

Credit Opinion

30 April 2024

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

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Quzhou Qutong Development Group Co., Ltd.

Surveillance credit rating report

CCXAP upgrades Quzhou Qutong Development Group Co., Ltd.'s long-term credit rating to A_g-, with stable outlook.

Summary

CCXAP has upgraded the long-term credit rating of Quzhou Qutong Development Group Co., Ltd. ("QQDG" or the "Company") to A_g- from BBB_g+, with stable outlook. The rating upgrade is based on the enhancing regional fiscal metrics of Quzhou City, which strengthens the local government's capacity to support the Company. It also reflects the important position of the Company as a crucial transportation infrastructure construction entity in Quzhou City.

The long-term credit rating of QQDG reflects (1) Quzhou 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 Quzhou Municipal Government's capacity to provide support reflects Quzhou City's status as a prefecture-level city in Zhejiang Province, with relatively fast economic growth and good fiscal stability.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) important strategic role as the transportation infrastructure construction entity in Quzhou City; (2) good access to funding; and (3) good track record of receiving government payments.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities; and (2) moderate debt management and moderate asset liquidity.

The stable outlook on QQDG's rating reflects our expectation that Quzhou Municipal Government's capacity to provide support will remain stable, and the Company will maintain its important strategic role in transportation infrastructure construction in Quzhou City over the next 12 to 18 months.

Rating Drivers

- Important strategic role as the transportation infrastructure construction entity in Quzhou City
- Medium exposure to commercial activities
- Moderate debt management and moderate asset liquidity
- Good access to funding
- Good track record of receiving government payments

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Quzhou 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 strengthened market position, material reduction in commercial business exposure, or improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Quzhou 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 weakened market position, material decrease in government payments, or deteriorated debt management.

Key Indicators

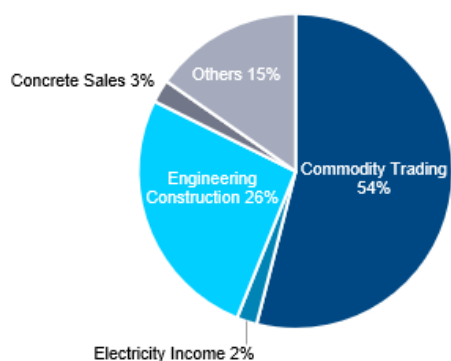
	2020FY	2021FY	2022FY	2023Q3
Total Asset (RMB billion)	20.0	28.0	36.6	40.1
Total Equity (RMB billion)	10.7	15.4	17.7	19.3
Total Revenue (RMB billion)	0.8	2.1	3.6	4.1
Total Debt/Total Capital (%)	37.4	38.0	45.8	46.7

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

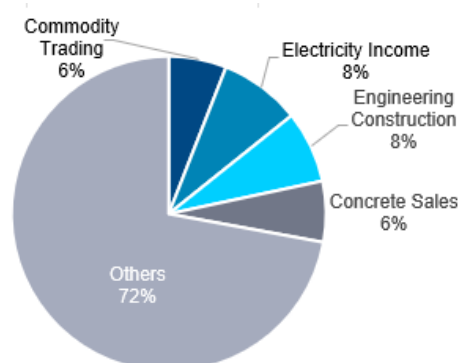
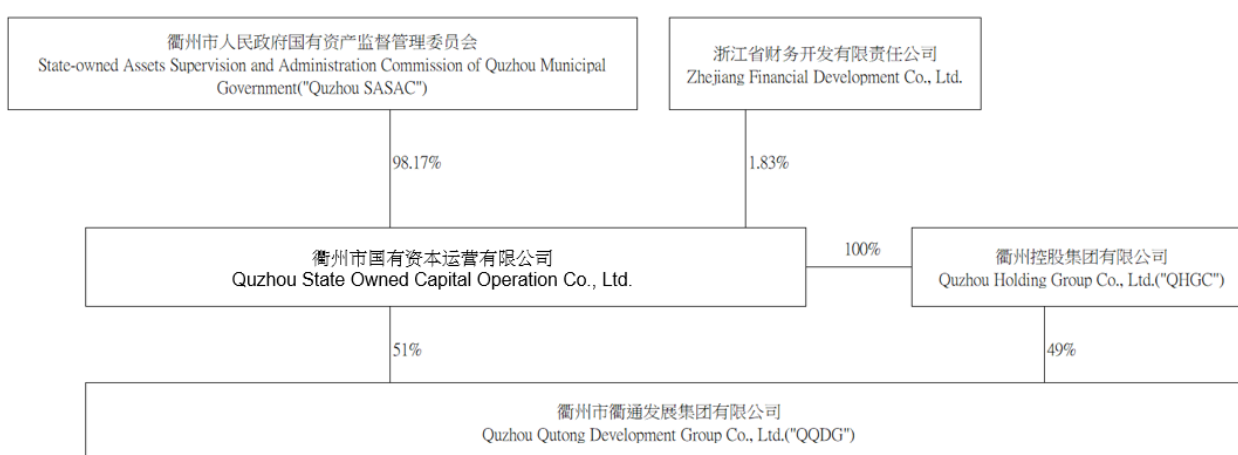
Source: Company data, CCXAP research

Corporate Profile

Founded in 2002, QQDG, formerly known as Quzhou Communications Investment Group Co., Ltd., is an important local infrastructure investment and financing company ("LIIFC") for major transportation infrastructure projects in Quzhou City. It is primarily engaged in transportation construction and operation, as well as power generation. The Company also undertakes commercial activities such as sales of construction materials and property development. As of 30 September 2023, the Company was wholly owned by Quzhou State-owned Assets Operation Co., Ltd. ("QSAO"), which directly held 51% of the Company's stakes and indirectly held the remaining 49% through its subsidiary Quzhou Holding Group Co., Ltd. Its ultimate controlling owner is the State-owned Assets Supervision and Administration Commission of Quzhou Municipal Government ("Quzhou SASAC").

Exhibit 1. Revenue structure in 2022

Source: Company information, CCXAP research

Exhibit 2. Gross profit structure in 2022**Exhibit 3. Shareholding chart as of 30 September 2023**

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Quzhou Municipal Government has a very strong capacity to provide support, given Quzhou City's status as a prefecture-level city in Zhejiang Province, with relatively fast economic growth and good fiscal stability.

Quzhou City is one of the prefecture-level cities in Zhejiang Province, with a total population of 2.53 million and an area of 8,844 square kilometers. Quzhou City has rich mineral resources which drives the local industrial development. It is also the largest fluorine chemical base in China. The pillar industries in Quzhou City include chemicals, machinery, cement, papermaking, and food processing. With continuous industrial development, the economic strength of Quzhou City has grown at a relatively fast pace. The gross regional product ("GRP") of Quzhou City increased from RMB200.3 billion in 2022 to RMB212.5 billion in 2023, with economic growth ranking 5th among prefecture-level cities in Zhejiang Province in 2023. With the continuous development of the regional economy, the local government's general budgetary revenue rose significantly, from RMB17.3 billion to RMB20.4 billion, representing a YoY growth of 18.0%. It also has good fiscal stability with tax income contributing to around 80% of the general budgetary revenue over the past three years. However, its fiscal balance is weak, with a general budgetary revenue/general budgetary expenditure ratio of 33.7% in 2023,

reflecting a high reliance on fiscal support from higher-tier governments and proceeds from land sales to balance its fiscal budget. As of 31 December 2023, the outstanding amount of local government debt grew to RMB103.1 billion, accounting for 48.5% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Quzhou City

	2021FY	2022FY	2023FY
GRP (RMB billion)	187.6	200.3	212.5
GRP Growth (%)	8.7	4.8	6.8
General Budgetary Revenue (RMB billion)	16.4	17.3	20.4
General Budgetary Expenditure (RMB billion)	51.8	56.8	60.6
Local Government Debt (RMB billion)	72.0	86.4	103.1

Source: Finance Bureau of Quzhou City, CCXAP research

Given the strategic importance role of QQDG to the local economy, we believe the enhancing regional fiscal metrics of Quzhou City will strengthen the local government's capacity to support the Company. It is very likely the Quzhou Government will provide stronger support to the Company if needed. As the Quzhou Municipal Government actively improves the transportation network in Quzhou City, such as building transportation hubs and promoting green transportation equipment, we believe that the Company will remain its strategic role in the transportation development in Quzhou City.

Government's Willingness to Provide Support

Important strategic role as the transportation infrastructure construction entity in Quzhou City

The Company has continued to play an important role in the implementation of infrastructure construction and urban development policies in Quzhou City, and has successfully completed major provincial construction projects. In addition, the Company represents the Quzhou Municipal Government in participating in projects such as municipal highways and shipping hubs, and in high-speed rail projects under the equity participation model. Given its important strategic market position and distinguished role from other state-owned enterprises, we believe that the Company is unlikely to be replaced in the foreseeable future.

QQDG is the primary transportation infrastructure construction platform in Quzhou City, focusing on the investment, financing, construction, and operation of key transportation infrastructure projects, such as highways, comprehensive passenger transport hubs, and water conservancy facilities. These transportation infrastructure projects are strategically aligned with the urban planning and development policies of Quzhou City, and the sources of funding are mainly government fiscal appropriations and self-raised funds. However, the Company's road projects do not generate income and mainly rely on government fund to achieve breakeven. Currently, the construction of transportation infrastructure projects has basically been completed, showing low capital expenditure pressure. As of 30 September 2023, the Company had three major transportation infrastructure projects under construction, with an uninvested amount of RMB689.0 million.

In addition, The Company also represents the Quzhou Municipal Government to participates in the construction and operation of railways and provincial highways under the equity participation model, mainly with government funding and self-raised funds. As of 30 September 2023, the Company had 5 major transportation infrastructure construction projects under equity participation model, with a total investment amount of RMB2.6 billion.

QQDG is also engaged in the power generation business, which involves the operation of two hydropower stations constructed under its self-operated shipping development project. The two hydropower stations have a

total installed capacity of 36,000 KW as of 30 September 2023. The power generated by the two operating power stations will be sold to a local power supply company at an agreed price. The power generation business has shown a stable development momentum and brings recurring income to the Company.

Medium exposure to commercial activities

QQDG is also engaged in commercial activities such as self-operated project construction, engineer construction, commodity trading, building materials sales, and property development businesses. Although the Company's commercial activities account for a relatively high proportion, accounting for about 30% of its total assets, we consider the commercial business risks to be manageable, given that most of the commercial activities has low business risks and the local government has provided financial support to some of the self-operated projects.

At present, QQDG focuses on the construction of self-operated projects, including industrial parks, schools, comprehensive transportation hubs, and office buildings. The construction costs of such self-operated projects will be balanced by the operating income generated after the construction is completed. As of 30 September 2023, the Company had completed the construction of 12 major self-operated projects, with a total investment of RMB11.9 billion. Due to the public welfare nature of these projects, the construction expenditure will be partly supported by government fiscal appropriations. As of 30 September 2023, the Company had 5 major self-operated projects under construction or planning, with a total estimated investment of RMB9.1 billion, and an uninvested amount of RMB7.7 billion.

Furthermore, QQDG is also engaged in the engineer construction business, including road maintenance and building engineering construction. It obtains the projects mainly through public bidding. As of 30 September 2023, the Company had large amount of engineer construction projects at hand, with a total contracted amount of RMB2.2 billion, indicating relatively good sustainability of the business.

Since 2021, QQDG has been in the commodity trading business under a demand-driven business model. The main products of the commodity trading business are steel, cement, coal, and alloys. In the first three quarter of 2023, the Company's revenue from this segment was around RMB1.6 billion, accounting for 38.1% of its total revenue, and was the main source of its income growth. However, this segment faces certain concentration risk as of 30 September 2023, as the top 5 suppliers and top 5 customers account for 84.7% and 75.4% of total procurement and sales value, respectively. Meanwhile, this business has a low gross profit margin of around 1.5%.

The Company's building materials sales and property development are managed by subsidiary Zhejiang Baohong Construction Industrial Manufacturing Co., Ltd ("Baohong Construction"). Baohong Construction is engaged in the production and sales of building materials, including commercial concrete, building industrialized components and prefabricated concrete parts. However, the concentration of suppliers and customers is relatively high, and is susceptible to fluctuations in the building materials industry. As of 30 September 2023, this segment faces certain concentration risk, as top 5 suppliers and top 5 customers account for 61.4% and 75.4% of total procurement and total sales, respectively. Baohong Construction's property development projects under construction involves a resettlement housing project and a commercial housing project. As of 30 September 2023, the Company has 4 major property projects under construction or planning, with a total investment amount of RMB7.2 billion and outstanding amount of RMB4.0 billion. The large outstanding amount exerted certain capital expenditure pressure on the Company.

Moderate debt management and moderate asset liquidity

QQDG has moderate debt management, as reflected by its rapid debt growth and modest debt structure. Its total debt increased from RMB14.9 billion at end-2022 to RMB16.9 billion at end-2023Q3, and its total capitalization ratio, measured as a ratio of total debt to total capital, slightly increased from 45.8% to 46.7% over the same period. Moreover, the Company's debt structure needs to be improved. As of 30 September 2023, its short-term debt amounted to RMB5.2 billion, accounting for 31% of its total debt, and its cash to short-term debt ratio was around 0.2x, indicating relatively high short-term debt servicing pressure. We expect the Company's debt leverage to remain high in the next 12 to 18 months, given its large number of construction projects in the pipeline.

Furthermore, the Company'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), income rights, and lands (recorded as intangible assets), which accounted for more than 50% of total asset. It is noteworthy that this low asset liquidity may undermine the Company's financing flexibility. In addition, the amount of restricted asset was RMB3.5 billion, which was mainly used as collateral, accounted for 8.6% of total asset.

Good access to funding

We consider QQDG's access to funding to be good, given its strong banking relationships and access to the bond market. As of 30 September 2023, the Company has obtained sufficient credit facilities from major domestic policy banks or commercial banks, with total credit facilities of around RMB14.8 billion and available credit facilities of RMB5.9 billion. Since 2021, the Company has been an active issuer in the public bond market. As of 30 September 2023, it had issued multiple types of onshore bonds such as commercial papers, MTNs, and corporate bonds, with a total outstanding amount of RMB6.2 billion, as well as offshore bonds with a total outstanding amount of USD200 million. As of 30 September 2023, banks loans and bonds accounted for about 84.1% of the Company's total debt, while non-standard financing and shareholder loans accounted for the remaining 15.9%.

Good track record of receiving government payments

QQDG has received continuous support from the local government, including capital injections, asset transfers, project grants, and financial subsidies. From 2022 to 2023Q3, the Company received asset injection of RMB1.6 billion (mainly land), equity interest in local state-owned enterprises of RMB828.4 million, as well as cash injection of RMB10 million. In addition, the Company received government subsidies of RMB284.5 million over the same period. The continuous support from the local government significantly enhancing its capital strength and broadening its business mix. Overall, given the Company's important position and its contribution to regional economic development, we believe QQDG will continue to receive support from the government.

ESG Considerations

QQDG assumes environmental risks through its infrastructure projects. Such risks could be moderated by conducting environmental studies and detailed planning before the commencement of the projects and close supervision during construction.

As a public services provider in Quzhou City, the Company also faces social risks. Demographic changes, public awareness, and social priorities shape government's target for QQDG, which may affect the government's propensity to support the Company.

QQDG's governance considerations are also material as the Company is subject to oversight and reporting requirements to the local government, 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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