

Credit Opinion

30 April 2024

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

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Zouping Financial Development Group Co., Ltd.

Surveillance credit rating report

CCXAP affirms the long-term credit rating of Zouping Financial Development Group Co., Ltd. at BBB_g, with stable outlook.

Summary

The BBB_g long-term credit rating of Zouping Financial Development Group Co., Ltd. (“ZPFD” or the “Company”) reflects Zouping City Government’s (1) strong capacity to provide support, and (2) very high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of Zouping City Government’s capacity to support reflects its status as one of the top 100 counties in China, with moderate economic strength and fiscal profile.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) essential role in infrastructure construction and operation of Zouping City; (2) dominant position in providing public services; 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) increasing debt level to support investment in public policy projects; and (3) fair access to funding.

The stable outlook on ZPFD’s rating reflects our expectation that the local government’s capacity to support will remain stable, and the Company’s characteristics, such as its pivotal role in infrastructure construction and operation of Zouping City, will remain largely unchanged over the next 12-18 months.

Rating Drivers

- Essential entity in infrastructure construction and operation of Zouping City
- Dominant position in providing public services
- Good track record of receiving government support
- Medium exposure to commercial activities
- Increasing debt level to support investment in public policy projects
- Fair access to funding from domestic banks and bond market

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Zouping City Government's capacity to support the Company strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as improved debt management or diversifying funding channels.

What could downgrade the rating?

The rating could be downgraded if (1) Zouping City 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 decrease in importance of its policy role, increasing exposure to commercial activities, or material decrease in government payments.

Key Indicators

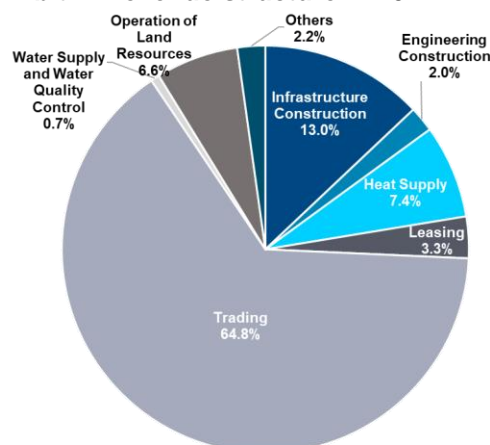
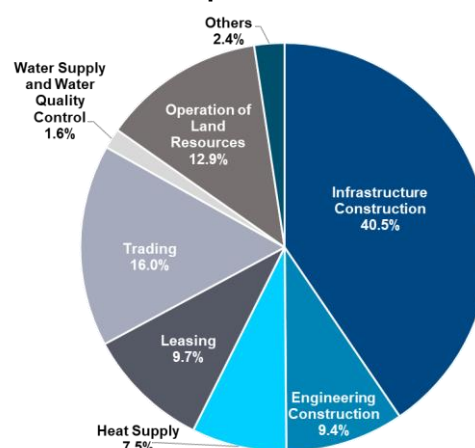
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	27.3	32.7	38.3	38.5
Total Equity (RMB billion)	17.1	17.5	23.2	23.1
Total Revenue (RMB billion)	1.3	2.0	2.1	0.8
Total Debt/Total Capital (%)	27.4	33.6	33.5	33.5

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

Source: Company data, CCXAP research

Corporate Profile

Founded in July 2019, ZPFD is the largest local infrastructure investment and financing company ("LIIFC") by total assets in Zouping City. After consolidation of the local state-owned enterprises in 2022, the Company has become the most important LIIFC engaged in infrastructure construction, operation of land resources, and provision of essential public services such as heat supply and water supply, in accordance with the economic development strategy and social development requirements of Zouping City. The Company also expands to commercial activities such as trading, leasing, property development, as well as industrial investment including equity investment and fund investment. As of 31 December 2023, the Company was directly and wholly owned by the State-owned Assets Center of Zouping City and Zouping City Government was the ultimate controller.

Exhibit 1. Revenue structure in 2022**Exhibit 2. Gross profit structure in 2022**

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe Zouping City Government has a strong capacity to provide support given its status as one of the top 100 counties in China, with moderate economic strength and fiscal profile.

Shandong is the third largest province in China by gross regional products ("GRP") in 2023, with a solid foundation in different industries such as logistics, shipbuilding, marine technology, chemical, automotive, and agri-food. Binzhou City is located at the overlap area of several economic zones. It has formed five traditional industries such as high-end aluminum, new chemical industry, textile, grain processing, animal husbandry and aquatic products; and cultivated five emerging industries such as high-end equipment manufacturing, new generation information technology, new energy and new materials, medical care and health, and modern service.

Binzhou City reported a GRP of RMB311.9 billion, which increased by 5.0% year-over-year ("YoY") in 2023, and ranked 13th among prefecture-level cities in Shandong Province. Binzhou Municipal Government's general budgetary revenue increased from RMB27.6 billion to RMB29.2 billion in 2023, of which tax revenue accounted for 64.7% of general budgetary revenue. The fiscal balance of Binzhou City was relatively weak as the general budgetary revenue could cover around 57.6% of general budgetary expenditure over the past three years. Meanwhile, Binzhou Municipal Government's government fund budgetary income decreased to RMB26.8 billion from RMB30.5 billion, driven by the drop in income from transfer of state-owned land during the downturn in China's housing sales and land market. Moreover, the local government's outstanding debt demonstrated rapid growth, increasing from RMB101.0 billion at end-2021 to RMB133.9 billion at end-2023, which accounted for 42.9% of its GRP.

Exhibit 3. Key economic and fiscal indicators of Binzhou City

	2021FY	2022FY	2023FY
GRP (RMB billion)	287.2	297.5	311.9
GRP Growth (%)	8.3	3.9	5.0
General Budgetary Revenue (RMB billion)	28.7	27.6	29.2
General Budgetary Expenditure (RMB billion)	47.8	48.1	52.7
Local Government Debt (RMB billion)	101.0	119.9	133.9

Source: Binzhou Municipal Government, CCXAP research

Zouping City is a county-level city located in the southern of Binzhou City. It has developed 5 national-level name cards of China's Cotton Textile City, China's Sugar Capital, China's Corn Oil Township, Zouping National High-end Aluminum High-tech Industrialization Base, and National New Industrialization Industry Demonstration Base. Benefiting from its industrial development, Zouping City showed ongoing economic growth for the past three years. Zouping City's GRP rose by 3.5% YoY to RMB65.2 billion in 2023, ranking the 1st among nine districts/counties in Binzhou City. Its general budgetary revenue slightly increased to RMB7.9 billion in 2023. At the same time, tax revenue contributed 64.7% of its general budgetary revenue and a proportion of nearly 26.7% of Binzhou City's tax revenue. However, Zouping City Government's tax revenue decreased by RMB1.1 billion to RMB5.1 billion in 2023 compared to that of 2021, mainly due to the relocation of steel production. In addition, its fiscal balance ratio (general budgetary revenue/general budgetary expenses) decreased from 81.9% in 2021 to 58.4% in 2023. Zouping City Government relied on transfer income from higher-level government and government bond issuance to achieve fiscal balance. As of 31 December 2023, the outstanding debt of Zouping City Government was RMB20.1 billion, accounting for 30.8% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Zouping City

	2021FY	2022FY	2023FY
GRP (RMB billion)	63.2	64.4	65.2
GRP Growth (%)	6.8	2.7	3.5
General Budgetary Revenue (RMB billion)	7.9	7.9	7.9
General Budgetary Expenditure (RMB billion)	9.6	10.4	13.6
Local Government Debt (RMB billion)	14.8	17.8	20.1

Source: Zouping City Government, CCXAP research

Government's Willingness to Provide Support

Essential entity in infrastructure construction and operation of Zouping City

ZPFD acts as the essential LIIFC in Zouping City and is delegated by the local government to undertake local infrastructure construction, state-owned asset operation, as well as the operation of land resources, focusing on implementing the strategic blueprint for economic and district development in Zouping City.

ZPFD is commissioned to carry out various infrastructure construction projects such as road upgrading and reconstruction, comprehensive river improvement, and renovation of shantytowns under the agency construction model. The Company signs entrusted construction contracts with the local government or other government agencies, and the related parties will typically pay the total cost incurred plus a markup of 10%-15%. The Company's business model gradually changed to self-operation model including urban water supply integration, improvement of urban water supply system, as well as sewage treatment plant and sewage pipe networks. As of 30 September 2023, the Company had sufficient project reserves and the key projects under construction and planning had a total investment of RMB11.0 billion and an uninvested amount of RMB5.8 billion, indicating good sustainability of the business.

ZPFD also takes part in the engineering construction business mainly in urban road restoration, temporary road modification and restoration, as well as road maintenance through its subsidiary. It acquires the municipal engineering projects through the government's public tender process or designation by government departments. Until now, the engineering projects undertaken by the Company are relatively small-scale and can usually be completed within one year. From 2020 to 2022, the Company reported revenue in this business of RMB21 million, RMB56 million, and RMB42 million, respectively.

Additionally, ZPFD and its subsidiary are mainly responsible for the operation of land resources, which are the designated entities to invest in the rural land remediation projects and land quota trading within Zouping City. Upon the completion of demolition, resettlement, and reclamation on the land by related villages and towns, surplus land quotas will be created and traded for RMB610 thousand per mu, the price margin will be recorded by the Company. In our view, ZPFD's important role in supporting local development of Zouping City is not easily replaced by other LIIFCs.

Dominant position in providing public services

ZPFD provides essential public services in Zouping City consisting of heat supply and water supply. The Company's subsidiary is the sole heat supplier in the main urban area of Zouping City. It purchases high-temperature hot water generated by heat generation from upstream thermal power plants, cools down and depressurizes through heat exchange stations, and delivers hot water available for heating to end users through self-owned pipelines. Since 2021, as Zouping City promoted the integration of heating business, the Company has become the primary entity responsible for urban and township heating. As of 30 September 2023, the Company had a pipeline network length of 457 kilometers and a heating area of 10.3 million square meters.

ZPFD is also responsible for the production and supply of tap water, covering the major areas such as Changshan, Gaoxin, Jiaoqiao, Handian, Haosheng, Sunzhen, Jiuhu, Mingji, and part of Weiqiao. This business demonstrates a strong public welfare nature and ensures a stable water supply in these areas. Apart from this, the Company engages in water quality control and provides services to schools, kindergartens, and farmers.

Good track record of receiving government support

ZPFD has in the past received significant support from the local government in the form of project payments, capital contributions, equity transfers, cash and asset injections, and fiscal subsidies to support its investments and operation of its businesses. In 2022, the local government made a capital contribution to the Company in an aggregate amount of RMB1.9 billion and its paid-in capital increased to RMB2.0 billion. Meanwhile, three major LIIFCs in Zouping City including Zouping State-owned Assets Investment Holdings co., Ltd. ("ZPSI"), Shandong Zoujin Urban Development and Construction Co., Ltd. and Shandong Zou Nong Urban and Rural Construction Co., Ltd. were consolidated into the Company, which largely diversified its business coverage and clarified its strategic position. From 2020 to 2023H1, the local government also injected state-owned assets of approximately RMB9.0 billion into ZPFD, significantly enlarging the Company's capital strength.

As of 30 September 2023, the Company's major completed projects reported total invested amount of RMB3.8 billion and total repayment of RMB1.5 billion, respectively. In addition, the local government has from time to time provided fiscal subsidies to the Company to support its business and operations. From 2020 to 2023H1, the local government provided operating subsidies of more than RMB3.3 billion. In light of ZPFD's key and strategic role in promoting the local development of Zouping City, we expect the Company to receive strong support from the local government when necessary.

Medium exposure to commercial activities

ZPFD actively explores new commercial business opportunities to diversify its sources of income. These commercial activities mainly include trading, leasing, property development, as well as industrial investment. Given the proportion of commercial assets to total assets was around 30%, we estimate the ZPFD's exposure to commercial activities is medium.

In order to speed up the market-oriented transformation, the Company has actively expanded its trading businesses such as liquid aluminum, iron ore, and corn germ sales since 2019, which are in line with local industry characteristics. However, its trading business demonstrated high concentration on the suppliers and customers, which may exert higher volatility in operation if the cooperation with any party is terminated.

As the most important state-owned assets management entity in Zouping City, ZPFD owns large number of leasable properties, which are usually leased to government agencies or the enterprises settle in, providing stable rental income to the Company. Apart from the leasable properties, other assets such as wetland parks and tourist attractions are expected to generate diversified income during operation. Although these state-owned assets accounted certain proportion of total assets, most of these assets were injected by the local government. Therefore, they will not incur capital spending due to the available for lease and operate status and the risk of this business is controllable, in our view. Moreover, it is engaged in the construction of industrial parks, which is expected to generate rental income upon completion of construction. As of 30 September 2023, there were 2 industrial parks under construction, with a total investment of RMB1.4 billion and uninvested amount of RMB1.3 billion.

ZPFD also conducts industrial investment to promote the development of local industries, in the forms of direct equity investment and fund investment. The Company has invested in some local enterprises but the returns of these investments are subject to the operational and financial uncertainty of investees, in our view. The Company undertakes the rescue function of local enterprises through investing in some private-owned enterprises and local rescue funds, which have higher operation risks during market downturns.

In addition, the Company's property development projects are generally invested in land for equity participation and receive financial dividends. It mainly provides land as shareholders and would not be in charge of the subsequent investment and construction. Compared with self-developed model, the business and financial risks arising from the project equity investment are relatively controllable. However, during the downturns in China's property market, property development would be exposed to more uncertainties during construction and sales.

Increasing debt level to support investment in public policy projects

ZPFD's total debt recorded rapid growth along with the ongoing investment in several infrastructure construction projects. The Company's total debt increased from RMB6.5 billion at end-2020 to RMB11.6 billion at mid-2023; while the total capitalization ratio rose from 27.4% to 33.5%. The debt leverage was maintained at a moderate level, thanks to the asset injections from the local government. As of 30 June 2023, the Company's short-term debt accounted for 35.2% of the total debt, and cash to short-term debt ratio was around 0.4x, indicating relatively high short-term repayment pressure. Considering that the Company's large scale of key projects under construction and planning, most of which will go to vital public projects such as infrastructure construction and facilities renovation (water supply system and heating pipe networks) for providing public services, the Company's total debt burden is expected to further increase over the next 12-18 months.

In addition, the liquidity of the Company's assets was relatively weak. As of 30 June 2023, inventories, accounts receivable, other receivables, and fixed assets accounted for approximately 72.6% of total assets. The inventories and fixed assets are mainly the costs of infrastructure construction, properties, and pipeline network, which were considered low liquidity. The low asset liquidity may undermine the Company's financial flexibility. Meanwhile, the progress of invoicing for completed projects has lagged behind, which also weakens the liquidity of the Company's assets and reduces the Company's earning capacity.

Fair access to funding from domestic banks and bond market

ZPFD has access to various funding including bank borrowing and direct financing. Leveraging the Company's state-owned background and strategic importance to the local development in Zouping City, it is able to secure various sources of financing with competitive financing costs. Bank loans account for majority of the Company's total debt, it maintains good and long-term relationships with policy banks and nationwide joint-stock commercial banks in China. As of 30 September 2023, the Company had approved bank facilities of RMB13.5 billion and unused credit lines totaling approximately RMB5.7 billion, supporting its various funding needs. Also, its major subsidiary, ZPSI participated in the domestic debt capital market by issuing 2 bonds from January 2023 to April 2024, with a total amount of RMB800 million. Moreover, the Company tapped into offshore bond market in 2023, raising JPY14.7 billion. However, the Company had certain exposure to non-standard financing products such as finance leases and trusts with higher financing costs, which accounted for around 33.2% of total debt as of 30 June 2023.

ESG Considerations

ZPFD faces environmental risks because it has undertaken infrastructure construction projects. 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.

ZPFD bears social risks as it plays as it implements public policy initiatives by building public infrastructure in Zouping 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.

ZPFD's governance considerations are also material as the Company is subject to oversight by the Zouping City 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 \(July 2022\)](#).

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