

Credit Opinion

22 August 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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Zhengding State-owned Assets Holding and Operating Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g to Zhengding State-owned Assets Holding and Operating Group Co., Ltd., with stable outlook.

Summary

The BBB_g long-term credit rating of Zhengding State-owned Assets Holding and Operating Group Co., Ltd. (“ZDSH” or the “Company”) reflects (1) Zhengding County Government’s strong capacity to provide support; and (2) the local government’s very high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of Zhengding County Government’s capacity to support reflects Zhengding County’s well-defined functional position and increasing economic growth, but constrained by its unstable revenue structure and relatively high debt burden.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) important role in urban and rural construction, urban operation, and industrial incubation of Zhengding County; and (2) good track record of receiving government support.

However, the rating is constrained by the Company’s (1) rapid debt growth with large capital expenditure pressure; and (2) relatively weak asset liquidity.

The stable outlook on ZDSH’s rating reflects our expectation that the local government’s capacity to support will remain stable, and the Company will maintain its strategic role in the development of Zhengding County in the next 12-18 months.

Rating Drivers

- Important role in urban and rural construction, urban operation, and industrial incubation of Zhengding County
- Good track record of receiving government support
- Low but increasing exposure to commercial activities
- Rapid debt growth with large capital expenditure pressure
- Relatively weak asset liquidity
- Fair access to funding with high concentration on bank loans

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Zhengding County Government's capacity to support 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 diversified funding channels.

What could downgrade the rating?

The rating could be downgraded if (1) Zhengding County 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 regional significance or deteriorated financing ability.

Key Indicators

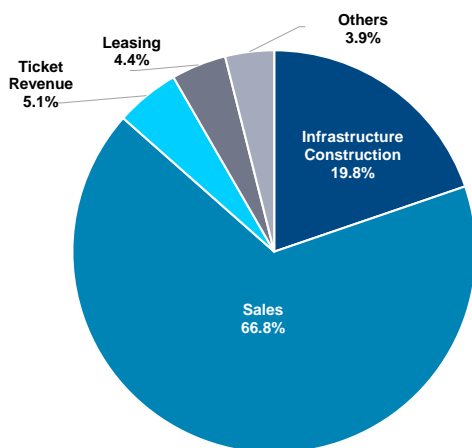
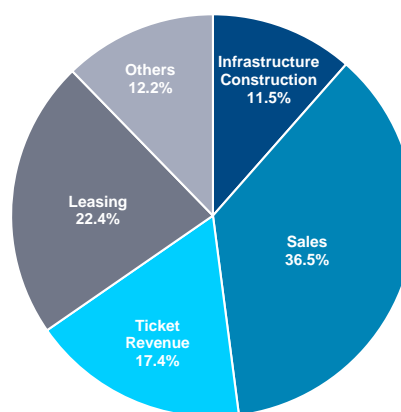
	2021FY	2022FY	2023FY	2024Q1
Total Asset (RMB billion)	9.7	14.7	17.4	19.3
Total Equity (RMB billion)	8.6	12.9	13.3	14.3
Total Revenue (RMB billion)	0.8	0.9	1.3	0.4
Total Debt/Total Capital (%)	1.6	3.3	8.2	13.6

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

Source: Company data, CCXAP research

Corporate Profile

Established in October 2022, ZDSH is an important urban and rural construction and development investment and financing entity, urban operation entity, as well as industrial cultivation entity in Zhengding County. Guided by the local government, the Company consolidated 9 local state-owned enterprises ("SOEs") in Zhengding County from 2022 to 2023 and is responsible for infrastructure construction, water supply operation, maintenance service and affordable housing operation in Zhengding County. ZDSH also has diversified its business into commercial activities such as supermarket operation, grain and oil sales, trading, sand and gravel sales, charging pile operation, and cultural tourism. As of 31 March 2024, the Company is wholly and directly owned by the Finance Bureau of Zhengding County.

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

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Zhengding County Government has a strong capacity to provide support given its well-defined functional position and increasing economic growth, but constrained by its unstable revenue structure and relatively high debt burden.

Hebei Province is a northern province of China with a good geographic location and rich resources such as coal, steel and marine resources. Together with the Bohai Sea, it encloses the direct-administered municipalities of Beijing and Tianjin, forming coordinated development of the Beijing-Tianjin-Hebei region. Although affected by the Chinese policy to reduce capacity in the coal and steel industries, Hebei Province's economic scale has steadily increased over the past five years. In 2023, Hebei Province recorded a gross regional production ("GRP") of RMB4,394.4 billion with a year-over-year ("YoY") growth rate of 5.5%, ranking 11th among all provinces in China. Hebei Province is expected to benefit from the promotion of national strategies including the coordinated development of the Beijing-Tianjin-Hebei region and the construction of Xiong'an New District. Hebei Province's fiscal income also increased steadily, however, its fiscal self-sufficient ratio, as calculated by general budgetary revenue over general budgetary expenditure, was moderate and its fiscal income relies on support from the higher-tier government. In 2023, its general budgetary revenue amounted to around RMB428.6 billion, increasing from RMB416.8 billion in 2021.

Shijiazhuang City is the capital city of Hebei Province and serves as political, economic, technological, financial, cultural, and information center in Hebei Province. Shijiazhuang City is also a major hub for railway transportation in China, indicating excellent transportation advantages. In recent years, Shijiazhuang City has been actively developing five major industrial clusters, including the new generation electronic information industry, biopharmaceutical industry, equipment manufacturing industry, modern food industry, and modern commerce and logistics industry. Supporting by its policy advantages, transportation advantages as well as mature industry structure, Shijiazhuang City's economic indicators rank among the top in Hebei Province. Over the past three years, Shijiazhuang City demonstrated steady economic growth. In 2023, Shijiazhuang City recorded a GRP of RMB753.4 billion with a YoY growth rate of 6.2%, ranking 2nd among all prefectural-level cities in Hebei Province. Its general budgetary revenue also increased from RMB65.4 billion in 2021 to RMB70.7 billion in 2023, ranking 1st among all prefectural-level cities in Hebei Province. However, Shijiazhuang Municipal Government's self-sufficiency was moderate. Its average budgetary self-sufficiency ratio (general budgetary

revenue/general budgetary expenditure) was around 58.2% over the past three years. Shijiazhuang Municipal Government also relies on transfer income from Hebei Province and issuing government bonds to achieve fiscal balance. As of the end of 2023, the local government's outstanding debt amounted to RMB230.8 billion, accounting for about 30.6% of GRP.

Exhibit 3. Key Economic and Fiscal Indicators of Shijiazhuang City

	2021FY	2022FY	2023FY
GRP (RMB billion)	649.0	708.0	753.4
GRP Growth (%)	6.6	6.2	6.1
General Budgetary Revenue (RMB billion)	65.4	66.4	70.7
General Budgetary Expenditure (RMB billion)	109.6	118.9	120.0
Local Government Debt (RMB billion)	172.7	203.1	230.8

Source: Shijiazhuang Municipal Government, CCXAP research

Zhengding County is a county under the jurisdiction of Shijiazhuang City and is recognized as one of the National Famous Historical and Cultural Cities by the State Council of China. Zhengding County has several functional areas including China (Hebei) Pilot Free Trade Zone Zhengding Area, Shijiazhuang Comprehensive Bonded Zone, Zhengding New Town, as well as Zhengding High-tech Industrial Development Zone. Zhengding County has continued to build the "4+1" pillar industries including digital economy, high-end equipment manufacturing, biomedicine, modern logistics and headquarters economy. Benefiting from its well-defined functional position and continuously improving industrial structure, Zhengding County demonstrated increasing economic growth. In 2023, Zhengding County recorded a GRP of RMB36.1 billion with a YoY growth rate of 6.9 %, and its general budgetary revenue increased to RMB5.7 billion from RMB4.8 billion in 2021. However, its general budgetary revenue structure is relatively unstable, with an average tax to general budgetary revenue ratio of around 36.3% over the past three years. The sales of relocation housing accounted for over 40% of general budgetary revenue from 2021 to 2023, which is considered unsustainable sources of income. Zhengding County also relies on government fund income. However, the government fund income bears high volatility especially during the downturn of Chinese property market. From 2021 to 2023, Zhengding County's government fund income was RMB3.5 billion, RMB7.9 billion, and RMB5.6 billion, respectively. In addition, as of the end of 2023, the local government's outstanding debt amounted to RMB23.5 billion, accounting for about 65.1% of GRP and indicating relatively large debt pressure.

Exhibit 4. Key Economic and Fiscal Indicators of Zhengding County

	2021FY	2022FY	2023FY
GRP (RMB billion)	30.3	33.8	36.1
GRP Growth (%)	4.8	8.0	6.9
General Budgetary Revenue (RMB billion)	4.8	5.5	5.7
General Budgetary Expenditure (RMB billion)	7.0	8.3	8.1
Local Government Debt (RMB billion)	17.3	19.4	23.5

Source: Zhengding County Government, CCXAP research

Government's Willingness to Provide Support

Important role in urban and rural construction, urban operation, and industrial incubation of Zhengding County

With the authorization of the local government, ZDSH is in charge of infrastructure construction in most areas of Zhengding County. ZDSH also shoulders the responsibilities of urban operation in Zhengding County, including water supply operation, charging pile operation, maintenance service and affordable housing operation.

ZDSH undertakes various infrastructure construction projects mainly through agency construction model. In October 2022, ZDSH signed "*Construction Project Entrusted Investment and Construction Agreement*" with the Zhengding County Government and would be responsible for the infrastructure construction in most areas of Zhengding County. Under agency construction model, the construction funds come from the local government and the Company is in charge of project construction and management. The Company would charge a certain mark-up, generally 12%, based on construction cost. As of 31 March 2024, the Company had completed 46 major projects, with a total invested amount of RMB1.4 billion and received government payment of RMB380 million. Meanwhile, the Company had numbers of projects under construction and planning, with a total planned investment of RMB3.2 billion and an uninvested amount of RMB2.6 billion, indicating sufficient project reserve.

The Company also engages in urban operation in Zhengding County including water supply operation, charging pile operation, maintenance service and affordable housing operation. The local government granted the franchise rights for water supply with 30-year term in the urban area and Tiexi District of Zhengding County to the subsidiary of ZDSH in August 2022. Water supply is vital to the local livelihood and industrial development.

Moreover, ZDSH undertakes maintenance service business including sanitation, municipal services, landscaping, and lighting in the urban area of Zhengding County according to the contract with local government department. The contract period is 3 years and the annual service fee is RMB199 million.

In addition, ZDSH participates in the operation of affordable housing. In 2023, the Company purchased 1,514 public rental housing units from the Housing and Construction Bureau of Zhengding County, with a purchase price of approximately RMB400 million. The Company would be responsible for the rental and daily management of the affordable housing.

Overall, ZDSH has a large scope for development and a strong capacity for business sustainability in Zhengding County, as well as an essential role in the urban operation. In our view, the Company is unlikely to be replaced by other local SOEs in the foreseeable future.

Good track record of receiving government support

ZDSH has a good track record of receiving government support in various forms such as equity transfer, asset injection, financial subsidies, and capital injection. As of 31 March 2024, the local government transferred equities of 9 local SOEs, tourism resources, operation right of sand, gravel and auxiliary materials, and other assets to ZDSH, increasing its capital reserve to RMB12.3 billion and broadening its business scope. From 2022 to 2024Q1, the local government injected capital of RMB890 million in total to the Company, enhancing ZDSH's capital strength. Over the same period, the Company consistently received a total of RMB99 million in financial subsidies from the local government.

Low but increasing exposure to commercial activities

Apart from public businesses, ZDSH is also engaged in commercial businesses such as supermarket operation, grain and oil sales, trading, sand and gravel sales, and cultural tourism. We consider the Company's exposure to commercial businesses to be low. Majority of the commercial assets is transferred from local government without large investment needs. However, considering that the two large self-operated projects would be

conducted by ZDSH, we estimate ZDSH's commercial activities would increase and capital expenditure pressure would be large.

ZDSH conducts sales business through different subsidiaries and different segments including supermarket operation, grain and oil sales, sand and gravel sales, and trading. The revenue of supermarket operation is the primary source of ZDSH's total revenue. In 2023, the revenue of supermarket operation was RMB517.0 million and accounted for around 39% of total revenue. However, this business would be suffered product and price competition by the trend of online shopping. The Company would focus on the rural market and provide delivery services in villages and towns of Zhengding County to mitigate the impact caused by online shopping. Moreover, the Company conducts sand and gravel sales through itself and its subsidiary. The sand and gravel are mainly obtained through public auction or generated from the Company's engineering projects. However, the sales of sand and gravel are greatly affected by the market conditions especially during the downturn of property market, the business stability is relatively weak. The Company also expands to trading business in 2023. The main trading products are coal, cement concrete, and iron ore products. The account period of trading business generally would not exceed 90 days. However, the Company bears certain concentration risk with a high proportion of top 5 suppliers and customers. Moreover, the gross profit margin of trading business is relatively low.

As the National Famous Historical and Cultural City, Zhengding County has rich cultural tourism resources. In 2022, the local government transferred the tourism assets and operating rights within the jurisdiction of Zhengding County with total book value of around RMB3.4 billion to the Company. The major tourism asset is Rong Guo Fu, which was built for filming the Chinese masterpiece "Dream of Red Mansions". The Company mainly obtains income through tickets, tour guide services and cultural and creative products. In 2023, the number of tourists of Rong Guo Fu was around 1.0 million. The Company plans to renovate and upgrade its cultural tourism projects to create a 5A-level scenic spot in Zhengding County.

Through public auction, the Company has acquired the public resource usage rights for new energy infrastructure in 37 parking lots in Zhengding County in RMB201 million. The Company also plans to conduct Zhengding New Energy Infrastructure Project with a total planned investment amount of RMB943 million. The Company expects to balance its funds through revenue generated from charging fees for charging pile, leasing fees of new energy vehicles, and advertising revenue.

The Company also plans to use self-operation model to conduct 2 large projects, namely Zhengding County Digital Agricultural Product Logistics Park and Supporting Dual-Use Project and Zhengding Tiexi District Urban Renewal Project, with a total estimated investment amount of RMB8.9 billion. These 2 self-operation projects are in the early planning stage and the Company expects to achieve fund balancing through leasing and operation revenue. ZDSH is also responsible for the fund raising of the self-operated projects. We estimate the self-operated projects would bring relatively large capital expenditure pressure to the Company.

Rapid debt growth with large capital expenditure pressure

ZDSH's debt had grown rapidly over the past three years due to the purchase of franchise rights and affordable housing, as well as the expansion of business. As of 31 March 2024, the Company's total debt increased to RMB2.2 billion from RMB143.8 million at end-2021. Although its capitalization ratio increased from 1.6% to 13.6% over the same period, it was still deemed as reasonable level. Meanwhile, the Company also maintains relatively good debt maturity structure. As of 31 March 2024, the short-term debt to total debt ratio was 20.7%. At the same time, the unrestricted cash to the short-term debt ratio was 2.4x, indicating that its cash reserve could fully cover its short-term debt. Considering the large scale of construction projects in pipeline and the ongoing

project investments, we expect that the Company's future investment amount in self-operated projects will be more than RMB9.0 billion and the Company will rely on external financing to fulfill its investment needs, further increasing its debt burden and capital expenditure pressure in the next 12-18 months.

ZDSH has relatively weak asset liquidity. As of 31 March 2024, the other non-current assets, inventories, investment properties and intangible assets accounted for around 79% of its total assets. These assets were mainly the operation right of sand, gravel and auxiliary materials, tourism resources, construction costs of infrastructure construction, as well as purchased affordable housing, which were considered as low liquidity. Moreover, the asset valuation of the operation right of sand, gravel and auxiliary materials is relatively high, at around RMB7.0 billion. We should pay attention to whether the high asset valuation can bring stable returns in corresponding sales.

Fair access to funding with high concentration on bank loans

ZDSH has fair access to funding with high concentration on bank loans. As of 31 March 2024, bank loans accounted for around 90% of its total debt, majority of which were provided by policy bank, large state-owned commercial banks, and national jointed-stock commercial banks. The average financing cost of bank loans was at a reasonable level of 4.16%. As of 31 March 2024, the Company had total bank facilities of RMB6.6 billion, with the available portion being RMB3.9 billion, indicating a relatively sufficient standby liquidity. Moreover, the Company's exposure to non-standard financing products is controllable, accounting for around 9% of its total debt as of 31 March 2024. The Company's non-standard financing only consisted of financial leasing.

ESG Considerations

ZDSH is exposed to environmental risks because it has undertaken construction projects. Such risks could be moderated by conducting environmental studies and planning before the commencement of projects, and close monitoring during the construction phase.

ZDSH bears social risks as it plays a crucial role in the social welfare of the residents in Zhengding 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.

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

Structural Considerations

ZDSH's senior unsecured debt rating is equivalent to its long-term credit rating. We believe that government support will flow through the Company given its strategic role in the development of Zhengding 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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