

Credit Opinion

22 May 2024

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 Zhicheng Agricultural Development Group Co., Ltd.

Initial credit rating report

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

Summary

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

Our assessment of 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 support, which is based on the Company’s (1) status as the sole state-owned enterprise (“SOE”) focusing on agricultural development in Zoucheng City; and (2) good track record of receiving government support.

However, the rating is constrained by the Company’s (1) increasing exposure to commercial activities with relatively large investment needs; (2) fast debt growth with relatively large short-term debt burden; and (3) fair access to funding with high reliance on urban commercial banks.

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

Rating Drivers

- Sole state-owned enterprise (“SOE”) focusing on agricultural development in Zoucheng City
- Increasing exposure to commercial activities with relatively large investment needs
- Good track record of receiving government support
- Fast debt growth with relatively large short-term debt burden
- Fair access to funding with high reliance on urban commercial banks

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) 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 improved debt management or diversifying the financing channels.

What could downgrade the rating?

The rating could be downgraded if (1) 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 increased exposure to commercial activities.

Key Indicators

	2021FY	2022FY	2023FY
Total Asset (RMB billion)	2.1	3.7	11.0
Total Equity (RMB billion)	0.2	1.4	8.1
Total Revenue (RMB billion)	0.1	0.2	0.4
Total Debt/Total Capital (%)	91.3	58.5	24.9

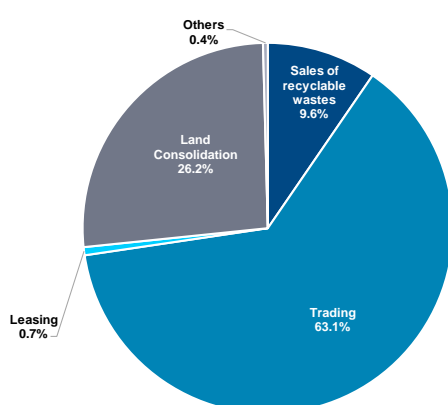
All ratios and figures are calculated using CCXAP’s adjustments.

Source: Company data, CCXAP research

Corporate Profile

Established in January 2018, SDZC is one of the key SOEs in Zoucheng City and focuses on agricultural development in Zoucheng City. In accordance with the economic and industrial development plan of Zoucheng City, SDZC is responsible for rural revitalization and agricultural development by undertaking policy-driven projects, including land consolidation, agricultural industrialization, rural infrastructure construction projects, and policy-oriented grain storage. The Company is also involved in commercial activities, including the construction and operation of industrial parks, property development, as well as trading. In order to integrate local resources, the local government transferred the recycled wastes with a book value of RMB5.9 billion to SDZC in 2023 and appointed SDZC as the sole SOE in Zoucheng City to conduct the sales of recycled wastes business. Thanks to the asset injection from local government, SDZC’s total assets increased from RMB3.7 billion in 2021 to RMB11.0 billion in 2023. As of 31 December 2023, Finance Bureau of Zoucheng City was the ultimate controller of the Company, holding 100% of the Company’s shares.

Exhibit 1. Revenue structure in 2023



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 47th among CCID's Top 100 Counties in China in 2023.

Shandong Province is the third largest province in China by gross regional products ("GRP"), with 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 2023, Jining City reported a GRP of RMB551.6 billion, representing 6.5% year-over-year ("YoY") growth and ranking 6th among 16 prefecture-level cities in Shandong Province. However, Jining City has moderate fiscal metrics and a moderate debt profile. The Jining Municipal Government's general budgetary revenue was RMB47.5 billion in 2023, and its fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was around 60% over the past three years. Tax incomes slightly decreased to RMB32.4 billion in 2023 from RMB33.2 billion in 2021, accounting for 68.1% of its general budgetary revenue. As of 31 December 2023, its government debt to GRP ratio was 31.1%.

Exhibit 2. Key economic and fiscal indicators of Jining City

	2021FY	2022FY	2023FY
GRP (RMB billion)	507.0	531.7	551.6
GRP Growth (%)	8.5	4.4	6.5
General Budgetary Revenue (RMB billion)	44.1	44.8	47.5
General Budgetary Expenditure (RMB billion)	72.7	74.7	78.3
Local Government Debt (RMB billion)	134.5	151.4	171.4

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 47th among CCID's Top 100 Counties in China in 2023. 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 RMB104.1 billion in 2023, accounting for the GRP of 19.6% of Jining City. Zoucheng City Government's general budgetary revenue also has recorded several consecutive years of growth. In 2023, its general budgetary revenue increased by 6.5% YoY to RMB9.1 billion, of which tax revenue accounted for 62.4% of its general budgetary revenue, indicating relatively good fiscal quality. Meanwhile, Zoucheng City Government has good financial self-sufficiency with fiscal balance ratios above 95% over the past three years. As of 31 December 2023, the outstanding government debt of Zoucheng City Government was RMB11.6 billion, accounting for 11.2% of its GRP.

Exhibit 3. Key economic and fiscal indicators of Zoucheng City

	2021FY	2022FY	2023FY
GRP (RMB billion)	96.1	100.9	104.1
GRP Growth (%)	8.7	5.0	7.0
General Budgetary Revenue (RMB billion)	8.4	8.6	9.1
General Budgetary Expenditure (RMB billion)	8.8	8.5	9.1
Local Government Debt (RMB billion)	9.1	10.3	11.6

Source: Zoucheng City Government, CCXAP research

Government's Willingness to Provide Support

Sole SOE focusing on agricultural development in Zoucheng City

SDZC is one of the key SOEs in Zoucheng City and focuses on agricultural development in Zoucheng City. The Company has a clear functional positioning in public-oriented business, especially in the agricultural sector. In 2022, Zoucheng City received approval from the Shandong Provincial Government to establish the Zoucheng Provincial Agricultural High-tech Industrial Development Zone ("Zoucheng Agricultural HIDZ") with the theme of integrated development of the entire industrial chain of edible and medicinal fungi. As the sole state-owned enterprise to focus on local agricultural development, the Company plays an essential role in the construction and operation of the Zoucheng Agricultural HIDZ, fostering the agriculture transformation and upgrading as well as the revitalization of rural economic development in Zoucheng City. SDZC has the policy mandate to undertake major construction projects, along with the local government's broad strategy in developing Zoucheng City.

SDZC is engaged in infrastructure construction mainly through agency construction model and self-construction model. Under the agency construction model, the Company signs an entrusted construction agreement with Zoucheng City Natural Resources and Planning Bureau. After the project is completed, the entrusting parties would pay SDZC the construction cost plus a certain markup. As of 31 December 2023, SDZC had 3 projects under construction, including comprehensive management of coal mining subsidence areas, land greening and water conservancy management, with a total estimated investment amount of RMB501 million and an uninvested amount of RMB355 million. However, SDZC had not yet recognized any revenue from infrastructure construction as of the end of 2023.

Additionally, SDZC is entrusted by the local government to conduct land consolidation in Zoucheng City's townships. The Company undertakes land consolidation projects by collaborating with private-owned companies, mainly Shandong Ligu Jinxiu Urban Development and Construction Co., Ltd ("Ligu Jinxiu"). SDZC is responsible for fund raising while Ligu Jinxiu is responsible for land consolidation. The Company would achieve fund balancing by selling the surplus land quotas to Zoucheng City Natural Resources and Planning

Bureau after land consolidation. The Company and the cooperative enterprise would allocate the revenue in a ratio of 7:3, respectively. As of 31 December 2023, the Company had completed 21.8 thousand mu of land consolidation with a total investment amount of RMB83 million. However, the Company had not received payments from Zoucheng City Natural Resources and Planning Bureau at the end of 2023 and needed to advance the project payment of the cooperative enterprise. At the same time, the Company had 43.8 thousand mu of lands under consolidation with a total planned investment amount of RMB422 million and an outstanding amount of RMB330 million. The land consolidation business is subject to the land market and government policies.

SDZC is also responsible for policy-oriented grain storage involving the purchase, storage, and wholesale of grain and edible oil. The main products are wheat, soybean, corn and soybean oil, respectively, that guarantee food supply in Zoucheng City. From 2021 to 2023, the local government also provides financial subsidies totaling around RMB60 million to the business.

Increasing exposure to commercial activities with relatively large investment needs

In addition to public activities, SDZC is also engaged in commercial activities such as the construction and operation of industrial parks, property development, as well as trading. While commercial activities generate supplemental income, they may pose higher business and financial risks than public businesses. Due to the expansion of self-operated construction projects, we believe that SDZC's exposure to commercial activities would increase and the Company would have relatively large investment needs in the future.

SDZC takes the responsibility to promote agricultural and industrial development by participating in the industrial park construction and operation. We consider the riskiness of this business to be manageable as the development of industrial parks is more policy-driven and related to the Company's public policy business, which was also under the guidance of the Zoucheng City Government. As of 31 December 2023, the Company had 3 industrial park projects under construction, including stone sand industrial park, strawberry industry demonstration zone, and mushroom town industrial park, with a total investment amount of RMB1.5 billion and an uninvested amount of RMB722 million. Meanwhile, there was 1 industrial park project under planning, with a total investment amount of RMB 820 million. The Company expected to achieve fund balance through leasing and operation revenue. However, the Company's investment recovery cycle of industrial parks is long, making it more difficult to achieve fund balancing in short period of time and may expose the Company to large capital expenditure pressure. As the Company's industrial park projects are aligned with the local government plans, the Company has received government special bond to support the construction of strawberry industry demonstration zone and mushroom town industrial park, which could partially mitigate the Company's capital expenditure pressure.

The Company also undertakes property development business with self-raised funds. As of the end of December 2023, the Company had 1 commercial residential housing under construction with a total investment amount of RMB320 million and an outstanding amount of RMB175 million. However, the fund balancing of property development business would suffer from high volatility due to uncertainty of construction and sales progress during the downturn of China's property market.

Moreover, the Company engages in trading business, mainly including coal, grain reserves, and agricultural products. Although trading business can provide the Company with additional revenue, the Company is exposure to certain concentration risks. In 2023, the top 5 suppliers accounted for 94.6% of the total procurement. In addition, the Company participates in the sales of recyclable wastes, primarily sand and gravel formed from construction projects. As of 31 December 2023, there was 1 self-operated project under planning,

namely river sand mining project, with a total estimated investment amount of RMB1.7 billion. This project is expected to achieve fund balance through sales of sand and gravel.

Good track record of receiving government support

As an important entity in agricultural development in Zoucheng City, SDZC has a good track record in receiving government support in terms of capital injections, equity and asset transfers, financial subsidies as well as government special bond support. Since its establishment, the local government transferred various state-owned equity and assets to the Company, broadening its business scope as well as enhancing operating and capital strength. From 2021 to 2023, the Company's capital reserve increased from RMB101 million to RMB7.3 billion as a result of the asset and equity transfers from the local government. Since the Company is positioned as the only state-owned enterprises undertaking the sales of recyclable wastes business in Zoucheng City, the local government transferred relevant resources to the Company to consolidate its state-owned assets. The Company received recyclable wastes from the local government of RMB5.9 billion in 2023. Moreover, the local government injected cash of RMB638 million as paid-in capital to the Company in 2023, further enhancing the Company's capital strength. In addition, from 2021 to 2023, the Company received financial subsidies totaling around RMB60 million to support its grain reserve business. As of end-2023, the Company received government special bonds amounted to around RMB191 million for supporting its investment in construction projects. The track record of government support indicates the government's propensity to support the Company. Given the Company's important role in the agricultural development of Zoucheng City, we believe that the local government will continue to provide ongoing support to the Company over the next 12 to 18 months.

Fast debt growth with relatively large short-term debt burden

Driven by continuous financing and investment for construction projects, SDZC's total debt level has been growing over the past three years. As of 31 December 2023, the Company's total debt increased to RMB2.7 billion from RMB1.8 billion at end-2021. However, the total capitalization ratio decreased from 91.3% at end-2021 to 24.1% at end-2023 driven by the asset injection from the local government in 2023. The significant increase in the total debt is mainly caused by the investment in industrial park projects, which is in line with the region's development needs.

In addition, the Company has a certain short-term repayment pressure given its relatively high short-term debt burden. As of 31 December 2023, the Company's short-term debt accounted for 57.4% of its total debt and the cash to short-term debt ratio was 0.7x, which could not fully cover its short-term debt. Meanwhile, a large portion of cash (93.5%) is pledged for bank loans and deposits, further weakened SDZC's financial flexibility. Considering the future capital expenditure needs for construction projects, we expect the Company's total debt level would continue to rise over the next 12-18 months.

Besides, SDZC's asset liquidity is relatively weak. As of 31 December 2023, SDZC's inventories accounted for 84.0% of the total assets. The vast majority of inventories, around 64.1% of the total, are recyclable wastes transferred from local government and are considered having relatively low liquidity. Additionally, the Company had pledged assets of RMB976 million for loans, representing 8.9% of total assets as of end-2023.

Fair access to funding with high reliance on urban commercial banks

SDZC had a high reliance on bank loans for its capital expenditure. Bank loans accounted for around 70% of the total debt. However, majority of bank loans are provided by urban commercial banks in Shandong Province. As of 31 December 2023, the Company had obtained total bank facilities of RMB3.0 billion, with an unutilized

amount of RMB731.5 million, demonstrating relatively tight standby liquidity. Meanwhile, around 73.6% of total bank facilities were provided by urban commercial banks in Shandong Province, implying relatively high concentration on urban commercial banks and relatively limited funding channels. The Company also actively strengthens cooperation with policy banks, large state-owned commercial banks and national joint-stock commercial banks such as Agricultural Development Bank of China, China Construction Bank Corporation, and Industrial Bank Co., Ltd to improve its financing channels. In addition, the Company's exposure to non-standard product financing was moderate, accounting for around 10% of its total debt.

ESG Considerations

SDZC assumes environmental risks through its construction projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

SDZC bears social risks as it plays an essential strategic role in the agricultural development of 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.

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

Structural Considerations

SDZC'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 agricultural development 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 4. Peer Comparison

	Shandong Zhicheng Agricultural Development Group Co., Ltd.	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	BBB _g
Shareholder	Finance Bureau of Zoucheng City (100%)	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 agricultural development in Zoucheng City	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)	11.0	22.2	18.1	52.1
Total Equity (RMB billion)	8.1	8.7	7.5	17.2
Total Revenue (RMB billion)	0.4	1.8	2.3	8.9

All ratios and figures are calculated using CCXAP's adjustments based on financial data as of 31 December 2023.

Source: Company data, CCXAP research

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