

Credit Opinion

19 June 2023

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

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Zibo City Asset Operation Group Co., Ltd.

Initial credit rating report

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

Summary

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

Our assessment of Zibo Municipal Government’s capacity to provide support reflects Zibo City’s status as a regional central city in Shandong Province, with sound economic fundamentals and relatively strong fiscal strength.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) high strategic importance as the urban developer and operator in Zibo City, with sufficient project reserves; (2) solid track record of receiving government payments; and (3) diversified funding sources.

However, the Company’s rating is constrained by (1) medium exposure to commercial activities, with large capital expenditure needs; and (2) rapid debt growth and moderate asset liquidity.

The stable outlook on ZCAO’s rating reflects our expectation that Zibo Municipal Government’s capacity to provide support will remain stable, and that the Company will maintain its important strategic position in the development of Zibo City over the next 12 to 18 months.

Rating Drivers

- High strategic importance as the urban developer and operator in Zibo City
- Sufficient project reserves in public activities
- Solid track record of receiving government payments
- Medium exposure to commercial activities with large capital expenditure needs
- Rapid debt growth and moderate asset liquidity
- Diversified funding sources

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Zibo Municipal 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 improved debt management and reduced exposure to non-standard financing.

What could downgrade the rating?

The rating could be downgraded if (1) Zibo Municipal 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, increased exposure to commercial activities or a deteriorated financing ability.

Key Indicators

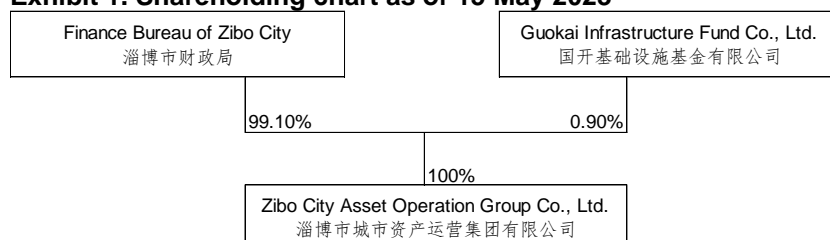
	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	101.5	151.7	200.1	207.7
Total Equity (RMB billion)	51.7	61.2	80.2	80.4
Total Revenue (RMB billion)	6.4	15.9	32.9	6.4
Total Debt/Total Capital (%)	41.7	48.4	51.0	52.4

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

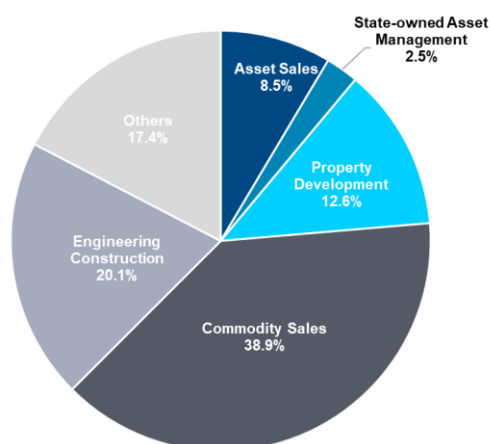
Source: CCXAP research

Corporate Profile

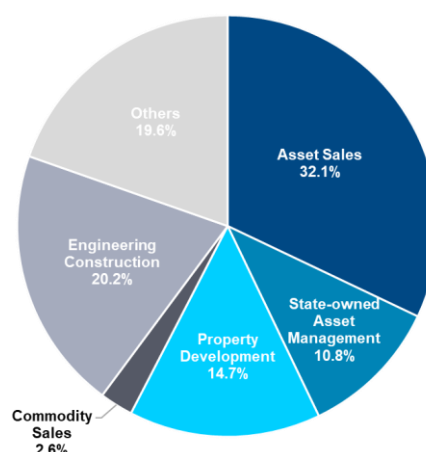
Founded in 2003, ZCAO is the largest municipal-level local infrastructure investment and financing company ("LIIFC") in Zibo City and plays the most important role in the urban development and operation of Zibo City. The Company is primarily responsible for local key public-policy activities, such as land consolidation, engineering construction, and infrastructure construction. In addition, ZCAO is also engaged in diversified profit-driven commercial activities such as property development, state-owned asset operations, and commodity sales. As of 31 March 2023, the Company was under the control of the Finance Bureau of Zibo City ("Zibo Finance Bureau"), which directly held 99.09% of the Company's share. Moreover, China Development Bank indirectly held 0.91% of the Company's shares through Guokai Infrastructure Fund Co., Ltd.

Exhibit 1. Shareholding chart as of 15 May 2023

Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2022

Source: Company information, CCXAP research

Exhibit 3. Gross profit structure in 2022**Rating Considerations****Government's Capacity to Provide Support**

We believe the Zibo Municipal Government has a very strong capacity to provide support to the Company, given its status as a regional central city in Shandong Province, with sound economic fundamentals and strong fiscal strength.

In 2022, Shandong is the third largest province in China by gross regional products ("GRP"), with a solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive and agri-food. Located in the central part of Shandong Province, Zibo City is one of the core cities of the Shandong Peninsula urban agglomeration and a regional central city of Shandong Province approved by the State Council. Thanks to its abundant tourism, industrial, and mining resources, Zibo City recorded GRPs of RMB367.4 billion, RMB420.1 billion, and RMB440.3 billion in 2020, 2021, and 2022, respectively, ranking 7th by GRP among 16 prefecture-level cities in Shandong Province over the past three years. The growth rate of GRP increased to 4.7% in 2022 from 2.5% in 2020. Zibo City has strong fiscal strength. In 2022, its general budgetary revenue covered around 73% of its general budgetary expenditure, and tax incomes accounted for 65% of its general budgetary revenue. However, the government's debt burden has been increasing over the past three years. As of 31 December 2022, Zibo City's outstanding government debt balance amounted to RMB108 billion, accounting for 24.5% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Zibo City

	2020FY	2021FY	2022FY
GRP (RMB billion)	367.4	420.1	440.3
GRP Growth (%)	2.5	9.4	4.7

General Budgetary Revenue (RMB billion)	32.2	36.9	37.4
General Budgetary Expenditure (RMB billion)	52.3	52.3	51.4
Local Government Debt (RMB billion)	77.5	94.6	108.0

Source: Statistics Bureau of Zibo City, CCXAP research

Government's Willingness to Provide Support

High strategic importance as the urban developer and operator in Zibo City, with sufficient project reserves

ZCAO is the largest LIIFCs in Zibo City in terms of total assets and plays an essential role in local land consolidation and infrastructure construction. The Company is the most important entity delegated by Zibo Municipal Government to carry out such businesses, and implements the development plans for specific areas as formulated by the local government.

ZCAO is mainly responsible for land consolidation in Zibo New District. Zibo New District is located in the center of Zibo City and positioned as the leading functional area to promote the development of culture, sports, education, and finance. Generally, the Company signs land consolidation agreements with the Land Reserve Trading Center of Zibo City and carries out land demolition, compensation, development, and consolidation within the planned area. The local government will then pay the Company in installments based on the actual cost plus a markup return upon completion. As of 31 March 2023, the Company had 7 land projects under consolidation, with a total investment of RMB1.5 billion and an uninvested amount of RMB1.0 billion.

Furthermore, ZCAO is the sole municipal-level entity in Zibo City that undertakes infrastructure construction, adopting an agency construction model. As of 31 March 2023, the Company had 17 large-scale projects under construction, with a total investment of RMB39.2 billion and an outstanding amount of RMB6.6 billion. ZCAO is also authorized by the Finance Bureau of Wenchang Lake Management Committee to carry out infrastructure construction in Wenchang Lake. The Company had 2 projects under construction as of 31 March 2023, including shantytown renovation, road construction and upgrading, with an uninvested amount of RMB2.1 billion. In addition, the Company also takes part in self-constructed projects with large capital expenditures, such as hospitals and industrial parks constructions, with an uninvested amount of more than RMB11.1 billion. This model is less dependent on government payments but exposes the Company to greater funding and business risks. The construction costs of such projects will be balanced by future operating income.

The Company has undertaken resettlement housing constructions and public rental housing projects over the years. The Company received allocation funds from the government for the construction of resettlement housing projects. As of 31 March 2023, the Company had 3 resettlement housing projects under construction, with a total investment of RMB9.9 billion and an outstanding amount of RMB3.3 billion. Most of the resettlement housing had been sold. The Company has also received good financial support from the government for public rental housing, such as providing initial funds for the construction and operating subsidies to compensate for the operation and maintenance expenses of leasable assets. Moreover, as of 31 March 2023, these public rental housing had high occupancy rates of over 95%.

In addition, ZCAO's engineering construction business is operated by several subsidiaries focusing on urban infrastructure projects. As a state-owned entity, the Company has certain advantages in obtaining local municipal projects such as roads, hospitals, and schools. The engineering construction projects are concentrated in Zibo City, and are generally settled by stages according to the progress of the project. As of 31 December 2022, the Company had 8 key projects under construction, of which the total planned investment amount and uninvested amount were RMB 2.8 billion and 1.5 billion, respectively.

Overall, ZCAO's land consolidation and infrastructure construction projects are essential to both the local residents and the development blueprint of the local government. Sufficient project reserves also ensure the sustainability of Company's development, and we believe that ZCAO will not be easily replaced by other state-owned enterprises in the foreseeable future.

Medium exposure to commercial activities with large capital expenditure needs

Apart from public activities, ZCAO is also involved in a diversified range of commercial activities that contribute the majority of its revenue, including property development, state-owned asset operations, and commodity sales. These commercial activities may also entail higher operational and business risks than its public policy activities. At the same time, large expenditures will be incurred, which will exert financing pressure on the Company. This is mainly due to the large-scale of construction projects such as commercial buildings and commodity houses. Based on our estimates, as of 31 March 2023, the Company had medium exposure to the market-driven businesses and the commercial risks are controllable, although it accounted for more than 30% of its total assets.

ZCAO's property development business involves the development of commercial housing and office buildings. As of 31 March 2023, the Company had several commercial housing and office buildings under development, with a total investment of RMB6.5 billion and an uninvested amount of RMB1.6 billion, which were mostly sold or leased out. The Company mainly relies on external financing for the construction of commercial housing and office buildings, and the local government seldom provides direct support for these activities. This may expose the Company to certain business risks. Meanwhile, the Company had large land reserves of 1.2 million square meters, most of which would be developed into commercial housing and office buildings. Considering its current and future investment in property development for commercial housing construction, the Company may face a certain capital expenditure burden. Moreover, under the recent downturn of the real estate market, the Company may face more operating uncertainties.

Additionally, ZCAO owns a large number of investment properties that generates recurring income and sound gross profit. This is achieved mainly through leasing offices to municipal government agencies, schools, hospitals, as well as enterprises. The Company's leasable assets are acquired from government allocation, self-construction and direct purchases with diversified uses. As of 31 March 2023, ZCAO has more than 130 leasable assets, with a total area of nearly 1.9 million square meters and a face value of RMB26.5 billion. Most of these properties were leased to municipal institutions by signing long-term contracts with Zibo Finance Bureau, who regularly adjusts the rent. The remaining properties were leased at market rates, which were highly dependent on market performance. However, the ongoing construction of leasable assets require further investment by the Company. Among them, the Zibo Entrepreneurship and Innovation Valley Phase I is a key project under construction, with a total investment amount of RMB5.1 billion and an uninvested amount of RMB1.5 billion.

Furthermore, ZCAO's commodity sale business contributes considerable income to the Company, but the profit is relatively small. Its products mainly include frozen meat, building materials and chemical products. The customer and supplier concentration risks for frozen meat and chemical products were high, as the sales from the top 5 customers and top 5 suppliers accounted for large proportions of its total sales and total procurement over the past years. This is especially true for the frozen meat sales business, which has only one private-owned customer, namely Qingdao Bingobaas Technology Co., Ltd. In addition, since most of the frozen meat is purchased from overseas suppliers, the Company is prone to certain currency risks.

Considering the large expenditure needs of its commercial activities including the salable and leasable commercial properties under construction, we expect the Company's debt level to continue to grow over the next 12-18 months.

Solid track record of receiving government payments

As the urban operator of Zibo City, ZCAO serves an important public policy function and is strategically important to local social and economic development. The Company has received ongoing support from the Zibo Municipal Government in terms of capital injections, project repayments, and operating subsidies. The Company is expected to receive ongoing government payments for its public policy activities. For example, from 2020 to 2023Q1, the total investments and repayments of the Company's completed land consolidation projects were RMB1.7 billion and RMB5.6 billion, respectively.

In addition, from 2020 to 2022, the local government had injected nearly RMB3.1 billion in cash into the Company, substantially enhancing the capital strength of the Company. As of 31 March 2023, the Company's registered capital and paid-in capital had increased to RMB6.1 billion and RMB5.5 billion, respectively. Meanwhile, the accumulated increase in capital reserve in terms of cash and asset transferred from the local government were RMB21.3 billion and RMB1.8 billion, respectively. Among them, the local government transferred 100% of the equity of Zibo Cultural Tourism Development Group Co., Ltd. to the Company in 2021. Apart from that, the Company had received a total of around RMB585 million in operating subsidies in the past three years, including subsidies for public-policy construction projects.

We expect ZCAO to receive ongoing government support as needed to sustain the further construction of government-mandated public projects and investments.

Rapid debt growth and moderate asset liquidity

ZCAO had reported fast debt growth owing to its large number of construction projects over the past few years. As of 31 March 2023, the Company's total debt increased to RMB87.0 billion from RMB37.0 billion at end-2020; while its capitalization ratio increased from 41.7% to 52.4%. At the same time, the Company showed a relatively large proportion of short-term debt and moderate liquidity. Its short-term debt accounted for 34.7% of the total debt, and its cash to short-term debt ratio decreased to 0.4x from 1.1x at end-2020.

In addition, ZCAO has moderate asset liquidity. As of 31 March 2023, the Company's pledged a number of assets for loans, including inventories, investment properties and fixed assets, with a total restricted amount of RMB21.7 billion, accounting for 26.9% of net assets. On top of that, as of 31 March 2023, the Company's total asset mainly consisted of inventories and non-current assets, accounting for around 80% of total asset. The inventory were mainly construction projects and lands to be developed, while the non-current assets are mainly investment properties and construction in progress. These inventories are considered illiquid and could undermine the Company's financial position.

Diversified source of funding

ZCAO's large investment needs could be partially supported by its good refinancing ability. It maintains good relationships with large state-owned banks and commercial banks. As of 31 March 2023, the Company had obtained total bank credit facilities of RMB83.1 billion, with an unutilized amount of RMB46.2 billion, indicating sufficient liquidity buffer. The Company is also an active issuer in the onshore debt capital market. In 2022, the Company issued 14 tranches of onshore bonds, raising RMB11.4 billion, with coupon rates ranging from 2.39% to 4.80%. ZCAO and its subsidiary have issued RMB5.8 billion of onshore bonds from January to June 2023. However, as of 31 March 2023, the Company had showed relatively high exposure to non-standard financing, with around 25% of debt financing coming from trusts and financial leases.

Taking into account ZCAO's important status and key role in local development of Zibo City, we expect the

Company to maintain good access to domestic bank loans and bond markets.

ESG Considerations

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

ZCAO bears social risks in implementing public policy initiatives through the building of public infrastructure in Zibo 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.

ZCAO's governance considerations are also material as the Company is subject to oversight by the Zibo Municipal Government and must 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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