

Credit Opinion

2 November 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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Zoucheng Limin Construction Development Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Zoucheng Limin Construction Development Group Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Zoucheng Limin Construction Development Group Co., Ltd. (“ZCLM” or the “Company”) reflects Zoucheng City 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 the Zoucheng City Government’s capacity to provide support reflects Zoucheng City’s relatively good economic strength and fiscal metrics, ranking it among the Top 100 counties in China and as the top county in Jining City by gross regional production (“GRP”).

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) important role in infrastructure construction in Zoucheng City, especially in the Mencius Lake New District; and (2) good track record of receiving government support.

However, the Company’s rating is constrained by its (1) medium exposure to commercial activities; (2) high refinancing needs and short-term debt burden; and (3) medium contingent liability risks.

The stable outlook on ZCLM’s 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 infrastructure construction in Zoucheng City will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Important role in infrastructure construction of Zoucheng City
- Good track record of receiving government support
- Medium exposure to commercial activities
- High refinancing needs and short-term debt burden
- Medium contingent liabilities risk

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the Zoucheng City Government's capacity to provide support strengthens; or (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as reduced exposure to commercial activities and 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, deteriorated refinancing ability, or increased exposure to commercial activities.

Key Indicators

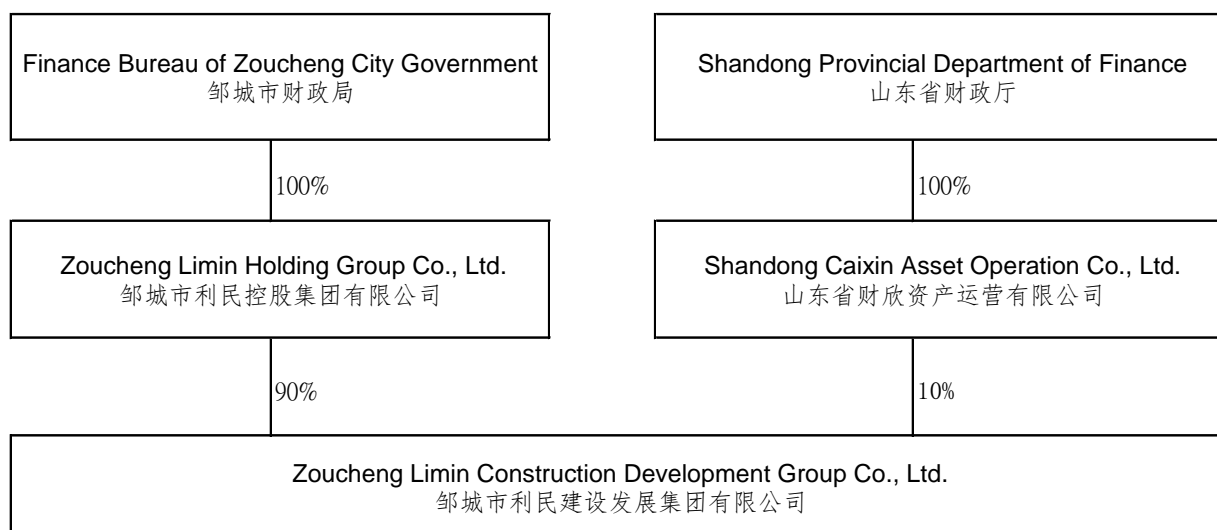
| | 2020FY | 2021FY | 2022FY |
|------------------------------|--------|--------|--------|
| Total Asset (RMB billion) | 14.7 | 18.4 | 21.2 |
| Total Equity (RMB billion) | 5.2 | 6.5 | 8.2 |
| Total Revenue (RMB billion) | 1.3 | 1.5 | 1.6 |
| Total Debt/Total Capital (%) | 59.9 | 59.1 | 50.2 |

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

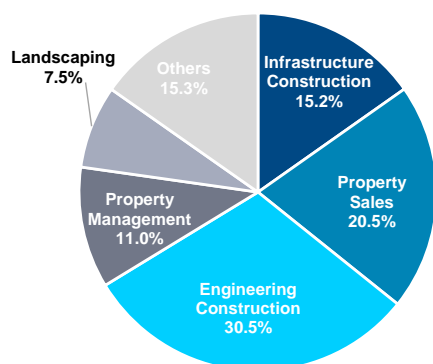
Source: Company information, CCXAP research

Corporate Profile

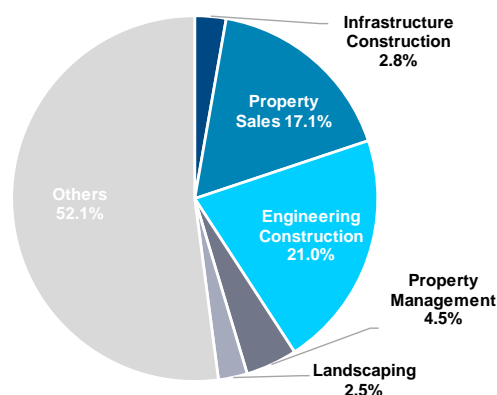
Founded in 2012, ZCLM is one of the key local infrastructure investment and financing companies ("LIIFCs") in Zoucheng City, responsible for infrastructure construction in Zoucheng City, particular in the Mencius Lake New District. The Company diversified its business into infrastructure construction, engineering construction, property sales, property management, landscaping and product sales. As of 31 March 2023, Finance Bureau of Zoucheng City was the ultimate controller of ZCLM, holding 90% of the Company's shares through Zoucheng Limin Holding Group Co., Ltd. The remaining 10% of the shares were held by Shandong Caixin Asset Operation Co., Ltd., which is wholly held by Shandong Province Department of Finance.

Exhibit 1. Shareholding chart as of 31 March 2023

Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2022

Source: Company information, CCXAP research

Exhibit 3. Gross profit structure in 2022**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 among CCID's Top 100 Counties in China in 2022.

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. 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 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 moderate debt profile. The Jining Municipal Government's fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was around 60% over the past three years. Affected by the tax refund policy, tax incomes decreased to RMB30.2 billion in 2022 from RMB33.2 billion in 2021,

accounting for 67.4% of its general budgetary revenue. As of 31 December 2022, its government debt to GRP ratio was 28.5%.

Exhibit 4. 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: Jining Municipal Government, CCXAP research

Located in the southwest of Shandong Province, Zoucheng City is a county-level city under the management of Jining City. It has good traffic advantages and rich coal resources, ranking 49th among CCID's 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 recent years. Supported by abundant resources, several large energy enterprises have settled in Zoucheng City including Yankuang Energy Group Company Limited and Huadian Power International Zouxian Power Plant. Zoucheng City is the largest county/district in Jining City by GRP. It had a GRP of RMB100.9 billion in 2022, accounting for the GRP of 19.0% of Jining City. 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 5. 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: Zoucheng City Government, CCXAP research

Government's Willingness to Provide Support

Important role in infrastructure construction in Zoucheng City

There are six major LIIFCs in Zoucheng City under the control of the Zoucheng City Government. Each of them has a clear position under the government's planning. Zoucheng Urban Assets Holding Group Co., Ltd. ("ZCUA") is mainly responsible for infrastructure construction, public services and state-owned assets management in Zoucheng City. Shandong Zhengfang Holding Group Co. Ltd. is responsible for infrastructure construction especially the Zoucheng City Economic Development Zone, and public services in Zoucheng City. ZCLM is a key entity for infrastructure construction in Zoucheng City, especially the Mencius Lake New District

of Zoucheng City. It has completed several projects since its establishment including ecological landscape construction of Yangxia river, the exhibition center, the Wanglan shanty town project and the Chenglan shanty town project. Both Wanlan and Chenglan have been listed as the key shanty town renovation projects of Shandong Province.

ZCLM mainly conducts infrastructure construction through agency construction. Under the agency construction model, the Company signs an agency agreement with the Zoucheng City Government. After the project is completed and passed the acceptance examination, the Finance Bureau of Zoucheng City would pay the actual cost plus a markup of no less than 6% to ZCLM. As of 31 December 2022, the Company had 8 entrusted construction projects under construction and planning, with a total investment of RMB1.4 billion and an uninvested amount of RMB786 million, which mainly includes hospitals, schools, and high-speed rail station connecting line projects.

ZCLM is also engaged in road engineering construction projects such as village-to-village projects and county road construction through signing engineering construction contracts mainly with the Transportation Bureau of Zoucheng City and other local state-owned enterprises. ZCLM possesses two Class II Qualifications for Specialized Contracting of highway surface work and highway subgrade work. As of 31 December 2022, the Company had 43 contracts on hand with a contract value of RMB720 million. There was a key road construction project under construction, namely the 2020 traffic project county road maintenance project, with an uninvested amount of RMB284 million.

Medium exposure to commercial activities

ZCLM engages in various commercial activities including property development, property management, landscaping, product sales and self-operated projects. The Company's commercial activities accounted for a large portion of its total assets while the business risks are considered medium. While commercial activities contribute the vast majority of revenue and cash flow, they may also pose higher operating and business risks than traditional infrastructure construction businesses.

ZCLM's property development business includes commodity housing projects and resettlement housing projects. As of 31 December 2022, the Company had a commodity housing project under construction, Ruyi Garden, with an uninvested amount of RMB250 billion, of which around 60% has been sold. Meanwhile, there was a commercial project orienting migrant workers had been completed and was on sale, but the sales progress was relatively slow. Meanwhile, the Company had 2 commodity housing projects under planning with a planned total investment of RMB1.1 billion, and had obtained the relevant land use rights. During the downturn in China's property market, due to uncertainty of construction and sales progress, the fund balance of this business would suffer from high volatility.

The Company also undertakes some self-operated projects. As of end-2022, there was one self-operated project under construction, which is a rehabilitation and retirement center and a special care building, with a total investment of RMB1.1 billion and an uninvested amount of RMB127 million. This project is expected to achieve fund balancing by leasing. In addition, as of end-2022, the Company has investment properties with a book value of around RMB3.5 billion, accounting for around 16.6% of total assets, which are mainly self-financed and self-built office buildings. However, they just generate small rental revenue and are highly related to the actual investment attraction in the area.

ZCLM is also engaged in property management business. The main service target is Yankuang Energy Group Company Limited, a state-owned coal mining company. The Company's reliance on a single customer could

hinder its bargaining power. As of 31 December 2022, the service area was 5.7 million square meters including housing, offices and communities in Jining and Heze. This business contributed a certain amount of supplementary revenue to the Company over the past three years. The revenue of property management business was around RMB179 million in 2022, accounting for around 11% of the total revenue.

Good track record of receiving government support

ZCLM has received ongoing support from the local government including project payments, operational subsidies, capital injections, equity shares transfer, and asset transfers. In 2018, the local government increased its paid-in capital by RMB400 million to RMB700 million. From 2020 to 2022, the Company received a total of RMB310 million in financial subsidies. In 2022, the local government transferred RMB844 million of seedling assets and allocated RMB222 million in cash as ZCLM's capital reserves, enhancing its capital strength and bringing additional income. Given the important role of ZCLM in infrastructure construction in Zoucheng City, we expect the Company will continue to receive support from the local government over the next 12 to 18 months.

High refinancing needs and short-term debt burden

ZCLM has high refinancing needs caused by its relatively large portion of short-term debt with large maturity amount. From 2020 to 2022, the Company's total debt increased to RMB8.3 billion from RMB7.8 billion. As of end-2022, short-term debt accounted for 59.7% of total debt, of which the long-term debt due within 2023 amounted to around RMB2.3 billion. The cash to short-term debt ratio was around 0.5x, indicating that its cash balance was insufficient to cover its short-term debt. Nevertheless, from 2020 to 2022, the Company's financial leverage measured by the total capitalization ratio (total debt/total capital) decreased to 50.1% from 59.9% due to the increase in total capital. Considering its ongoing investment especially in commercial activities with longer investment period, we expected the Company's debt leverage to remain at a relatively high level over the next 12-18 months.

ZCLM has a less balanced financing structure which also increases its refinancing risks. It has different financing channels including bank loans, bond insurance, and non-standard product financing. However, it showed a reliance on non-standard financing which accounted for around 35% 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. In addition, the bank borrowings were mainly secured loans, pledged loans and guaranteed loans, and all outstanding bonds were guaranteed by ZCUA.

The Company maintains good relationships with banks and financial companies, which partially release its refinancing needs. As of 31 December 2022, the Company had total credit facilities of RMB4.8 billion, of which the available amount was RMB742 million. The facilities were provided by diversified banks and financial companies such as Industrial and Commercial Bank of China Limited, EverGrowing Bank Company Limited, and Bank of Jining Company Limited. The refinancing environment in Zoucheng City is moderate and the local LIIFCs bear a relatively higher funding cost. ZCLM's refinancing ability is highly subject to changes in the local financing market.

Moreover, ZCLM's assets liquidity was moderate. As of end-2022, the restricted assets had a book value of RMB3.8 billion, accounting for around 18.1% of total assets. In addition, the Company has franchise of reservoir and mining rights with book values of around RMB376 million and RMB981 million, respectively, however, the Company generated minimal income from the reservoir and has not started the mining business yet.

Medium contingent liabilities risk from external guarantees to the local state-owned enterprises

The Company bears moderate contingent risk resulting from large external guarantees. As of 31 December 2022, the Company's external guarantees amounted to RMB2.6 billion, accounting for 31.9% of its net assets, and were provided to local state-owned enterprises ("SOEs"). The phenomenon of mutual guarantees between local SOEs is common in Zoucheng City. In case a credit event occurs, the Company may face certain contingent liability risks and cross-default risks. Considering the important role of the SOEs in Zoucheng City, we estimate the local government would provide timely support to most of them so that contingent risk resulting from external guarantees would be controllable.

ESG Considerations

ZCLM 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.

ZCLM bears social risks as it implements public policy initiatives by undertaking infrastructure construction projects 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.

ZCLM'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

ZCLM'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 infrastructure construction in 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

| | Zoucheng Limin Construction Development Group Co., Ltd. | Shandong Zhengfang Holding Group Co., Ltd. | Zoucheng Urban Assets Holding Group Co., Ltd. |
|-----------------------------|---|--|--|
| Long-Term Credit Rating | BBB _g - | BBB _g | BBB _g |
| Shareholder | Zoucheng Limin Holding Group Co., Ltd. (90%) and Shandong Caixin Asset Operation Co., Ltd. (10%) | 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 Mencius Lake New District | Key entity in infrastructure construction in Zoucheng City, especially the Zoucheng Economic Development Zone | Key entity in urban infrastructure and state- owned assets operation in Zoucheng City |
| Total Asset (RMB billion) | 21.2 | 16.2 | 55.5 |
| Total Equity (RMB billion) | 8.2 | 6.8 | 21.6 |
| Total Revenue (RMB billion) | 1.6 | 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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