

Credit Opinion

16 January 2024

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

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Zaozhuang Infrastructure Investment Development Group Co., Ltd.

Initial credit rating report

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

Summary

The BBB_g long-term credit rating of Zaozhuang Infrastructure Investment Development Group Co., Ltd. (“ZZII” or the “Company”) reflects Zaozhuang Municipal Government’s very strong capacity to provide support and its very high willingness to provide support based on our assessment of the Company’s characteristics.

Our assessment of Zaozhuang Municipal Government’s capacity to provide support reflects its important role as modern manufacturing base and emerging technological innovation base in Shandong Province, with increasing economic strength.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) important role in supporting local economic development; (2) important responsibilities in undertaking water supply business; and (3) solid track record of receiving government supports.

However, the rating is constrained by the Company’s (1) medium exposure to commercial activities; (2) increasing debt level; and (3) medium exposure to contingent liabilities.

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

Rating Drivers

- Important role in supporting local economic development
- Solid track record of receiving government supports
- Medium exposure to commercial activities
- Access to diversified funding
- Increasing debt level driven by large number of construction projects
- Medium exposure to contingent liabilities

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Zaozhuang Municipal Government's capacity 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 lower exposure to contingent liabilities.

What could downgrade the rating?

The rating could be downgraded if (1) Zaozhuang Municipal Government's capacity to provide support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to provide support, such as decreased government payments, or deteriorated debt management.

Key Indicators

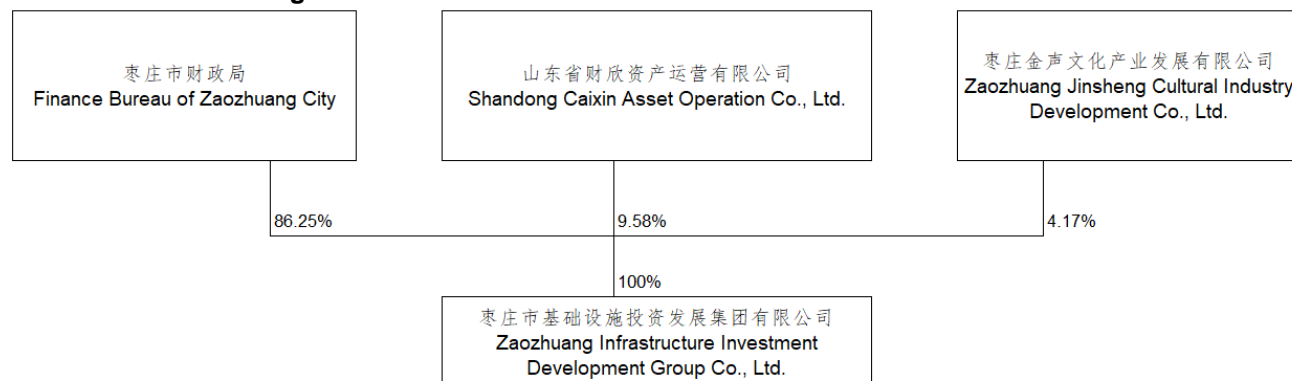
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	17.0	19.3	22.0	24.1
Total Equity (RMB billion)	11.6	11.9	12.1	12.1
Total Revenue (RMB billion)	0.8	1.3	2.0	1.0
Total Debt/Total Capital (%)	24.5	26.8	38.1	41.9

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

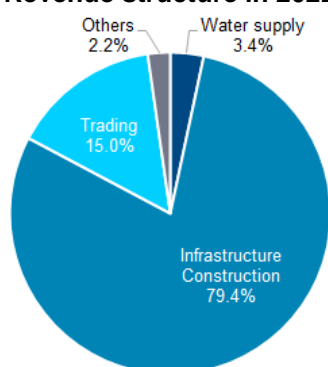
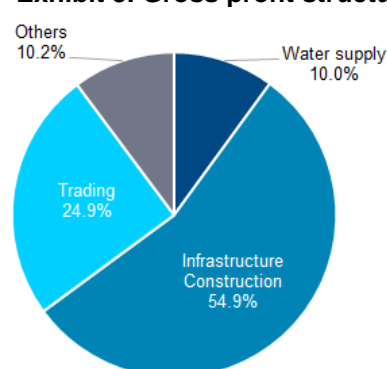
Source: Company data, CCXAP research

Corporate Profile

Founded in November 2016, ZZII is a pivotal infrastructure construction company in Zaozhuang City and plays an important role in the urban development and operation of Zaozhuang City. The Company mainly engages in infrastructure construction, land quota development and sales, and water supply business. It also engages in commercial businesses such self-operated construction, and building material trading. As of 30 June 2023, the Company was under the control of the Finance Bureau of Zaozhuang City ("Zaozhuang Finance Bureau"), which directly held 86.25% of the Company's share. Moreover, Shandong Caixin Asset Operation Co., Ltd. and Zaozhuang Jinsheng Cultural Industry Development Co., Ltd. ("Jinsheng") directly held 9.58% and 4.17% of the Company's shares, respectively.

Exhibit 1. Shareholding chart as of 30 June 2023

Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2022**Exhibit 3. Gross profit structure in 2022**

Source: Company information, CCXAP research

Rating Considerations**Government's Capacity to Provide Support**

We believe the Zaozhuang Municipal Government has very strong capacity to provide support to the Company, given its status as a modern manufacturing base and emerging technological innovation base in Shandong Province, with increasing economic strength.

Shandong Province is the third largest province in terms of gross regional product ("GRP") in China over the past three years, with a solid industrial foundation in logistics, shipbuilding and marine technology, chemical, automotive and agri-food. Located in the southern part of Shandong Province, Zaozhuang City is an important modern manufacturing base and emerging technology innovation base in Shandong Province approved by the State Council. Zaozhuang City has established 6 advanced manufacturing industries including high-end equipment, high-end chemical industry, new materials, new energy, new medicine, new generation information technology, and 3 major industries including high-quality and efficient agriculture, new trade and logistics industry, and characteristic cultural tourism and health care industries.

Benefit from its modern industrial structure, Zaozhuang City's economy grew steadily in recent years. In 2022, Zaozhuang City's GRP was recorded at RMB203.9 billion, representing a year-on-year ("YoY") increase of 4.5%. Zaozhuang Municipal Government's general budgetary revenue increased from RMB 15.9 billion in 2021 to RMB16.8 billion in 2022. However, affected by tax rebate policy, its tax revenue decreased to RMB11.2 billion in 2022 from RMB12.2 billion in 2021. Its fiscal balance ratio (general budgetary revenue/general budgetary

expenditure) is moderate, averaging at 54.8% over the past three years, reflecting Zaozhuang Municipal Government's reliance on the transfer income from higher tier government and government fund income. As of end-2022, its outstanding government debt amounted to RMB65.3 billion, equivalent to 27% of its GRP.

Exhibit 4. Key Economic and Fiscal Indicators of Zaozhuang City

	2020FY	2021FY	2022FY
GRP (RMB billion)	173.3	195.2	203.9
GRP Growth (%)	3.0	8.3	4.5
General Budgetary Revenue (RMB billion)	14.8	15.9	16.8
General Budgetary Expenditure (RMB billion)	27.1	27.4	31.0
Local Government Debt (RMB billion)	48.6	56.2	65.3

Source: Zaozhuang Municipal Government, CCXAP research

Government's Willingness to Provide Support

Important role in supporting local economic development

As the pivotal infrastructure construction company in Zaozhuang City, ZZII's business plays an important role in supporting the development of Zaozhuang City. The Company mainly undertakes various key infrastructure construction projects, land quota development and sales, and water supply business that are crucial to local economic development and benefit the general public and local employment.

The Company and its subsidiaries engage in the infrastructure construction business by signing entrusted construction agreements with entrusting parties, and transfer the project ownership to them after the projects are completed. The entrusting parties would pay the actual incurred costs plus certain markup to the Company according to the construction progress. As of 30 June 2023, the Company completed 2 major infrastructure construction projects, with a total investment amount of RMB3.0 billion. Meanwhile, ZZII had 5 major construction projects under construction and planning, including science education demonstration park, civil air defense evacuation base, school, as well as water supply project, with total investment amount of RMB8.1 billion and uninvested amount of RMB7.7 billion. The infrastructure construction projects in the pipelines will ensure the sustainability of the business, but also bring certain capital expenditure pressure to the Company.

ZZII has a monopoly position in the land quota development in Zaozhuang City. It is the sole designated entity with the right to conduct land quota development and sales in Zaozhuang City through its subsidiary Zaozhuang Anze Land Development Co., Ltd. ("Zaozhuang Anze"), covering Xuecheng District, Shizhong District, Yicheng District, Shanting District and Taierzhuang District. Zaozhuang Anze signed land consolidation agreements with the local government. The local state-owned enterprises were designated by the local government to conduct work on demolition, consolidation, and reclamation of the land, and receive consolidation fees based on the progress of the land consolidation from Zaozhuang Anze. Zaozhuang Anze obtains revenue by selling land quotas to local governments and enterprises in Shandong Province. However, as the land quota development business changes with the government land sales policy, the Company did not conduct any sales of land quotas in 2022. From 2022 to 2023H1, the Company had completed land quotas of 1,209 mu waiting to be sold. As of 30 June 2023, the Company had 8 land projects under consolidation, with a total investment of RMB32.8 million and outstanding investment of RMB28.7 million.

ZZII also provides water supply service in Xuecheng District at prices guided by the local government. Benefiting from the renovation and expansion of water plants in recent years, the water sales volume has increased from 7.0 million tons in 2020 to 9.4 million tons in 2022. As of 30 June 2023, the Company had water supply capacity

of 60 thousand cubic meters per day. The Company also had one water pipeline project under construction as of the same date, with a total investment of RMB201 million and outstanding investment of RMB151 million. We believe that the replacement cost for the Company's role is high as ZZII undertakes essential public projects for the region.

Medium exposure to commercial activities

ZZII's major commercial businesses mainly include self-operation projects and building materials trading, generating supplementary income to the Company. However, they may also pose higher operational and business risks. The Company's commercial assets account for around 25% of total assets by the end of June 2023, we estimate the Company's risk exposure to commercial business is moderate.

ZZII undertakes some self-operated construction projects. The Company achieves fund balance through operation revenue of the projects, such as rental income and aviation revenue. However, there is a certain degree of uncertainty in income from self-construction projects. As of 30 June 2023, there were 2 key projects under construction, with a total investment amount of RMB2.4 billion and uninvested amount of RMB1.9 billion. The largest self-construction project in term of total investment amount is Zaozhuang Civil Airport. It is significantly important to promote local economic development and improve the travel convenience of local people. The Company is expected to balance the investment through operating revenues, such as taking off and landing, passenger service and parking fees. However, the investment recovery cycle is long, making it more difficult to achieve fund balance in short period of time.

The main products of ZZII's trading business are building materials, such as rebar, stone, and cement. The trading business has generated considerable amount of revenue to the Company, accounting for around 15% of the Company's total revenue in 2022. ZZII produced the building materials on its own or purchases the finished building materials and sell them to customers. However, the concentration risk from upstream and downstream customers are relatively high, with the top 5 suppliers and customers accounting for around 75% and 54% of the total procurement and the total sales, respectively. Moreover, most customer are private-owned enterprises with delay payment periods granted by the Company, exposing the Company to certain recovery risk.

Good track record of receiving government supports

Finance Bureau of Zaozhuang Municipal Government has strong equity control over ZZII by directly holding 86.25% of the company's shares. ZZII has a proven track record of receiving support from the local government over the years. From 2020 to 2023H1, the local government provided government subsidies to support its operation, with a total amount of RMB34 million. We believe that given ZZII's important position and its close relationship with the local government, the Company is expected to receive ongoing government support as needed in the next 12-18 months.

Increasing debt level driven by large number of construction projects

ZZII's total debt has been growing rapidly over the past three years driven by its large number of construction projects. As of 30 June 2023, the Company's total debt increased to RMB8.7 billion from RMB3.7 billion as of end-2020, while the total capitalization ratio rose from 24.5% to 41.9%. The Company's short-term debt accounting for around 30.2% of the total debt as of the same date. However, the Company has restricted assets pledged for loans, including investment properties, cash, fixed assets, inventories and account receivables, accounting for 57.6% of net assets and 28.9% of total assets. As of 30 June 2023, the Company planned to

invest around RMB9.8 billion for its construction projects under construction and planning. Given the Company's large capital expenditure pressure for its infrastructure construction and land quota development projects under construction and planning, we expect the Company's debt level would further increase for the next 12-18 months.

Access to diversified funding

ZZII has access to different sources of funding, including bank loans, onshore bond financing and non-standard financing. As of 30 June 2023, the Company had total credit facilities of RMB8.8 billion, with an unutilized portion of RMB1.8 billion. The credit facilities were provided by domestic banks, including city commercial banks, large state-owned commercial banks, national joint-stock commercial banks, and policy banks. Nevertheless, the credit facilities were concentrated in regional banks in Shandong Province, such as Weihai City Commercial Bank and Bank of Qingdao, which accounted for 68% of total credit facilities. We expect the Company to further expand its funding channels. Apart from that, the Company has a good track record for fund-raising activities in domestic bond market. From 2022 to 2023, ZZII issued 4 tranches of onshore bonds, raising RMB3.1 billion. As of 30 June 2023, the Company's exposure to non-standard financing is controllable, accounting for around 10% to 15% of the total debt.

Medium exposure to contingent liabilities

The Company bears moderate contingent risk resulting from relatively large external guarantees, which could potentially increase its repayment obligations. As of 30 June 2023, the Company's external guarantees amounted to RMB3.5 billion, accounting for 28.6% of its net assets. All the external guarantees were provided to local state-owned enterprises, mainly Jinsheng and Lunan (Zaozhuang) Economic Development Investment Co., Ltd., accounting for 47% and 43% of its total external guarantees, respectively. The guaranteed enterprise did not provide any counter guarantee measures. In case a credit event occurs in the region, it may lead to large-scale cross-effects. However, we believe that the credit risk of the guarantee is moderately controllable, taking into account the government's support to local SOEs.

ESG Considerations

ZZII faces environmental risks because it has undertaken urban infrastructure construction and land quota 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.

ZZII bears social risks as it is engaged in provision of public projects in Zaozhuang 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.

In terms of corporate governance, the Company is subject to oversight by the local 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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