

Credit Opinion

19 July 2024

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB _g +
Outlook	Stable

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Shangrao Urban Operation (Holding) Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Shangrao Urban Operation (Holding) Group Co., Ltd., with stable outlook.

Summary

The BBB_g+

 long-term credit rating of Shangrao Urban Operation (Holding) Group Co., Ltd. (“SUOG” or the “Company”) reflects Shangrao Municipal Government’s (1) very strong capacity to support, and (2) very high willingness to support, based on our assessment of the Company’s characteristics.

Our assessment of the Shangrao Municipal Government’s capacity to provide support reflects its fifth ranking in terms of economic strength in Jiangxi Province, with fast economic growth and moderate fiscal profile.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) essential role as one of the four state-owned assets operation entities in Shangrao City; (2) key position as the major infrastructure construction and land development platform in Shangrao City; and (3) solid track record of receiving government payments.

However, the rating is constrained by the Company’s (1) medium exposure to commercial activities; (2) rapid debt growth and moderate asset liquidity; and (3) medium contingent liability risk from external guarantees.

The stable outlook on SUOG’s rating reflects our expectation that the local government’s capacity to support the Company will remain stable, and the Company will maintain its important position as the major infrastructure construction and land development entity in Shangrao City.

Rating Drivers

- Essential role as one of the four state-owned assets operation entities in Shangrao City
- Key position as the major infrastructure construction and land development platform in Shangrao City
- Solid track record of receiving government payments
- Medium exposure to commercial activities
- Fast debt growth and moderate asset liquidity
- Diversified access to financing channels
- Medium contingent liability risk from external guarantees

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's capacity to provide support strengthens; and (2) changes in Company's characteristics enhance local government's willingness to provide support, such as decreased exposure to commercial activities and improving debt management.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's capacity to provide support weakens; or (2) changes in Company characteristics decrease the local government's willingness to provide support, such as reduced regional significance and deteriorated financing capability.

Key Indicators

	2021FY	2022FY	2023FY	2024Q1
Total Asset (RMB billion)	123.1	129.8	136.1	137.6
Total Equity (RMB billion)	48.8	49.7	53.0	53.6
Total Revenue (RMB billion)	5.3	5.9	5.8	1.3
Total Debt/Total Capital (%)	58.8	59.4	58.0	58.1

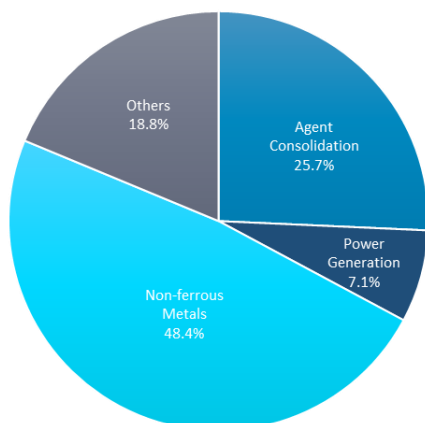
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

Corporate Profile

Established in 2020 and formerly known as Shangrao City Urban Investment Cultural Tourism Development Co., Ltd, SUOG is an important local infrastructure investment and financing Companies ("LIIFCs") in Shangrao City after equity transfer and capital injection in December 2022. The Company is mainly responsible for land development, shantytown renovation, resettlement housing construction, urban infrastructure construction and state-owned assets operation in Shangrao City as well as commercial businesses including self-operated projects construction, production and trading of aluminum, electricity generation, expressway operation, property sales, engineering construction and hotel management. As of 31 March 2024, the State-owned Assets Supervision and Administration Commission of Shangrao City ("Shangrao SASAC") was the ultimate controller of the Company holding 100% stakes of the Company through Shangrao Investment Holding Group Co., Ltd. ("SIHG").

Exhibit 1. Revenue Structure in 2023



Source: Company information, CCXAP research

Exhibit 2. Shareholding Structure as of 31 March 2024



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Shangrao Municipal Government has a strong capacity to provide support to the Company, given its fifth ranking in terms of economic strength in Jiangxi Province, with fast economic growth and moderate fiscal profile.

Shangrao City is a prefecture-level city located in the northeast of Jiangxi Province. The economic strength of Jiangxi Province lies at middle level among all provinces in China. In 2023, Jiangxi Province's Gross Regional Product ("GRP") reached RMB3.2 trillion, ranking 15th among all provinces in China, with a year-on-year ("YoY") increase of 4.1%. Its general budgetary revenue increased from RMB294.8 billion in 2022 to RMB306.0 billion in 2023, as a result of a significant increase in tax revenue to RMB 202.2 billion with a relatively high YoY growth rate of 13.0%.

Shangrao City is located in the Yangtze River Delta Economic Area. As an important transport hub in China, Shangrao City has a convenient and advanced transportation network connecting major cities in China. Thanks to promotions of pillar industries, the economic strength of Shangrao City continued to grow in the past year. In 2023, Shangrao City recorded GRP of RMB340.2 billion, ranking the fifth among 11 prefecture-level cities in

Jiangxi Province, with a good economic growth rate of 6.7%. With the ongoing development of the regional economy, Shangrao City's fiscal income has also increased. In 2023, its general budgetary revenue increased by 7.9% YoY to RMB27.1 billion, with tax income accounting for 67.8%, indicating a moderate fiscal stability. However, the fiscal balance of Shangrao City is still weak, with a general budgetary revenue/general budgetary expenditure ratio of 33.2% in 2023. During the same period, Shangrao City had an outstanding direct government debt balance of RMB132.8 billion, accounting for 39.0% of the Shangrao City's GRP. The local government debt scale is expanding at a relatively fast pace, and the overall regional debt pressure is relatively high taking into account of the debt burden of local state-owned enterprises.

Exhibit 3. Key Economic and Fiscal Indicators of Shangrao City

	2021FY	2022FY	2023FY
GRP (RMB billion)	304.4	331.0	340.2
GRP Growth (%)	9.0	5.1	6.7
General Budgetary Revenue (RMB billion)	23.6	25.1	27.1
General Budgetary Expenditure (RMB billion)	75.2	79.4	81.5
Local Government Debt (RMB billion)	86.9	111.8	132.8

Source: Statistic Bureau of Shangrao City, CCXAP research

Government's Willingness to Provide Support

Essential role as one of the four state-owned assets operation entities in Shangrao City

There are four main state-owned assets operation entities in Shangrao City. SIHG is the largest state-owned capital investment platform in Shangrao City, directly holding the equity interests of other three main state-owned platforms, SUOG, Shangrao State-owned Assets Development Group Co., Ltd. ("SADG") and Shangrao Agricultural Culture Tourism Development Group Co., Ltd. ("SACT"), each with clear positioning in the development of the region. SADG focus on construction and operation of industrial parks and transportation while SACT conducts construction and operation in the field of agricultural, cultural and tourism industry. As a major infrastructure construction entity and an important comprehensive urban operation service provider in Shangrao City, SUOG has played an essential and active role in implementing the local government's major strategic initiatives for urban planning and municipal construction in Shangrao City by undertaking a series of infrastructure and resettlement housing construction as well as land development projects in the region. Given its essential role in regional development, we believe that the Company will not be easily replaced by other state-owned enterprises in the foreseeable future.

Key position as the major infrastructure construction and land development platform in Shangrao City

As the main urban developer in Shangrao City, the Company is entrusted by the local government to undertake land consolidation and infrastructure construction. The agency construction business is sustainable given considerable infrastructure construction projects under construction in the pipeline, but could also exert certain capital expenditure pressure to the Company. However, taking into account the fact that the urbanization of Shangrao City has entered into the advanced stage, we expect the number of infrastructure construction projects of the Company will gradually decline.

SUOG conducts infrastructure construction projects mainly through its subsidiary under agency construction model. The Company signs construction agreements with entrusting parties, usually with a certain degree of markup. The Company undertakes infrastructure construction projects including road, pipe networks and flood control landscaping projects in the urban area of Shangrao City, which significantly benefits people's livelihood

and promotes the urbanization development in Shangrao City. As of 31 December 2023, the Company had completed 8 key infrastructure construction projects with a total invested amount of RMB6.8 billion and had received the project repayment of RMB4.9 billion. Meanwhile, the Company had 6 projects under construction with gross investment amount of RMB6.3 billion and an uninvested amount of RMB2.6 billion; it also had 11 infrastructure construction projects under planning, with a total estimated investment of RMB5.6 billion. Given the sufficient infrastructure projects in the pipeline, we believe the Company's infrastructure construction business has good sustainability.

Authorized by Shangrao Municipal Government, the Company undertakes land development projects in Shangrao City. The Company signs an agency construction agreement with the entrusted party to consolidate the land. The entrusted party makes payment to the Company based on development costs and markup. As of 31 December 2023, the Company had invested RMB28.1 billion into the land development projects under construction, with collected payment of only RMB2.0 billion, indicating slow progress of government payment. Besides, the Company has cooperated with Shangrao Natural Resources Bureau to carry out land development projects since 2019. The Shangrao Natural Resources Bureau would pay 20% of the actual incurred costs to the Company annually and return project costs to the Company upon project completion. As of 31 March 2024, the Company had invested RMB150 million with recognized revenue of RMB95 million, and received repayments of RMB186 million. Overall, uncertainty exists in this business as it is subject to the local government's policy and the land market conditions.

Besides, the Company also undertakes resettlement housing construction projects under agency construction model. As of 31 December 2023, the Company had 15 resettlement housing projects under construction, with a total estimated investment of RMB11.8 billion and an uninvested amount of RMB4.0 billion, indicating large capital expenditure pressure. However, the Company had only 2 proposed resettlement housing projects with estimated total investment of RMB1.5 billion, demonstrating moderate business sustainability for this segment. In addition, most of the Company's resettlement houses have not yet started selling, resulting in low selling rate. It has received the repayment amount of only RMB1.1 billion from this business with an invested amount of RMB7.8 billion and a recognized revenue of RMB5.0 billion. It faces fiscal balance problems because of the long payback period for these projects.

Medium exposure to commercial activities

SUOG also engages in commercial activities, such as production and trading of aluminum, electricity generation, public transportation operation, product sales, expressway operation, property sales, and hotel management businesses. We consider the Company's exposure to commercial businesses to be medium, as its market-driven businesses accounted for around 30% of its total assets. These activities have been a good supplement to the Company's revenue but could exert certain funding pressure and business risks.

SUOG started production and trading of aluminum business in 2020 via acquisition of 30% equity interests of Fujian Minfa Aluminum Co Ltd ("Minfa Aluminum", stock code: 002578.SZ), an A-share listed company, becoming the main income source of the Company. In 2023, the revenue from production and trading of business achieved RMB2.8 billion, accounting for 48.4% of its total revenue. Minfa Aluminum is primarily engaged in the research, development, production, and sales of architectural aluminum, industrial aluminum, and architectural aluminum formwork. Most of the products are sold domestically, accounting for over 90% of total sales in 2023. However, affected by reduced demand in the construction industry and squeezed product prices due to fierce market competition, the gross profit margin of this business has decreased from 7.8% in 2021 to 4.7% in 2023. Meanwhile, the business has a relatively diversified customer base as the sales from the

top five customers accounted for 30.0% of the total sales in 2023. However, there is a high concentration risk regarding to upstream suppliers as the top five suppliers accounted for 80.6% of the total procurement in 2023.

SUOG participates in photovoltaic power business through its subsidiaries. The Company's photovoltaic projects are the first batch of poverty alleviation photovoltaic projects. As of 31 March 2024, the Company's photovoltaic power stations were mainly located in four districts and counties near Shangrao City, with a total installed capacity of 256.6 MW. The contribution of photovoltaic power business to the Company is low, accounting for only around 7% of total revenue in the past three years. Besides, the revenue of this business relies heavily on government subsidies and related policies. From 2021 to 2023, the Company has received government subsidies of totally RMB508 million to support the business development. However, the business' profitability has deteriorated due to the removal of subsidies for national photovoltaic power generation projects and the impact of fair grid access policies since 2021. Moreover, due to the rising costs caused by the accounting adjustment of asset depreciation since 2023, the gross profit margin of this business has declined from 20.5% in 2021 to 15.6% in 2023.

SUOG also engages in public transportation operation business in Shangrao City. As of 31 December 2023, the Company had 103 bus routes and 832 buses. In order to gain revenue, the Company also provides chartered bus services and additional services such as car repair, QR code, and charging. However, due to high maintenance costs and labor costs, the business is running under deficit. Due to the public welfare nature of the business, the local government has provided subsidies to support its daily operation. The Company has received government subsidies of totally RMB155 million during 2021 to 2023. The Company also participated in expressway operation business through its subsidiary. Shangwu Expressway is a toll road covering a distance of 53.0 kilometers, and the collected toll is used for debt repayment by the government. It has generated operating income of RMB155 million during the past three years, providing supplementary income for the Company.

Meanwhile, the Company also engaged in self-operated projects including infrastructure construction and urban renewal projects, which help promote local industry and improve people's livelihood. After these projects are completed, the Company generates profits from property leasing and operations for fund balance. As of 31 December 2023, the Company had 2 self-operated projects under construction, with a total planned investment of RMB1.8 billion and an outstanding amount of RMB838 million. However, since the large initial investment amount on these projects, coupled with relatively long construction and payback periods, there are uncertainties with regard to future return of these projects.

The Company also participates in product sales, expressway operation, property sales, and hotel management businesses, providing limited contribution to the Company's total revenue as a result of relatively small operating scale of these businesses.

Solid track record of receiving government payments

As one of the four municipal major state-owned enterprises under the Shangrao Municipal Government, SUOG has received recurring financial support, including financial subsidies and capital injections. In 2021, the Company received capital injection of RMB7.5 billion from the local government, substantially enhancing its capital strength. The Shangrao Municipal Government also supports the Company in the form of equity transfers and asset injections, such as rainwater and sewage pipe networks, properties, and successively transferred 70% of the equity interests of Shangrao Agricultural Reclamation Industry Investment and Development Co., Ltd. to the Company without compensation, with a total value of RMB13.3 billion at the end of 2022, enlarging its business scope and profitability. In addition, SUOG also received government subsidies totaling RMB1.6 billion

from 2021 to 2023, supporting its future investments and debt repayments. Given SUOG's important strategic role in the region, we expect the Company will continue to receive support from the government in the future.

Rapid debt growth with relatively large short-term debt maturities

Due to ongoing capital expenditure for infrastructure construction projects, SUOG's total debt has increasingly grown. The Company's total debt had increased to RMB73.8 billion as of 31 March 2024 from RMB66.8 billion as the end of 2021. Meanwhile, its capitalization ratio, calculated as the ratio of total debt to total capital, fell from 58.8% at the end of 2021 to 58.1% at the end of 2024Q1 as a result of asset injections by its parent company and the local government. In addition, as of 31 March 2024, its short-term debt accounted for about 35.1% of its total debt, and cash to short-term debt ratio was 0.1x, indicating certain short-term debt servicing pressure. Considering the Company's large capital expenditure needs for its extensive construction projects in the pipeline, which will cause fund occupation due to slow project repayments progress, we expect the Company may continue to rely on external financing for its financing needs of construction projects and maintain a relatively fast debt growth for the next 12-18 months.

Moderate asset liquidity

In addition, SUOG's asset liquidity is considered moderate as reflected by its assets are primarily composed of inventories and receivables, both with relatively low liquidity. As of 31 March 2024, the inventories and the receivables amounted to RMB78.8 billion, accounting for 57.3% of total assets. Inventories are mainly development costs for infrastructure construction projects, while receivables are mainly unreceived payments from the agencies of government or other state-owned companies, all of which are considered low liquidity. In addition, 8.6% of the Company's total assets were fixed assets mainly consisting of land-use rights, properties for leasing, Shangwu Expressway, and photovoltaic power generating projects, while investment properties and other non-current financial assets accounted for 20.2% of SUOG's total assets in the same period, which can generate supplementary income to the Company but constrained by its lower-than-expected return. Overall, the moderate asset liquidity may undermine the Company's financial flexibility.

Diversified access to financing channels

SUOG had good access to various sources of funding, including bank loans, onshore and offshore bond financing and non-standard financing. As of 31 December 2023, it had obtained total credit facilities of RMB51.7 billion from diversified policy banks and major domestic commercial banks, with available amount of RMB24.7 billion, indicating sufficient standby liquidity. As of 31 March 2024, around 42.8% of the Company's debt was provided by the debt capital market with total outstanding amount of RMB29.7 billion, including various bond types such as corporate bonds, MTNs, SCPs, and PPNs. Additionally, the Company's subsidiary also has two offshore bonds with total outstanding amount of USD97.0 million. It is necessary to keep track of the Company's refinancing situation in the debt capital market considering its large debt repayment pressure. In addition, the Company has a moderate exposure to non-standard financing, such as financial leasing, which accounted for around 14.5 % of its total debt at end-2023.

Medium contingent liability risk from external guarantees

SUOG has medium exposure to external guarantee. As of 31 March 2024, the Company's external guarantee amounted to RMB8.0 billion, representing about 17.2% of its net assets. The guarantees for Shangrao ETDZ and county-level LIIFCs amounted to RMB1.7 billion, accounting for 21.4% of the total external guarantees. All these external guarantees were provided to local state-owned enterprises, with relatively low credit risks

considering that they will receive supports from the local government when needed. We expect that the contingent liability risk of the Company is controllable, as it has taken counter-guarantee measures in all of the guarantees. However, if a credit event occurs in the region, it may lead to large-scale cross-default.

ESG Considerations

The Company is subject to environmental laws and regulations governing air pollution, noise emissions, hazardous substances, water and waste discharge and other environmental matters issued by the national governmental authorities. SUOG assumes environmental risks for its infrastructure projects. Such risks could be mitigated by conducting environmental studies and detailed planning prior to the commencement of projects and close supervision during construction.

SUOG is also exposed to social risks as it implements public-policy initiatives by building public infrastructure in Shangrao Municipal. Demographic changes, public awareness and social priorities shape government's development strategy, and it will affect the government's propensity to support the Company.

The Company's governance considerations are also material as it is subject to oversight and reporting requirements to the local government, reflecting its public-policy role and status as a government-owned entity. SUOG believes that it is in compliance in all material respects with the applicable governmental regulations, rules and executive orders in each jurisdiction in which it operates. The Company maintains regular communication with local governments and regulatory authorities through its management team or representatives, ensuring compliance with the requirements and conditions for obtaining and maintaining the licenses, concessions, permits, or certificates.

Rating Methodology

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

Exhibit 4. Peer Comparison

	Shangrao Urban Operation (Holding) Group Co., Ltd.	Shangrao City Construction Investment Development Group Company Limited
Long-Term Credit Rating	BBB _g +	BBB _g +
Shareholder	Shangrao Investment Holding Group Co., Ltd.	Shangrao Urban Operation (Holding) Group Co., Ltd. (98%); Jiangxi Provincial Administrative Assets Group Co., Ltd. (2%)
Positioning	One of the four state-owned assets operation entities in Shangrao City; Responsible for infrastructure construction, land development, resettlement housing construction in Shangrao City	Responsible for infrastructure construction, land development, resettlement housing construction in Shangrao City
Total Asset (RMB billion)	136.1	126.9
Total Equity (RMB billion)	53.0	45.8
Total Revenue (RMB billion)	5.8	5.6
Total Debt/Total Capital (%)	58.0	60.3

All ratios and figures are calculated using CCXAP's adjustments based on 2023FY financials.

Source: Company data, CCXAP research

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