

Credit Opinion

27 June 2024

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

Analyst Contacts

Christy Liu +852-2860 7130

Credit Analyst

christy_liu@ccxap.com

Amy Chen +852-2860 7140

Assistant Credit Analyst

amy_chen@ccxap.com

Elle Hu +852-2860 7120

Executive Director of Credit Ratings

elle_hu@ccxap.com

**The first name above is the lead analyst for this rating and the last name above is the person primarily responsible for approving this rating.*

Client Services

Hong Kong +852-2860 7111

Heze Investment Development Group Co., Ltd.

Surveillance credit rating report

CCXAP affirms Heze Investment Development Group Co., Ltd.'s long-term credit rating at BBB_g+, with stable outlook.

Summary

The BBB_g+ long-term credit rating of Heze Investment Development Group Co., Ltd. ("HZID" or the "Company") reflects the Heze Municipal Government's (1) very strong capacity to provide support, and (2) very high willingness to provide support based on our assessment of the Company's characteristics.

Our assessment of Heze Municipal Government's capacity to provide support reflects Heze City's sound economic fundamentals, 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; and (2) good track record of receiving government supports.

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

- Important strategic position as the largest investment and financing entity in Heze City
- Important role in infrastructure construction and public utility services
- Medium exposure to commercial activities
- Rapid debt growth driven by the continuous investment in construction projects
- Diversified access to funding
- Good track record of receiving government supports

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's capacity to support strengthens; or (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, or improved debt management and asset liquidity.

What could downgrade the rating?

The rating could be downgraded if (1) the local 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

	2021FY	2022FY	2023FY	2024Q1
Total Asset (RMB billion)	57.6	68.6	67.1	68.6
Total Equity (RMB billion)	35.6	37.2	34.0	34.1
Total Revenue (RMB billion)	5.5	8.2	8.4	2.0
Total Debt/Total Capital (%)	24.1	29.4	35.2	37.1

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

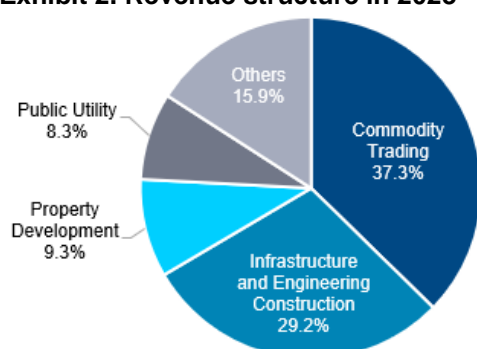
Source: Company data, CCXAP research

Corporate Profile

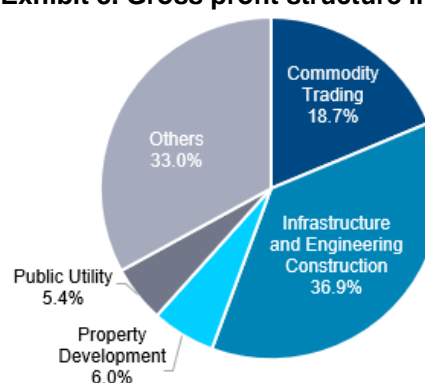
Founded in July 1990, HZID is the largest state-owned capital operation entity in terms of asset size and the key industry investment and financing platform in Heze City. The Company is primarily responsible for public activities, including infrastructure construction, water supply, heat supply, and steam supply. It also participates in different commercial activities such as property development, self-operated project construction and production and sales business. As of 31 March 2024, 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 2024

Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2023

Source: Company information, CCXAP research

Exhibit 3. Gross profit structure in 2023**Rating Considerations****Government's Capacity to Provide Support**

We believe the local government of Heze City has a very strong capacity to provide support given its sound economic fundamentals, with increasing economic strength and moderate fiscal metrics.

Shandong Province is the third largest province in China by gross regional product ("GRP"), with a solid industrial foundation in 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 2023, Heze City reported a GRP of RMB446.4 billion, recording an economic growth of 6.8% year-over-year ("YoY"). Its fiscal balance was modest, with an averaged general budgetary revenue to general budgetary expenditure ratio of 43.8%, and tax accounted for 69.3% of the general budgetary revenue on average over the past three years. However, the government fund income dropped from RMB40.6 billion in 2022 to RMB36.0 billion in 2023 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 2023, Heze Municipal Government reported an outstanding government debt of RMB150.1 billion and accounted for 33.6% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Heze City

	2021FY	2022FY	2023FY
GRP (RMB billion)	397.7	420.5	446.4
GRP Growth (%)	8.8	4.2	6.8
General Budgetary Revenue (RMB billion)	28.4	30.1	31.7
General Budgetary Expenditure (RMB billion)	63.3	69.2	73.5
Local Government Debt (RMB billion)	110.8	131.2	150.1

Source: Heze Municipal Government, CCXAP research

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

HZID is the largest state-owned asset operation entity in terms of asset size and the key industry investment and financing platform in Heze City, with important strategic position. As of 31 March 2024, its total assets and net assets amounted to RMB68.6 billion and RMB34.1 billion, ranking top among the local state-owned enterprises in Heze City. 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 developed into the major public utility server in Heze City. There are another 6 major local infrastructure investment and financing companies under the governance of Heze Municipal Government, each of them has different roles in Heze City. Specifically, Heze Finance Investment Group Co., Ltd. is another important state-owned asset operation entity, which focuses on key infrastructure construction projects, policy-oriented grain storage and public transportation. Given its important strategic market position, we believe the Company is unlikely to be replaced in the foreseeable future.

Important role in infrastructure construction and public utility services

HZID carries out various infrastructure construction projects mainly through the engineering construction model, including shantytown renovation, resettlement housing, municipal engineering, municipal pipe network, and water conservancy construction projects in Heze City with relevant qualifications. Benefiting from its state-owned background, the Company newly acquired 108 high-quality contracts with total contracted amount of RMB8.0 billion in 2023. As of 31 March 2024, the Company had uncompleted contracts in hand with a total amount of RMB8.1 billion. Among them, the top five engineering construction projects under construction had a planned investment of RMB6.5 billion and an uninvested amount of RMB2.0 billion, respectively. Considering that the payment of the projects is paid according to the construction progress and some projects are supported by government special funds, we expect the Company's investment pressure to be controllable. For the completed public-private partnership ("PPP") construction project, in which HZID held 85.0% equity of project company as social capital and was responsible for the project construction, the Company had received total payment of RMB580.0 million from the local government as of 31 March 2024 and was no longer involved in construction and additional investment.

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 entered the business of water supply. It is the only entity to provide water supply in the urban area of Heze City, covering residential and non-residential customers. As of 31 March 2024, the Company owned pipeline network with total length of 601.2 kilometers, and two water plants with a daily water supply capacity of 150,000 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 248 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. As of 31 March 2024, HZID had 4 key projects in public utility segments under construction, with the total investment and uninvested amount of RMB3.4 billion and RMB1.5 billion, respectively.

Medium exposure to commercial activities

Apart from the public policy activities, the Company also participates in different commercial activities consisting of property development, self-operated project construction and production and sales business. HZID's exposure to commercial activities was medium, with the commercial assets accounting for less than 30% of total assets.

HZID's property development business mainly involves the construction and sales of residential properties in Heze City. As of 31 March 2024, the Company had 2 key projects under construction including commercial housing and office buildings, with a total investment of RMB2.7 billion and an uninvested amount of RMB335.2 million. Meanwhile, the Company had no subsequent planned development projects. Therefore, we expect the exposure to the property development segment 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. Apart from that, HZID's subsidiary, Heze Urban Construction Engineering Development Group Co., Ltd. ("HZUC"), signed resettlement housing handover agreement with Heze Tianchuang Jinyuan Property Management Co. Ltd. in 2023, and partly sold Minjiang Road resettlement housing (residential housing, commercial shops, and underground storage rooms) under market-oriented method, realizing total sales revenue of RMB461 million in 2023. HZID had 3 resettlement housing projects under construction, with a planned investment amount of RMB5.5 billion and an uninvested amount of RMB755 million as of 31 March 2024.

Besides, 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, such as leasing income, tuition fees, training fees, accommodation fees and catering income. However, relatively large investment needs put high capital expenditure pressure on HZID, and the payback period is expected to be long. As of 31 March 2024, the Company had 2 key self-operate projects under construction, with a total estimated investment of more than RMB1.6 billion, and an uninvested amount of more than RMB600 million.

HZID also engages in the production and sales business, with diversified products such as building materials, meat and processing of by-products, sales of medicines and precision mold. In 2023, revenue from this segment increased to RMB3.1 billion from RMB2.0 billion in 2022, which was one of the large contributors to the total revenue. However, there is a certain risk of high concentration from downstream customers. For example, in 2023, the top 5 customers of precision mold sales represented 81.1% of the sales amount. These market-driven businesses may also pose higher operating and business risks to the Company compared with its public-policy businesses.

Good track record of receiving government supports

HZID has a good track record of receiving supports 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.

Moreover, the Company continued to receive government operational subsidies of RMB22.9 million in 2023, supporting its operation. In 2023, the Company received special funds of RMB865.6 million 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.

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

HZID's total debt rapidly increased from RMB15.5 billion as of 31 December 2022 to RMB20.1 billion as of 31 March 2024 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 2024, the Company's total capitalization ratio was 37.1%. However, the Company bears certain short-term debt pressure, and its short-term debt to total debt ratio remained at a relatively high level of 49.5% and its unrestricted cash to short-term debt ratio was 0.2x as of the same date. 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 RMB7.2 billion, accounting for 10.4% of the total assets and 21.0% of the net assets as of 31 March 2024. It is noteworthy that this low asset liquidity may undermine the Company's financing flexibility.

Diversified access to funding

HZID has maintained access to different financing channels such as bank loans, domestic bond issuance, and non-standard products financing. Bank loans became the main funding source for the Company, which accounted for more than 60% of the total debt as of 31 March 2024. As of the same date, the Company had total bank facilities of RMB24.9 billion, with the available portion being RMB10.5 billion, indicating sufficient standby liquidity. They were mainly provided by policy banks and state-owned joint-stock banks such as Agricultural Development Bank of China and China Construction Bank Corporation. HZID also has access to domestic capital market, and direct financing accounted for less than 10% of the total debt as of 31 March 2024 slightly decreased from 11.4% YoY. From January 2023 to May 2024, the Company and its subsidiary HZUC issued a 2-year private placement note and 2 corporate bonds with the coupon rate ranging from 3.2% to 4.5%, raising a total of RMB1.5 billion. Meanwhile, the non-standard financing accounted for less than 10% of total debt which we consider to be at a reasonable level.

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 \(July 2022\)](#).

Appendix

Exhibit 5. Peer Comparison

	Heze Investment Development Group Co., Ltd.	Heze Finance Investment Group Co., Ltd.
Long-Term Credit Rating	BBB _g +	BBB _g +
Shareholder	Heze SASAC (97.93%) and Shandong Caixin Asset Operation Co., Ltd. (2.07%)	Heze SASAC (100%)
Positioning	Pivotal entity in state-owned capital operation and key municipal industry investment in Heze City	Pivotal entity in urban construction and operation in Heze City
Total Asset (RMB billion)	67.1	36.7
Total Equity (RMB billion)	34.0	15.1
Total Revenue (RMB billion)	8.4	5.8

All ratios and figures are calculated using CCXAP's adjustments based on financial data as of 31 December 2023.

Source: Company data, CCXAP research

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China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 1904-1909, 19/F, Jardine House,
1 Connaught Place, Central, Hong Kong

Website: www.ccxap.com

Email: info@ccxap.com

Tel: +852-2860 7111

Fax: +852-2868 0656