

Credit Opinion

21 June 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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Zoucheng Urban Assets Holding Group Co., Ltd.

Surveillance credit rating report

CCXAP affirms Zoucheng Urban Assets Holding Group Co., Ltd.'s long-term credit rating at BBB_g, with stable outlook.

Summary

The BBB_g long-term credit rating of Zoucheng Urban Assets Holding Group Co., Ltd. ("ZCUA" 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 support reflects Zoucheng City's relatively good economic strength and fiscal metrics, as one of the Top 100 counties in China.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) the largest local infrastructure investment and financing company ("LIIFC") by total assets in Zoucheng City; (2) important role in the infrastructure construction in Zoucheng City; and (3) good track record of government support.

However, the Company's rating is constrained by its (1) medium exposure to commercial activities; (2) moderate debt management with a large maturity scale; and (3) high contingent liabilities risk.

The stable outlook on ZCUA 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 Zoucheng City will remain unchanged over the next 12 to 18 months.

Rating Drivers

- The largest LIIFC in Zoucheng City by total assets
- Important role in the infrastructure construction in Zoucheng City
- Good track record of government support
- Medium exposure to commercial activities
- Moderate debt management with a large maturity scale
- High 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; 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 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

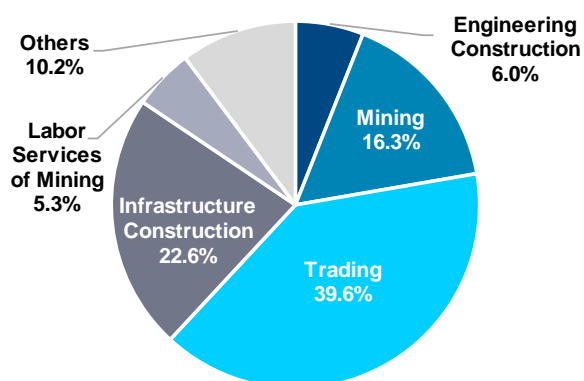
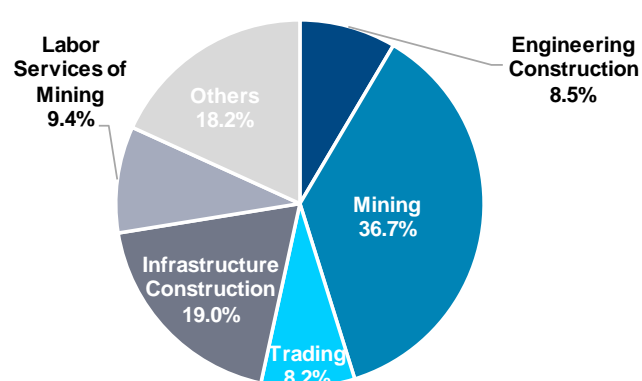
	2021FY	2022FY	2023FY
Total Asset (RMB billion)	55.7	55.5	52.1
Total Equity (RMB billion)	21.2	21.6	17.2
Total Revenue (RMB billion)	7.3	8.7	8.9
Total Debt/Total Capital (%)	53.4	52.7	60.8

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

Source: Company data, CCXAP research

Corporate Profile

Founded in 2003, ZCUA is the largest LIIFC in Zoucheng City in terms of asset size. It is one of the key state-owned enterprises for Zoucheng City Government to implement strategic and economic development policies. The Company shoulders the responsibility for public infrastructure projects and public services, including infrastructure construction, resettlement housing construction, heat supply, and electricity supply in local urban areas. It also engages in some commercial activities, including mining, trading, yeast production, as well as property leasing. As of 31 December 2023, ZCUA was directly and wholly owned by the Finance Bureau of Zoucheng City.

Exhibit 1. Revenue structure in 2023**Exhibit 2. Gross profit structure in 2023**

Source: Company data, 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 3. 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. Zoucheng City ranked 47th among CCID's Top 100 Counties in China in 2023, with good traffic advantages and rich coal resources. 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 grown for consecutive years. 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 4. 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

The largest LIIFC in Zoucheng City by total assets

There are six major LIIFCs under the control of the Finance Bureau of Zoucheng City in Zoucheng City. Each of them has a clear position under the government's planning. Among them, ZCUA is the largest one and its total assets are much larger than others. As of 31 December 2023, ZCUA's total assets amounted to RMB52.1 billion. In addition, the Company has the largest outstanding amount of bonds among the LIIFCs in Zoucheng City. We believe that a default by ZCUA could have a significant impact on the local government's reputation and local financing environment. The Company is mainly responsible for infrastructure construction, public services and state-owned assets management such as coal resources in Zoucheng City. The other two LIIFCs with certain scale are Shandong Zhengfang Holding Group Co. Ltd. ("Zhengfang Group") and Zoucheng Limin Construction Development Group Co., Ltd. ("Limin Construction"), with total assets of RMB18.1 billion and RMB22.2 billion as of end-2023, respectively. Zhengfang Group is responsible for infrastructure construction in Zoucheng City especially the supporting facilities in Zoucheng City Economic Development Zone, and Limin Construction is mainly responsible for infrastructure construction in Zoucheng City, particularly in Mencius Lake New District. In 2023, the government transferred the equities of several subsidiaries and some assets without ownership certificates out of the Company due to the adjustments of local government plans, which reduced the Company's net assets by RMB4.3 billion compared to the end of 2022. After the asset transfer, ZCUA has remained the largest LIIFC in Zoucheng City in terms of asset size.

Important role in the infrastructure construction in Zoucheng City

Along with the development of Zoucheng City, ZCUA has undertaken several major infrastructure construction projects including affordable housing in the mining areas, river management projects, road construction and improvement projects, and wastewater treatment plants. ZCUA engages in infrastructure construction mainly through the build-transfer("BT") model, agency construction model and undertaking engineering construction by public bidding. The projects under the BT model were undertaken many years ago and all of them were

completed. The Company will recognize the revenue and costs of these projects according to repurchase agreements signed with the local government. The Company had completed projects under the BT model with a total investment of around RMB7.7 billion, which mainly include river treatment, road network transformation and affordable housing construction. Under the agency construction model, the Company signs entrusted construction agreements with the local governments. After the project is completed and examined, the Company would transfer the project to the local government and the government would pay ZCUA the construction cost plus several markup. As of 31 December 2023, the Company has invested RMB1.3 billion in key infrastructure construction projects under construction. However, the sustainability of the Company's infrastructure construction under the agency model is influenced by its limited project reserves.

The Company also conducts engineering construction by public bidding and the projects are mainly municipal projects such as urban roads, bridges, and sewage facilities. The Finance Bureau of Zoucheng City will pay the Company construction fees according to the progress of the project construction. The Company currently has a second-level qualification for general contracting of municipal engineering construction and a third-level qualification for general contracting of housing construction. Revenue from engineering construction increased over the past three years. In 2023, the Company generated a revenue of RMB531.6 million from engineering construction.

Moreover, the Company provides essential public services in Zoucheng City with franchise advantages, including heat and electricity supply. As of 31 December 2023, the Company's heat supply business scope mainly covered the urban area of Zoucheng City with a coverage area of around 6.3 million square meters and a pipe network length of 21 kilometers. However, due to the public nature of these businesses, the profitability of them is relatively low. Due to the adjustments in government planning, the gas supply segment of ZCUA was transferred out in 2023. The Company is no longer engaged in gas supply business.

Medium exposure to commercial activities

The Company engages in various commercial activities including mining, trading, yeast production as well as property leasing. Based on our assessment, the Company's exposure to commercial activities is medium as the commercial assets accounted for less than 30% of total assets.

ZCUA engaged in commercial activities mainly through its wholly owned subsidiary, namely Shandong Honghe Holdings Group Co., Ltd. ("SDHH"), with businesses covering mining, trading, yeast production and property sales. SDHH's mining business mainly involves coal mining, as well as some aluminum and silver mining. As of 31 December 2023, the Company had 2 coal mines in production with a total recoverable reserve amount of around 29.5 million tons. Because of soaring coal prices, the gross margins of SDHH's coal mining sector were high of above 55% over the past three years. The coal market is easily affected by policy changes and economic conditions, usually demonstrating high fluctuation. The correction of coal prices may pressure the Company's margin. SDHH also involves trading on coal, non-ferrous metal and building materials, which contributed the largest component of total revenue. With the expansion of the scale of the trading business, the Company's credit exposure may increase when providing a period of account to its customers.

Besides the SDHH, ZCUA itself also participates in some commercial activities such as property leasing and hotel management. Although engaging in commercial business would expand the Company's revenue scale, such business would bring more uncertainties to the Company and the local government may not provide direct support to them. According to the future planning, the Company plans to increase investment in hotels and projects such as parking lots, which may expose the Company to larger business risks such as increasing capital expenditure burden and unbalancing funding.

Moderate debt management with a large debt maturity

The Company demonstrated moderate debt management with relatively high debt leverage and a concentrated debt structure. As of 31 December 2023, the total debt amounted to RMB26.7 billion with a total capitalization ratio of 60.8%. The increase in the capitalization ratio in 2023 is mainly due to the transfer of assets. We expect the Company may maintain a relatively high total leverage ratio in the next 12-18 months considering future investment planning and slow government repayment. As of 31 December 2023, the Company had high short-term debt level of RMB15.4 billion, which accounted for 57.6% of total debt, and consisted of a large amount of maturing or puttable bonds. In addition, the cash to short-term debt was around 0.3x.

Moreover, the Company's asset liquid was weak which may weaken its financial flexibility. As of 31 December 2023, other receivables and inventory totally represented around 63% of total assets, which mainly consist of receivables from engineering projects and land assets with low liquidity. Meanwhile, the total restricted assets were RMB5.4 billion which accounted for 10.3% of total assets, and cash or cash equivalent was the largest component of it.

Fair access to funding from banks and the domestic bond market

The Company has access to multiple financing channels including banks, onshore and offshore bond market and financial companies. The debt from bank loans and bond issuances accounted for the majority of total debt. From January 2023 to May 2024, ZCUA itself issued 18 tranches of onshore bonds raising around RMB8.7 billion, including MTNs, Corporate Bonds and Private Placement Bonds. Moreover, the Company issued 4 tranches of offshore bonds raising around CNY1.4 billion over the same period. However, majority of ZCUA's offshore bonds has short tenor below one year. The Company has built good long-term relationships with different domestic banks such as China Construction Bank Corporation, Huaxia Bank Co., Ltd., and China Bohai Bank Co., Ltd. As of 31 December 2023, the Company had total bank facilities of RMB12.2 billion and the available portion amounted to RMB5.2 billion. At the same time, non-standard financing accounted for around 10% of total debt, mainly consisting of trusts and financial leases.

The Company's refinancing ability has a significant impact on its financing stability considering its relatively high financing cost, which may be easily influenced by the change in the market. The financing of local LIIFCs in Zoucheng City mainly relies on banks and debt capital market while some LIIFCs have certain exposure to non-standard financing. The refinancing environment is moderate and the LIIFCs in Zoucheng City generally bear a relatively high spread of interest rates.

Good track record of government support

The Company has a good track record of receiving support from the local government in terms of subsidies, special bond funds, asset injection and equity transfer. In 2021, the Zoucheng City Government injected RMB150 million in cash and transferred equity shares and physical assets including public security organ building and business center with a total amount of RMB792 million to ZCUA. In 2023, the Company's paid-in capital was increased by a government injection of RMB50 million. Moreover, from 2021 to 2023, the Company received continuous government subsidies with a total amount of RMB371 million. Considering the completion of ZCUA's infrastructure construction projects and large government-related receivables, the Company would receive the related government payments in the future. However, it may depend on the government's fiscal revenue and its planning.

High contingent liability risk from external guarantees to local state-owned enterprises

The Company bears high contingent risk resulting from large external guarantees. As of 31 December 2023, the Company's external guarantees amounted to RMB9.9 billion, accounting for 57.3% of its net assets, and were provided to state-owned enterprises ("SOEs"). This is mainly due to the increasing financing needs of local SOEs. Mutual guarantees between local SOEs are common in Zoucheng City. We estimate that the external guarantees of ZCUA would further increase in the future to support the local SOEs. However, in case a credit event occurs, the Company may face certain contingent liability risks and cross-default risks. Considering the important role of state-owned enterprises in Zoucheng City, we estimate the local government may provide timely support so that contingent risk resulting from external guarantees would be controllable.

ESG Considerations

ZCUA assumes environmental risks through its infrastructure projects and coal mining. Coal mining will cause certain damage to local land resources and water resources through the mining progress. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

ZCUA bears social risks as it plays an essential strategic role in the 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.

In terms of corporate governance, 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

ZCUA's senior unsecured debt rating is equal to its long-term credit rating. We believe that government support will flow through the Company given the importance of the Company to local development, 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 Urban Assets Holding Group Co., Ltd.	Shandong Zhengfang Holding Group Co., Ltd.	Zoucheng Limin Construction Development Group Co., Ltd.	Shandong Zhicheng Agricultural Development Group Co., Ltd.
Long-Term Credit Rating	BBB _g	BBB _g	BBB _g ⁻	BBB _g ⁻
Shareholder	Finance Bureau of Zoucheng City (100%)	Finance Bureau of Zoucheng City (76.51%) and Agricultural Development Infrastructure Fund Co., Ltd. (23.49%)	Zoucheng Limin Holding Group Co., Ltd. (90%) and Shandong Caixin Asset Operation Co., Ltd. (10%)	Finance Bureau of Zoucheng City (100%)
Positioning	Key entity in urban infrastructure and state-owned assets operation in Zoucheng City	Key entity in infrastructure construction in Zoucheng City, especially the Zoucheng Economic Development Zone	Key entity in infrastructure construction in Zoucheng City, especially the Mencius Lake New District	Key entity in agricultural development in Zoucheng City
Total Asset (RMB billion)	52.1	18.1	22.2	11.0
Total Equity (RMB billion)	17.2	7.5	8.7	8.1
Total Revenue (RMB billion)	8.9	2.3	1.8	0.4

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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