

Credit Opinion

3 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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Mengcheng Development Zone Xingmeng Investment Co., Ltd.

Initial credit rating report

CCXAP assigns first time long-term credit rating of BBB_g- to Mengcheng Development Zone Xingmeng Investment Co., Ltd., with a stable outlook.

Summary

The BBB_g- long-term credit rating of Mengcheng Development Zone Xingmeng Investment Co., Ltd. ("XMIC" or the "Company") reflects (1) the Mengcheng County Government's relatively strong capacity to provide support; and (2) the local government's extremely high willingness to provide support, based on our assessment of the Company's characteristics.

Our assessment of Mengcheng County Government's capacity to provide support reflects its ongoing economic growth, but constrained by its relatively weak fiscal metrics.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) 100% direct ownership by the Mengcheng County Government; (2) important role in the infrastructure construction and industrial development in Mengcheng County; and (3) good track record of receiving government support.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities; (2) moderate access to funding; and (3) medium exposure to contingent liabilities.

The stable outlook on XMIC's rating reflects our expectation that Mengcheng County Government's capacity to provide support will remain stable, and that the Company will maintain its important position in the development of Mengcheng County over the next 12 to 18 months.

Rating Drivers

- Important role in the infrastructure construction and industrial development in Mengcheng County
- Medium exposure to commercial activities
- Good track record of receiving government support
- Increasing debt level to support investment in construction projects
- Moderate access to funding
- Medium exposure to contingent liabilities

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Mengcheng County Government's ability 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 reduced exposure to risk commercial activities and improved access to funding.

What could downgrade the rating?

The rating could be downgraded if (1) Mengcheng County Government's ability to provide support weakens; or (2) the Company's characteristics change in a way that decreases the local government's willingness to provide support, such as reduced regional significance or material deteriorated debt management.

Key Indicators

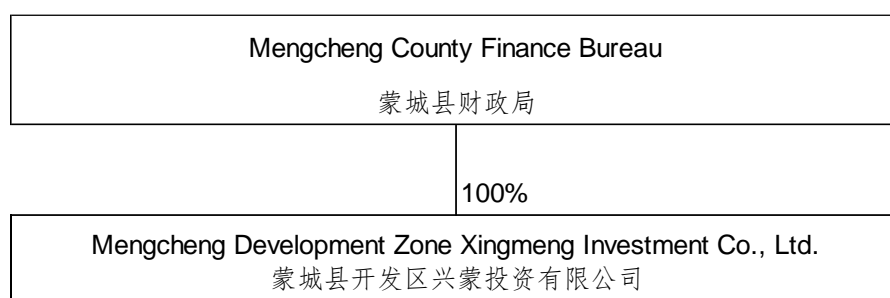
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	4.6	7.2	9.5	10.5
Total Equity (RMB billion)	2.8	4.6	5.0	5.1
Total Revenue (RMB billion)	0.6	0.8	1.3	0.4
Total Debt/Total Capital (%)	33.4	30.6	40.4	46.5

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

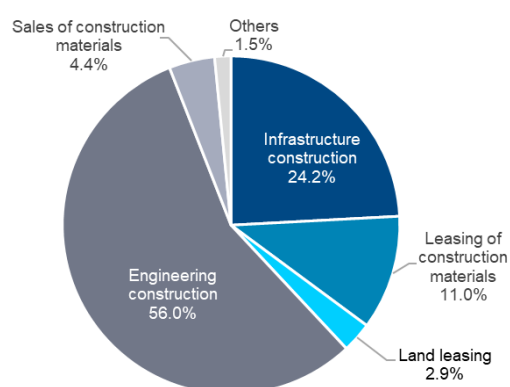
Source: Company information, CCXAP research

Corporate Profile

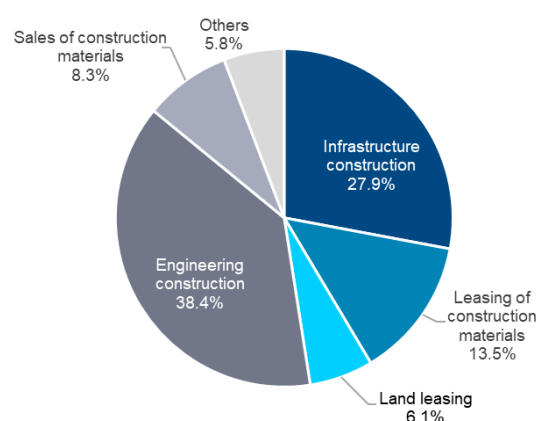
Founded in 2017, XMIC is one of the core local infrastructure investment and financing companies ("LIIFCs") in Mengcheng County. The Company is engaged in diversified businesses, such as infrastructure construction, engineering construction, land leasing, sales of construction materials, and leasing of construction materials. As of 30 June 2023, the Mengcheng County Finance Bureau was the ultimate controller of XMIC, directly holding 100% shares of the Company.

Exhibit 1. Shareholding chart as of 30 June 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 that the Mengcheng County Government has a relatively strong capacity to provide support to the Company, given its ongoing economic growth. However, its fiscal metrics were relatively weak.

Bozhou City is a prefecture-level city in northwestern Anhui Province and the hinterland of the Huanghuai Plain. It is one of the cities in the Strategy for integrated development of the Yangtze River Delta. Its pillar industries include Chinese medicine, liquor and agricultural products processing, automobile and parts manufacturing, and cultural tourism. The economic strength of Bozhou City was at the median level among provincial-level cities in Anhui Province, but continued to improve steadily in recent years with growth rates higher than that of Anhui Province. In 2022, its gross regional product ("GRP") increased to RMB210.2 billion from RMB180.6 billion in 2020. At the same time, the general budgetary revenue of Bozhou Municipal Government increased from RMB12.6 billion to RMB14.8 billion. The fiscal balance ratio of the Bozhou Municipal Government remained moderate. In 2022, the fiscal balance ratio (calculated by general budgetary revenue/general budgetary expenditure) was 38.5%. The debt profile of the Bozhou Municipal Government is relatively weak. At the end of 2022, the government debt balance increased to RMB83.9 billion, accounting for around 39.9% of GRP. Bozhou City's GRP was RMB111.6 billion in the first half of 2023, with a growth rate of 7.3% compared to the first half of 2022.

Exhibit 4. Key economic and fiscal indicators of Bozhou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	180.6	197.3	210.2
GRP Growth (%)	4.1	8.6	4.2
General Budgetary Revenue (RMB billion)	12.6	14.0	14.8
General Budgetary Expenditure (RMB billion)	39.1	37.7	38.5
Local Government Debt (RMB billion)	61.7	72.6	83.9

Source: Bozhou Municipal Government, CCXAP research

Mengcheng County is located in the Southeast of Bozhou City, which is also within the coverage of the integrated planning of the Yangtze River Delta, and enjoys favorable conditions for economic development. Besides, Mengcheng County enjoys abundant natural resources such as mineral and coal resources. It is a large producer of agricultural products such as high-quality wheat, corn, yam, cotton, and rapeseed. In accordance with the report of CCID Consulting, Mengcheng County has been ranked in the list of “Top 100 Counties (Cities) for Business Environment” in 2019 and “Top 100 Counties in the Yangtze River Delta” in 2022. The leading industries in Mengcheng County include automobile and equipment manufacturing, new building materials and household products, food manufacturing and agricultural products processing. In 2022, Mengcheng County’s GRP amounted to RMB45.9 billion, with a YoY growth rate of 4.4%. Mengcheng County Government’s general budgetary revenue kept increasing over the past three years, which increased to RMB2.8 billion in 2022 from RMB2.4 billion in 2020. However, its fiscal balance ratio remained moderate with ratios less than 40% over the past three years, 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 2022, the outstanding debt of Mengcheng County Government increased to RMB17.8 billion, accounting for 38.8% of its GRP.

Exhibit 5. Key economic and fiscal indicators of Mengcheng County

	2020FY	2021FY	2022FY
GRP (RMB billion)	39.2	42.9	45.9
GRP Growth (%)	3.2	8.7	4.4
General Budgetary Revenue (RMB billion)	2.4	2.6	2.8
General Budgetary Expenditure (RMB billion)	7.1	6.7	7.0
Local Government Debt (RMB billion)	12.8	15.0	17.8

Source: Mengcheng County Government, CCXAP research

Government’s Willingness to Provide Support**Important role in the infrastructure construction and industrial development in Mengcheng County**

XMIC is one of the core LIIFCs in Mengcheng County and is directly owned by the local government. The Company plays an important role in the industrial and economic development of Mengcheng County, especially the Mengcheng County Economic Development Zone (“Mengcheng EDZ”), through largely contributing to the local infrastructures and capital attraction. The Company has introduced number of enterprises to Mengcheng County through the construction of industrial parks, forming an important contribution to the local government’s tax revenue.

XMIC’s infrastructure construction business mainly includes the urban and rural construction land increase and decrease linked projects in Mengcheng County. These projects aim to increase the urban construction land by consolidate the rural arable land. According to the agreement signed with the Mengcheng Natural Resources and Planning Bureau, the Company undertakes the vacation and reclamation of homesteads in 17 townships

and street offices in Mengcheng County and the project cycle is 7 years. The local government usually pays 120% of the Company's total investment (including the cost of land acquisition and relocation) to the Company, which usually be settled annually. As of the end of June 2023, the total investment of the project is approximately RMB992.0 million, with a total of RMB914.0 million invested. The project has recognized revenue of RMB712.0 million, of which RMB387.9 million has been paid back during the same period. Meanwhile, the Company has proposed projects with a total planned investment of RMB1.6 billion. The Company has sufficient project reserves that support good stability and sustainability of the infrastructure construction business.

For the land leasing business, the Company generally acquires assets from projects that were shut down due to poor management in the early stage, then rents or sells these facilities to generate revenue after renovation and reconstruction. The land leasing business is generally for revitalizing the distressed assets of Mengcheng County and will benefit the economic growth of the County.

Medium exposure to commercial activities

XMIC is engaged in diversified commercial activities including engineering construction, construction of industrial parks and rental housing, sales of construction materials and leasing of construction materials. The contribution from these commercial activities to the revenue increased yearly to more than 70% in 2022. However, these commercial activities may entail higher operational and business risks than public policy activities. Based on our estimates, the Company had medium exposure to commercial activities, which accounted for less than 30% of its total assets.

XMIC is engaged in engineering construction through its subsidiary and construction projects are mainly within Mengcheng County acquired through tender invitations and public bidding. The main customers in recent years are government, state-owned enterprises, as well as enterprises settled in Mengcheng County. As of the end of June 2023, The Company had 2 key projects under construction, with a total investment of RMB320.9 million and an outstanding amount of RMB21.9 million. The Company also has 3 proposed projects with a total planned investment of RMB3.3 billion. These proposed projects are planned to be carried out in phases, which could alleviate the pressure on funding requirements. However, a portion of the project payment settled untimely by private-owned enterprises caused amounts of accounts receivable. Meanwhile, as the business is mainly concentrated in Mengcheng County, it is susceptible to being affected by regional market sentiment in the future.

XMIC also has self-operated projects including industrial parks and rental housing, aiming to support local industries and supplement its income. The business plans to recover the pre-invested funds through sale or rental. The Company has a large investment in the construction of industrial parks. As of 30 June 2023, the Company had 6 projects under construction, with a total investment of RMB1.5 billion and an outstanding amount of RMB929.2 million. The Company also has 5 proposed projects with a total planned investment of RMB4.9 billion. These self-construction projects are highly related to local industrial development and the progress of investment attraction, which may bring greater uncertainties to the Company.

The sales of construction materials cover purchasing steel, building materials, and other materials. The Company adds costs and certain profit margins to the purchase prices before selling. However, the top five customers from upstream and downstream account for 82.57% and 62.09% respectively as of 30 June 2023, the concentration risk from upstream and downstream customers is high.

The Company's leasing of construction materials business primarily procures projects through bidding. It signs leasing contracts with downstream construction companies based on the project obtained. The reserve of aluminum templates and other building materials basically meets the Company's leasing needs at the present

time and the demand for subsequent purchases will be reduced. However, the concentration of downstream customers is high, sales from the top five customers accounting for 81.7% of the total sales as of 30 June 2023. Because most customers are private-owned enterprises, the payback status requires more attention.

Solid track record of receiving government support

As one of the core LIIFCs of Mengcheng County, XMIC has a good track record of receiving support from the local government in the form of asset injections, project repayments and government subsidies to support its operation. The Company received government subsidies of over RMB239.0 million from 2020 to 2023H1. The government also injected assets into the Company to enhance its capital strength. For example, the Company received RMB922.0 million in cash as paid-in capital from the government in 2021. The Company also received land development and consolidation project repayments of RMB387.9 million in 2021. Given the Company's important position and its close relationship with the local government, we expect that the Company will continue to receive support from the local government.

Increasing debt level to support investment in construction projects

XMIC shows a rising debt burden owing to its expansion in construction projects over the past three years. As of 30 June 2023, the Company's total debt increased to RMB4.4 billion from RMB1.4 billion at end-2020. The Company's capitalization ratio increased from 33.4% to 46.5% during the same period, but remained at a moderate level. As of 30 June 2023, the Company's short-term debt accounted for 36.5% of total debt and the cash to short-term debt ratio was around 0.6x, indicating refinancing needs for its short-term debt.

XMIC has a large investment plan for its infrastructure construction and commercial business. As of 30 June 2023, the proposed land-linked project still requires a total planned investment of RMB1.6 billion in the future. Moreover, the Company plans to expand its commercial activities. With large investment needs, we expect the Company's debt level will continue to increase in the next 12 to 18 months.

Moderate access to funding

XMIC has moderate access to funding constrained by its small operating scale. It relies highly on indirect financing and has limited access to the domestic debt market. The debt from bank loans accounted for a majority of the total debt. The Company maintains long-term relationships with different large domestic banks including large state-owned commercial banks and joint-stock commercial banks. As of 30 June 2023, the Company had total bank facilities of RMB5.7 billion, with the available portion being RMB3.2 billion. As of end-June 2023, non-standard financing borrowing accounted for around 15% of total debts with relatively high costs, including financial leases and trust loans, which reduced the financial flexibility of the Company. The Company expanded its funding channels and successfully issued two tranches of offshore bonds in July and August 2023 to raise a total of CNY810.0 million.

Medium exposure to contingent liabilities

XMIC's credit profile is constrained by its external guarantees, which could potentially increase its repayment obligations. As of 30 June 2023, the Company had external guarantees of RMB1.5 billion, accounting for around 29.0% of its net assets, which exposes the Company to substantial contingent liabilities. The guarantees are provided to other LIIFCs in Mengcheng such as Mengcheng County Urban Development Investment Holding Group Co., Ltd with a total amount of RMB720 million. In case a credit event occurs, the Company may face large-scale cross-effects risks, which could negatively impact its credit quality. Nevertheless, we believe that the contingent risk of the external guarantee is moderately controllable, considering the position of these state-

owned enterprises and may receive timely support from the local government.

ESG Considerations

XMIC faces environmental risks because it has undertaken infrastructure construction projects. Such risks could be mitigated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

XMIC bears social risks in implementing public policy initiatives through the building of public infrastructure in Mengcheng County. 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.

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

Structural Considerations

XMIC'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 strong role in the development of Mengcheng County, 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 \(July 2022\)](#).

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