

## Credit Opinion

12 June 2023

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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## Zoucheng Urban Assets Holding Group Co., Ltd.

### Initial credit rating report

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub> to Zoucheng Urban Assets Holding Group Co., Ltd., with stable outlook.**

### Summary

The BBB<sub>g</sub> 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 extremely 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) medium 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
- Medium 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

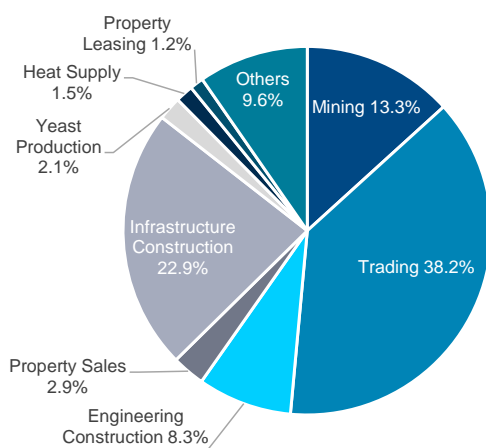
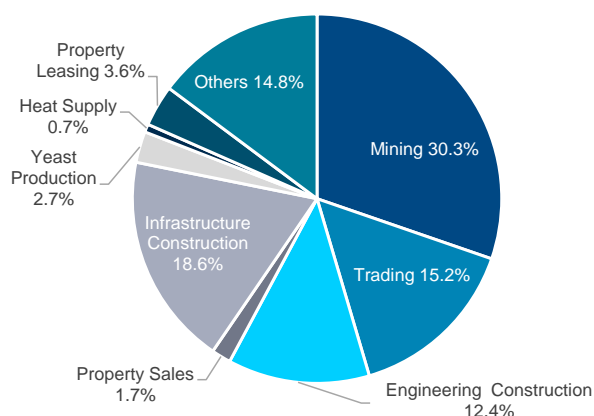
	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	50.4	55.7	55.5	53.4
Total Equity (RMB billion)	19.9	21.2	21.6	21.7
Total Revenue (RMB billion)	6.6	7.3	8.7	1.9
Total Debt/Total Capital (%)	52.3	53.4	52.7	51.5

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

Source: 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 welfare services, including infrastructure construction, resettlement housing construction, heat supply, and gas supply in local urban areas. It also engages in some commercial activities, including mining, trading, yeast production, property sales, as well as property leasing. As of 31 March 2023, ZCUA was directly and wholly owned by the Finance Bureau of Zoucheng City.

**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 Zoucheng City Government has a strong capacity to provide support given its relatively good economic strength and fiscal metrics, ranking 49<sup>th</sup> out of CCID Top 100 Counties in China in 2022.

Shandong Province is the third largest province in China by gross regional products ("GRP") in 2022, with a solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive and agri-food. Jining City is located in the southern part of Shandong Province, which 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 steadily improved over the past three years. In 2022, it reported a GRP of RMB531.7 billion, representing 4.4% year-over-year ("YoY") growth, and general budgetary revenue of RMB44.8 billion. However, Jining City has moderate fiscal metrics and a debt profile. The Jining Municipal Government's fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was around 60% over the past three years. Tax incomes decreased to RMB30.2 billion in 2022 from RMB33.2 billion in 2021 because of the tax refund policy, accounting for 67.4% of its general budgetary revenue in 2022. As of 31 December 2022, its government debt to GRP ratio was 28.5%.

**Exhibit 3. Key economic and fiscal indicators of Jining City**

	2020FY	2021FY	2022FY
GRP (RMB billion)	449.4	507.0	531.7
GRP Growth (%)	3.6	8.5	4.4
General Budgetary Revenue (RMB billion)	41.2	44.1	44.8
General Budgetary Expenditure (RMB billion)	69.6	72.7	74.7
Local Government Debt (RMB billion)	109.5	134.5	151.4

Source: Statistics of Bureau of Jining City, CCXAP research

Located in the southwest of Shandong Province, Zoucheng City is a county-level city under the management of Jining City with good traffic advantages and rich coal resources, ranking 49<sup>th</sup> out of CCID Top 100 Counties in China in 2022. 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 the recent year. Supported by affluent resources, several large energy enterprises have settled in Zoucheng City, such as Yankuang Energy Group Company Limited and Huadian Power International Zouxian Power Plant. Zoucheng City is the largest counties/districts in Jining City by GRP. It had a GRP of RMB100.9 billion in 2022, accounting for 19.0% of Jining City's GRP. Zoucheng City Government's general budgetary revenue also has recorded several consecutive years of growth. In 2022, its general budgetary revenue increased by 1.8% YoY to RMB8.6 billion. Meanwhile, Zoucheng City Government had good financial self-sufficiency with fiscal balance ratios above 90% over the past three years. However, its tax revenue dropped by around 5.8% YoY to RMB5.2 billion in 2022 due to the taxes refund policy, accounting for 60.4% of its general budgetary revenue. As of 31 December 2022, the outstanding debt of Zoucheng City Government was RMB10.3 billion, accounting for 10.2% of its GRP.

#### Exhibit 4. Key economic and fiscal indicators of Zoucheng City

	2020FY	2021FY	2022FY
GRP (RMB billion)	82.4	96.1	100.9
GRP Growth (%)	4.0	8.7	5.0
General Budgetary Revenue (RMB billion)	8.0	8.4	8.6
General Budgetary Expenditure (RMB billion)	8.2	8.8	8.5
Local Government Debt (RMB billion)	8.0	9.1	10.3

Source: Statistics of Bureau of Zoucheng City, 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 the others. As of 31 December 2022, ZCUA's total assets amounted to RMB55.5 billion. In addition, the Company has the largest outstanding amount of bonds among the LIIFCs in Zoucheng City. 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 RMB16.2 billion and RMB21.2 billion as of end-2022, 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.

#### 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 March 2023, the Company has invested RMB1.2 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 2022, the Company received RMB724.2 million from engineering construction.

Moreover, the Company provides essential public services in Zoucheng City with franchise advantages, including heat and gas supply. As of 31 March 2023, the Company's heat supply business scope mainly covered the urban area of Zoucheng City with a coverage area of around 3,750 thousand square meters and a pipe network length of 16.8 kilometers. The Company's gas supply business covers the whole residential users and part of industrial and commercial enterprise users in Zoucheng City. However, due to the public nature of these businesses, the profitability of them is relatively low.

#### **Medium exposure to commercial activities**

The Company engages in various commercial activities including mining, trading, yeast production, property sales 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 2022, the Company had 2 coal mines in production with a total recoverable reserve amount of 26.2 million tons. Meanwhile, there were 2 coal mines under construction, with an uninvested amount of RMB910.7 million. As the Company's prospecting for these coal mines has not yet made substantive progress, SDHH suspended the follow-up investment and construction. 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 policies and economic conditions, usually demonstrating high fluctuation. The correction of coal prices after the balance of demand and supply in the future 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 which generate a small portion of total revenue recently. 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 Agricultural Technology Center and 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 maturity debt**

The Company demonstrated moderate debt management with relatively high debt leverage and a concentrated debt structure. As of 31 March 2023, the total debt amounted to RMB23.0 billion with a total capitalization ratio of 51.5%. ZCUA maintained moderate total capitalization ratios which were in the range of 50-55% over the past three years. 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 March 2023, the Company had high short-term debt level of RMB10.9 billion which accounted for 63.2% of total debt and consist of a large amount of maturing or puttable bonds. In addition, the cash to short-term debt was around 0.4x.

Moreover, the Company's asset liquid was weak which may weaken its financial flexibility. As of 31 March 2023, other receivables and inventory totally represented around 62% of total assets, which mainly consist of government related-receivables and land with low liquidity. Meanwhile, the total restricted assets were RMB4.7 billion which accounted for 8.8% 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, domestic bond market and financial companies. The debt from bank loans and bond issuances accounted for the majority of total debt. From January 2023 to April 2023, ZCUA itself issued 6 tranches of bonds raising around RMB2.3 billion, including MTNs and Corporate Bonds. The Company has also built good long-term relationships with different domestic banks such as China Construction Bank Corporation, Huaxia Bank Co., Ltd., Bank of Rizhao Co., Ltd., and China Bohai Bank Co., Ltd. As of 31 March 2023, the Company had total bank facilities of RMB11.2 billion and the available portion amounted to RMB6.2 billion. At the same time, non-standard financing accounted for around 15% of total debt.

The Company's refinancing ability has a significant impact on its financing stability considering its relatively high financing cost, which may easily influence 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 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. As of 31 December 2022, the book value of the assets injected into the Company from the government amounted to RMB14.5 billion which increased the Company's capital strength. Moreover, from 2020 to 2023Q1, the Company received continuous government subsidies with a total amount of RMB583 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. Regarding the importance of the Company to local development, we expect the Company will receive ongoing support from the local government.



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

The Company bears moderate contingent risk resulting from large external guarantees. As of 31 March 2023, the Company's external guarantees amounted to RMB6.5 billion, accounting for 30.0% of its net assets, and were provided to state-owned enterprises. The phenomenon of mutual guarantees between local state-owned enterprises ("SOEs") is common in Zoucheng City. 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 would 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 \(July 2022\)](#).

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