

## Credit Opinion

3 December 2024

Ratings	
Senior Unsecured Debt Rating	BBB <sub>g</sub>
Long-Term Credit Rating	BBB <sub>g</sub>
Outlook	Stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

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## Zouping Huirong Industrial Investment Group Co., Ltd.

### Initial credit rating report

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub> to Zouping Huirong Industrial Investment Group Co., Ltd., with stable outlook.**

### Summary

The BBB<sub>g</sub> long-term credit rating of Zouping Huirong Industrial Investment Group Co., Ltd. ("ZPHR" or the "Company") reflects the Company's (1) strong regional competitiveness in public utility services and industrial development in Zouping City; and (2) supplementary income benefited from a relatively diverse business structure.

However, the rating is constrained by the Company's (1) relatively weak profitability with low return on assets; and (2) fast-growing debt with weak debt servicing capability.

The rating also reflects a high likelihood of support from the Zouping City Government when needed, given the Company's (1) direct ownership and ultimate control by the Zouping City Government; (2) regional importance in urban operation and industrial development in Zouping City; and (3) good track record of receiving ongoing government support.

The stable outlook on ZPHR's rating reflects our expectation that the Company will maintain its regional competitiveness and importance in market-driven activities in Zouping City over the next 12-18 months. We also expect that the Company will continue to receive ongoing support from the local government.

## Rating Drivers

- Strong regional competitiveness in public utility services in Zouping City
- Important position in industrial park development and operation in Zouping City
- Supplementary income from commodity sales and other businesses
- Relatively weak profitability with low return on assets
- Fast-growing debt with weak debt servicing capability
- High likelihood of support from the Zouping City Government

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) the likelihood of government support for the Company improves; or (2) the Company's stand-alone credit profile improves significantly, such as improving financial profile including an increase in capital strength and profitability.

### What could downgrade the rating?

The rating could be downgraded if (1) the likelihood of government support for the Company decreases; or (2) the Company's stand-alone credit profile weakens significantly, such as a deterioration in financial leverage or weakened liquidity position.

## Key Indicators

	2021FY	2022FY	2023FY	2024H1
Total Assets (RMB billion)	4.4	5.2	10.6	11.2
Total Equity (RMB billion)	1.9	2.1	6.0	6.4
Total Revenue (RMB billion)	0.5	0.8	0.9	0.5
Net Profit (RMB million)	43.8	81.7	56.1	8.9
EBIT Margin (%)	14.0	19.3	15.4	15.2
Return on Assets (%)	-	3.0	1.8	-
Total Debt/Total Capital (%)	22.9	31.5	20.8	21.7
Total Debt/EBITDA (x)	4.4	5.1	9.5	-
EBITDA/Interest (x)	10.4	6.2	2.5	-
FFO/Total Debt (%)	13.6	6.6	5.1	-

All ratios and figures are calculated using CCXAP's adjustments. Indicators marked with "-" are not applicable or not comparable.

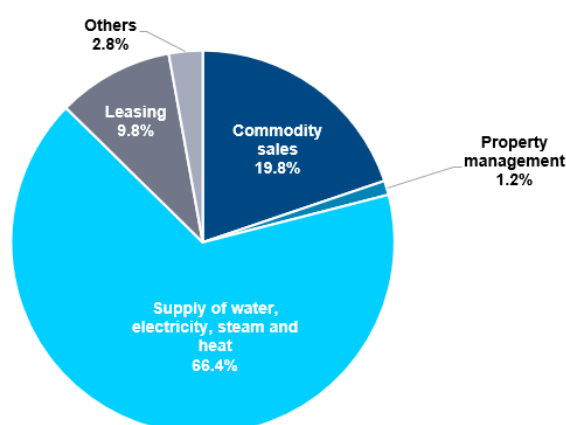
Source: Company data, CCXAP research

## Corporate Profile

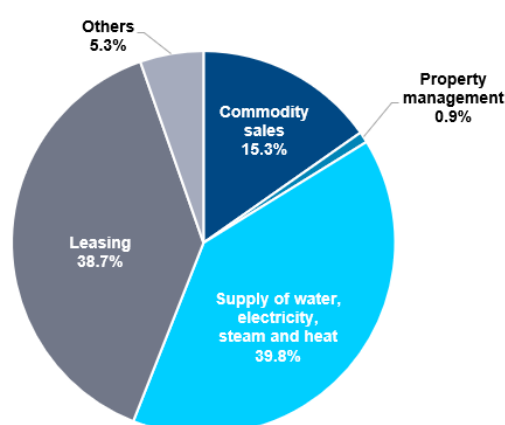
Established in 2020, ZPHR is a local state-owned enterprise mainly operating in Zouping City, a country-level city in Binzhou City, Shandong Province. It is positioned as the only industrial platform in Zouping City and is mandated to promote regional industrial upgrading. The Company is mainly engaged in the public utility services such as the supply of water, steam, heat and electricity, as well as commodity sales, the processing of aluminum products, and leasing business. As of 30 June 2024, the Company is directly owned and controlled by the Zouping City State-owned Assets Center.

**Exhibit 1. Shareholding chart as of 30 June 2024**

Source: Company information, CCXAP research

**Exhibit 2. Revenue structure in 2023**

Source: Company information, CCXAP research

**Exhibit 3. Gross profit structure in 2023****Rating Considerations****Business Profile****Strong regional competitiveness in public utility services in Zouping City**

ZPHR has strong regional competitiveness in the provision of public utility services in Zouping City. The public utility services include the supply of heat, steam and water, which provide the Company with stable revenues and cash flow. It has relatively strong public welfare and regional characteristics, resulting in high entry barriers.

ZPHR is the sole heat supplier in Zouping City and has a dominant market position. The Company's heating business covers the entire Zouping City, with a service area of approximately 10.0 million square meters. It is divided into residential heating, non-residential heating, and industrial gas supply, with residential heating accounted for around 90% of its total supply. As of 30 June 2024, the Company has a heating network length of 350.0 kilometers, with a total heating capacity of 20 million square meters, providing heating services to over 64 thousand households, covering 294 communities. The heat supply has a quasi-public attribution, and the price was regulated by the government, which was around RMB22.0 per square meter for residents and RMB32.0 per square meter for non-residents. As of 30 June 2024, the Company had 2 heat supply pipelines upgrading projects under construction with a total investment of RMB54.3 million. The completion of these projects is expected to increase the heating business's revenue due to the enlargement of the service area and improvement of heating efficiency.

ZPHR also provides water supply services in Zouping City, including water purification, rural tap water and water quality testing services, serving more than 247.5 thousand households with a coverage area of 61.5 square kilometers. As of 30 June 2024, the Company ran a water purification plant with an annual water purification capacity of 15 million tons. Meanwhile, the Company provides rural tap water services to 12 towns through one water supply facility with a daily capacity of 42.0 thousand tons. In addition, the Company provides water and wastewater testing, technical consultation, and technical services to users.

In 2023, the revenue from public utility services increased by 11.0% year-on-year (“YoY”) to RMB613.5 million and the gross profit margin was around 15.1%, mainly due to business expansion and increase in pipeline network. The Company’s revenue may increase along with the development of the region. Meanwhile, the public utility services are essential for urbanization development and social welfare, which have lower cyclical risks. We believe that the Company has a strong competitive position in the region, underpinned by its high replacement cost, as these public services are vital to the citizens of Zouping City.

### **Important position in industrial park development and operation in Zouping City**

Fostering the industrial development of Zouping City, ZPHR is responsible for investment attraction and asset operation for the industrial parks, such as the Weiqiao Aluminium Deep Processing Industrial Park, including investment attraction, standard factory building and leasing, as well as comprehensive services such as energy supply and safety protection. As of 30 June 2024, the Company had two main industrial parks under operation, with more than 90 enterprises settled in, mainly the aluminum processing enterprises and papermaking enterprises. At the same time, it had one industrial park project under construction as of same date, namely the Aluminium Deep Processing Industrial Park Phase 4, with an estimated total investment amount of RMB880.0 million and an uninvested amount of RMB708.0 million. Upon completion of this project, it is expected that the funds will be in balance through leasing.

In addition to industrial parks leasing, the Company’s park operations also provide energy supply services. This business model is based on sales-driven procurement, whereby the Company purchases electricity, steam, water and other energy sources and sells to the companies located in the parks. Both procurement and sales prices are based on market rates. From 2021 to 2023, the Company generated energy supply revenue of RMB234 million, RMB312 million and RMB304 million, with gross profit margins of 12.72%, 9.15% and 7.75%, respectively. This business is susceptible to external environmental influences, resulting in relatively unstable operating revenue and gross profit margins, which requires attention to the subsequent stability of profitability in the future.

### **Supplementary income from commodity sales and other businesses**

In line with the industrial development of Zouping City and based on the local aluminum industry chain, ZPHR manufactures, processes and sells aluminum products in Zouping City, mainly aluminum engine parts for automobiles. The main downstream customers are electric vehicles and fuel vehicles manufacturers. This business is the second largest contributor to the total revenue, contributing for 18.8% of the Company’s revenue in 2023. In 2023, the aluminum sales business’s revenue grew to RMB176 million from RMB111 million in 2022, owing to the market recovery after the epidemic. However, this segment is cyclical, as the underlying products are sensitive to economic cycles and price volatility. The gross profit margin of this business sector fluctuated but remained at over 10% over the past three years. As of the end of June 2024, there was one casting quality improvement project under construction (with an estimated total capacity of 14,100 tons), with a total investment amount of RMB100.0 million and an uninvested amount of RMB25.0 million. Together with the completion of this project, we expect that the scale and capacity of the Company’s aluminum sales will expand in the next 12-

18 months.

Through its subsidiaries, ZPHR also engages in commodity trading. Relying on the advantages of the local industrial chain, the trading products include liquid aluminum, clean coal, steel scrap, coke, and crude oil. The Company adopts a demand-on-purchase model, which means that the Company only makes procurement with upstream suppliers when orders from downstream customers are made, earning the trade differences. Due to the Company's limited bargaining power, the gross profit margin of this business is relatively low, averaging at 5.9% over the past three years. However, the Company is exposed to high-concentration risks, as it heavily relies on its top suppliers and customers. In 2023, the top 5 suppliers and customers of commodity sales accounted for 61.1% of the total procurement and 60.9% of total sales respectively, demonstrating high concentration risks.

The Company had a range of leasable properties, mainly public utilities such as hospitals, health centers, and reservoirs. The tenants are mostly government-related units for public utilities. The leasable assets are acquired or self-built with a total investment of RMB2.5 billion. In 2023, the Company recorded a leasing revenue of RMB90.5 million, providing supplementary revenue and cashflow to the Company. The occupancy rate of leasable properties is over 80%, and the leasing terms are typically 4-5 years, bring a relatively stable cashflow to the Company. In October 2023, the local government transferred 18 reservoirs to the Company, enlarging the Company's leasable asset scale. In the future, with the completion of projects under construction and the increasing occupancy rate of properties, the leasing income is expected to grow, bringing supplementary revenue to the Company. However, the leasing business is heavily influenced by local economic and market conditions and is subject to uncertainty.

The Company is also involved in other commercial activities, such as engineering construction, property management, and financial guarantee business, which account for less than 5% of the Company's revenue in 2023. The Company also acquired the car park franchise rights from the local government in 2023. However, these assets were gained by the Company through acquisitions.

## Financial Profile

### Relatively weak profitability with low return on assets

ZPHR's revenues have grown rapidly over the past three years due to the expansion of the Company's public utility services and increased sales of aluminum products. From 2021 to 2023, the Company's total revenue increased significantly from RMB547.0 million to RMB924.6 million. The income from public utility services business is the main contributor, accounting for 66.4% of the Company's total revenue in 2023, followed by commodity sales (19.8%), and leasing (9.8%). However, due to its public benefit characteristics, the Company's public utility services are less profitable. Meanwhile, the commodity sales business has weak bargaining power, resulting in low gross margins. The Company's EBIT margin decreased from 19.3% in 2022 to 15.4% in 2023, while the return on assets also dropped from 3.0% to 1.8% over the same period. The decrease in EBIT margin and return on assets was mainly due to the Company had several projects under construction in 2023, which did not generate revenue. As at 30 June 2024, the Company's major projects under construction had a total investment of RMB1.0 billion and an uninvested amount of RMB774.0 million. Meanwhile, in 2023, the government allocated parking assets with a total value of RMB1.2 billion to the Company. However, the car parks are generating only RMB1.2 million per annum.

### Fast-growing debt with weak debt servicing capability

Due to the expansion of its business scope and projects under construction, ZPHR's total debt has been growing rapidly over the past three years. As of 30 June 2024, the Company's total debt increased to RMB1.8 billion from RMB558.4 million as of end-2021, while its capitalization ratio (total debt to total capital) decreased slightly from 22.9% to 21.7% over the same period mainly due to the ongoing government capital injection.

ZPHR's stand-alone debt-serving metrics are weakened by its increasing debt burden. the Company's debt servicing capacity was weakened as the total debt/EBITDA ratio increased significantly from 4.4x in 2021 to 9.5x in 2023, while the EBITDA/total interest ratio declined from 10.4x to 2.5x over the same period. Meanwhile, the Company is exposed to relatively high refinancing pressure given its high level of short-term debt. As of 30 June 2024, its short-term debt accounted for 51.2% of its total debt, and the cash to short-term debt ratio was only 0.2x. The Company's external financing channels are mainly bank loans and non-standard financing, of which bank loans accounted for more than 70% of the total debt as of 30 June 2024. Its financing channels concentrated on regional banks such as urban commercial banks. As at the same date, the Company had total bank facilities of RMB942.0 million, with an available amount of RMB150.0 million. Moreover, the Company had a relatively large exposure to non-standard financing as of end-June 2024, mainly financial leasing, which accounted for approximately 25% of the total debt.

The Company's cash generation capacity of the core business is good, with an average cash-to-revenue ratio of around 1.0x over the last three years. However, its FFO/total debt ratio decreased to 8.0% in 2023, compared to 13.6% in 2021, due to ongoing investment in business expansion and project construction. Given the Company's further business expansion, its debt levels may continue increase in the future. The Company's proportion of restricted assets is high, which may have a negative impact on its financing flexibility. As of 30 June 2024, the Company had pledged assets mainly including inventories, investment properties and intangible assets, with a total amount of RMB2.0 billion for loans, accounting for 18.0% of its total assets.

## External Support

### High likelihood of support from the Zouping City Government

We expect a high likelihood of government support from the Zouping City Government in times of need. Our expectation incorporates the considerations of the Company's (1) direct ownership and ultimate control by the Zouping City Government; (2) regional importance in urban operation and industrial development in Zouping City; and (3) good track record of receiving ongoing government support, including capital injection, equity transfers, and financial subsidies.

Zouping City 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. Riding on its industrial development, Zouping City has been experiencing continuous economic growth for the past three years. Zouping City's GRP increased by 3.5% YoY to RMB65.2 billion in 2023, ranking the 1<sup>st</sup> among nine districts/counties in Binzhou City. Its general budgetary revenue also increased for years to RMB7.9 billion in 2023, of which tax revenue accounted for 64.7% of its general budgetary revenue, indicating relatively good fiscal quality.

The shareholding structure and business operations of the Company are closely linked to the local government. The Zouping City Government maintains a high degree of control over the operations of ZPHA, including the formulation of business strategies and the appointment of the Board of Directors and key management personnel. The Company is also required to report its annual budget, objectives, plans and performance to Zouping City State-owned Assets Center.

Given its regional significance in the urban operation and industrial development of Zouping City, ZPHR has a good track record of receiving government support, including capital injection, equity and assets transfer, and financial subsidies. In 2022 and 2023, the Zouping City State-owned Assets Center injected a total of RMB962 million cash into the Company, significantly increasing its paid-in capital. Since 2021, the Company also received equity and asset transfers from the local government, which strengthened the Company's capital strength and broadened its business scope. For instance, in 2023, the local government transferred a wide range of assets to the Company, including heat supply pipelines, reservoirs and car parks. Moreover, from 2021 to 2024H1, the Company received ongoing subsidies of RMB6.4 million to support its operations. In addition, the Company received special government bonds of RMB854.0 million to support its projects construction, such as the aluminum deep processing industrial park project.

## Structural Considerations

ZPHR'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 regional importance in urban operation and industrial development in Zouping 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 [General Corporate \(April 2019\)](#).



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