

Credit Opinion

24 April 2024

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

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Qufu Xingda Investment Development Co., Ltd.

Surveillance credit rating report

CCXAP affirms the long-term credit rating of Qufu Xingda Investment Development Co., Ltd. at BBB_g-, with stable outlook.

Summary

The BBB_g- long-term credit rating of Qufu Xingda Investment Development Co., Ltd. (“QFXD” or the “Company”) reflects Qufu City Government’s relatively strong capacity to provide support and its extremely high willingness to provide support based on our assessment of the Company’s characteristics.

Our assessment of Qufu City Government’s capacity to support reflects Qufu City’s moderate fiscal metrics, supporting by its rich tourism resources base.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) full ownership and ultimate control by Qufu City Government; (2) sole entity undertaking public infrastructure construction projects within Qufu City; and (3) solid track record of government support.

However, the rating is constrained by the Company’s (1) higher business risk in property development and industrial park construction; (2) ongoing debt growth with certain capital expenditure pressure; and (3) fair access to financing channels.

The Stable outlook on QFXD rating reflects our expectation that Qufu City Government’s capacity to provide support will be stable, and the Company’s characteristics such as its strategic role in the development and operation of Qufu City will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Full ownership and ultimate control by Qufu City Government
- Sole entity undertaking public infrastructure construction projects within Qufu City
- Solid track record of government support
- Higher business risk in property development and industrial park construction
- Ongoing debt growth with certain capital expenditure pressure
- Fair access to financing channels

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Qufu City 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 lowering exposure to risky commercial activities, and diversifying the financing channels.

What could downgrade the rating?

The rating could be downgraded if (1) Qufu City 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 reduced strategic significance, deteriorated debt management, or increased exposure to commercial activities.

Key Indicators

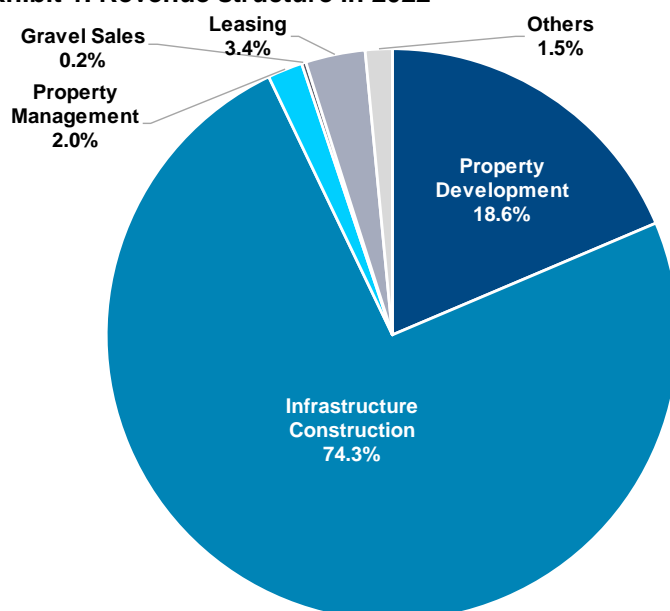
| | 2020FY | 2021FY | 2022FY | 2023H1 |
|------------------------------|--------|--------|--------|--------|
| Total Asset (RMB billion) | 11.7 | 13.7 | 17.0 | 19.4 |
| Total Equity (RMB billion) | 6.5 | 7.0 | 7.1 | 7.1 |
| Total Revenue (RMB billion) | 1.2 | 1.2 | 1.2 | 0.9 |
| Total Debt/Total Capital (%) | 31.2 | 32.0 | 42.7 | 45.4 |

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

Source: Company data, CCXAP research

Corporate Profile

Founded in September 2015, QFXD is the pivotal local infrastructure investment and financing company ("LIIFC") in Qufu City with the largest total assets. In accordance with the economic development strategy and social development requirements of Qufu City, QFXD is responsible for public infrastructure and policy-driven projects, including infrastructure construction and resettlement housing construction. The Company also carries out some commercial activities, consisting of property development, gravel sales, property management, and industrial parks construction and operation. As of 30 June 2023, it was directly and wholly owned by Qufu City State-owned Assets Service Center, and Qufu City Government was its ultimate controller.

Exhibit 1. Revenue structure in 2022

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe Qufu City Government has a relatively strong capacity to provide support given its moderate fiscal metrics, supporting by its rich tourism resources base.

In 2023, Shandong is the third largest province in China by gross regional products ("GRP"), with solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive and agri-food. Located in the southern part of Shandong Province, Jining City is one of the central cities in the Huaihai Economic Zone approved by the Shandong Provincial Government. Thanks to its diversified industrial structure such as coal mining, machinery and equipment manufacturing, paper and paper products, chemical industry goods, and textiles, Jining City's economic strength and fiscal strength had been steadily improved over the past three years. In 2023, Jining City reported a GRP of RMB551.6 billion, representing 6.5% year-over-year ("YoY") growth and ranking 6th among 16 prefecture-level cities in Shandong Province. However, Jining City has moderate fiscal metrics and a moderate debt profile. The Jining Municipal Government's general budgetary revenue was RMB47.5 billion in 2023, and its fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was around 60% over the past three years. Tax incomes slightly decreased to RMB32.4 billion in 2023 from RMB33.2 billion in 2021, accounting for 68.1% of its general budgetary revenue. As of 31 December 2023, its government debt to GRP ratio was 31.1%.

Exhibit 2. Key economic and fiscal indicators of Jining City

| | 2021FY | 2022FY | 2023FY |
|---|--------|--------|--------|
| GRP (RMB billion) | 507.0 | 531.7 | 551.6 |
| GRP Growth (%) | 8.5 | 4.4 | 6.5 |
| General Budgetary Revenue (RMB billion) | 44.1 | 44.8 | 47.5 |
| General Budgetary Expenditure (RMB billion) | 72.7 | 74.7 | 78.3 |
| Local Government Debt (RMB billion) | 134.5 | 151.4 | 171.4 |

Source: Jining Municipal Government, CCXAP research

Qufu City is a county-level city managed by Jining City. As the hometown of Confucius, Qufu City has accumulated rich tourism resources and formed strong cultural tourism industry, supporting its economic development in the past years. Qufu City has also developed “2+3” pillar industrial clusters including new-generation information technology, high-end equipment, biomedicine, new building materials, and food processing. In 2023, Qufu City’s GRP was RMB44.2 billion, representing a YoY increase of 6.3%.

Its general budgetary revenue slightly increased to RMB2.4 billion in 2023 from RMB2.3 billion in 2022. Qufu City Government had relatively good fiscal stability, the tax income accounted for around 72.7% its general budgetary revenue over the past few years. However, Qufu City’s Government fund income has declined due to the drop in land transfer revenue over the past three years. From 2021 to 2023, the government fund income of Qufu City Government decreased from RMB55.0 billion to RMB41.8 billion, while its land transfer revenue decreased from RMB50.9 billion to RMB36.6 billion. Moreover, Qufu City’s fiscal balance was moderate and its average general budgetary revenue/general budgetary expenditure ratio was around 53.7% over the past three years. Qufu City Government relies on transfer income from higher-level government and debt issuance to achieve fiscal balance. As of 31 December 2023, the outstanding government debt of Qufu City was RMB10.0 billion at the same time, accounting for 22.7% of its GRP.

Exhibit 3. Key economic and fiscal indicators of Qufu City

| | 2021FY | 2022FY | 2023FY |
|---|--------|--------|--------|
| GRP (RMB billion) | 40.3 | 42.7 | 44.2 |
| GRP Growth (%) | 8.3 | 4.6 | 6.3 |
| General Budgetary Revenue (RMB billion) | 2.5 | 2.3 | 2.4 |
| General Budgetary Expenditure (RMB billion) | 4.5 | 4.5 | 4.5 |
| Local Government Debt (RMB billion) | 8.8 | 9.4 | 10.0 |

Source: Qufu City Government, CCXAP research

Government’s Willingness to Provide Support

Sole entity undertaking public infrastructure construction projects within Qufu City

QFXD is the largest LIIFC in Qufu City, which controls and manages most of the key LIIFCs in the region. The Company has an essential strategic role in the development of Qufu City, with a policy mandate to undertake major construction projects, along with the local government’s broad strategy in developing Qufu City.

QFXD’s subsidiaries conducted infrastructure construction mainly by agency construction model before. Under the agency construction model, the Company signs an entrusted construction agreement with the Finance Bureau of Qufu City or the local state-owned enterprises. After the project is completed, the entrusting parties would pay QFXD the construction cost plus generally 20% markup. As of 30 June 2023, QFXD had completed more than 10 large-scale projects including roads, bridges, shanty town renovation, scenic renovation, and other public facilities, with a total investment of RMB7.4 billion.

Meanwhile, QFXD had large construction projects and sufficient project reserves that ensured its sustainability. The Company had 8 infrastructure projects under construction and planning, with a total investment of approximately RMB6.6 billion and an invested amount of RMB5.9 billion. These projects adopt self-operated model instead of agency construction model according to the Company’s development strategy. Fund balance is achieved through the future operating income of the project, such as pipeline network leasing, real estate sales, land transfer, as well as cemetery leasing and sales. We believe QFXD’s policy function and its importance to Qufu City will be enhanced through the undertaking of these new projects.

The visibility and predictability of the Company's business position is high and its policy mandate is strong, in our view. We also expect the Company to undertake most of the public projects in the mandated areas and transfer-out of its public projects is unlikely.

Solid track record of government support

As an essential entity in infrastructure construction and public utility operation in Qufu City, QFXD has solid track record of receiving ongoing support from the local government in terms of asset injections, equity transfers and, operating subsidies. In order to build the largest and the most important LIIFC in Qufu City, the local government transferred three major LIIFCs to QFXD in 2019, including Qufu state owned capital investment and operation group Co., Ltd., Qufu Cultural Tourism Development Investment (Group) Co., Ltd., and Shandong Zhicheng Construction Group Co., Ltd. The successful consolidation of the LIIFCs significantly enlarged the range of business coverage of the QFXD.

QFXD continued to receive government payments and subsidies in support of its on-going operation. As of 30 June 2023, the Company has invested around RMB7.4 billion in completed infrastructure construction projects and received repayments of RMB3.4 billion. Moreover, from 2020 to June 2023, QFXD received ongoing government subsidies of around RMB359 million. The magnitude and track record of government support indicates the government's propensity to support the Company.

Nevertheless, QFXD's business model in infrastructure construction is shifting from agency construction model to self-operated model, which will negatively affect its direct payments from the local government in the future with higher uncertainties in project fund balancing, in our view. The local government may focus on capital and operational asset injections to support QFXD's development, which will enhance its operating and capital strength accordingly.

Higher business risk in property development and industrial park construction

QFXD's major commercial businesses include property development, gravel sales, property management, and industrial park construction and operation, exerting relatively high capital expenditure pressure. The Company's risk exposure to commercial business was medium as we estimated the commercial assets accounted for less than 30% of total assets as of 30 June 2023. However, the increasing investments in commercial activities will inevitably expose the Company to higher business and financial risks. Moreover, the fund balancing of property development business would suffer from high volatility especially during the downturn in China's property market.

QFXD's subsidiary conducts property development business and builds its local branding, which mainly includes commodity housing projects and resettlement housing projects. As of 30 June 2023, the Company had 6 property development projects under construction, with total investment amount of RMB2.8 billion and uninvested amount of RMB878 million. The selling rate of the property development projects under construction was at the range of 60% to 70%. The resettlement housing part of several projects will be invested and constructed after the cash inflow is obtained from the sale of commodity housing part, according to the management. However, the fund balancing of property development business would suffer from high volatility due to uncertainty of construction and sales progress during the downturn in China's property market. Moreover, increasing investment in property development may bring more operating uncertainties and financial risks to the Company as the property sales are easily affected by the market conditions. We should pay attention to the sales progress of QFXD's property development projects.

QFXD also takes the responsibility to attract investments and promote the development of local industries by participating the industrial park construction and operation. We opine the riskiness of this business is manageable as the development of industrial parks is more policy-driven and related to the Company's public policy business, which was also under the guidance of Qufu City Government. As of 30 June 2023, the Company had 7 industrial park projects under construction, with a total investment amount of RMB3.6 billion and uninvested amount of RMB2.8 billion. The Company would continuous to rely on external financing for these self-operated projects, which would increase QFXD's capital expenditure burden. These projects include science and technology incubation center, 5G industrial park, as well as the research center, which are expected to received cash inflow through leasing and selling after the completion of construction. However, the Company's investment recovery cycle of industrial parks is long, making it more difficult to achieve fund balancing in short period of time and may expose the Company to larger investment and execution risks. In addition, the Company had not recorded any operating revenue generated from the leasing and sale of factory buildings in industrial parks as of 31 December 2023.

Gravel sales is one of the main businesses of QFXD, of which the main products are sand and stones. The Company has the mining right of a mine in Qufu City until 5 August 2027 with mining area of 0.2 square kilometers and annual production capacity of 270 tons. The local government also continues to inject the city's gravel resources into the Company, and it is assigned to carry out mining, restoration, and management of river gravel resources in a unified manner. However, due to the decrease in market demand, constraint of environmental policies, and construction and renovation of factory building, the revenue of gravel sales significantly dropped to RMB3 million in 2022 from RMB164 million in 2020. After the completion of construction and renovation of factory building and the coming change in environmental regulations, the Company expected there would be a recovery of this business in 2024.

Ongoing debt growth with certain capital expenditure pressure

Driven by continuous financing and investment for construction projects, QFXD's total debt has been growing over the past three years. The significant increase in the total debt is mainly driven by the investment in several infrastructure construction projects, we believe its debt growth is in line with the region's development need. The Company's total debt increased from RMB2.4 billion at end-2020 to RMB5.9 billion at mid-2023, while the total capitalization ratio rose from 31.2% to 45.4%. As of 30 June 2023, short-term debt of QFXD was RMB981.0 million, accounting for around 17% of the total debt.

However, as large pipeline projects, including infrastructure, property development, and industrial park construction projects under construction or planning require ongoing external capital support. We estimate, the Company still need to invest around RMB9.7 billion in the future. Considering the large capital expenditure needs of its construction projects, we expect the Company's total debt will continue to rise.

Fair access to funding channels

QFXD has fair access to financing channels and majority of the debts were come from domestic banks. The Company has built good long-term relationships with policy banks and major commercial banks such Agricultural Development Bank of China, Industrial and Commercial Bank of China, and Bank of Jining Co., Ltd. As of 30 June 2023, the Company had total bank facilities of RMB6.9 billion, with available portion being RMB1.7 billion. The Company also tapped into offshore bond market, raising CNY207 million in 2023. In addition, we considered its exposure to non-standard product financing was moderate, accounting for around 15% of its total debt, with average cost of around 8.3%. The overall financing cost of the Company was around 7.4%. Given

the QFXD's important status and the key role in the local development of Qufu City, we expect the Company to maintain access to stable funding from the local commercial banks.

ESG Considerations

QFXD assumes environmental risks through its infrastructure projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

QFXD bears social risks as it plays an essential strategic role in the development of Qufu 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, QFXD has established a sound and effective internal control framework and a corporate governance structure in which shareholders, directors, supervisors, senior management team, and internal departments collectively and efficiently perform their duties. The Company is also subject to oversight by Qufu City 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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