

Credit Opinion

13 October 2023

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

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Yueyang City Operation Investment Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Yueyang City Operation Investment Group Co., Ltd., with stable outlook

Summary

The BBB_g+ long-term credit rating of Yueyang City Operation Investment Group Co., Ltd. (“YCOG” or the “Company”) reflects Yueyang Municipal Government’s (1) very strong capacity to provide support; and (2) very high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of Yueyang Municipal Government’s capacity to provide support reflects Yueyang City’s economic importance in Hunan Province, with its economic and fiscal strengths continuing to grow.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) strong position in transportation infrastructure construction of Yueyang City and its increased importance following the injection of local state-owned enterprises; (2) good track record of receiving government support; and (3) good access to funding from banks and the bond market.

However, the rating is constrained by the Company’s (1) large future capital expenditure for self-operated projects; (2) fast debt growth and modest asset liquidity; and (3) moderate exposure to external guarantees.

The stable outlook on YCOG’s rating reflects our expectation that the local government’s capacity to provide support will remain [], and the Company will continue to play an important role in transportation infrastructure of Yueyang City.

Rating Drivers

- Strong position in transportation infrastructure construction of Yueyang City
- Large future capital expenditure for self-operated projects
- Good track record of receiving government support
- Fast debt growth and modest asset liquidity
- Good access to funding from banks and the bond market
- Moderate exposure to external guarantees

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's ability to provide support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as decrease in exposure to commercial activities and decrease in exposure to external guarantees.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's ability to provide support weakens; or (2) the Company's characteristics change in a way that decreases the local government's willingness to provide support, such as reduced regional significance or material increase in exposure to external guarantees.

Key Indicators

	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	34.3	41.9	49.8	50.7
Total Equity (RMB billion)	18.3	19.1	20.4	20.3
Total Revenue (RMB billion)	1.6	3.3	3.5	0.9
Total Debt/Total Capital (%)	41.7	49.5	54.2	56.6

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

Source: CCXAP research

Corporate Profile

Founded in April 2012, YCOG is an important infrastructure construction and state-owned asset operation and management entity in Yueyang City. The Company mainly engages in local transportation infrastructure construction, land development, shantytown renovation and affordable housing construction projects. It is also involved in other commercial activities such as engineering construction, trading, and fuel oil sales. As of 31 March 2023, the Company was wholly owned and ultimately controlled by the State-owned Assets Supervision and Administration Commission of the Yueyang Municipal People's Government.

Exhibit 1. Revenue Structure in 2022

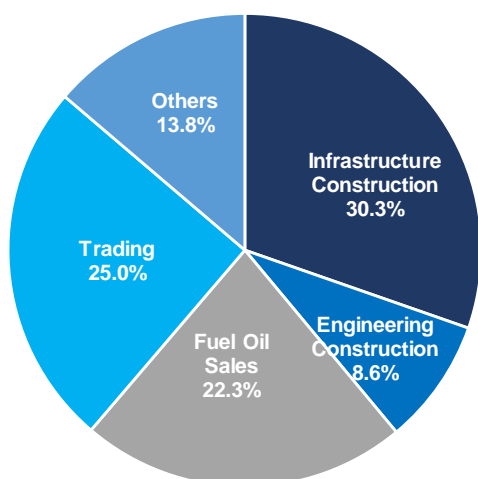
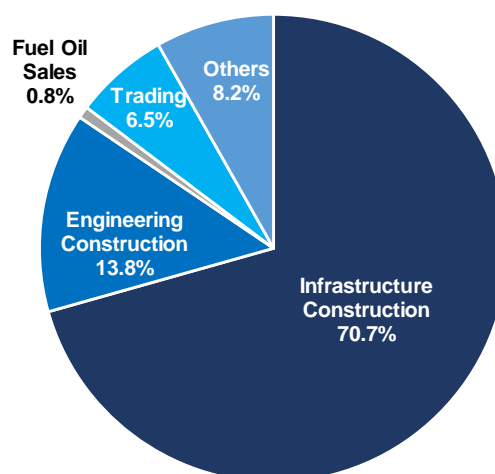


Exhibit 2. Gross profit structure in 2022



Source: Company information, CCXAP research

Rating Considerations

Government’s Capacity to Provide Support

We believe that the Yueyang Municipal Government has very strong capacity to provide support, given its economic importance in Hunan Province with its economic and fiscal strengths continuing to grow.

Located in the central part of China, Hunan Province is one of the important cradles of Chinese civilization and an important grain production base. In 2022, the gross regional product (“GRP”) of Hunan Province was RMB4.9 trillion, ranking 9th among all provinces in China. Affected by the COVID-19 pandemic and tax refund factors, general public budget revenue decreased to RMB310.2 billion in 2022 from RMB325.1 billion in 2021, with tax revenue accounting for 64.6% of general public budget revenue.

Located in the northeastern part of Hunan Province, Yueyang City is a node city in the national Yangtze River Economic Belt and an urban agglomeration in the middle reaches of the Yangtze River. It has superior location advantages and convenient transportation. It is also an international shipping center and the largest international container port and direct shipping port in Hunan Province. Yueyang City is an important petrochemical, papermaking, and electric power energy base. Benefiting from its good location advantages and optimized industrial structure, Yueyang City’s GRP increased from RMB400.2 billion in 2020 to RMB471.1 billion in 2022, ranking second only to Changsha City among prefecture-level cities in Hunan Province. In the first half of 2023, its GRP continued to increase by 4.4% year-on-year to RMB223.1 billion. As the economy continues to grow, the general budgetary revenue of Yueyang City has also increased from RMB15.3 billion in 2020 to RMB18.5 billion in 2022. However, Yueyang City has weak fiscal self-sufficiency, as reflected by its average fiscal balance ratio of around 30% over the past three years. Therefore, it relies heavily on higher-tier government transfer payments and local land sales. At the end of 2022, Yueyang City’s local government debt balance was RMB92.3 billion, accounting for 19.6% of GRP.

Exhibit 3. Key Economic and fiscal indicators of Yueyang City

	2020FY	2021FY	2022FY
GRP (RMB billion)	400.2	440.3	471.1
GRP Growth (%)	4.2	8.1	5.4
General Budgetary Revenue (RMB billion)	15.3	17.1	18.5
General Budgetary Expenditure (RMB billion)	53.9	54.8	55.7
Local Government Debt (RMB billion)	67.7	79.5	92.3

Source: Statistics Bureau of Yueyang City, CCXAP research

Government's Willingness to Provide Support

Strong position in transportation infrastructure construction of Yueyang City

There are two key local infrastructure investment and financing companies ("LIIFCs") in Yueyang City, namely, YCOG and Yueyang Construction and Investment Group Co., Ltd. ("YCIG"), both of which have a clear positioning in regional development. YCIG is the most important LIIFC with the largest assets in Yueyang City. It is mainly responsible for infrastructure construction, social housing development and bus operations projects in Yueyang City. YCOG is the second largest LIIFC in Yueyang City by asset size. It is mainly responsible for transportation infrastructure construction, land development, shantytown renovation, and affordable housing construction in the region. In addition, it participates in city operations in Junshan District of Yueyang City, such as water supply and public transportation. The Company has a strong market position in undertaking transportation infrastructure projects in Yueyang City and has made great contributions to local economic and social development. Given its strategic importance to the urban construction of Yueyang City, we believe the Company is unlikely to be replaced by other local state-owned enterprises in the foreseeable future.

The transportation infrastructure construction projects of the Company are mainly undertaken by its subsidiary, Yueyang Communications Construction Investment Group Co. Ltd ("YCCI"). YCCI undertakes infrastructure construction projects through an agency construction model. Upon completion of construction, the entrusting parties will settle with the Company based on the project investment amount plus a certain markup, and the payment will be made within 3 to 5 years. As of 31 March 2023, the Company's major infrastructure construction projects under construction required a total estimated investment of about RMB4.3 billion, with uninvested amount of around RMB2.6 billion. These projects mainly include the construction of roads, drainage, and transportation facilities.

The Company is also engaged in affordable housing construction, land development, and city operations in Junshan District through YCCI's subsidiary, Yueyang Junshan District City Construction Investment Co., Ltd. ("YJCI"). YJCI has a regional advantage in undertaking affordable housing construction and land development projects in Junshan District. Entrusted by the Junshan District Government, YJCI is the sole land developer in Junshan District. From 2020 to 2022, it had consolidated a total of approximately 400,000 square meters of land. It is also the only water supply and public transportation service provider in Junshan District. However, we consider the sustainability of affordable housing construction to be moderate, with projects under construction to be completed within three years and no ongoing projects. As of 31 March 2023, YJCI's major affordable housing projects under construction required a total estimated investment of about RMB1.9 billion, with uninvested amount of about RMB1.1 billion. Moreover, the land development business is susceptible to local land market conditions and land policies.

Large future capital expenditure for self-operated projects

In addition to public activities, YCOG is also engaged in commercial businesses, mainly including engineering construction, trading, and fuel oil sales. We consider the Company's current exposure to commercial businesses to be low, accounting for about 15% of its total assets. However, self-operated construction projects will put great pressure on the Company's future capital expenditures.

The Company has been engaged in trading business through its subsidiaries. Trade products mainly include steels and chemical raw materials. This business provides supplementary income to the Company. In 2022, the revenue from trading business accounted for 25% of total revenue, but with low gross profit margin of about 2%. In addition, this business is subject to concentration risks as the Company has high dependence on its top 5 customers and suppliers.

YCOG also participates in engineering construction projects in Yueyang City, including highway engineering, wharf improvement projects, and logistics projects. As of 31 March 2023, the Company had completed 32 engineering construction projects with a total contract value of RMB361.1 million and had 5 projects under construction with a total contract value of RMB92.4 million, indicating that the business scale was small.

The Company participates in the fuel oil sales business via YJCI, which mainly involves the sales of refined oil, solvent oil, fuel oil, liquefied petroleum gas, and natural gas. This business provides supplementary income to the Company. In 2022, the revenue from trading business accounted for 22.3% of total revenue, but with low gross profit margin of less than 1%.

At present, YCOG focuses on the construction of self-operated projects, mainly including hospitals, logistics parks, and parking lots. As of 31 March 2023, the Company's self-operated construction projects under construction or planning required a total estimated investment of about RMB14.5 billion, with uninvested amount of approximately RMB11.8 billion. Although these projects will generate operating income after completion, they also put great pressure on the Company's capital expenditures and operating capabilities.

Good track record of receiving government support

YCOG regularly receives support from the local government in the form of operating subsidies, special funds, capital injections, and asset transfers. In 2020, the local government transferred 60% of the equity interests of two district-level LIIFCs, including YJCI in Junshan District and Yueyang Building Economic Construction Investment Co., Ltd in Yueyanglou District, to the Company's subsidiary YCCI, broadening its business scope and increasing its assets and revenue scale. The Company has received ongoing capital injections, significantly enhancing its capital strength. From 2020 to 2022, the local government injected RMB2.6 billion into the Company and its subsidiaries. The local government also provided special funds to the Company to support the construction of infrastructure projects. As of 30 June 2023, the Company had received special funds of about RMB4.3 billion. Besides, the local government has regularly made project payments to the Company. As of 31 March 2023, the Company had received RMB3.6 billion from completed agency projects, and is expected to receive around RMB1.5 billion in the next three years. From 2020 to 2022, the Company received a total of about RMB1.1 billion in government subsidies to support its general operations. Given the Company's important role in undertaking infrastructure construction projects and providing public services in Yueyang City, we believe the local government will continue to provide strong support to the Company.

Fast debt growth and modest asset liquidity

YCOG's debt has grown rapidly over the past three years. The Company's total debt increased from RMB13.1 billion at end-2020 to RMB26.6 billion at end-2023Q1, with a total capitalization ratio of 56.6%. The increase

in debt was mainly attributable to the ongoing financing of construction projects. In addition, the Company has certain short-term debt repayment pressure. As of 31 March 2023, its short-term debt accounted for about 28.4% of total debt, and its cash to short-term debt ratio was 0.5x. Given its high capital expenditure pressure, we expect the Company's debt burden to continue to increase in the next 12 to 18 months.

YCOG has modest asset liquidity, which may undermine its financing flexibility. The Company's total assets mainly consist of inventories, other non-current assets, and construction in progress, all with low liquidity, accounting for 65.8% of total asset at end-2023Q1. Inventories mainly represent the investment costs of infrastructure construction projects, other non-current assets mainly include land reserves, and construction in progress mainly consist of investment costs of self-operated projects. Furthermore, as of 31 March 2023, the Company had pledged assets of RMB4.9 billion for loans, accounting for 9.8% of total assets.

Good access to funding from banks and the bond market

YCOG has good access to funding, as reflected by its sufficient standby liquidity and track record of bond issuance. The Company has approved lines of credit from many commercial and policy banks, including Industrial and Commercial Bank of China and Agricultural Development Bank. As of 31 March 2023, it had obtained total credit facilities of RMB23.1 billion, with available credit facilities of RMB7.0 billion. The Company also has access to the bond market. From 2020 to mid-2023, the Company and its subsidiaries raised RMB7.1 billion via issuance of 13 domestic bonds, including corporate bonds, MTNs, and PPNs. In addition, the Company was less dependent on non-standard financing. As of 31 March 2023, its non-standard debt amounted to about RMB1.3 billion, accounting for 4.7% of the total debt.

Moderate exposure to external guarantees

YCOG has moderate exposure to external guarantees, which limits its credit rating. As of 31 March 2023, the Company had outstanding external guarantees of about RMB3.3 billion, accounting for 16.2% of its net assets. However, we consider the Company's contingent liability risks to be manageable, as all of the external guarantees are provided to local state-owned enterprises with stable business operations.

ESG Considerations

YCOG faces environmental risks because it has undertaken transportation infrastructure construction and land development projects. Such risks could be moderated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

YCOG bears social risks as it implements public policy initiatives by undertaking transportation infrastructure construction and land development in Yueyang 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.

YCOG's governance considerations are also material as the Company is subject to oversight by the Yueyang Municipal Government and has to meet several 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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