

Credit Opinion

8 February 2024

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

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Heze Finance Investment Group Co., Ltd.

Surveillance credit rating report

CCXAP upgrades Heze Finance Investment Group Co., Ltd.'s long-term credit rating to BBB_g+, with stable outlook.

Summary

China Chengxin (Asia Pacific) Credit Ratings Company Limited ("CCXAP") has upgraded the long-term credit rating of Heze Finance Investment Group Co., Ltd. ("HZFI" or the "Company") to BBB_g+

 from BBB_g, reflecting the improving comprehensive strength of Heze City. The Heze Municipal Government continues to receive large number of transfer payments from the Shandong Provincial Government, demonstrating its importance in Shandong Province.

The BBB_g long-term credit rating of HZFI reflects Heze Municipal Government's (1) very strong capacity to provide support based on our assessment of Heze City; 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 increasing economic strength and moderate fiscal metrics.

The rating also reflects the local government's very high willingness to provide support, based on the Company's (1) strategic role in investing and constructing key municipal projects and the economic and social development of Heze City; and (2) good track record of receiving government supports.

However, the rating is constrained by the Company's (1) high exposure to commercial activities; (2) increasing debt burden driven by construction projects; and (3) medium contingent risks resulting from external guarantees.

The stable outlook on HZFI's rating reflects our expectation that the local government's capacity to provide support will remain stable, and the Company will maintain its strategic role in the economic and social development of Heze City over the next 12-18 months.

Rating Drivers

- Strategic role in investing and constructing key municipal projects and the economic and social development of Heze City
- Providing public services with regional dominance and high sustainability
- Good track record of receiving government supports
- High exposure to commercial activities
- Increasing debt burden driven by construction projects
- Access to different funding channels
- Medium contingent risks resulting from external guarantees

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Heze Municipal Government's capacity to support strengthens; and (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.

What could downgrade the rating?

The rating could be downgraded if (1) Heze Municipal 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, decreased government payments, or deteriorated debt management.

Key Indicators

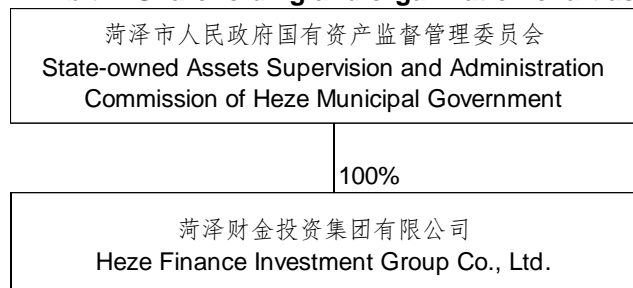
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	25.6	30.3	32.4	33.2
Total Equity (RMB billion)	11.4	14.6	14.7	14.8
Total Revenue (RMB billion)	5.1	5.2	5.4	2.8
Total Debt/Total Capital (%)	26.1	28.6	33.4	37.9

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

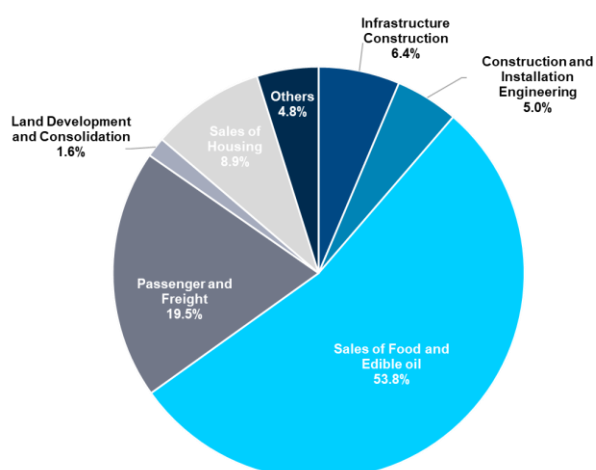
Source: Company data, CCXAP research

Corporate Profile

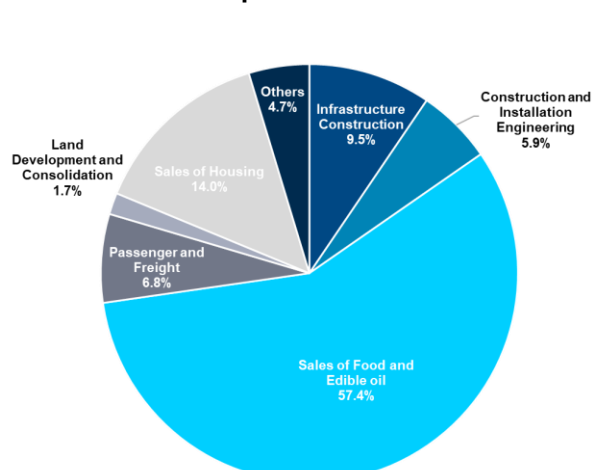
Founded in March 1994, HZFI is an important local infrastructure investment and financing company ("LIIFC") in Heze City, which is one of the leading entities in the development blueprint of Heze Municipal Government. The Company plays a strong strategic role in the social, economic, and urban development of Heze City. Specifically, HZFI is responsible for major public policy projects, including infrastructure construction, land development and consolidation, policy-oriented grain storage, and public transportation. It also engages in commercial activities such as sales of housing, sales of commercial food and edible oil, cultural tourism, as well as industrial investment. As of 30 June 2023, the State-owned Assets Supervision and Administration Commission of Heze Municipal Government ("Heze SASAC") had 100% ownership of HZFI.

Exhibit 1. Shareholding and organization 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 the local government of Heze City has a strong capacity to provide support given its sound economic fundamentals, with increasing economic strength and moderate fiscal metrics.

Shandong is the third largest province in China by gross regional products ("GRP"), with a solid foundation in different 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 RMB445.0 billion, recoding an economic growth of 6.5% year-over-year ("YoY"). Heze City demonstrated improving comprehensive strength over the past three years. The general budgetary revenue of Heze Municipal Government also increased from RMB28.4 billion in 2021 to RMB31.7 billion in 2023. Its fiscal balance was modest, with a general budgetary revenue to general budgetary expenditure ratio of 43.1%, and tax accounted for 64.8% of the general budgetary revenue. The Heze Municipal Government continues to receive large number of transfer payment from the Shandong Province, demonstrating its importance in Shandong Province. From 2021 to 2023, Heze Municipal Government totally received the transfer payments of RMB119.7 billion from Shandong Provincial Government and obtained the government

special bonds of RMB59.7 billion. In 2022, the sum of general-purpose transfer payments, specific-purpose transfers, and government fund budget transfer payments of Heze Municipal Government ranked 1st among all prefecture-level cities in Shandong Province. However, the government fund income dropped by RMB11.6 billion YoY to RMB29.0 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 weigh on the land sales in following years. As of 31 December 2023, Heze Municipal Government reported an outstanding government debt of RMB150.1 billion and accounted for 33.7% of its GRP, increasing from that of RMB131.2 billion and 31.2% as of 31 December 2022.

Exhibit 4. Key economic and fiscal indicators of Heze City

	2021FY	2022FY	2023FY
GRP (RMB billion)	397.7	420.5	445.0
GRP Growth (%)	8.8	4.2	6.5
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

Strategic role in investing and constructing key municipal projects and the economic and social development of Heze City

HZFI is one of the most important LIIFCs in Heze City that undertakes city development projects and provision of public services. Moreover, the Company is positioned as a pivotal entity in state-owned capital operation and the key municipal project investment and financing platform of Heze City. HZFI focuses on the key infrastructure construction projects, policy-oriented grain storage, public transportation, as well as land development and consolidation, which are crucial to the economic and social development of Heze City. In addition, the Company has performed well in undertaking major livelihood projects in Heze City.

HZFI carries out key infrastructure construction projects on both agent construction basis and self-construction basis. Under agent construction basis, the Company signs an entrusted construction contract with the entrusting unit (mainly government departments and local state-owned enterprises) in relation to its infrastructure construction services and is in charge of the implementation of certain major public infrastructure projects. As of 30 June 2023, HZFI had completed several projects consisting of pipeline of heating supply, hospital, and government service center, as well as school. These projects are essential to local economic development and provide benefits to the general public and local employment. At the same time, the Company had a total of 7 projects under construction, with a total investment of RMB957.0 million and an outstanding amount of RMB329.0 million. Meanwhile, the Company had 3 projects under planning, with a planned investment of RMB823.0 million.

According to business plan of HZFI, the Company would gradually switch the business model of infrastructure construction from agent construction basis to self-construction basis. There were 2 key self-construction projects under construction, namely, Heze Municipal Hospital East Campus and Water Storage & Supply Security Project, with a total investment of RMB4.0 billion. Heze Municipal Hospital East Campus is the important livelihood project in Heze City and is expected to be the largest medical complex in Southwest Shandong Province after completion. Water Storage & Supply Security Project is the key water conservancy project aimed at alleviating local water shortages and enhancing water supply security in Heze City. These two projects also

receive government special fund to support its construction, which would partially mitigate the Company's capital expenditure pressure.

HZFI also engages in municipal project construction through engineering construction, with relevant construction qualifications. The Company acquires projects through open market or negotiation with third parties, which are mainly concentrated in Heze City. Thanks to its strategic position in regional development, the Company has certain advantages in acquiring local municipal projects with multiple contracts in hand. The Company newly signed 7 municipal projects with a total amount of approximately RMB118.0 million in 2022. According to the management, the Company proposes to reduce the project scale for engineering construction business in the future and focuses on existing projects.

In addition, HZFI participates in the land development and consolidation business in rural land remediation projects in Heze City, by conducting works on homesteads within the pilot areas. The Company is required to invest funds and entrust enterprises to dismantle, reorganize and reclaim rural construction land into cultivated land, in order to create surplus land quotas, that are exchanged in Shandong Province. As of 30 June 2023, the Company had 2 lands to be consolidated, with a total area of 0.3 million square meters and investment of around RMB150.0 million.

In view of HZFI's strategic role in the development of local economic and social development, we believe that the potential substitution is relatively low and government support is very likely in the near future.

Providing public services with regional dominance and high sustainability

HZFI is responsible for policy-oriented grain storage involving the purchase, storage, transfer, and wholesale of grain and edible oil. The main products are municipal-level grain reserves, national grain with minimum purchase prices, and national temporary grain reserves, respectively, that guarantee food supply in the society. The local government also provides subsidies to the business due to its public welfare nature. As of 30 June 2023, the Company had total reserves of 110.0 thousand tons of municipal-level grain, 140 thousand tons of national grain with minimum purchase prices, and 62.0 thousand tons of national temporary grain. Moreover, the Company owned 27 grain storage areas in Heze City and total capacity of 1.2 million tons.

Also, HZFI is the leading public transportation operator, providing passenger transport services within the majority area of Heze City, including the operation of passenger transport liner and public transport. The Company takes part in this dominant business in terms of contracting and self-operated with different public vehicles, mainly operates long-distance passenger transportation between urban areas (counties) to other urban areas, intercity buses from Heze City to various counties, urban and rural public transportation, as well as the public transportation within several counties including Juancheng, Chengwu, and Shanxian. As of 30 June 2023, HZFI had over 2,000 public vehicles operating in approximately 200 routes, with the amount of annual transported passengers reaches approximately 13 million.

We believe that the replacement cost of the Company is very high as these public services are essential for local residents, showing high sustainability.

Good track record of receiving government supports

The Company has a good track record of receiving support from the local government in terms of subsidies, capital injection, special funds, and equity transfers. The local government increased the Company's capital base through direct cash and asset injections. From 2020 to 2023H1, the Company received 100% equity of several companies, significantly enhancing its business scope. In 2021, the local government transferred coal

prospecting rights to the Company with assessed value of RMB3.9 billion, increasing its capital reserve. In addition, from 2020 to 2023H1, the Company received ongoing subsidies for carrying out policy-support activities such as infrastructure construction projects and policy-oriented grain storage business, with total amount of approximately RMB872.0 million. As of 30 June 2023, the local government provided special bond of RMB930.0 million to support the Company's ongoing construction and operation.

Considering HZFI's strategic role in Heze City and close relationship with Heze Municipal Government, we expect the local government will continue to enlarge the Company's asset size through cash and asset injection. We also believe that the Company will receive subsidies and special bonds from the local government in a timely manner.

High exposure to commercial activities

HZFI engages in various commercial activities mainly including sales of housing, sales of commercial food and edible oil, cultural tourism, as well as industrial investment. HZFI's commercial assets accounted for large proportion of total assets, in our estimation, some of the commercial activities are subject to volatile market and counterparties risk. Despite some of these activities that are more policy-driven and related to its public policy businesses, it is more difficult for the government to provide direct support to the Company if the commercial activities continue to expand.

Sales of food and edible oil is the main business of HZFI, which covers more than 290 prefecture-level cities and contributed the majority of the Company's revenue. The Company adopts both direct selling and agent selling models, and has developed long-term business relationships with more than 300 dealers. The Company's top 5 customers accounted for 8.2% and 3.7% of total sales in 2022 and 2023H1, respectively, showing a low concentration. Moreover, around 80% of business was settled by cash or prepaid payment, therefore, we believe the risk associated with this business is controllable.

HZFI has engaged in housing transactions within Heze City; however, in recent years, there has been an increased destocking pressure. The Company's sales of housing business is highly concentrated in Heze City, which is affected by changes in local regulatory policies and economic conditions, as evidenced by the significant drop in revenue. During the downturn in China's property market, the fund balancing would experience high volatility because of the uncertainty of construction and sales progress, causing higher business and financial risks to the Company. As of 30 June 2023, HZFI had 3 projects under construction, with a total investment of RMB5.4 billion and an uninvested amount of RMB2.3 billion.

Moreover, HZFI has expanded to cultural tourism but it is subject to the economic conditions in recent years. The Company has operated two commercial parks, including Chinese Peony Garden and Caozhou Peony Garden, which were acquired by the Company and transferred by the local government, respectively. These two commercial parks would generate income from the sales of ticket, commodity sales of related peony industries, hosting business events and study tour. However, these activities have not incurred relatively large-scale revenue. We need to continuously monitor the subsequent operation of these two peony gardens. Meanwhile, the Company has a Fangte Fantasyland project under construction with an estimated total investment of RMB1.0 billion. Upon completion, the Company plans to recover the cost from operating income.

Furthermore, HZFI conducts industrial investment business through fund investment, equity investment, and debt investment to support local industries, in relation to its assigned role as an industrial investment entity. The industries that the Company primarily invests in are also in line with the local pillars industries, such as high-end chemical industry, biomedicine, mechanical and electrical equipment manufacturing, new energy and new

material, as well as agricultural and sideline products. However, the returns of these investments are subject to the operation risk and financial performance of the investees, in our view.

According to the strategic plan of HZFI, the Company would carry out a series of self-operation projects in the future, such as Heze Shengyu Cold Chain Logistics Project and China (Cao County) Huaifu Intelligent Manufacturing Industrial Park, with an estimated investment amount of more than RMB4.4 billion in total. The Company plans to achieve fund balancing through operating revenue, such as leasing and selling of factories and office buildings, and providing logistic service. The large investment amount of self-operation projects may further enlarge the Company's capital expenditure pressure. Considering the importance of these projects to the economic and industrial development of Heze City, the Company is expected to receive special bond support from the local government for some self-operated projects to partially relieve its capital expenditure pressure.

Increasing debt burden driven by construction projects

With the continuous financing for construction projects, HZFI shows fast debt growth. As of 30 June 2023, the Company's total debt increased to RMB9.0 billion from RMB4.0 billion as of end-2020. The Company has also maintained increasing debt leverage over the past three years. As 30 June 2023, its total capitalization ratio, as measured by total debt to total capital, increased to 37.9% from 26.1% in 2020. HZFI demonstrated certain short-term debt pressure but gradually improved its debt structure. Its short-term debt to total debt ratio reduced from 59.2% at end-2020 to 38.1% as of 30 June 2023. Driven by large capital expenditure needs of its construction projects, we expect the Company's total debt to continue to grow over the next 12-18 months but maintain a reasonable debt leverage.

Access to different funding channels

The Company has access to different funding channels, such as bank loans, domestic bond market, and non-standard financing. Bank loans contribute the most of its total debts, which accounted for 73.2% of the total debt, with an average funding cost of less than 6% as of 30 June 2023. The Company has built long-term borrowing relationships with various domestic banks in China, including Agricultural Development Bank of China, China Construction Bank Corporation, and Heze Rural Commercial Bank Co., Ltd.. As of 30 June 2023, the Company received total credit facilities of RMB7.9 billion and the available portion being RMB1.3 billion. HZFI is accepted by large domestic banks.

Meanwhile, the Company has access to the onshore bond market in 2023. The Company issued 3 tranches of onshore bonds with a total amount of RMB2.0 billion and reasonable coupon rate at the range of 4.99% to 5.37%. The non-standard financing (mainly financial leasing) accounted for 20% to 25% of the total debt and close attention is required to the relatively large proportion. However, in view of the HZFI's important status and key role in the social and economic development in Heze City, we expect the Company would maintain stable funding access from banks.

Medium contingent risks resulting from external guarantees

HZFI had moderate exposure to external guarantees. As of 30 June 2023, the external guarantee amount of HZFI was RMB2.3 billion, accounting for 15.5% of its net asset. Among them, the top counterparty for these external guarantees was Heze City Investment Holdings Group Co., Ltd., with a high proportion of 62.2% of the total external guarantees. The Company is reducing the exposure of external guarantees to private-owned enterprises. Although, the external guarantee of RMB32.0 million was provided to a private-owned enterprise,

Shandong Runze Pharmaceuticals Co., Ltd. as of 30 June 2023. This guarantee was released in November 2023. In case a credit event occurs, relatively the Company may face certain contingent liability risks.

ESG Considerations

HZFI is exposed to environmental risks due to undertaking infrastructure construction and land consolidation. Such risks could be mitigated by conducting environmental studies and detailed planning prior to the start of the projects and close monitoring during the construction phase. HZFI's key operations are in material compliance with currently applicable national and local environmental, health and safety laws and regulations.

In terms of social awareness, the Company has played a crucial role in the social welfare of Heze City by undertaking policy-oriented grain storage and public transportation services. Demographic changes, public awareness and social priorities shape the government's development strategy, and it will affect the government's propensity to support the Company.

HZFI'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 Finance Investment Group Co., Ltd.	Heze Investment Development Group Co., Ltd.	Heze Urban Construction Engineering Development Group Co., Ltd.
Long-Term Credit Rating	BBB _g +	BBB _g +	BBB _g
Shareholder	Heze SASAC (100%)	Heze SASAC (97.93%) and Shandong Caixin Asset Operation Co., Ltd. (2.07%)	Heze Investment Development Group Co., Ltd. (50.4%) and Heze City Investment Holdings Group Co., Ltd. (49.6%)
Positioning	Pivotal entity in state-owned capital operation and key municipal project investment and financing platform of Heze City	Pivotal entity in state-owned capital operation and key municipal industry investment and financing platform of Heze City	Major entity in infrastructure construction and public services in Heze City
Total Asset (RMB billion)	32.4	68.6	26.6
Total Equity (RMB billion)	14.7	37.2	9.3
Total Revenue (RMB billion)	5.4	8.2	4.7

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

Source: Company data, CCXAP research

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