

Credit Opinion

29 June 2023

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

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Heze Investment Development Group Co., Ltd.

Initial credit rating report

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

Summary

The BBB_g+

Our assessment of Heze Municipal Government's capacity to provide support reflects Heze City's increasing economic strength and moderate fiscal metrics.

The rating also reflects the local government's willingness to provide support, based on the Company's (1) strong market position as the largest investment and financing entity in Heze City; (2) good track record of receiving government support; and (3) good access to multiple financing channels.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities; and (2) rapid debt growth driven by the continuous investment in construction projects.

The stable outlook on HZID's rating reflects our expectation that the local government's capacity to provide support will remain stable, and the Company will maintain its important strategic role in undertaking local public activities of Heze City over the next 12-18 months.

Rating Drivers

- Strong market position as the largest investment and financing entity in Heze City
- High sustainability of public services with increasing operation scale
- Good track record of receiving government support
- Medium exposure to commercial activities
- Rapid debt growth driven by the continuous investment in construction projects
- Good access to multiple funding channels

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the Heze Municipal Government's capacity to support strengthens; and (2) the Company's characteristics change in a way that enhances the local government's willingness to support, such as lower exposure to risky commercial activities, and improved debt management and asset liquidity.

What could downgrade the rating?

The rating could be downgraded if (1) the Heze Municipal Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to support, such as reduced strategic significance, deteriorated financing ability, or decreased government payments.

Key Indicators

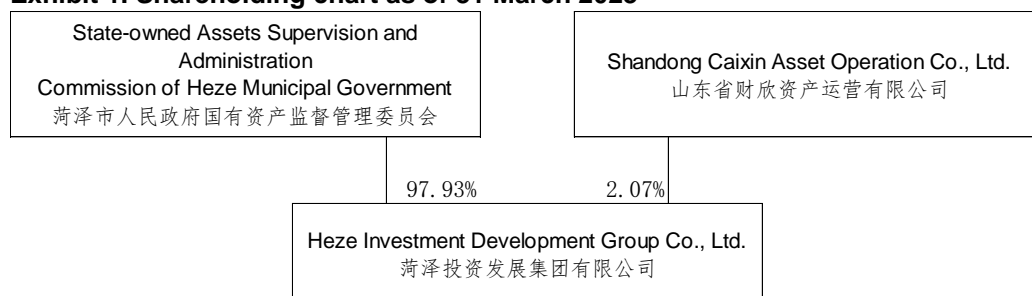
	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	30.2	57.6	68.6	69.7
Total Equity (RMB billion)	9.8	35.6	37.2	37.3
Total Revenue (RMB billion)	4.1	5.5	8.2	1.7
Total Debt/Total Capital (%)	46.1	24.1	29.4	31.9

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

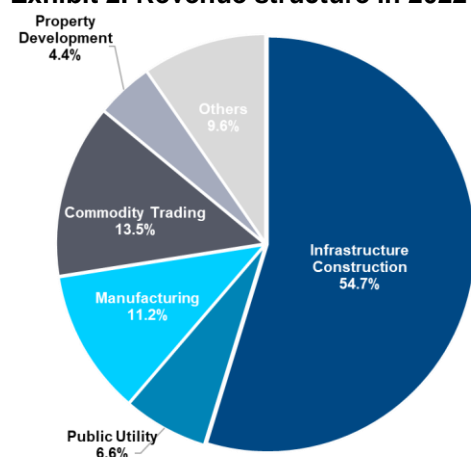
Source: Company information, CCXAP research

Corporate Profile

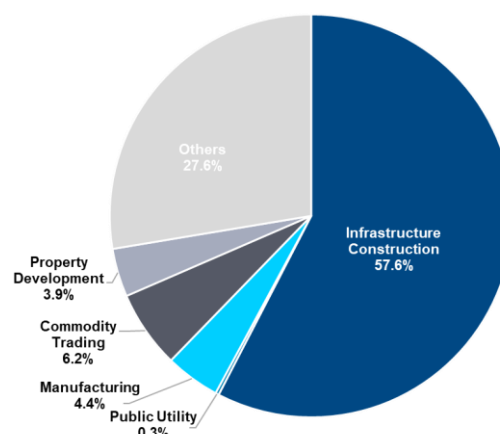
Founded in July 1990, HZID is the largest local infrastructure investment and financing company ("LIIFC") in Heze City, in terms of asset size. The Company is primarily responsible for public activities, including infrastructure construction, water supply, heat supply, and steam supply. It also participates in different commercial activities such as property development, self-operated project construction, commodity sales, and manufacturing. As of 31 March 2023, the State-owned Assets Supervision and Administration Commission of Heze Municipal Government had 97.93% ownership of HZID and Heze Municipal Government was the ultimate controller of HZID. Shandong Caixin Asset Operation Co., Ltd., which was wholly owned by Shandong Provincial Department of Finance, had the remaining 2.07% ownership.

Exhibit 1. Shareholding chart as of 31 March 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 local government of Heze City has a strong capacity to provide support given its sound economic fundamentals, with increasing economic strength and moderate fiscal metrics.

Shandong is the third largest province in China by gross regional products ("GRP"), with a solid foundation in different industries such as logistics, shipbuilding, marine technology, chemical, automotive, and agri-food. Heze City is a prefecture-level city of Shandong Province and is located in the southwest of Shandong Province with a good economic foundation. Heze City's GRP ranked 8th among 16 prefecture-level cities in Shandong Province over the past three years. Heze City's economic growth is mainly driven by the key industries including the high-end chemical industry, biomedicine, mechanical and electrical equipment manufacturing, new energy and new material, agricultural and sideline products, as well as trade logistics and e-commerce.

In 2022, Heze City reported a GRP of RMB420.5 billion, recoding an economic growth of 4.2% year-over-year ("YoY"). Its fiscal balance was modest, with a general budgetary revenue to general budgetary expenditure ratio of 44.3%, and tax accounted for 66.7% of the general budgetary revenue. However, the government fund income dropped by RMB11.2 billion to RMB36.1 billion in 2022 due to the reduction of state-owned land use rights transfer. This income is mainly affected by regulatory policies and the land market, we expect the downturn of the real estate industry may lead to a decrease in following years. As of 31 December 2022, Heze Municipal Government reported an outstanding government debt of RMB131.2 billion and accounted for 31.2% of its GRP, increased from that of RMB110.8 billion and 27.9% as of 31 December 2021.

Exhibit 4. Key economic and fiscal indicators of Heze City

	2020FY	2021FY	2022FY
GRP (RMB billion)	348.3	397.7	420.5
GRP Growth (%)	3.9	8.8	4.2
General Budgetary Revenue (RMB billion)	23.8	28.4	29.0
General Budgetary Expenditure (RMB billion)	63.0	63.3	65.4
Local Government Debt (RMB billion)	86.8	110.8	131.2

Source: Statistics of Bureau of Heze City, CCXAP research

Government's Willingness to Provide Support**Strong market position as the largest investment and financing entity in Heze City**

HZID is the largest LIIFC in Heze City in terms of asset size, with strong market position. Since its establishment, the Company has played an important role in the implementation of infrastructure construction, and has successfully completed major infrastructure projects. After the consolidation of Heze Water Affairs Group Co., Ltd. ("Heze Water") and Heze Tongsheng Investment Development Group Co., Ltd. ("Heze Tongsheng") in 2021, HZID's market position further strengthened. Given its important strategic market position, we believe the Company is unlikely to be replaced in the foreseeable future.

HZID carries out various infrastructure construction projects mainly through the engineering construction model, agent construction model, and public-private partnership ("PPP") model. Under the agent construction model, the Company signs an agreement with the entrusting party Heze Economic Development Zone Management Committee, and the entrusting party pays based on the construction cost plus an agreed rate of return, generally around 8%, after examination of the completion of construction projects. As of 31 March 2023, there were 3 resettlement housing projects under construction, with a planned investment of RMB4.9 billion and an uninvested amount of RMB755 million.

Under the engineering construction model, HZID mainly undertakes the shantytown renovation, resettlement housing, municipal engineering, municipal pipe network, and water conservancy construction projects in Heze City with relevant qualifications. Thanks to its state-owned background, the Company newly acquired 69 high-quality contracts with total contracted amount of RMB5.7 billion in 2022. As of 31 March 2023, the Company had a total contracted amount on hand of RMB12.9 billion. Among them, the top five engineering construction projects under construction had a planned investment of RMB6.5 billion and an uninvested amount of RMB2.4 billion, respectively. The sufficient project reserves ensure the sustainability of the Company's infrastructure construction business. Considering that the payment of the projects is paid according to the progress and some projects are supported by special funds, the Company's investment pressure is controllable, in our view.

Under the PPP model, HZID entered into the "Shan County Jiashan Xindu Comprehensive Development PPP Project Contract" in 2021 and held 85.0% equity of project company as social capital. According to the PPP contract, the Company was responsible for the construction and operation of the National Fitness Center, Roads, Shan County Art Exchange Center, Primary School, and Science and Technology Museum. The Company's construction parts of the project have been completed and entered the operation stage and the Company had invested RMB573.1 million as of 31 March 2023. The fund balancing of the PPP project is expected to achieve through the subsidies provided by the Shan County Government and operating income within the operation period of 10 years. However, the payment of PPP projects was slow and the receivable amount was RMB 515.7 million as of 31 March 2023.

High sustainability of public services with increasing operation scale

HZID provides essential and regional dominant public services in Heze City through its several subsidiaries, including water supply, heat supply, and steam supply. After the consolidation of Heze Water in 2021, the Company newly enters the business of water supply. It is an only entity to provide water supply in the urban area of Heze City, covering residential and non-residential customers. As of 31 December 2022, the Company owned pipeline network length of 652.30 kilometers and a water plant, with a daily water supply capacity of 130,000 tons.

HZID also engages in heat supply business by providing heat energy to residential and commercial customers in around 85% areas of Heze City with pipe network length of around 240 kilometers. Moreover, HZID provides industrial steam supply services to commercial customers, mainly in Heze Economic and Technological Development Zone and the northern urban area of Heze City with increasing district coverage. However, given the public nature of heat supply and water supply, the profitability is relatively low and highly rely on the government subsidies.

Considering the indispensability and increasing operation scale of these public services, we believe the replacement cost of the Company is very high. As of 31 March 2023, HZID had 3 key projects in public utility segments under construction, with total investments and uninvested amounts of RMB2.8 billion and RMB801 million, respectively.

Good track record of receiving government support

HZID has a good track record of receiving support from Heze Municipal government in terms of subsidies, capital injection, special funds, and equity transfer. In 2021, the local government transferred 100% equity of Water Group and Heze Tongsheng to HZID, significantly enlarging its capital strength and business scale. As of 31 March 2023, the registered capital and capital reserve of HZID were RMB8.0 billion and RMB20.5 billion, respectively. Moreover, from 2020 to 2022, the local government consistently provided a total of RMB70.9 million in subsidies for the Company, supporting its operation of public businesses. As of 31 December 2022, the Company totally received special bond and special funds of RMB2.2 billion to support its construction projects and operation. Given the strategically important role of the Company in Heze City and its close relationship with the Heze Municipal Government, we believe that the HZID will continue to receive different kinds of support from the local government.

Medium exposure to commercial activities

HZID's exposure to commercial activities is medium as the commercial assets accounted for less than 20% of total asset as of 31 March 2023. Apart from the public policy activities, the Company also participates in different commercial activities consisting of property development, self-operated project construction, commodity sales, and manufacturing.

HZID's property development business mainly involves the construction and sales of residential properties in Heze City. As of 31 March 2023, the Company had 3 projects under construction including commercial housing and office buildings, with a total investment of RMB3.2 billion and an uninvested amount of RMB797.7 million. Meanwhile, the Company had no land reserves for property development and subsequent planned development projects. Therefore, the exposure to the property development segment we consider to be lower in the short to medium term. However, during the downturns in China's property market, the construction projects would be exposed to more uncertainties during construction, sales, and operation.

At present, HZID focuses on the construction of self-operated projects, including industrial parks, vocational education centers and economic parks. The construction costs of such self-operated projects will be balanced by the operating income generated after the construction is completed. However, relatively high pressure on capital expenditure is arising from the construction projects. As of 31 March 2023, the Company had 2 key self-operate projects under construction, with a total estimated investment of RMB3.1 billion, and an uninvested amount of RMB2.4 billion.

HZDI also engages in the commodity trading business, with diversified trading products such as supply chains, building materials, medicines, and medical devices. However, the top 5 supplies and customers of commodity trading business represented 60.1% and 72.2% of the purchase and sales amount, respectively, at end-2022, demonstrating relatively high concentration risk. In addition, the Company participates in manufacturing businesses such as mold making, building material production, and pig slaughtering business, bringing supplemental income to the Company. These market-driven businesses may also pose higher operating and business risks to the Company compared with its public-policy businesses, in our view.

Rapid debt growth driven by the continuous investment entity in construction projects

HZID's total debt rapidly increased from RMB8.4 billion as of 31 December 2020 to RMB17.5 billion as of 31 March 2023 due to the continuous investment in construction projects in Heze City. Although HZID's total debt recorded rapid growth, the Company maintained a moderate capitalization ratio over the past three years, thanks to the ongoing capital and asset injection from the local government. As of 31 March 2023, the Company's total capitalization ratio was 31.2%. However, the Company bears certain short-term debt pressure, its short-term debt to total debt ratio raised from 43.8% at end-2020 to 49.1%. Due to the large uninvested amount of construction projects and maturing debt, we estimate the Company would continue to rely on external financing such as bank loans and bond issuance. As a result, its total debt would further increase over the next 12-18 months.

Furthermore, HZID's asset liquidity is moderate as its total assets mainly consist of assets with low liquidity. These include costs from construction projects (recorded as inventories, construction in progress, and other non-current assets), receivables, and lands (mainly recorded as intangible assets). The Company also pledged a certain amount of assets and the restricted assets amounted to RMB6.9 billion, accounting for 18.5% of the net asset. It is noteworthy that this low asset liquidity may undermine the Company's financing flexibility.

Good access to multiple funding channels

HZID has good access to multiple financing channels such as bank loans, domestic bond issuance, and non-standard products financing. The debt from bank loans and bond issuances accounted for the majority of total debt. As of 31 March 2023, the Company had total bank facilities of RMB21.8 billion, with the available portion being RMB7.8 billion, indicating a sufficient standby liquidity. They were mainly provided by large domestic banks such as Agricultural Development Bank of China and China Construction Bank Corporation. Meanwhile, the non-standard financing accounted for less than 10% of total debt which we consider to be a reasonable level. Benefiting from large proportion of bank loans with lower-cost, the weighted average financing cost of HZID was less than 5%. Considering, the Company's status as the largest LIIFC of Heze City, we expect HZID will continue to receive support from the local government.

ESG Considerations

HZID is exposed to environmental risks due to undertaking key infrastructure construction. 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.

The Company bears social risks as it implements public policy initiatives by playing an important role in the social welfare of Heze 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.

HZID's governance considerations are also material as the Company is subject to oversight by Heze 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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