Credit Opinion

19 December 2024

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

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Hubei Lvye Industrial Investment Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g to Hubei Lvye Industrial Investment Group Co., Ltd., with stable outlook.

Summary

The BBB_g long-term credit rating of Hubei Lvye Industrial Investment Group Co., Ltd. ("LIIG") is underpinned by the Company's (1) status as important industrial investment and operation entity in Daye City; (2) good regional competitiveness in product sales business; and (3) increasing revenue along with diversifying business profile.

However, the rating is constrained by the Company's (1) relatively weak profitability; (2) fast debt growth due to large capital expenditure; (3) modest debt servicing capability and liquidity profile; and (4) moderate access to funding.

The rating also reflects a very high likelihood of receiving support from the Daye City Government when needed, which is based on the Company's (1) full ownership and ultimate control by the Daye City Government; (2) significance in promoting the industrial development in Daye City; and (3) solid track record of receiving support from the local government including subsidies, capital injections and asset transfers.

The stable outlook on LIIG's rating reflects our expectation that the Company will continue to receive solid support from the Daye City Government. We also expect the Company to maintain its strategic role as the important industrial development platform in Daye City over the next 12 to 18 months.

Rating Drivers

- Important industrial investment and operation entity in Daye City
- Good regional competitiveness in product sales business
- Supplementary income from human resource services
- Increasing revenue along with diversifying business profile, but with relatively weak profitability
- Fast debt growth due to large capital expenditure
- Modest debt servicing capability and liquidity profile
- Moderate access to funding
- Very high likelihood of receiving government support

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the likelihood of support from the Daye City Government increases; (2) the quality of the Company's investment portfolio materially improves, such as having a higher level of asset liquidity and generating better recurring cash flow from investees; or (3) 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 likelihood of support from the Daye City Government decreases; (2) the performance of the Company's investment portfolio deteriorates; or (3) the Company shows weakened access to funding and eroded liquidity profile.

Key Indicators

	2021FY	2022FY	2023FY	2024H1
Total Assets (RMB million)	370.3	926.0	3,508.1	5,319.5
Total Equity (RMB million)	78.8	333.6	2,970.5	4,400.9
Total Revenue (RMB million)	54.3	67.6	153.1	86.9
Net Profits (RMB million)	31.4	31.3	52.8	-2.9
EBIT Margin (%)	59.3	59.5	44.4	6.2
Return on Assets (%)	8.7	6.2	3.1	-
Total Debt/Total Capital (%)	75.7	47.6	8.2	12.9
Total Debt/EBITDA (x)	7.0	6.9	3.6	-
EBITDA/Interest (x)	32.0	5.2	5.1	-
FFO/Total debt (%)	1.6	1.2	8.9	-

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

Source: Company data, CCXAP research

Corporate Profile

Established in 2022, LIIG is fully funded by Hubei Guanggudong State-owned Capital Investment and Operation Group Co., Ltd. ("GSIG"), which is a state-owned operating asset investment and operation institution authorized by the Daye City Government. As an important industrial investment and operation entity in Daye City, the Company engages in businesses such as new energy construction and operation, commodity sales, and human resources services. As of 30 June 2024, LIIG was 60% owned and ultimate controlled by State-owned Assets Supervision and Administration Bureau of Daye Municipal People's Government ("Daye SASAB"), while GSIG held the remaining 40% shares.

Exhibit 1. Revenue structure in 2023

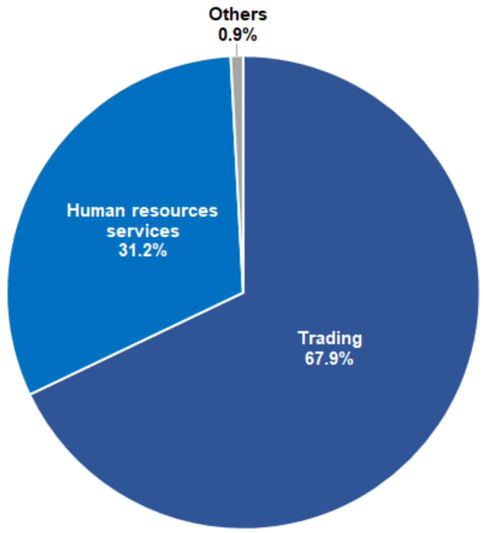
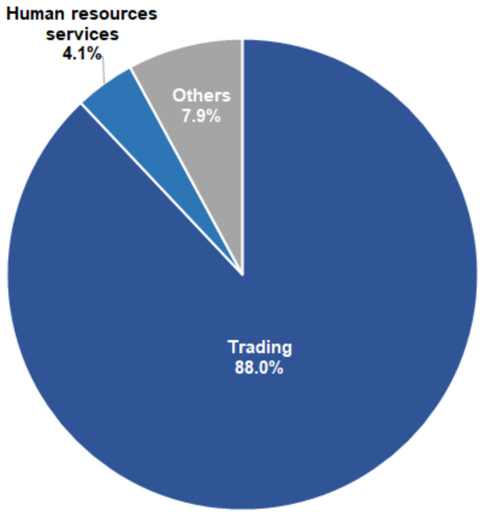
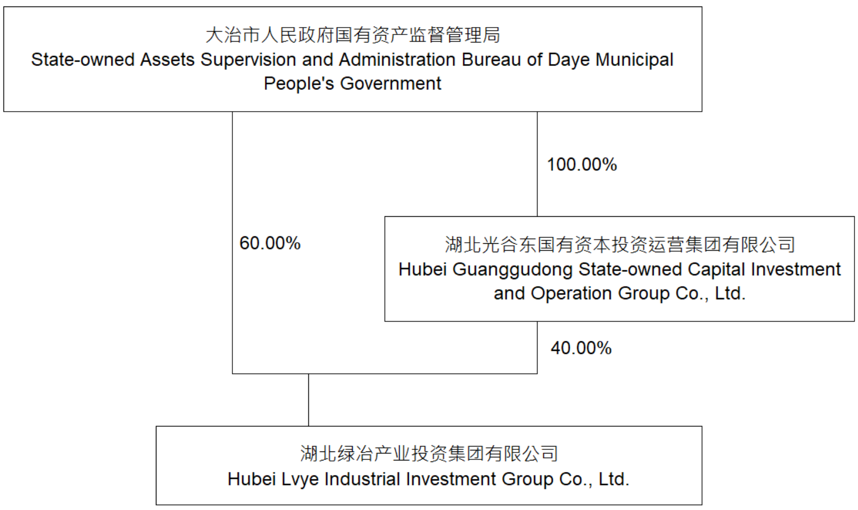


Exhibit 2. Gross profit structure in 2023



Source: Company information, CCXAP research

Exhibit 3. Shareholding chart as of 30 June 2024



Source: Company information, CCXAP research

Rating Considerations

Business Profile

Important industrial investment and operation entity in Daye City

As an important industrial investment platform in Daye City, the Company mainly focuses on new energy construction and operation, such as green electricity and green hydrogen projects, which is aligned with local policy of transformation and upgrade of traditional industrial enterprises. However, the large-scale investments in new energy construction and operation projects have exerted high capital expenditure pressure to the Company, with uncertainty regarding future profitability.

At present, the Company has started the construction of three hydrogen production plants and three integrated energy stations for hydrogenation. The Company will achieve returns through operating the integrated energy stations, but with uncertainty regarding future profitability. As of 30 September 2024, the Company had invested RMB208 million into the projects, with uninvested amount of RMB3.2 billion, indicating high capital expenditure pressure. In addition, the Company plans to construct a hydrogen energy innovation and technology park, including an intelligent manufacturing base, park facilities and talent apartments, with a total investment of RMB1 billion and a total construction area of 140,000 square meters. We expect the Company to primarily rely on external financing including government financial subsidies, bank loans, and issuing corporate bonds to fulfill its capital expenditure needs.

Good regional competitiveness in product sales business

The product sales business involves the trading of diversified commodities, including grain and oil, wine, building materials, asphalt, and stone materials, with good regional competitiveness. Due to a significant increase in asphalt sales, the Company's product sales business experienced substantial growth in 2023, achieving an income of RMB104.0 million, accounting for 67.9% of the Company's total income.

The Company is the only entity responsible for purchase, and storage of grain in Daye City. Under the guidance of local government, the Company uniformly procures and stores grain. For grain sales, the Company sells rice, wheat, and finished product of grain at market prices to the customers, mainly including school canteens, government agencies, enterprise canteens, and large grain and oil trading enterprises. In 2023, the grain business achieved sales revenue of RMB24.1 million. Due to its public welfare nature, the local government has provided subsidies for the Company to support the grain business.

The Company's main trading commodity is asphalt concrete, which are primarily used for road surface paving and maintenance. Through cooperation with core suppliers, the Company secures stable supplies of asphalt oil and stone materials. Based on orders from downstream construction parties, the Company mixes the materials into asphalt concrete for sales. However, the business shows relatively high concentration risk as its top 5 suppliers and customers accounted for around 66.3% and 80.0% of its total procurement and sales in 2024H1, respectively. In 2023, sales revenue from asphalt products increased from RMB13.0 million in 2022 to RMB42.9 million.

The Company also operates wine and building materials trading, mainly with sales to related construction clients of GSIG. The Company has established stable suppliers to provide efficient supply and comprehensive services for GSIG's construction clients, promoting the sustainable development of the business. Additionally, the Company's stone material trading is mainly conducted through contract purchases or public platform trading models, while sales are primarily auctioned through open bidding. However, these businesses have high reliance on top 5 suppliers and customers, indicating certain business risks to the Company.

Supplementary income from human resource services

In addition to industrial investment and product sales businesses, the Company has also involved in human resource services. The Company primarily provides services such as labor dispatch, outsourcing, and personnel agency, and achieves operating income through commissions, labor management fees, and dispatched personnel wages. The Company has cooperation with the Daye Public Security Bureau in the provision of police auxiliary personnel labor dispatch services, resulting a large increase of revenue in 2023, with the human resources services achieved revenues of RMB47.8 million.

Financial Profile

Increasing revenue along with diversifying business profile, but with relatively weak profitability

Benefited from business expansion, LIIG's total revenue increased from RMB54.3 million in 2021 to RMB153.1 million in 2023, representing a CAGR of 68.0%. The product sales business is the main contributor, accounting for 67.9% of total revenue in 2023, followed by human resources services of 31.2%. The gross profit margin increased from 4.1% in 2021 to 10.7% in 2023, mainly due to the increase in asphalt sales, which has relatively higher profit margin.

LIIG's profitability is relatively weak as reflected by its low return on assets. In 2023, the Company's return on assets was as low as 3.1%, mainly due to the current low returns from its construction projects and the operations of building stone and mineral resources. Additionally, the liquidity and profitability of the assets injected by the government are relatively weak. However, its EBIT margin is high, averaging at 54.4% over past three years, thanks to the constant investment return from Hubei Sanxin Gold Copper Limited Company, in which the Company holds 10.2% stake. We expect the Company's profitability will gradually improve upon the completion of its construction projects.

Fast debt growth due to large capital expenditure

Due to large capital expenditure on its industrial investment projects, LIIG's total debt has been growing rapidly over past few years. As of 30 June 2024, the Company's total debt increased to RMB649.3 million from RMB245.3 million at end-2021. Due to the capital and asset injections from GSIG and the local government, the Company's total equity significantly increased, reducing its debt leverage to a reasonable level, which was 12.9% at mid-2024. We expect the Company's debt burden will continue to increase, given its large capital expenditure needs for its industrial investment projects.

Modest debt servicing capability and liquidity profile

As the Company's debt burden and financing costs increased, its debt servicing capability is modest. In 2023, its EBITDA interest coverage ratio descended from 32.0x in 2021 to 5.1x, and its debt to EBITDA ratio decreased from 7.0x in 2021 to 3.6x. The Company is also exposed to high short-term debt repayment pressure as its short-term debt accounted for 78.1% of its total debt as of 30 June 2024. Meanwhile, its cash to short-term debt ratio was 0.7x, indicating that its cash reserve could not fully cover the short-term debt.

Moderate access to funding

The Company shows moderate access to funding, as it highly relies on bank loans and non-standard financing. As of 30 June 2024, the non-standard debts accounted for about 20% of the total debt, which would bring higher refinancing pressure to the Company. Meanwhile, the Company has limited standby liquidity. As of 30 June 2024, the Company had total credit facilities of RMB254.0 million from diversified domestic policy banks and commercial banks, with available amount of RMB43.1 million. Given the Company's limited available credit facilities and large outstanding investment on its industrial investment projects, we consider additional funding channel is needed to fulfil its large capital expenditure, such as onshore and offshore debt capital market.

External Support

High likelihood of support from Daye City Government

We expect LIIG has a very high likelihood of receiving support from the Daye City Government in times of need. This expectation incorporates our considerations of the Company's (1) full ownership and ultimate control by the Daye City Government; (2) significance in promoting the industrial development in Daye City; and (3) solid track record of receiving support from the local government including subsidies, capital injections, and asset transfers.

Daye City is rich in mineral resources and has strong industrial capabilities. It is fostering six industries including new energy and intelligent connected vehicles, new materials, high-end intelligent equipment manufacturing, life and health, electronic information, and the aviation industry. In 2023, Daye City achieved a gross regional product of RMB86.3 billion, an annual increase of 6.2%. Supported by ongoing economic growth, the general budgetary revenue of Daye City also increased from RMB4.1 billion in 2022 to RMB4.8 billion in 2023.

Daye SASAB maintains an extremely high degree of control over LIIG's operations, including the formulation of business strategies and the appointment of the board of directors and key management personnel. The Company is also required to report its annual budget, objectives, plans and performance to Daye SASAB. Its strategy and investment align with Daye City Government's policies by investing in green power projects to promote industrial upgrading in the region. In addition, the Company is an important industrial investment arm of GSIG, an important state-owned assets operation and infrastructure construction entity in Daye City.

Given its strategic and economic importance in cultivating local industries in Daye City, LIIG receives solid supports from GSIG and Daye City Government via assets and capital injections, subsidies and granting of franchise rights. Since 2023, GSIG and Daye SASAB have injected cash, lands, forestry assets, green power projects, and the operating rights of building stone and mineral resources to the Company and its subsidiaries, increasing the Company's capital reserves by about RMB4.0 billion. Besides, Daye City Government also injected equities of state-owned enterprises in Daye City to the Company to broaden its business scope and enhance its competitiveness. From 2021 to mid-2024, the Company had received subsidies of totally RMB10.1 million, including grain subsidies and interest subsidies.

We considered the Company's socio-political implications to be high as the Company is commissioned by the local government to play an important role in strategic investing and operation of important industrial projects. Given its strategic position in the development of Daye City, we believe that the local government will continue to provide support to the Company.

Rating Methodology

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

A credit rating is the analytical result of current credit worthiness and forward-looking opinion on the credit risk of a rated entity or a debt issue. Credit ratings issued by CCXAP are opinions on the current and relative future credit risk of the rated entities or debt issues, but do not address any other risks, including but not limited to liquidity risk, market price risk, and interest rate risk.

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