Credit Opinion

30 August 2024

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

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Yichang City Development and Urban Operation Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Yichang City Development and Urban Operation Co., Ltd., with stable outlook.

Summary

The BBB_g+ long-term credit rating of Yichang City Development and Urban Operation Co., Ltd. ("YCUO" or the "Company") is underpinned by the Company's (1) strategic position as the urban operation service provider of Yichang City; (2) strong regional competitiveness in public utility business; and (3) diversified business portfolio in commercial activities.

However, the rating is also constrained by the Company's (1) relatively weak profitability; (2) fast growing debt burden; and (3) relatively weak liquidity position with limited financial flexibility.

The rating also reflects our expectation of a very high likelihood of strong support from the Yichang Municipal Government and its parent, Yichang Urban Development Investment Group Co., Ltd. ("YUDI"), when necessary, given the Company's (1) status as the important subsidiary of YUDI involved in market-driven businesses; and (2) regional importance in urban operation in Yichang City. We believe that YUDI has a very strong capacity to support the Company by dint of its (1) status as a key subsidiary of Yichang City Development Holding Group Co., Ltd. ("YCHG"), which is ultimately owned and controlled by the Yichang Municipal Government; (2) strong strategic role carrying out public policy mandates in Yichang City; and (3) good track record of shareholder and government supports.

The stable outlook on YCUO's rating reflects our expectation that the Company will maintain its strong regional competitiveness, serving as the urban operation entity in Yichang City over the next 12-18 months.

Rating Drivers

- Very high likelihood of strong support from the Yichang Municipal Government and its parent company
- Strategic position as the urban operation service provider of Yichang City, with a diversified business portfolio
- Strong regional competitiveness in public utility business
- Stable cash flow generated from bridge tolls
- Rapidly expanding trading business but limited contribution to profit
- Relatively weak profitability
- Fast-growing debt burden with reasonable debt leverage
- Relatively weak liquidity position with limited financial flexibility

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the parent company's capacity or willingness to provide support strengthens; and (2) the Company's stand-alone credit profile improves significantly, such as stronger market position and improvement in profitability.

What could downgrade the rating?

The rating could be downgraded if (1) the credit quality of YUDI deteriorates or parental support is expected to be weakened; or (2) the Company's standalone credit quality worsens significantly, including a material drop in credit metrics and poor debt management.

Key Indicators

	2022FY	2023FY
Total Assets (RMB billion)	7.5	12.5
Total Equity (RMB billion)	3.4	6.1
Total Revenue (RMB billion)	4.8	8.1
Net Profits (RMB billion)	0.2	0.1
EBIT Margin (%)	3.3	2.2
Return on Assets (%)	2.1	1.8
Total Debt/Total Capital (%)	41.3	42.2
Total Debt/EBITDA (x)	6.6	14.1
EBITDA/Interest (x)	7.0	3.5
FFO/Total debt (%)	17.0	4.2

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

Source: Company data, CCXAP research

Corporate Profile

Founded in 2022, YCUO is positioned as an urban operation service provider by carrying out diversified businesses such as trading, bridge operation, water supply, sewage treatment, garbage disposal, gas supply, smart parking, property management services and labor services businesses in Yichang City, to support urban development. As of 31 December 2023, the Company was wholly owned by YUDI, which was 100% owned by

YCHG. YCHG is the most important city development and state-owned assets operation entity in Yichang City and is directly owned and ultimately controlled by the State-owned Assets Supervision and Administration Commission of the People's Government of Yichang City ("Yichang SASAC"). YCUO recorded a total revenue of RMB4.8 billion in 2022 and RMB8.1 billion in 2023, respectively.

Exhibit 1. Revenue structure in 2023

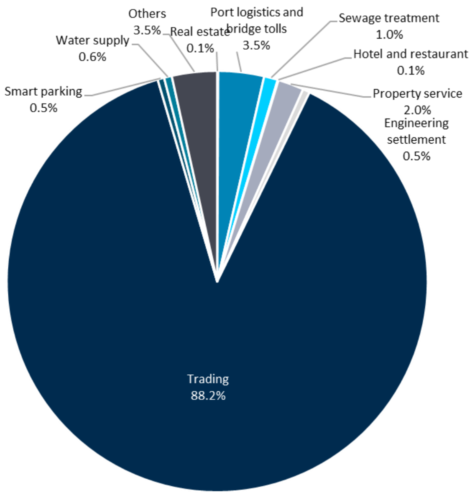
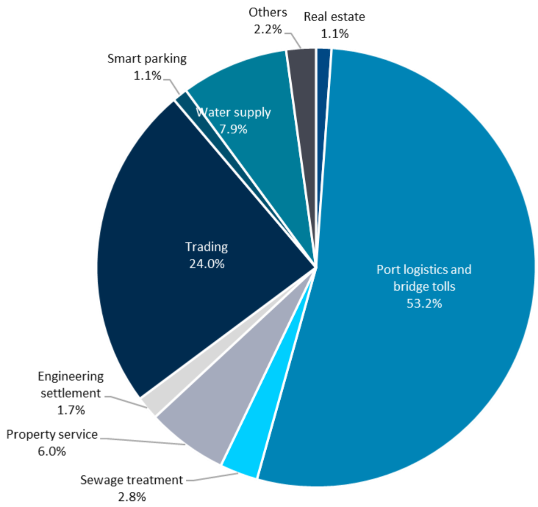


Exhibit 2. Gross profit structure in 2023



Source: Company information, CCXAP research

Exhibit 3. Shareholding chart as of 31 December 2023

宜昌市人民政府国有资产监督管理委员会
State-owned Assets Supervision and Administration Commission of Yichang Municipal People's Government

100%

宜昌城发控股集团有限公司
Yichang City Development Holding Group Co., Ltd.

100%

宜昌城市发展投资集团有限公司
Yichang Urban Development Investment Group Co., Ltd.

100%

宜昌城发城市运营有限公司
Yichang City Development and Urban Operation Co., Ltd.

Source: Company information, CCXAP research

Rating Considerations

Business Profile

Strategic position as the urban operation service provider of Yichang City, with a diversified business portfolio

YCUO serves as a core urban operation service provider in Yichang City, with a resource advantage. The Company has franchise rights to conduct bridge operations, urban water supply, gas supply, and sewage and garbage treatment businesses in Yichang City, which are beneficial to the local social and economic development. The Company also engages in multiple commercial businesses, such as trading, smart parking, and property management services. We believe the Company possesses significant strategic importance for the urban development of Yichang City with an aim to integrate urban resources and increase their values.

In addition to public utility services and bridge tolls businesses, the Company has also diversified into other commercial businesses, mainly including trading, hotel management, smart parking, and property management services, forming a well-diversified business portfolio. We believe that the Company can diversify its business risks and mitigate revenue volatility through the synergistic operation of its multiple business segments, which is credit-positive.

Strong regional competitiveness in public utility business

YCUO has strong regional competitiveness in providing public utility services in Yichang City. The public utility services include water supply, sewage and garbage treatment, as well as gas supply, providing the Company with stable revenue and cash flow. We believe that the Company has strong competitiveness in the region underpinned by its high replacement cost as these public services are vital to residents.

As of 31 December 2023, the Company had 4 water supply plants with a daily water supply capacity of 282.0 thousand tons, covering Xiaoting District, Dianjun District, Baiyang Park of High-tech Zone, Gujiadian Town of Zhijiang City, Xiakou Scenic Area and Yichang Base of Gezhouba Group and providing water services to 96.4 thousand households. Furthermore, the Company plans to renovate current water plants and build new water plants to increase water supply capacity.

In addition, the Company runs a sewage and garbage treatment business through 5 sewage treatment plants with a daily sewage treatment capacity of 169.0 thousand cubic meters, covering Yichang City's Xiaoting District, the eastern area of Wujiagang District, the High-tech Zone, Dianjun District, Pinghu Scenic Area and Pinghu Peninsula, and 5 garbage treatment plants, with a daily garbage treatment capacity of 1,240 tons. In 2022 and 2023, the water supply and sewage treatment businesses generated revenues of RMB132.4 million and 133.8 million, respectively.

Moreover, the Company carries out a gas supply business with a total annual gas supply of about 10 million cubic meters, mainly in the Gezhouba-Ziyang area.

Stable cash flow generated from bridge tolls

For the bridge tolls business, the income comes from the operation charging rights of the Yichang Yangtze River Highway Bridge (“the Bridge”). The operation period of the Bridge is as long as 30 years, starting from September 2001 to September 2031. There is strong transportation demand as the traffic volume remained stable at 8.7 million vehicles in 2022 and 8.1 million vehicles in 2023, bringing stable revenue and cash flow to the Company every year. From 2022 to 2023, the bridge tolls business realized revenue of RMB251 million and RMB263 million, respectively. Moreover, the Company plans to renovate and expand the Bridge to extend the toll period and ensure the sustainability of the business.

Rapidly expanding trading business but limited contribution to profit

YCUO’s largest revenue source is the trading business, which is primarily involved in sales of coal, steel and coke, to chemical and energy companies along the Yangtze River through its subsidiaries. With certain regional advantages of transportation hubs in ports and logistics parks, the Company also introduces leading enterprises to promote strategic cooperation, and jointly builds a full industry chain service platform. The trading business was expanding rapidly along with broadening trading products and integration of supply chain resources, with revenue generated from trading business of RMB4.0 billion in 2022 and RMB7.1 billion in 2023. The Company's suppliers and customers are relatively diversified. In 2023, the procurement from the top five suppliers accounted for 31.0% of the total procurement and the sales from the top five customers accounted for 28.2% of the total sales. However, the trading business has a low profit margin and limited contribution to the Company's profit, and it is susceptible to the volatility of commodities prices and global economic conditions.

Moreover, the Company is also responsible for operating other businesses such as hotel management, smart parking, and property management services, accounting for less than 5% of the Company's total revenue in 2023. Overall, these businesses contribute less to the Company's overall revenue but are relatively stable.

Financial Profile

Relatively weak profitability

Benefited from the expansion of trading business and equity assets injected from its parent company, YCUO's total revenue increased from RMB4.8 billion in 2022 to RMB8.1 billion in 2023, representing a 68.8% YoY growth. The trading business is the main contributor, accounting for 88.2% of total revenue in 2023, followed by bridge tolls (3.5%), property service (2.0%), and sewage treatment (1.1%). Benefiting from the rapid expansion of revenue scale, the Company's period expense ratio (mainly including management fee and finance cost) decreased to 2.0% in 2023 from 3.0% in 2022. YCUO's profitability remains relatively weak, as reflected by the weak return on assets and EBIT margin. The Company's EBIT margin slightly decreased from 3.3% in 2022 to 2.2% in 2023; while the return on assets decreased from 2.1% to 1.7% over the same period.

In 2023, the profit margin of water supply and smart parking businesses declined to 24.7% and 7.7% (2022:66.9% and 11.5%) respectively, while the bridge tolls business maintained a relatively high profit margin of 57.8%. On the bright side, the engineering settlement turned losses into profits with profit margins increasing to 11.3% from -5.1% and the gross profit margin of the property service business also improved as it rose to 10.6% from 3.3%.

Overall, YCUO's diversified business portfolio could partially support its income over the next 12 to 18 months. However, the Company's profitability is expected to remain relatively weak.

Fast-growing debt with reasonable debt leverage

Due to the expansion of its business scope and relatively large capital expenditure on its construction development projects, YCUO's total debt has been growing rapidly since its establishment in 2022. As of 31 December 2023, the Company's total debt increased to RMB4.5 billion from RMB2.4 billion at end-2022. Due to the increase in capital reserves and minority shareholders interests benefiting from equity assets injected from its parent company, the scale of the Company's total equity further increased, keeping its debt leverage at a reasonable level in recent years, which was 42.2% at end-2023. Considering the further development of its diversified business and the relatively large capital expenditure on its construction projects, such as new water plants, urban park renovation and smart parking lots, we expect that the Company will rely on external financings to meet its capital expenditures and the total debt level will continue to increase.

Relatively weak liquidity position with limited financial flexibility

The Company is exposed to certain short-term debt repayment pressure as its short-term debt accounted for 40.9% (end-2022: 31.4%) of its total debt as of 31 December 2023. Meanwhile, after excluding restricted cash, the cash to short-term debt ratio was 0.4x, indicating that its cash reserve could not fully cover the short-term debt. YCUO's debt servicing capability decreased as its total debt/EBITDA ratio increased from 6.6x in 2022 to 14.1x in 2023 while the EBITDA/total interest ratio declined from 17.0x to 4.0x over the same period.

In addition, YCUO's financing channels are mainly bank loans and non-standard financing. As of 31 December 2023, the Company has obtained total bank credit facilities of RMB7.9 billion, with an unutilized amount of RMB5.5 billion. However, its parent company with stronger funding capacity can provide funding support to YCUO when necessary, alleviating the Company's refinancing pressure. We expect that the Company will continue to broaden its financing channels, such as increasing its credit facilities and issuing onshore or offshore bonds.

External Support

Very high likelihood of strong support from the Yichang Municipal Government and its parent company

We anticipate the Company has a very high likelihood of support from the Yichang Municipal Government and its parent company when necessary, given its (1) status as the core subsidiary of YUDI in the market-driven businesses; and (2) strategic importance in urban operation in Yichang City. We believe that YUDI has a strong capacity to support the Company by dint of its (1) status as a key subsidiary of YCHG, which is ultimately owned by the Yichang Municipal Government; (2) strong strategic role for YCHG carrying out public mandates; and (3) good track record of shareholder and government supports.

We believe the Yichang Municipal Government has very strong capacity to support when necessary, reflected by its leading economic competitiveness in Hubei Province, with steady economic growth. In 2023, its GRP increased to RMB575.6 billion, representing a YoY growth of 7.1%, ranking 3rd among 17 prefecture-level cities in Hubei province. In the first quarter of 2024, Yichang City's GRP amounted to RMB120.2 billion, up 4.9% YoY.

YCUO has an important position in YUDI's operations as the primary operating subsidiary in trading and urban operation businesses. It contributes most of the revenue stream for YUDI, accounting for 53.3% of YUDI's total revenue and 12.3% of YUDI's total profit in 2023. Since 2022, YUDI has transferred shares of several state-owned companies to YCUO, significantly enhancing the Company's capital strength and broadening its business scope. We expect the Company will continuously receive comprehensive support from its parent company.

YUDI's capacity to provide support is largely underpinned by YCHG. Ultimately owned and controlled by the Yichang SASAC, YCHG is the most important city development and state-owned assets operation entity in Yichang City. In addition, the Yichang Municipal Government maintains a high degree of control over YUDI's operations through YCHG, including the formulation of business strategies and the appointment of the board of directors and key management personnel. YCHG is also required to report its annual budget, objectives, plans and performance to Yichang SASAC. Furthermore, YCHG has a proven track record of receiving support from the local government in terms of financial subsidies and asset injections.

Rating Methodology

The methodology used in this rating is the Rating Methodology for General Corporate (April 2019).

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