

## Credit Opinion

2 February 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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## Zibo Zichuan Finance Holding Co., Ltd.

### Initial credit rating report

### CCXAP assigns first-time long-term credit rating of Zibo Zichuan Finance Holding Co., Ltd. at BBB<sub>g</sub>-, with stable outlook.

#### Summary

The BBB<sub>g</sub>- long-term credit rating of Zibo Zichuan Finance Holding Co., Ltd. (“ZCFH” or the “Company”) reflects Zichuan District 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 Zichuan District Government’s capacity to support reflects Zichuan District’s comprehensive strength, with ongoing economic growth and improving fiscal metrics.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) important role in regional development of the Zichuan District, primarily responsible for the development of industrial parks and supporting infrastructure; and (2) solid track record of receiving government supports.

However, the rating is constrained by the Company’s (1) moderate exposure to commercial activities; and (2) fast debt growth driven by continuous investment in infrastructure projects and industrial parks.

The stable outlook on ZCFH’s rating reflects our expectation that the Zichuan District Government’s capacity to provide support will be stable, and the Company’s important role in regional development of Zichuan District will remain unchanged over the next 12 to 18 months.

## Rating Drivers

- Important role in regional development of the Zichuan District, primarily responsible for the development of industrial parks and supporting infrastructure
- Moderate exposure to commercial business activities
- Solid track record of receiving government supports
- Fast debt growth driven by continuous investment in infrastructure projects and industrial parks
- Access to multiple funding channels

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) Zichuan District 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 materially lowering exposure to risky commercial activities, and improving debt management and financing ability.

### What could downgrade the rating?

The rating could be downgraded if (1) Zichuan District 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, decreased government payments, or increased exposure to commercial activities.

## Key Indicators

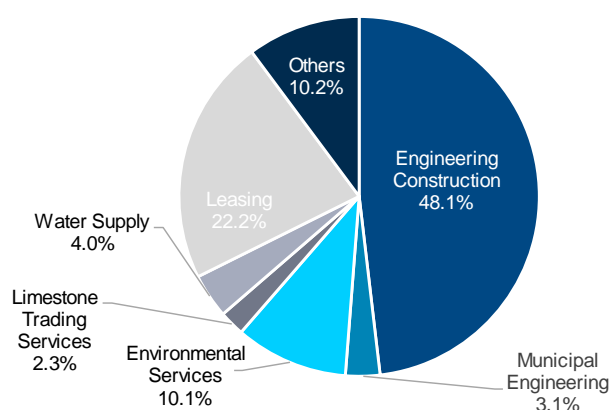
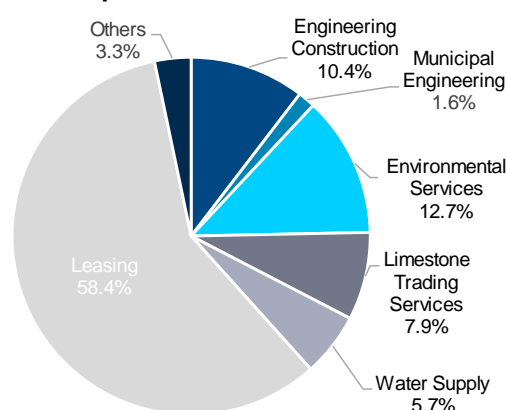
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	10.5	13.8	15.7	17.1
Total Equity (RMB billion)	6.6	7.2	6.8	7.1
Total Revenue (RMB billion)	1.8	1.2	0.8	0.5
Total Debt/Total Capital (%)	27.7	38.5	48.9	47.8

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

Source: Company data, CCXAP research

## Corporate Profile

Founded in July 2017, ZCFH is one of the two pivotal local infrastructure investment and financing companies ("LIIFCs") in Zichuan District. As an important urban infrastructure investment and state-owned capital investment and operation entity in Zichuan District, ZCFH is responsible for public infrastructure and welfare projects, including infrastructure construction, municipal engineering, and environmental services. It also has commercial activities, including industrial park development and operation, financial investment, leasing, limestone trading services. As of 30 June 2023, it was directly and wholly owned by the Zichuan State-owned Assets Supervision and Administration Bureau ("Zichuan SASAB").

**Exhibit 1. Revenue structure in 2022****Exhibit 2. Gross profit structure in 2022**

Source: Company data, CCXAP research

## Rating Considerations

### Government's Capacity to Provide Support

We believe the Zichuan District Government has a strong capacity to provide support, given Zichuan District's comprehensive strength, with ongoing economic growth and improving fiscal metrics.

Shandong Province is the third largest province in China by GRP, with a solid industrial foundation in industries such as logistics, shipbuilding, marine technology, chemical, automotive and agri-food. Zibo City is located in the central part of Shandong Province, which is one of the core cities of Shandong Peninsula Urban Agglomeration and a regional central city in Shandong Province approved by the State Council. With rich industrial resources and good location advantages, it has demonstrated an economic growth over the past three years, increasing from RMB367.4 billion in 2020 to RMB440.3 billion in 2022. Zibo City's GRP ranked the 7<sup>th</sup> by GRP among 16 prefecture-level cities in Shandong Province over the past three years. Despite the effects of the pandemic and tax refund policies, the general public budget revenue of Zibo City slightly increased from RMB32.2 billion in 2020 to RMB37.6 billion in 2022. It has good fiscal quality, with tax revenue accounting for 77.3% of its general public budget revenue on average over the past three years. Its fiscal balance is at a moderate level, with an average general budgetary revenue to general budgetary expenditure ratio of 67.8% over the past three years. As the end of 2022, Zibo City's government debt balance was RMB108.0 billion, accounting for 24.5% of GRP. In the first three quarters of 2023, Zibo City's GRP recorded RMB345.4 billion, a year-over-year ("YoY") increase of 5.2%.

**Exhibit 3. Key Economic and Fiscal Indicators of Zibo City**

	2020FY	2021FY	2022FY
GRP (RMB billion)	367.4	420.1	440.3
GRP Growth (%)	2.5	9.4	4.7
General Budgetary Revenue (RMB billion)	32.2	36.9	37.6
General Budgetary Expenditure (RMB billion)	52.3	52.3	52.6
Local Government Debt (RMB billion)	77.5	94.6	108.0

Source: Zibo Municipal Government, CCXAP research

Zichuan District is located in the central part of Zibo City, with a total area of 960 square kilometers. Supporting by its pillar industries such as machinery, building materials, textiles, and pharmaceuticals, Zichuan District has

continued to grow and develop in recent years. Zichuan District has demonstrated ongoing economic growth in recent years, the GRP of Zichuan District grew from RMB46.1 billion in 2020 to RMB52.8 billion in 2022, ranked 4<sup>th</sup> among 8 districts/counties in Zibo City. The general budgetary revenue of Zichuan District amounted to RMB3.6 billion in 2022, of which tax revenue accounted for 68.5%. Zichuan District has improving fiscal self-sufficiency. The general budgetary revenue/general budgetary expenditure ratio increased from 41.7% in 2020 to 76.8% in 2022 and the average ratio was 61.5% over the past three years. It also has a relatively low debt profile, with an outstanding debt of RMB6.5 billion at end-2022, accounting for 12.3% of GRP as of 31 December 2022. In the first three quarters of 2023, the GRP of Zichuan District was RMB4.1 billion, a YoY increase of 4.9%.

#### **Exhibit 4. Key Economic and Fiscal Indicators of the Zichuan District**

	2020FY	2021FY	2022FY
GRP (RMB billion)	46.1	51.9	52.8
GRP Growth (%)	2.1	8.0	2.4
General Budgetary Revenue (RMB billion)	3.5	3.4	3.6
General Budgetary Expenditure (RMB billion)	5.2	4.6	2.3
Local Government Debt (RMB billion)	5.0	6.1	6.5

Source: Zichuan District Government, CCXAP research

#### **Government's Willingness to Provide Support**

##### **Important role in regional development of the Zichuan District, primarily responsible for the development of industrial parks and supporting infrastructure**

As an important urban infrastructure investment and state-owned capital investment and operation entity in Zichuan District, ZCFH has a clear strategic role in regional development, especially in the development of industrial parks and supporting infrastructure. The Company is commissioned to carry out various key infrastructure construction projects, such as industrial parks, roads, ecological restoration construction and mine rehabilitation, which are crucial to local economic development and benefit the general public and local employment. We believe that the Company will not be easily replaced by other local state-owned enterprises in the foreseeable future.

The Company and its subsidiary mainly engage in the infrastructure construction business through the agency construction model, municipal engineering, and self-construction model. Under the agency construction model, the Company will self-fund the construction costs, and receive payments from the local government or Zibo Banyang Urban Development Co., Ltd, another major LIIFC in Zichuan District. The process payment amount equals to the total project costs plus a 15% markup after examining the projects. Under the self-construction model, the Company will achieve fund balancing through the economic value attached to the projects. As of 30 June 2023, there were 7 key infrastructure projects under construction, with a total investment amount of RMB7.3 billion and uninvested amount of RMB2.5 billion. However, there is a delay in the collection of payments for the agency construction projects.

Moreover, the Company also conducts infrastructure construction management through municipal engineering with the General Contracting Qualification Certificate for Municipal Engineering (Class 2). The Company mainly acquired projects through market-orient methods, such as public bidding. The main municipal engineering projects include bridges, drainage systems, flood control measures, and street lighting. As of 30 June 2023, there were 19 projects on hand, with a total contract value of RMB424 million.

In addition, the Company provides environmental services in Zichuan District through its subsidiary. As the major environmental service provider in Zichuan District, the Company is responsible for comprehensive sanitation services assigned by entrusting parties, including the collection, transportation and disposal of domestic wastes, road cleaning and sanitation, as well as enterprise cleaning and sanitation. According to the agreement, the entrusting parties would pay services fee to the Company.

### **Moderate exposure to commercial business activities**

Apart from the public policy activities, ZCFH also participates in commercial activities such as industrial park construction and operation, financial investment, leasing, and limestone trading services. Although the Company's commercial assets account for more than 30% of total assets as of the end of June 2023, we estimate the Company's risk exposure to commercial business is moderate due to the majority of its commercial activities is partially policy driven.

The Company is responsible for the investment and construction of industrial parks in Zichuan District to promote local investment attraction and industrial development. ZCFH undertakes self-operating industrial park construction projects, of which the Company self-finances, develops and directly manages or sells its own construction projects. The Company would achieve fund balancing through leasing and selling the industrial parks. However, there is a certain degree of uncertainty in operating income from self-construction projects. As of 30 June of 2023, there were 3 key self-operating industrial projects under construction, with a total investment amount of RMB3.9 billion and uninvested amount of RMB2.2 billion. The relatively large amount of uninvested amount of industrial park construction projects would exert certain capital expenditure pressure. Considering that ZCFH's aim is to boost the economic growth and industrial development of Zichuan District, we estimate the risk exposure of this business is moderate. However, the capital recovery cycle for industrial parks is typically long, requiring attention to the subsequent operation and investment return of the industrial parks.

ZCFH also conducts financial investment through equity investment and industrial fund investment. The Company's financial investment primarily serves the new and old growth driver transformation and industrial upgrading in Zichuan District. The Company had invested in various industries such as new materials, intelligent equipment manufacturing, new medical, and electronic information. As of 30 June 2023, the Company had 12 key direct equity investment projects, with a total investment amount of RMB509.9 million. However, the majority of invested companies of direct equity investment is local private-owned enterprises, which have higher operation risks during a market downturn. In terms of fund investment, the Company had participated in the establishment of the industrial investment funds as a limited partner. As of 30 June 2023, the Company had invested in 8 industrial funds with a total paid-up capital of RMB584.1 million. The financial investment business has significant volatility due to the performance of invested companies and change of economic situation. Moreover, the investment business is in the early stage.

In addition, the Company participates in the leasing business through industrial parks, pipeline network, reservoir canal, office buildings. Majority of the industrial park projects are self-construction, while other leasable assets are transferred from the local government. The primary lessees are government departments, local state-owned enterprises, and enterprises related to local pillar industries. In 2022, the leasing revenue was RMB178.7 million, accounting for 22.2% of total revenue. As the construction of the industrial park projects is completed and more companies settle in, ZCFH's rental income is expected to further increase in the future. However, ongoing investment in industrial park projects would bring large capital expenditure pressure. In addition, there is delayed payment of rental due to financial constraints of the tenant.

### **Solid track record of receiving government supports**

As a core LIIFC in the Zichuan District, ZCFH has a proven track record of receiving support from the local government in terms of capital injections, asset injections, equity transfer, and subsidies, to support its businesses and operations. In 2020, the Company received cash injection of RMB391 million from the Zichuan SASAB, which enhance its capital strength. Meanwhile, the Zichuan District Government transferred assets with book value of RMB903 million to ZCFH, such as heat supply networks, lands, and equity shares, which broadening the Company's business scope. In addition, from 2020 to 2022, the Company received ongoing financial subsidies from the local government with total amount of RMB178 million. In the first half of 2023, ZCFH received financial subsidies of RMB100 million from local government. As of 30 June 2023, the accumulated payments from local government for infrastructure construction projects was RMB1.5 billion. We expect that, as the pivotal state-owned enterprise in Zichuan District, the Company plays an irreplaceable role in the development and operation of the region, and will continue to receive ongoing supports from the local government over the next 12 to 18 months.

### **Fast debt driven by continuous investment in infrastructure projects and industrial parks**

Due to the large capital expenditure in infrastructure projects and industrial parks over the past few years, its total debt has seen a large increase. The Company's total debt rose from RMB2.5 billion in 2020 to RMB6.5 billion in 2023H1, with the total capitalization ratio also rose significantly from 27.7% to 47.8%. However, the Company has a relatively good debt structure. As of 30 June 2023, the Company's short-term debt amounted to RMB994.0 million, accounting for 14.8% of the total debt. Moreover, its cash to short-term debt ratio was around 1.0x, indicating the Company has adequate liquidity to cover its short-term debt repayment. Given its large capital expenditure pressure, we expect the Company's debt burden will continue to grow in the next 12 to 18 months.

The Company's asset liquidity is moderate. As of 30 June 2023, the Company's total assets consist mainly of fixed assets, inventories and account receivables, accounting for 64% of its total assets, which are considered to be low liquidity. Inventories are mainly infrastructure construction and self-operated project costs, fixed assets are reservoir canal and other buildings, while account receivables are mainly payment of infrastructure projects from the local government. Besides, as of 30 June 2023, the Company had pledged assets of RMB1.4 billion for loans, representing 8.2% of total assets. Some of the Company's other account receivables involves lending to local private-owned enterprises, and the Company bears certain recovery risk. The scale of the lending accounted for the relatively small portion of its total assets.

### **Access to multiple funding channels**

ZCFH has shown access to multiple sources of funding, including bank loans, onshore and offshore bond financing, and non-standard financing. Bank loans is the major financing channel of the ZCFH. The Company maintains good long-term relationships with several banks such as Agricultural Development Bank of China. As of 30 June 2023, the Company had obtained total credit facilities of RMB5.7 billion, with unutilized amount of RMB820 million. To support its business development, the Company receives large amount of bank loans from policy bank. The credit facilities from policy bank accounted for 71.6% of total bank facilities. However, the limited standby facilities may not satisfy its investment needs in construction projects, which would bring higher financing pressure. ZCFH has also participated in both onshore and offshore debt capital markets. As of January 2024, the Company had raised RMB1.0 billion through two tranches of domestic private corporate bond issuances, with coupon rates ranging from 5.0% to 6.0%. From 2021 to 2022, the Company issued two tranches of offshore bonds with total raising amount of USD94 million. Moreover, the Company maintained a manageable exposure to non-standard financing, accounting for 10% to 15% of its total debt as of 30 June 2023. Considering

the Company's important status as the Company's public roles in Zichuan District, we expect ZCFH to maintain access to domestic bank loans and capital markets.

## ESG Considerations

ZCFH bears environmental risks through its infrastructure construction projects and industrial parks. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

ZCFH bears social risks as it implements public policy initiatives by undertaking infrastructure construction, municipal engineering and environmental services in Zichuan District. 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.

ZCFH's governance considerations are also material as the Company is subject to oversight by the local government and the reporting requirements of the local government, reflecting its public policy role and status as a government-owned entity.

## Structural Considerations

ZCFH's senior unsecured debt rating is equal to its long-term credit rating. We believe that the government support will flow through the Company given its important role in regional development of Zichuan District, thereby mitigating any differences in 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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