

Credit Opinion

17 January 2025

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB _g +
Outlook	Stable

Analyst Contacts

Christy Liu +852-2860 7127

Credit Analyst

christy_liu@ccxap.com

Jessica Cao +852-2860 7128

Credit Analyst

jessica_cao@ccxap.com

Elle Hu +852-2860 7120

Executive Director of Credit Ratings

elle_hu@ccxap.com

**The first name above is the lead analyst for this rating and the last name above is the person primarily responsible for approving this rating.*

Client Services

Hong Kong +852-2860 7111

Zaozhuang Infrastructure Investment Development Group Co., Ltd.

Surveillance credit rating report

CCXAP affirms Zaozhuang Infrastructure Investment Development Group Co., Ltd. 's long-term credit rating at BBB_g+, with stable outlook.

Summary

The BBB_g long-term credit rating of Zaozhuang Infrastructure Investment Development Group Co., Ltd. ("ZZII" or the "Company") reflects Zaozhuang Municipal Government's very 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 Zaozhuang Municipal Government's capacity to provide support reflects its important role as modern manufacturing base and emerging technological innovation base in Shandong Province, with increasing economic strength.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) important role in supporting local economic development; (2) important responsibilities in undertaking water supply business; and (3) solid track record of receiving government supports.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities; (2) increasing debt level; and moderate asset liquidity; and (3) medium exposure to contingent liabilities.

The stable outlook on ZZII's rating reflects our expectation that the Zaozhuang Municipal Government's capacity to provide support will remain stable, and the Company will maintain its important role in the development of Zaozhuang City over the next 12 to 18 months.

Rating Drivers

- Important role in supporting local economic development
- Solid track record of receiving government supports
- Medium exposure to commercial activities
- Access to diversified funding
- Increasing debt level and moderate asset liquidity
- Medium exposure to contingent liabilities

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Zaozhuang Municipal Government's capacity to provide support strengthens; or (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as lower exposure to contingent liabilities, or improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) Zaozhuang Municipal 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 decreased government payments, or deteriorated financing ability.

Key Indicators

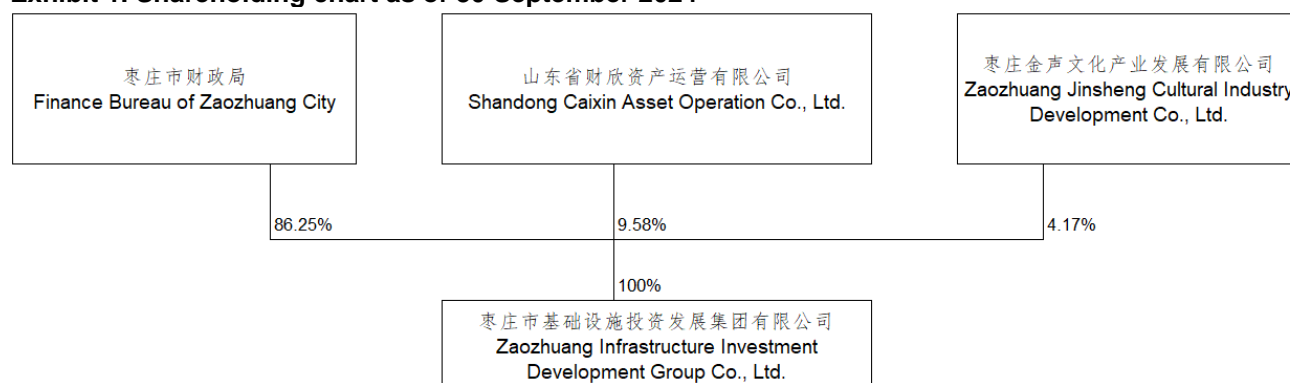
	2021FY	2022FY	2023FY	2024Q3
Total Asset (RMB billion)	19.3	22.0	24.0	28.9
Total Equity (RMB billion)	11.9	12.1	12.4	12.7
Total Revenue (RMB billion)	1.3	2.0	2.6	2.2
Total Debt/Total Capital (%)	26.8	38.1	40.8	44.7

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

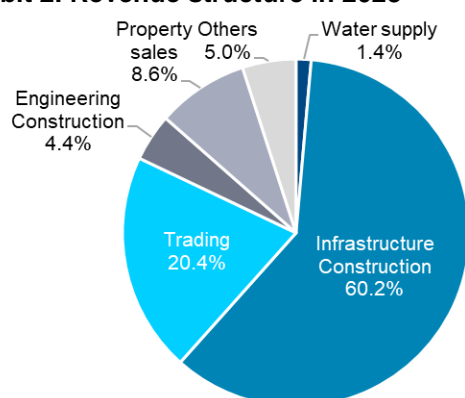
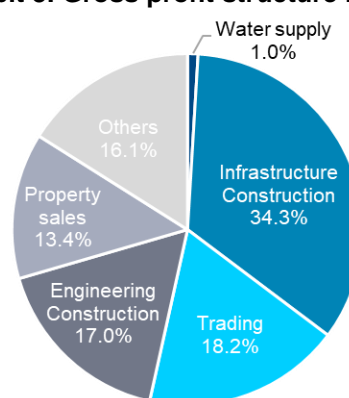
Source: Company data, CCXAP research

Corporate Profile

Founded in November 2016, ZZII is a pivotal state-owned asset operation and infrastructure construction company in Zaozhuang City and plays an important role in the urban development and operation of Zaozhuang City. The Company mainly engages in infrastructure construction, land quota development and sales, and water supply business. It also engages in commercial businesses such property sales, self-operated construction, and building material trading. As of 30 September 2024, the Company was under the control of the Finance Bureau of Zaozhuang City ("Zaozhuang Finance Bureau"), which directly held 86.25% of the Company's share. Moreover, Shandong Caixin Asset Operation Co., Ltd. and Zaozhuang Jinsheng Cultural Industry Development Co., Ltd. ("Jinsheng") directly held 9.58% and 4.17% of the Company's shares, respectively.

Exhibit 1. Shareholding chart as of 30 September 2024

Source: Company information, CCXAP research

Exhibit 2. Revenue structure in 2023**Exhibit 3. Gross profit structure in 2023**

Source: Company information, CCXAP research

Rating Considerations**Government's Capacity to Provide Support**

We believe the Zaozhuang Municipal Government has very strong capacity to provide support to the Company, given its status as a modern manufacturing base and emerging technological innovation base in Shandong Province, with increasing economic strength.

Shandong Province is the third largest province in terms of gross regional product ("GRP") in China over the past three years, with a solid industrial foundation in logistics, shipbuilding and marine technology, chemical, automotive and agri-food. Located in the southern part of Shandong Province, Zaozhuang City is an important modern manufacturing base and emerging technology innovation base in Shandong Province approved by the State Council. Zaozhuang City has established 6 advanced manufacturing industries including high-end equipment, high-end chemical industry, new materials, new energy, new medicine, new generation information technology, and 3 major industries including high-quality and efficient agriculture, new trade and logistics industry, and characteristic cultural tourism and health care industries.

Benefit from its modern industrial structure, Zaozhuang City's economy grew steadily in recent years. In 2023, Zaozhuang City's GRP was recorded at RMB215.7 billion, representing a year-on-year ("YoY") increase of 6.4%. The GRP of Zaozhuang City in the first three quarters of 2024 was RMB178.5 billion, representing 6.2% YoY

growth. Zaozhuang Municipal Government's general budgetary revenue increased from RMB16.9 billion in 2022 to RMB18.1 billion in 2023. Its fiscal balance ratio (general budgetary revenue/general budgetary expenditure) is moderate, averaging at 53.8% over the past three years, reflecting Zaozhuang Municipal Government's reliance on the transfer income from higher tier government and government fund income. As of end-2023, its outstanding government debt amounted to RMB79.1 billion, equivalent to 36.7% of its GRP.

Exhibit 4. Key economic and fiscal indicators of Zaozhuang City

	2021FY	2022FY	2023FY
GRP (RMB billion)	195.2	203.9	215.7
GRP Growth (%)	8.3	4.5	6.4
General Budgetary Revenue (RMB billion)	15.9	16.8	18.1
General Budgetary Expenditure (RMB billion)	27.4	32.6	35.2
Local Government Debt (RMB billion)	56.2	65.3	79.1

Source: Zaozhuang Municipal Government, CCXAP research

Government's Willingness to Provide Support

Important role in supporting local economic development

As the pivotal infrastructure construction company in Zaozhuang City, ZZII's business plays an important role in supporting the development of Zaozhuang City. The Company mainly undertakes key infrastructure construction projects, land quota development and sales, and water supply business that are crucial to local economic development and benefit the general public and local employment.

The Company and its subsidiaries engage in the infrastructure construction business by signing entrusted construction agreements with entrusting parties, and transfer the project ownership to them after the projects are completed. The entrusting parties would pay the actual incurred costs plus certain markup to the Company according to the construction progress. As of 30 September 2024, the Company completed 2 major infrastructure construction projects, with a total investment amount of RMB3.1 billion. Meanwhile, ZZII had 3 major construction projects under construction and planning, including science education demonstration park, civil air defense evacuation base, as well as school, with a total estimate investment amount of RMB4.6 billion and an uninvested amount of RMB1.8 billion. The infrastructure construction projects in the pipelines will ensure the sustainability of the business, but they also bring certain capital expenditure pressure to the Company.

ZZII has a monopoly position in the land quota development in Zaozhuang City. It is the sole designated entity with the right to conduct land quota development and sales in Zaozhuang City mainly through its subsidiary Zaozhuang Anze Land Development Co., Ltd. ("Zaozhuang Anze") by signing land consolidation agreements, covering Xuecheng District, Shizhong District, Yicheng District, Shanting District and Taierzhuang District. The local state-owned enterprises were designated by the local government to conduct work on demolition, consolidation, and reclamation of the land, and receive consolidation fees based on the progress of the land consolidation from Zaozhuang Anze. Zaozhuang Anze obtains revenue by selling land quotas to enterprises in Shandong Province. However, as the land quota development business changes with the government land sales policy, the sales of the Company's land quotas is sensitive to government planning and local land market conditions. With the reopening of the land trading platform in 2023, the Company has realized revenue from land quota sales of RMB77.9 million and RMB74.2 million in 2023 and the first three quarters of 2024, respectively. As of 30 September 2024, the Company completed land quotas of 2.3 thousand mu with a total investment of RMB32.6 million. At the same time, the Company had several land projects under consolidation, with a total investment of RMB310.0 million and outstanding investment of RMB200.0 million.

ZZII also provides water supply service in Xuecheng District at prices guided by the local government. Benefiting from the renovation and expansion of water plants in recent years, the water sales volume has increased from 9.4 million tons in 2022 to 11.1 million tons in 2023. As of 30 September 2024, the Company had water supply capacity of 53 thousand cubic meters per day. The Company also had one water pipeline project under construction as of the same date, with a total investment of RMB201 million and outstanding investment of RMB146 million. In addition, the Company has acquired water conservancy facilities and assets, such as Yanma Reservoir and Tai'erzhuang section of the Shengli Canal. The Company plans to increase revenue from water supply, sales of desilted gravel, power generation, fisheries and irrigation through the development of the reservoirs and canals in the future. We believe that the replacement cost for the Company's role is high as ZZII undertakes essential public projects for the region.

Medium exposure to commercial activities

ZZII's major commercial businesses mainly include property sales, self-operation projects and building materials trading, generating supplementary income to the Company. However, they may also pose higher operational and business risks. We estimate the Company's risk exposure to commercial business is moderate.

ZZII undertakes some self-operated construction projects. The Company plans to achieve fund balance through operation revenue and rental income. However, there is a certain degree of uncertainty in income from self-construction projects. As of 30 September 2024, there were 3 key projects under construction, with a total investment amount of RMB2.8 billion and uninvested amount of RMB1.2 billion. The largest self-construction project in term of total investment amount is Zaozhuang Civil Airport. It is significantly important to promote local economic development and improve the travel convenience of local people. The Company is expected to balance the investment through operating revenues, such as neighborhood commercial rental, passenger service and parking fees. However, the investment recovery cycle is long, making it more difficult to achieve fund balance in short period of time.

The Company is also engaged in property development recently, mainly including development of residential and surrounding shops, and office building. As of 30 September 2024, the Company had 6 property development projects under construction, with a total investment of RMB10.8 billion and outstanding investment of RMB6.3 billion. At the same time, there was 1 project under planning, with an estimated investment amount of RMB3.5 billion. However, increasing investment in property development may bring more operating uncertainties and financial risks to the Company as the property sales are easily affected by the market conditions. The cash collection and investment return of these property development projects are uncertain, especially during the downturn of the real estate market.

The main products of ZZII's trading business are building materials, such as rebar, stone, and cement. The trading business has generated considerable amount of revenue to the Company, accounting for around 20.4% of the Company's total revenue in 2023. ZZII produced the building materials on its own or purchases the finished building materials and sell them to customers. However, the concentration risk from upstream and downstream customers are relatively high in 2023, with the top 5 suppliers and customers accounting for around 64.7% and 52.2% of the total procurement and the total sales, respectively.

Good track record of receiving government supports

Finance Bureau of Zaozhuang Municipal Government has strong equity control over ZZII by directly holding 86.25% of the Company's shares. ZZII has a proven track record of receiving support from the local government over the years.

The Company received cash injection from 2023 to 2024Q3, increasing its paid-in capital from RMB2.1 billion as of end-2022 to RMB2.4 billion as of 30 September 2024. In addition, from 2023 to 2024Q3, the local government provided government subsidies to support its operation, with a total amount of RMB17.3 million. Meanwhile, the Company received repayments for its infrastructure construction projects. We believe that given ZZII's important position and its close relationship with the local government, the Company is expected to receive ongoing government support as needed in the next 12-18 months.

Increasing debt level and moderate asset liquidity

ZZII's total debt has been growing rapidly over the past three years driven by its large number of construction projects. As of 30 September 2024, the Company's total debt increased to RMB10.3 billion from RMB7.4 billion as of end-2022, while the total capitalization ratio rose from 38.1% to 44.7%. The Company's short-term debt accounted for around 22.1% of the total debt as of the same date. Moreover, the Company planned to invest around RMB13.1 billion for its construction projects under construction and planning as of 30 September 2024. Given the Company's large capital expenditure pressure for its infrastructure construction, land quota development projects, and self-operated commercial projects under construction and planning, we expect the Company's debt level would further increase for the next 12-18 months.

Moreover, the liquidity of the Company's assets was moderate. As of 30 September 2024, account receivables, inventories, investment property, fixed assets, construction in progress and intangible assets accounted for approximately 80.3% of total assets. The accounts receivable is mainly receivables from construction projects. The inventories and construction in progress are mainly cost of infrastructure construction and self-construction projects. The Company's investment properties and intangible assets are mainly land use right. All these assets were considered low liquidity which may undermine the Company's financial flexibility. Meanwhile, the Company has a relatively large amount of restricted assets pledged for loans which limit its liquidity, including investment properties, cash, fixed assets, inventories and account receivables, representing 42.9% of total assets.

Access to diversified funding

ZZII has access to different sources of funding, including bank loans, onshore bond financing and non-standard financing. The Company maintains good relationships with joint-stock commercial banks and large state-owned commercial banks. As of 30 September 2024, the Company had total credit facilities of RMB10.4 billion, with an unutilized portion of RMB3.5 billion. However, the credit facilities were concentrated in regional banks in Shandong Province, such as Weihai City Commercial Bank and Bank of Qingdao, which accounted for 55.8% of total credit facilities. Moreover, the Company has access to the onshore debt capital markets. In 2023, ZZII issued 2 tranches of onshore bonds, raising RMB1.1 billion, with coupon rate of 4.8% and 5.18%, respectively. As of 30 September 2024, the Company's exposure to non-standard financing is controllable, accounting for around 10% to 15% of the total debt.

Medium exposure to contingent liabilities

The Company bears moderate contingent risk resulting from relatively large external guarantees, which could potentially increase its repayment obligations. As of 30 September 2024, the Company's external guarantees amounted to RMB3.5 billion, accounting for 27.9% of its net assets. All the external guarantees were provided to local state-owned enterprises, mainly Jinsheng and Lunan (Zaozhuang) Economic Development Investment Co., Ltd., which accounted for 48.6% and 35.8% of its total external guarantees, respectively. The guaranteed enterprise did not provide any counter guarantee measures. In case a credit event occurs in the region, it may

lead to large-scale cross-effects. However, we believe that the credit risk of the guarantee is moderately controllable, taking into account the government's support to local SOEs.

ESG Considerations

ZZII faces environmental risks because it has undertaken urban infrastructure construction and land quota development projects. Such risks could be moderated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

ZZII bears social risks as it is engaged in provision of public projects in Zaozhuang 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 the local government and has to meet several reporting requirements, reflecting its public-policy role and status as a government-owned entity.

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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China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 1904-1909, 19/F, Jardine House,
1 Connaught Place, Central, Hong Kong

Website: www.ccxap.com

Email: info@ccxap.com

Tel: +852-2860 7111

Fax: +852-2868 0656