are primarily located in Yiwu City. As of 31 March 2024, the Company's major completed property projects were basically sold out, with a total investment amount of RMB8.6 billion, a saleable area of 647,500 square meters and a sold area of 558,500 square meters, and achieved total sales amount of RMB10.3 billion and payment collection of RMB9.5 billion. In addition, the Company had 20 major market-oriented property projects under development, with a total investment amount of RMB40.6 billion and an uninvested amount of RMB10.4 billion. However, as the sales of real estate projects could be adversely affected by the industry downturn of China's property market, the property development business may bring certain debt repayment pressure to the Company.

The Company also engages in the commodity trading business, which covers consumer staples, building materials and oil, and non-ferrous metals. We assess the risk of its commodity trading business as low. Consumer staples account for more than 50% of the product portfolio, which is less vulnerable to economic cycles. The suppliers and customers of its commodity trading business are also diversified, which reduces the concentration risk along the industry chain.

Good track record of receiving government payments

As the largest LIIFC in Yiwu City, YSCO has a proven track record of receiving government support in the form of debt repayment funding, project repayments, financial subsidies, capital injection and asset injection, which has effectively improved the liquidity, solvency and refinancing capabilities of YSCO. From 2021 to 2024Q1, the Company received government support of RMB6.6 billion. Despite the drop in land sales since 2022, the local government has been providing sustained support to improve the Company's financial flexibility and capital strength, such as the one-off interest subsidy of RMB646.9 million on its perpetual debt instrument in 2022. In 2023, the government injected its 40% stake in each of Yiwu Shuangjianghu Development Group Co., Ltd, and Yiwu Environmental Group Co., ltd into the Company, effectively elevating the importance of the Company. Besides, the Company also received the use rights of the water resource of reservoirs within Yiwu City, which increased the net asset of the Company. In the first quarter of 2024, the net assets of the Company further increased as a result of asset injection such as land assets. We expect the local government will continue to support the Company in the future given its important position in the region.

Increasing debt burden and moderate asset liquidity

YSCO’s total debt continued to increase due to ongoing investment needs. From 2021 to 2024Q1, the Company’s total debt increased from RMB118.1 billion to RMB139.5 billion, and its total capitalization ratio maintained at a relatively high level of around 70% since 2021. The Company also has relatively high short-term debt repayment pressure since its short-term debt accounted for about 45.1% of total debt as of 31 March 2024, and the liquidity profile was weak with a cash-to-short-term debt ratio of around 0.2x at the same time, indicating that its cash balance was insufficient to cover its short-term debt. However, we believe the debt burden can be mitigated by the Company’s resilient market operation business and strong access to capital.

YSCO’s asset liquidity was moderate as they were mainly inventories and non-current assets with weak liquidity. As of 31 March 2024, the inventories amounted to RMB79.1 billion, accounting for 30.4% of total assets, which mainly consisted of construction costs caused by infrastructure construction projects. Furthermore, as of 31 March 2024, the Company had pledged assets of RMB36.7 billion, accounting for 55.4% of net assets, which may impact the Company’s financing flexibility. However, YSCO owns the equity of listed company CCC Group, and large-scale investment property and water assets, which can bring stable operating income for the Company and partly offset its moderate liquidity profile.

Strong access to funding from commercial banks and bond markets

The Company’s strong credit profile has been recognized by different financial institutions and investors, with its overall financing cost lower than 4% as of 31 March 2024. Bank loans and the bond market are the main sources of funding for the Company. As of 31 March 2024, bank loans accounted for 43.6% of the Company's total debt. The Company maintains a good relationship with several banks, including policy banks and commercial banks. As of 31 March 2024, the Company’s total credit facilities were RMB94.1 billion, of which the unutilized amount was about RMB38.3 billion. Meanwhile, the bond financing accounted for 46.3% of the Company's total debt. The Company and its subsidiaries have successfully launched various debt issuances in both onshore and offshore markets. Given its strong credit profile, most of the bonds issued in 2024 were priced below 3%. In addition, the Company’s reliance on non-standard financing is low, accounting for around 10% of its total debt.

Medium contingent liability risk associated with external guarantees

YSCO has medium exposure to contingent liabilities. As of 31 March 2024, the Company’s external guarantees were RMB10.3 billion, accounting for 15.6% of its net assets, most of which were provided to local state-owned enterprises. Meanwhile, around 40% of the external guarantee was provided to private-owned enterprises (“POE”). However, we believe the overall risk of contingent liabilities is manageable as the guarantee to POE is primarily driven by the government’s strategy. If a credit event occurs, the government is highly likely to provide necessary support.

ESG Considerations

YSCO assumes environmental risks through its infrastructure construction projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

YSCO bears social risks as it implements public policy initiatives by building public infrastructure in Yiwu City. Demographic changes, public awareness and social priorities shape the Company's development targets and ultimately affect the local government's propensity to support the Company.

In terms of corporate governance, YSCO's governance considerations are also material as the Company is subject to local government oversight and reporting requirements, reflecting its public-policy role and status as a government-owned entity.

Rating Methodology

The methodology used in this rating is the Rating Methodology for China's Local Infrastructure Investment and Financing Companies (July 2022).

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