

Credit Opinion

31 July 2023

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

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Shandong Zhengfang Holding Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g to Shandong Zhengfang Holding Group Co., Ltd., with stable outlook.

Summary

The BBB_g long-term credit rating of Shandong Zhengfang Holding Group Co., Ltd. (“SDZF” or the “Company”) reflects Zoucheng City Government’s strong capacity to provide support and its extremely strong willingness to provide support based on our assessment of the Company’s characteristics.

Our assessment of the Zoucheng City Government’s capacity to support reflects Zoucheng City’s relatively good economic strength and fiscal metrics, as one of the Top 100 counties in China and the top counties by gross regional production (“GRP”) in Jining City.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) important role in the infrastructure construction of Zoucheng City, especially the Zoucheng Economic Development Zone (“Zoucheng EDZ”); (2) increasing importance in the provision of local public utility services; and (3) solid track record of government support.

However, the Company’s rating is constrained by its (1) medium exposure to commercial activities; (2) increasing debt burden with large investment needs; and (3) large share of non-standard financing and unstable financing structure.

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

Rating Drivers

- Important role in the infrastructure construction of Zoucheng City
- Increasing importance in the provision of local public utility services
- Medium exposure to commercial activities
- Solid track record of government support
- Large share of non-standard financing and unstable financing structure

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the Zoucheng 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 significantly improved refinancing ability.

What could downgrade the rating?

The rating could be downgraded if (1) the Zoucheng 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 or deteriorated refinancing ability.

Key Indicators

	2020FY	2021FY	2022FY
Total Asset (RMB billion)	10.0	13.9	16.2
Total Equity (RMB billion)	4.7	5.1	6.8
Total Revenue (RMB billion)	0.8	1.5	2.1
Total Debt/Total Capital (%)	43.5	54.4	50.8

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

Source: CCXAP research

Corporate Profile

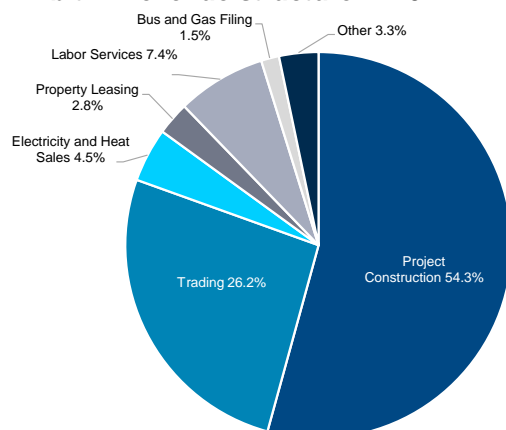
Founded in 2010, SDZF is one of the key local infrastructure investment and financing companies ("LIIFCs") in Zoucheng City, mainly responsible for infrastructure construction in the Zoucheng EDZ. The Company engages in diversified businesses, including infrastructure construction, bus operation, gas filling, industrial park operation, trading, and electricity and heat sales. SDZF was ultimately controlled by the Finance Bureau of Zoucheng City. As of 31 December 2022, the Finance Bureau of Zoucheng City held 76.51% of the Company's shares, and Agricultural Development Infrastructure Fund Co., Ltd. held the remaining 23.49% of the shares.

Exhibit 1. Shareholding chart as of 31 December 2022



Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2022



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe Zoucheng City Government has a strong capacity to provide support given its relatively good economic strength and fiscal metrics, ranking 49th out of CCID Top 100 Counties in China in 2022.

Shandong Province is the third largest province in China by GRP in 2022, with a solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive and agri-food. Jining City is located in the southern part of Shandong Province, which 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 steadily improved over the past three years. In 2022, it reported a GRP of RMB531.7 billion, representing 4.4% year-over-year ("YoY") growth, and general budgetary revenue of RMB44.8 billion. However, Jining City has moderate fiscal metrics and a debt profile. The Jining Municipal Government's fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was around 60% over the past three years. Tax incomes decreased to RMB30.2 billion in 2022 from RMB33.2 billion in 2021 because of the tax refund policy, accounting for 67.4% of its general budgetary revenue. As of 31 December 2022, its government debt to GRP ratio was 28.5%.

Exhibit 3. Key economic and fiscal indicators of Jining City

	2020FY	2021FY	2022FY
GRP (RMB billion)	449.4	507.0	531.7
GRP Growth (%)	3.6	8.5	4.4
General Budgetary Revenue (RMB billion)	41.2	44.1	44.8
General Budgetary Expenditure (RMB billion)	69.6	72.7	74.7
Local Government Debt (RMB billion)	109.5	134.5	151.4

Source: Statistics of Bureau of Jining City, CCXAP research

Located in the southwest of Shandong Province, Zoucheng City is a county-level city under the management of Jining City with good traffic advantages and rich coal resources, ranking 49th out of CCID Top 100 Counties in China in 2022. It has developed “1+5” pillar industries including digital economy, intelligent equipment manufacturing, high-end green chemical, new energy and new material, health medicine, and industrial robot, simulating Zoucheng City’s economic growth in the recent year. Supported by affluent resources, several large energy enterprises have settled in Zoucheng City, such as Yankuang Energy Group Company Limited and Huadian Power International Zouxian Power Plant. Zoucheng City is the largest counties/districts in Jining City by GRP. It had a GRP of RMB100.9 billion in 2022, accounting for 19.0% of Jining City’s GRP. Zoucheng City Government’s general budgetary revenue also has recorded several consecutive years of growth. In 2022, its general budgetary revenue increased by 1.8% YoY to RMB8.6 billion. Meanwhile, Zoucheng City Government has good financial self-sufficiency with fiscal balance ratios above 90% over the past three years. However, its tax revenue dropped by around 5.8% YoY to RMB5.2 billion in 2022 due to the taxes refund policy, accounting for 60.4% of its general budgetary revenue. As of 31 December 2022, the outstanding government debt of Zoucheng City Government was RMB10.3 billion, accounting for 10.2% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Zoucheng City

	2020FY	2021FY	2022FY
GRP (RMB billion)	82.4	96.1	100.9
GRP Growth (%)	4.0	8.7	5.0
General Budgetary Revenue (RMB billion)	8.0	8.4	8.6
General Budgetary Expenditure (RMB billion)	8.2	8.8	8.5
Local Government Debt (RMB billion)	8.0	9.1	10.3

Source: Statistics of Bureau of Zoucheng City, CCXAP research

Zoucheng EDZ is a provincial-level development zone approved by the Shandong Provincial Government in 1992, with a planned land area of 95.4 square kilometers. Zoucheng EDZ develops five leading industries including high-end green chemical industry, new energy and new materials, high-end equipment manufacturing, biomedicine and robotics. There formed three feature industrial parks in Zoucheng EDZ, namely Zoucheng Chemical Industry Park, High-end Equipment Manufacturing Industry Park, and New Energy and New Materials Industry Park. Over years of development, Zoucheng EDZ plays an important role in the economic growth and improvement of the financial income of Zoucheng City. In 2022, Zoucheng EDZ’s total output value for industrial enterprises above designated size and tax revenue accounted for more than 90% and 60% of these of Zoucheng City, respectively.

Government's Willingness to Provide Support

Important role in the infrastructure construction of Zoucheng City

There are six major LIIFCs in Zoucheng City under the control of Zoucheng City Government. Each of them has a clear position under the government's planning. Among them, SDZF is a key entity in infrastructure construction in Zoucheng City, mainly for projects in the Zoucheng EDZ such as industrial park construction, road construction and improvement, and river management. The Company has received government special bond funds for 12 major projects including industrial park projects and water supply projects.

SDZF engages in infrastructure construction mainly under the agency construction model. The Company signs entrusted construction agreements with Zoucheng Urban Construction Industry Development Co., Ltd., which is wholly owned by Zoucheng State-owned Assets Supervision and Administration Bureau ("Zoucheng SASAB") and mainly responsible for project construction, fundraising and management, investment control, and acceptance. The Company receives the actual construction cost plus a certain markup, generally 20%, as project construction revenue according to the construction progress of the project. In recent years, due to the sufficient project reserves in the Zoucheng EDZ, the Company's project construction income has increased year by year. As of 31 December 2022, the Company has completed key projects of RMB3.3 billion in total investment including the water diversion project, Zoucheng Lingang Logistics Park construction project, and public utilities. At the same time, the Company had key projects under construction and under planning with a total investment of RMB1.4 billion and an uninvested amount of RMB1.0 billion, which mainly includes road construction and improvement.

Increasing importance in the provision of public utility services

SDZF provides public utility services including bus operation and heat supply in Zoucheng City with certain franchise advantages. As the sole entity running the bus business in Zoucheng City, the Company had 1,067 operating vehicles and 66 bus routes covering intra-city lines and urban-rural lines as of the end-2022. The bus ticket prices were set by the local government at a relatively low level and the Company received operating subsidies from the local government for the bus business which covered part of the operating deficit.

With some small-scale power plants being required to shut down in Zoucheng EDZ, SDZF enters into the heat supply business in 2021 to fulfill the local needs which is essential to the livelihood of local residents and secure industrial activities. The Company provides heat for residents in Dongtan, Baodian and Nantun mining areas, and Yanzhou District. It also provides steam for companies located in the Zoucheng EDZ. As of end-2022, It had an annual capacity of 12 million square meters in heating and annual supply capacity of 5 million tons in steaming. With more companies settled in the Zoucheng EDZ, the revenue from the heat supply business is expected to increase. In addition, in 2022, the local government injected all the water plants in the urban and rural areas of Zoucheng City into the Company, which in turn expands the business scope to water supply in the future.

Solid track record of government support

SDZF has a solid track record of government support in terms of obtaining franchised business, special fund allocations for project construction, financial subsidies, asset transfer, and equity shares transfer. From 2020 to 2022, Zoucheng City Government totally injected cash of RMB720 million, assets of RMB4.1 billion, and equity shares of RMB511 million into the Company and its subsidiary. The injected assets include some stone mines, public housing and water plants, which will support the Company's asset and revenue growth. From 2020 to 2022, the Company received government subsidies of approximately RMB1.2 billion in total. In addition, the

local government also provides some preferential policies such as refunds for land consolidation, financial incentives for investment promotion, and asset transfer for revitalizing land or building resources. Given the important role in infrastructure construction and public services provision in Zoucheng City, we expect the Company will continue to receive support from the local government.

Medium exposure to commercial activities

SDZF engages in various commercial activities including trading, cemetery services, leasing, labor services, industrial property development, gas filling and equity investments. The Company's commercial activities accounted for a large portion of its total assets while such business risks are considered medium.

SDZF leased its purchased property and assets allocated by the local government to supplement its income, which mainly includes office buildings, parks and shops. As of end-2022, most of the leasable property was leased to the local government. In addition, the Company has a large investment in industrial park construction and supporting infrastructure, which plans to balance the initial investment mainly through rental and repurchase by companies to be stationed in the industrial park. Such business exposure is expected to increase in the near future. The properties that have been leased to or repurchased by the interested companies can mitigate the operational risk to a certain extent.

The Company also engages in trading business mainly under the back-to-back mode. Major products include coal, petroleum coke, ferronickel and nickel ore. The Company will enter into purchase orders according to sale contracts with its downstream customers, with a decent margin. Trading revenue has grown steadily in recent years, increasing to RMB561 million in 2022 from RMB513 million in 2021. Sales from the commodity trading segment account for a relatively large portion of the Company's operating income but generated small profit. At the same time, the concentration risk was high as the percentages of the Top 5 upstream and downstream customers were high.

Access to multiple funding sources but financing structure is relatively unstable

With the fast growth in the Zoucheng EDZ, SDZF has undertaken many major projects, leading the total debt to continue increasing. The total debt increased to around RMB7.0 billion in 2022 from RMB6.1 billion in 2021 and the total capitalization ratio (total debt/total capital) maintained at a moderate level of 50.8% in 2022. Considering the ongoing investment of the Company, it still needs to rely more on external financings such as government special funds, debt capital market and project loans to meet its capital needs.

SDZF has different financing channels such as banks, the domestic debt capital market, government special bond funds, and financial companies. However, it showed a reliance on non-standard financing and other payables, which accounted for a large portion of total debt as of the end of 2022. Such fundings are mainly short-term and have higher costs, heightening the refinancing needs for the Company.

SDZF's financing ability is supported by its good relationships with banks and the support of the local government. As of 31 December 2022, the Company had bank credit facilities of approximately RMB2.4 billion and had available credit lines of approximately RMB432.5 million. In addition, the Company obtained long-term government special bond funds of RMB493.5 million with a low cost from around 2.4% to 3.9%. Its subsidiary, namely Zoucheng Longcheng Investment Development Co., Ltd, had a bond guaranteed by another LIIFC in Zoucheng City with an outstanding amount of around RMB712.5 million as of the end-2022. SDZF also actively expands its financing channel, for example, in March 2023, the Company issued a 7-year green corporate bond

to raise RMB700 million. The financing structure is expected to improve if the percentage of long-term funding continues to increase.

The Company's refinancing ability has a significant impact on its financing stability, which may be easily influenced by the change in the financing market. The refinancing environment in Zoucheng City is moderate and the local LIIFCs bear a relatively higher funding cost. The phenomenon of mutual guarantees between local state-owned enterprises ("SOEs") exists in Zoucheng City, which exposes local SOEs to cross-default risks in case a credit event exists. As of end-2022, SDZF has provided external guarantees of around RMB665 million to local SOEs, accounting for around 9.8% of its net assets.

ESG Considerations

SDZF faces environmental risks because it has undertaken infrastructure construction in Zoucheng City. 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.

SDZF bears social risks as it implements public policy initiatives by undertaking infrastructure construction projects and providing public services in Zoucheng 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.

SDZF's governance considerations are also material as the Company is subject to oversight by the Zoucheng City Government and has to meet several reporting requirements, reflecting its public-policy role and status as a government-owned entity.

Structural Considerations

SDZF's senior unsecured debt rating is in line with its long-term credit rating. We believe that government support will flow through the Company given its important role in the industrial development of Zoucheng City, thereby mitigating any differences in an expected loss that could result from structural subordination.

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

	Shandong Zhengfang Holding Group Co., Ltd.	Zoucheng Urban Assets Holding Group Co., Ltd.
Long-Term Credit Rating	BBB _g	BBB _g
Shareholder	Finance Bureau of Zoucheng City (76.51%) and Agricultural Development Infrastructure Fund Co., Ltd. (23.49%)	Finance Bureau of Zoucheng City (100%)
Positioning	Key entity in infrastructure construction in Zoucheng City, especially the Zoucheng EDZ	Key entity in urban infrastructure and state-owned assets operation in Zoucheng City
Total Asset (RMB billion)	16.2	55.5
Total Equity (RMB billion)	6.8	21.6
Total Revenue (RMB billion)	2.1	8.7

All ratios and figures are calculated using CCXAP's adjustments based on financial data as of 31 December 2022.

Source: CCXAP research

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