

Credit Opinion

17 March 2025

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

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Zibo Zichuan Finance Holding Co., Ltd.

Surveillance credit rating report

CCXAP affirms Zibo Zichuan Finance Holding Co., Ltd.'s long-term credit rating at BBB_g-, with stable outlook.

Summary

The BBB_g- long-term credit rating of Zibo Zichuan Finance Holding Co., Ltd. ("ZCFH" or the "Company") reflects Zichuan District Government's 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 Zichuan District Government's capacity to support reflects Zichuan District's comprehensive strength, with ongoing economic growth and improving fiscal metrics.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) important role in regional development of the Zichuan District, primarily responsible for the development of industrial parks and supporting infrastructure; and (2) solid track record of receiving government supports.

However, the rating is constrained by the Company's (1) moderate exposure to commercial activities; and (2) fast debt growth driven by continuous investment in infrastructure projects and industrial parks.

The stable outlook on ZCFH's rating reflects our expectation that the Zichuan District Government's capacity to provide support will be stable, and the Company's important role in regional development of Zichuan District will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Important role in regional development of the Zichuan District, primarily responsible for the development of industrial parks and supporting infrastructure
- Moderate exposure to commercial business activities
- Solid track record of receiving government supports
- Fast debt growth driven by continuous investment in infrastructure projects and industrial parks
- Access to multiple funding channels but limited standby facilities

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Zichuan District 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 decreased risk exposure to commercial activities and improved debt management and financing ability.

What could downgrade the rating?

The rating could be downgraded if (1) Zichuan District 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, weakened financing ability or increased exposure to commercial activities.

Key Indicators

| | 2021FY | 2022FY | 2023FY | 2024H1 |
|------------------------------|--------|--------|--------|--------|
| Total Asset (RMB billion) | 13.8 | 15.7 | 18.6 | 18.8 |
| Total Equity (RMB billion) | 7.2 | 6.8 | 6.9 | 6.7 |
| Total Revenue (RMB billion) | 1.2 | 0.8 | 1.1 | 0.7 |
| Total Debt/Total Capital (%) | 38.5 | 48.9 | 53.1 | 52.3 |

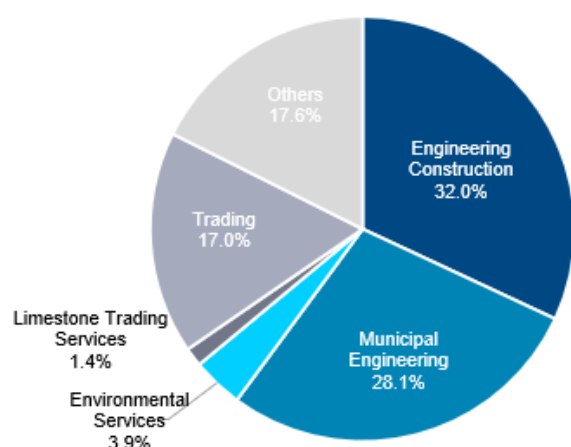
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

Corporate Profile

Founded in July 2017, ZCFH is one of the two pivotal local infrastructure investment and financing companies ("LIIFCs") in Zichuan District. As an important urban infrastructure investment and state-owned capital investment and operation entity in Zichuan District, ZCFH is responsible for public infrastructure and welfare projects, including infrastructure construction and municipal engineering. It also has commercial activities, including industrial park development and operation, financial investment, trading and leasing. As of 30 June 2024, it was directly and wholly owned by the Zichuan State-owned Assets Supervision and Administration Bureau ("Zichuan SASAB").

Exhibit 1. Revenue structure in 2023



Source: Company data, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Zichuan District Government has a strong capacity to provide support, given Zichuan District's comprehensive strength, with ongoing economic growth and improving fiscal metrics.

Shandong Province is the third largest province in China by GRP, with a solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive and agri-food. Zibo City is located in the central part of Shandong Province, which is one of the core cities of Shandong Peninsula Urban Agglomeration and a regional central city in Shandong Province approved by the State Council. Zibo City's GRP ranked the 7th by GRP among 16 prefecture-level cities in Shandong Province over the past three years. With rich industrial resources and good location advantages, it has demonstrated an economic growth over the past three years, with GRP increasing from RMB440.3 billion in 2022 to RMB488.4 billion in 2024.

Zibo City demonstrated improving comprehensive strength over the past three years with the general budgetary revenue slightly increased from RMB37.6 billion in 2022 to RMB41.1 billion in 2024. It has modest fiscal quality, with tax revenue accounting for 61.5% of its general budgetary revenue on average, and average general budgetary revenue to general budgetary expenditure ratio of 71.5% over the same period. As of the end of 2024, Zibo City's government debt balance was RMB142.7 billion, accounting for 29.2% of its GRP.

Exhibit 2. Key economic and fiscal indicators of Zibo City

| | 2022FY | 2023FY | 2024FY |
|---|--------|--------|--------|
| GRP (RMB billion) | 440.3 | 456.2 | 488.4 |
| GRP Growth (%) | 4.7 | 5.5 | 5.5 |
| General Budgetary Revenue (RMB billion) | 37.6 | 39.5 | 41.1 |
| General Budgetary Expenditure (RMB billion) | 52.6 | 55.0 | 57.8 |
| Local Government Debt (RMB billion) | 108.0 | 122.6 | 142.7 |

Source: Zibo Municipal Government, CCXAP research

Zichuan District is located in the central part of Zibo City, with a total area of 960 square kilometers. Supporting by its pillar industries such as machinery, building materials, textiles, and pharmaceuticals, Zichuan District has continued to grow and develop in recent years. Zichuan District has demonstrated ongoing economic growth with increasing debt profile in recent years, the GRP of Zichuan District grew slightly from RMB50.6 billion in

2022 to RMB50.7 billion in 2024, ranked 4th among 8 districts/counties in Zibo City. The general budgetary revenue of Zichuan District increased from RMB3.6 in 2022 to RMB3.9 billion in 2024, of which tax revenue accounted for 55.6%. The general budgetary revenue/general budgetary expenditure ratio increased from 76.8% to 81.7% over the same period, indicating an improving fiscal self-sufficiency. Its outstanding debt increased to RMB9.8 billion at end-2024, accounting for 19.4% of GRP as of 31 December 2024.

Exhibit 3. Key economic and fiscal indicators of the Zichuan District

| | 2022FY | 2023FY | 2024FY |
|---|--------|--------|--------|
| GRP (RMB billion) | 50.6 | 50.2 | 50.7 |
| GRP Growth (%) | 2.4 | 5.5 | 2.3 |
| General Budgetary Revenue (RMB billion) | 3.6 | 3.8 | 3.9 |
| General Budgetary Expenditure (RMB billion) | 4.6 | 4.7 | 4.8 |
| Local Government Debt (RMB billion) | 6.5 | 8.3 | 9.8 |

Source: Zichuan District Government, CCXAP research

Government's Willingness to Provide Support

Important role in regional development of the Zichuan District, primarily responsible for the development of industrial parks and supporting infrastructure

As an important urban infrastructure investment and state-owned capital investment and operation entity in Zichuan District, ZCFH has a clear strategic role in regional development, especially in the development of industrial parks and supporting infrastructure. The Company is commissioned to carry out various key infrastructure construction projects, such as industrial parks, roads, ecological restoration construction and mine rehabilitation, which are crucial to local economic development and benefit the public welfare. We believe that the Company will not be easily replaced by other local state-owned enterprises in the foreseeable future.

The Company and its subsidiary mainly engage in the infrastructure construction business through the agency construction model, municipal engineering, and self-construction model. Under the agency construction model, the Company will self-fund the construction costs, and receive payments from the local government or Zibo Banyang Urban Development Co., Ltd, another major LIIFC in Zichuan District. The process payment amount equals to the total project costs plus a 15% markup after examining the projects. Under the self-construction model, the Company will achieve fund balancing through the economic value attached to the projects. As of 30 June 2024, there were 4 key infrastructure projects under construction, with a total investment amount of RMB4.0 billion and uninvested amount of RMB733.9 million. However, there were no project reserves for the Company's infrastructure construction, which weakens the stability and continuity of the business. Moreover, there is a delay in the collection of payments for the agency construction projects.

Moreover, the Company conducts infrastructure construction management through municipal engineering with the General Contracting Qualification Certificate for Municipal Engineering (Class 2). The Company mainly acquired projects through market-orient methods, such as public bidding. The main municipal engineering projects include bridges, drainage systems, flood control measures, and street lighting. As of 30 June 2024, there were 35 projects on hand, with a total contract value of RMB576.4 million.

The Company provided environmental services in Zichuan District through its subsidiary. However, this subsidiary was transferred out of the Company and commenced marketing operations in July 2024.

Moderate exposure to commercial business activities

Apart from the public policy activities, ZCFH also participates in commercial activities such as industrial park construction and operation, financial investment, trading and leasing. Although the Company's commercial assets account for more than 30% of total assets as of the end of June 2024, we estimate the Company's risk exposure to commercial business to be moderate, as some of its commercial activities are partially policy driven.

The Company is responsible for the investment and construction of industrial parks in Zichuan District to promote local investment attraction and industrial development. ZCFH undertakes self-operating industrial park construction projects, of which the Company self-finances, develops and directly manages or sells its own construction projects. The Company would achieve fund balancing through leasing and selling the industrial parks. However, there is a certain degree of uncertainty in operating income from self-construction projects. As of 30 June of 2024, there were 3 key self-operating industrial projects under construction, with a total investment amount of RMB3.9 billion and uninvested amount of RMB1.4 billion. A large part of the Company's industrial projects under construction have been occupied by manufacturing enterprises that are interested in settling in Zichuan District. At the same time, the Company had a self-operating industrial project under planning, with a total investment amount of RMB1.3 billion. The relatively large amount of uninvested amount of industrial park construction projects would exert certain capital expenditure pressure. The Company expects to achieve financial balance by leasing or selling upon completion. However, the capital recovery cycle for industrial parks is typically long, requiring attention to the subsequent operation and investment return of the industrial parks.

ZCFH also conducts financial investment through equity investment and industrial fund investment. The Company's financial investment primarily serves the new and old growth driver transformation and industrial upgrading in Zichuan District. The Company had invested in various industries such as new materials, intelligent equipment manufacturing, new medical, and electronic information. As of 30 June 2024, the Company had 13 key direct equity investment projects, with a total investment amount of RMB325.8 million. The majority of invested companies are local private-owned enterprises, which have higher operation and concentration risks during a market downturn. In terms of fund investment, the Company had participated in the establishment of the industrial investment funds as a limited partner. The primary investments are directed towards industries such as intelligent equipment, new materials, and new pharmaceuticals. As of 30 June 2024, the Company had invested in 10 industrial funds with a total paid-up capital of RMB650.0 million and a cumulative investment return of RMB23.8 million. In 2023, the Company realized investment return of RMB60.8 million from its major equity investments. The financial investments business has significant volatility due to the early stage of the investment business. Meanwhile, it is sensitive to the performance of invested companies and changes in the economic situation.

ZCFH's trading business generates supplementary income to the Company, including the main products of corn starch and soybean meal. In 2023, the Company achieved trade revenue of RMB180.6 million with a relatively low gross profit margin of 3.4%. The Company's trading business generates a proportion of account receivables with Shandong Luwei Pharmaceutical Co., Ltd. ("Luwei Pharma"), exerting certain concentration risks. As Luwei Pharma is a large enterprise in Zichuan District, the overall risk of collecting payment is manageable. In addition, the concentration risk from upstream and downstream customers is high, with fewer than five suppliers and customers from the procurement and sales side by the end of 2023.

In addition, the Company participates in the leasing business through industrial parks, pipeline network, reservoir canal and office buildings, with annual rental income exceeds RMB130.0 million. Industrial parks are self-construction, while other leasable assets are transferred from the local government. The primary lessees are government departments, local state-owned enterprises, and enterprises related to local pillar industries. Rental payments have been made on an annual basis in recent years. As the construction of the industrial park

projects is completed and more companies settle in, ZCFH's rental income is expected to further increase in the future. However, ongoing investment in industrial park projects would bring large capital expenditure pressure.

Solid track record of receiving government supports

As a core LIIFC in the Zichuan District, ZCFH has a proven track record of receiving support from the local government in terms of capital injections, asset injections, equity transfer, and subsidies, to support its businesses and operations. From 2023 to 2024 H1, the Company received ongoing financial subsidies in cash from the local government with total amount of RMB290.0 million. The Company has received capital injections from the local government totaling RMB0.4 million in 2024. As of 31 December 2023, the accumulated payments from local government for infrastructure construction projects was RMB1.5 billion. We expect that, as the pivotal state-owned enterprise in Zichuan District, the Company plays an irreplaceable role in the development and operation of the region, and will continue to receive ongoing supports from the local government over the next 12 to 18 months.

Fast debt driven by continuous investment in infrastructure projects and industrial parks

Due to the large capital expenditure in infrastructure projects and industrial parks over the past few years, its total debt has seen a large increase. The Company's total debt rose from RMB6.5 billion as of end-2022 to RMB7.4 billion as of mid-2024. Its capitalization ratio, as measured by total debt to total capital, also rose significantly from 48.9% to 52.3%. However, the Company has a reasonable debt structure. As of 30 June 2024, the Company's short-term debt amounted to RMB1.9 billion, accounting for 25.3% of the total debt. Moreover, its cash to short-term debt ratio was more than 0.5x during the past three years, indicating the Company has moderate liquidity to cover its short-term debt repayment. Given its large capital expenditure pressure, we expect the Company's debt burden will continue to grow in the next 12 to 18 months.

The Company's asset liquidity is moderate. As of 30 June 2024, the Company's total assets consist mainly of fixed assets, inventories and account receivables, accounting for 67% of its total assets, which are considered to be low liquidity. Inventories are mainly infrastructure construction and self-operated project costs, fixed assets are reservoir canal and other buildings, while account receivables are mainly payment of infrastructure projects from the local government. Besides, as of 30 June 2024, the Company had pledged assets of RMB1.5 billion for loans, representing 8.0% of total assets. Some of the Company's other account receivables involves lending to local private-owned enterprises, and the Company bears certain recovery risk. The scale of the lending accounted for the relatively small portion of its total assets.

Access to multiple funding channels but limited standby facilities

ZCFH has shown access to multiple sources of funding, including bank loans, onshore and offshore bond financing, and non-standard financing. Bank loans is the major financing channel of the ZCFH. The Company maintains good long-term relationships with several banks such as Agricultural Development Bank of China. To support its business development, the Company receives large amount of bank loans from policy bank. The credit facilities from policy bank accounted for 76.4% of total bank facilities. However, the Company's spare liquidity is insufficient. As of 30 June 2024, the Company had obtained total credit facilities of RMB7.5 billion, which has been fully drawn for the liquidity supplementation and the construction of the projects. The limited undrawn credit facilities indicates that the Company does not have sufficient standby liquidity and may not be able to meet the investment needs of its construction projects, which would put further pressure on financing. ZCFH has also participated in both onshore and offshore debt capital markets. In January 2024, the Company

had raised RMB500.0 million through domestic private corporate bond issuance, with coupon rates at 5.0%. From January 2024 to January 2025, the Company issued three tranches of offshore bonds with total raising amount of around USD156 million. Moreover, the Company maintained a manageable exposure to non-standard financing, accounting for around 10% of its total debt as of 30 June 2024. Considering the Company's important status as the Company's public roles in Zichuan District, we expect ZCFH to maintain access to domestic bank loans and capital markets.

ESG Considerations

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

ZCFH bears social risks as it implements public policy initiatives by undertaking infrastructure construction, municipal engineering and environmental services in Zichuan District. 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.

ZCFH's governance considerations are also material as the Company is subject to oversight by the local government and the reporting requirements of 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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