

## Zouping Financial Development Group Co., Ltd.

### Initial Issuer Report

#### Summary

Issuer Rating	BBB
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	9 May 2023

#### Key Figures of Zouping and ZFDG (RMB billion)

	2021	2022
<b>Zouping</b>		
GDP	63.2	64.4
GDP growth rate (%)	6.8	2.7
Budgetary revenue	7.9	7.9
Government fund	2.9	3.9
Transfer payment	1.9	2.3
Budgetary expenditure	9.6	10.4
<b>ZFDG</b>	<b>2021</b>	<b>2022</b>
Assets	32.7	38.3
Equity	17.5	23.2
Revenue	2.0	2.1

Source: Public information, ZFDG and Lianhe Global's calculations

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB’ global scale Long-term Issuer Credit Rating with Stable Outlook to Zouping Financial Development Group Co., Ltd. (“ZFDG” or “the company”)

#### Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Zouping City, Binzhou City (“Zouping government”) would provide very strong support to ZFDG if needed, in light of its direct full ownership of ZFDG, ZFDG’s strategic importance as the sole local investment and development company (“LIDC”) that is responsible for infrastructure construction and state-owned asset operation in Zouping City, Binzhou City (“Zouping”), and the linkage between the Zouping government and ZFDG, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing operational and financial support. In addition, the Zouping government may face significant negative impact on its reputation and financing activities if ZFDG encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that ZFDG’s strategic importance would remain intact while the Zouping government will continue to ensure ZFDG’s stable operation.

#### Rating Rationale

**Zouping Government’s Ownership and Supervision:** The Zouping government directly holds the full ownership of ZFDG through the Zouping State-owned Assets Center (“Zouping SAMC”), and is the actual controller of the company. The Zouping government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Zouping government has assessment mechanism over the company and it appoints auditor to supervise the operating performance and financial position on a periodic basis.

**Strategic Importance to Zouping and Strategic Alignment:** ZFDG, as the most important LIDC in Zouping, is primarily responsible for infrastructure construction and operation of state-owned assets within the region with strong franchised advantages. The company undertakes most of the important municipal infrastructure projects in the region, and is responsible for the shantytown renovation, industrial park development and operation, gas and heat supply and land resource business within the region. ZFDG plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government’s development plans.

**Ongoing Government Support:** ZFDG received operational and financial support from the government. ZFDG had received a total subsidy amount of c. RMB2.7 billion from 2020 to 2022, mainly including operating subsidies. The Zouping government continued to inject cash, equity and other assets into ZFDG to expand its asset size and diversify its business. Besides, the Zouping government provides policy supports to ZFDG to ensure its business operation. Given its franchised advantage as the sole entity for infrastructure construction in Zouping, ZFDG has an advantage in acquiring land resources and major projects. We believe ZFDG is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

#### Analysts

Toni Ho  
 (852) 3462 9578  
[toni.ho@lhratingsglobal.com](mailto:toni.ho@lhratingsglobal.com)

Ben Yau  
 (852) 3462 9586  
[ben.yau@lhratingsglobal.com](mailto:ben.yau@lhratingsglobal.com)

#### Applicable Criteria

China Local Investment and Development Companies Criteria (5 December 2022)

**ZFDG's Financial Matrix and Liquidity Position:** ZFDG's total assets showed a continuous growth trend in the past years and reached RMB38.3 billion at end-2022 mainly due to its inventories, which has steadily increased in tandem with the company's infrastructure construction projects. The current assets of ZFDG accounted for c. 46.3% of the total assets as of end-2022, and the overall assets were less liquid. ZFDG's financial leverage (total liabilities to total assets) was 39.3% and its adjusted debt increased to c. RMB11.7 billion at end-2022. The liquidity of ZFDG was sufficient. ZFDG had an unrestricted cash balance and unused credit facilities of c. RMB1.4 billion and RMB4.2 billion at end-September 2022, respectively, compared with its debt due within one year of c. RMB3.1 billion. Besides, ZFDG has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

**Economy and Fiscal Condition of Zouping:** Zouping is a county-level city located in the south of the Binzhou City with a total land area of c. 1250 square kilometers. Zouping recorded an economic growth in 2022, achieving a GDP of c. RMB64.4 billion, with a year-on-year growth of 2.7%. The growth rate has slowed down compared to previous years due to the impact from COVID-19. The aggregate fiscal revenue of the Zouping government was mainly derived from the budgetary revenue and government fund income. In 2022, the budgetary revenue of the Zouping government reached c. RMB7.9 billion, with a year-on-year increase of 3%. Having said that, the tax revenue decreased due to the large-scale value-added tax credit refunds to support the economy. At the same time, the government fund income, which was mainly generated from land sales, increased to c. RMB3.9 billion in 2022 from c. RMB2.9 billion in 2021. The budget deficit of the Zouping government was c. 31.6% at end-2022, while the debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Zouping government was relatively high. The special purpose debt constituted a high proportion of the total debt.

## Rating Sensitivities

We would consider downgrading ZFDG's rating if (1) there is perceived weakening in support from the Zouping government, particularly due to its reduced strategic importance with diminished government functions, or (2) there is a significant reduction of the Zouping government's ownership of ZFDG, or (3) there is a downgrade in our internal credit assessment on the Zouping government.

We would consider upgrading ZFDG's rating if there is an upgrade in our internal credit assessment on the Zouping government.

## Operating Environment

### Economic Condition of Zouping

Zouping is a county-level city under the administration of Binzhou City ("Binzhou") in Shandong Province, and is located in the south of Binzhou. Zouping is an industrial city, focusing on the machinery industry, especially the medium and high-end aluminum products. Zouping has jurisdiction over 5 streets and 11 towns with a total land area of c. 1250 square kilometers. Zouping had a residential population of c. 0.8 million with an urbanization rate of 68.7% at end-2022.

Zouping realized a GDP of RMB64.4 billion in 2022, representing a growth rate of 2.7%. The growth rate has slowed down compared to previous years due to the impact from COVID-19. Zouping's economic growth was mainly fueled by the secondary and tertiary industries,

which accounted for 50.5% and 43.9% of Zouping's GDP, respectively, in 2022. The fixed asset investment also recorded steady growth in the past three years. Meanwhile, Zouping's GDP per capita reached c. RMB83,300 in 2022.

<b>Zouping's GDP and Fixed Asset Investment</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
GDP	55.9	63.2	64.4
-Primary industry (%)	5.5	5.5	5.6
-Secondary industry (%)	49.4	51.4	50.5
-Tertiary industry (%)	45.1	43.1	43.9
GDP growth rate (%)	2.7	6.8	2.7
Fixed asset investment	18.7	21.8	26.8
Fixed asset investment growth rate (%)	8.2	16.5	22.6
Population (million)	0.8	0.8	0.8

*Source: Public information and Lianhe Global's calculations*

## Fiscal Condition of Zouping

The aggregate fiscal revenue of the Zouping government was mainly derived from the budgetary revenue and transfer payment. The budgetary revenue of the Zouping government maintained steady and reached RMB7.9 billion with a year-on-year increase of 3% in 2022. Having said that, the tax revenue decreased due to the large-scale value-added tax credit refunds to support the economy. In addition, Zouping's government fund income, which was mainly generated from land sales, increased to c. RMB3.9 billion in 2022 from c. RMB2.9 billion in 2021.

The budget deficit of the Zouping government improved in 2021, but retreated to 31.6% in 2022 due to the higher budgetary expenditure to counter the Covid. The debt ratio (total outstanding debt/ aggregate fiscal revenue) of the Zouping government was relatively high. The local government's outstanding debt increased from c. RMB11 billion at end-2020 to c. RMB17.8 billion at end-2022, mainly due to the increase in special debt.

<b>Zouping's Fiscal Condition</b>			
<b>(RMB billion)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Budgetary revenue	7.2	7.9	7.9
Budgetary revenue growth rate (%)	3.3	9.8	3.0
Tax revenue	5.4	6.2	5.0
Tax revenue (% of budgetary revenue)	74.8	79.1	63.4
Government fund income	0.9	2.9	3.9
Transfer payment	2.2	1.9	2.3
<b>Aggregate revenue</b>	<b>13.7</b>	<b>14.7</b>	<b>15.9</b>
Budgetary expenditure	11.1	9.6	10.4
Budget deficit <sup>1</sup> (%)	<b>54.6</b>	<b>22.0</b>	<b>31.6</b>

<sup>1</sup> Budget deficit = (1-budgetary expenditure / budgetary revenue) \* 100%

*Source: Public information and Lianhe Global's calculations*

## Ownership Structure

### Government's Ownership

ZFDG was established in 2019 with an initial registered capital of RMB50 million, funded by Zouping SAMC. In October 2022, Zouping completed the restructuring of the regional LIDCs, the equities of Zouping State-owned Assets Investment Holding Company Ltd. and other two LIDCs were transferred to ZFDG. At end-2022, ZFDG had a shareholding structure in which the Zouping SAMC, as the controlling shareholder, held 100% of the

company's equity. The registered capital and paid-in capital were both c. RMB2 billion at the same time.

## Strategic Importance and Government Linkage

### Strategic Importance of ZFDG to Zouping

In October 2022, following the guidance of the Zouping government, Zouping completed the reorganization and merger of state-owned enterprises, where the equities of three LIDCs were transferred to ZFDG. ZFDG, as the most important LIDC in Zouping, is primarily responsible for the infrastructure construction and operation of state-owned assets within the region with strong franchised advantages. The company undertakes most of the important municipal infrastructure projects in the region, and is responsible for the shantytown renovation, industrial park development and operation, gas and heat supply and land resource business within the region. ZFDG plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government's development plans.

### Strong Linkage with the Local Government

ZFDG's linkage with the local government is strong as the Zouping government directly holds the full ownership of ZFDG. The Zouping government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Zouping government has assessment mechanism over the company and it appoints auditor to supervise the operating performance and financial position on a periodic basis.

### Government Support

ZFDG continued to receive financial subsidies, mainly including operating subsidies and tax breaks, from the local government to maintain its business operation. ZFDG received subsidies of c. RMB606.4 million, RMB1.0 billion and RMB1.1 billion in 2020, 2021 and 2022, respectively. The Zouping government will repurchase some infrastructure projects and provide policy supports to ZFDG to ensure its business operation.

ZFDG received multiple asset injections in the form of cash, reservoirs, pipelines, operating real estates and other assets, which reached RMB4.7 billion, RMB831.1 million and RMB3.3 billion in 2020, 2021 and 2022, respectively, from the Zouping government, to expand its asset size and diversify its business. We believe ZFDG is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

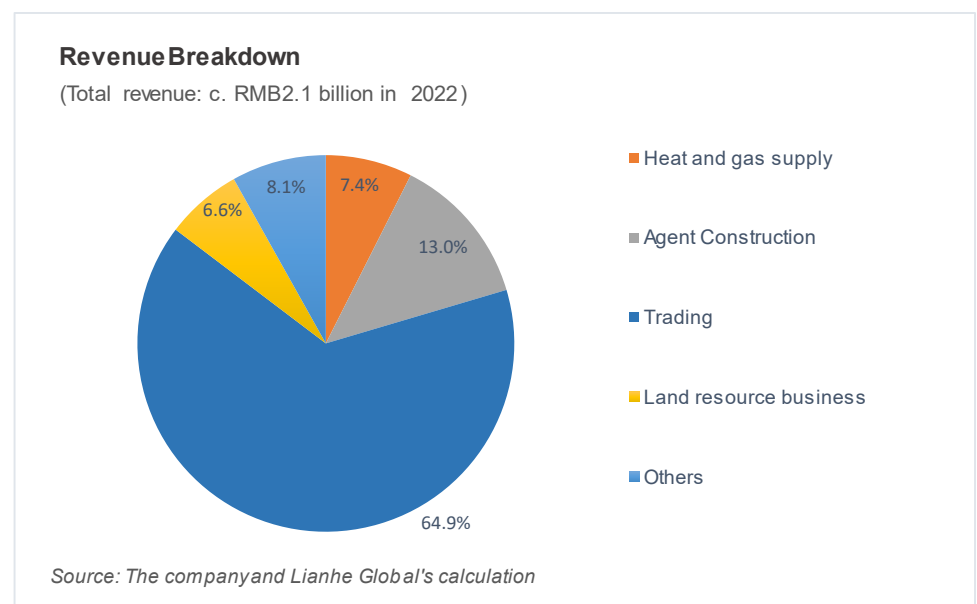
## Business Profile

### The Sole Entity Responsible for Infrastructure Construction and State-owned Asset Operation in Zouping

ZFDG is the sole LIDC in Zouping responsible for infrastructure construction and state-owned asset operation, as well as the gas and heat supply and land resource business within the region. The company's strong franchise advantage enables it to undertake important infrastructure construction projects such as road construction and renovation

projects, under the coordination plan of the Zouping government. Moreover, the Zouping government also entrusts the company with functions related to industrial park development and operation, investment attraction and other industrial upgrading projects. As the sole infrastructure construction body within the region, ZFDG plays a vital role in promoting economic and social development within the region.

The primary sources of operating revenue for ZFDG included its trading business, agent construction, heat and gas supply and land resource business. The revenue of the company reached c. RMB1.3 billion, RMB2.0 billion and RMB2.1 billion for 2020, 2021 and 2022, respectively. The fast revenue growth in 2021 was primarily attributable to its expanding trading business. The overall gross profit margin of ZFDG remained at 2.2%-4.8% for the past three years, representing a stable but low level resulted from the large proportion of low-margin trading business. In general, ZFDG's business was diversified, and it has regional advantages in its major businesses.



### Agent Construction

ZFDG is the sole entity responsible for infrastructure construction in Zouping. The company carries out municipal and other infrastructure projects in the region through entrusted construction and self-operating mode. The company signs project agreements with the Zouping government and related agencies under entrusted construction mode, which are later repurchased by the government with an additional margin. ZFDG's self-operated projects involve the company's funding, construction and operation, with assets under its ownership. These projects generate income from leasing and utility supply.

The company's monopoly on infrastructure construction in Zouping gives it a strong franchise advantage in the region. The revenue in this segment reached RMB143.7 million, RMB139.2 million and RMB271.1 million in 2020, 2021 and 2022, respectively. The gross profit margin was 23.2%, 23.3% and 14.1% in the corresponding period. Considering the needs of self-financing for most of the required funds for project construction, the long repayment period, and several large-scale projects under construction, ZFDG faces significant capital expenditure pressure.

### Land Resource Business

ZFDG started the land resource business in 2019, where it is mainly responsible for the operation of transferring the rural land into new land used for urban construction in Zouping. ZFDG coordinates related funds and pays bonus funds to towns after they completed the land consolidation process and acquired the land use indicators. The company sells the corresponding surplus land use indicators according to market demand with a net profit. The revenue of this segment reached c. RMB94.3 million and RMB137 million in 2021 and 2022, with a gross profit margin of -6% and 8.9%. The process of accepting and auctioning the land use indicators is lengthy, and the progress of each land plot can vary significantly. Having said that, ZFDG has considerable amount of land reserves.

### Trading

As an important source of revenue for ZFDG, the trading segment makes the company's business more diversified and plays a complementary role to its main business. ZFDG is mainly engaged in the trading of corn germ, crude oil, liquid aluminum, atomized steel shot, iron ore and iron powder. The revenue generated from this segment reached c. RMB1 billion, RMB1.5 billion and RMB1.4 billion in 2020, 2021 and 2022, respectively. The gross profit margin of the segment was relatively low, which was c. 0.4%-1.1% for the past three years. The suppliers and customers of the segment are concentrated, and most of them are private enterprises, indicating a high counterparty risk. Per management, the trading business may rely more on supply chain operations in the future, where the company communicates with both upstream and downstream partners through their supply chains.

### Heat and Gas supply

ZFDG, as the sole heating supplier in the main urban area of Zouping, is mainly responsible for providing heating services to residents and industries, as well as providing installation and supporting services within the region with a strong franchised advantage. At end-2022, the company has c. RMB3.1 billion of pipeline assets, of which RMB880 million was purchased in 2021 from the Zouping SAMC to integrate the region's heating business. The heating prices of the company are regulated by the government. The revenue of this segment reached c. RMB49.6 million, RMB105.6 million and RMB155.4 million in 2020, 2021 and 2022, respectively, with a stable gross profit margin in the past 2 years. The increase revenue in 2021 was resulted from the significant increase of heating volume along with the integration process. Having said that, the profitability of the segment is greatly affected by fuel prices.

### Other Businesses

Other businesses of ZFDG include engineering construction, leasing business, water charges and water quality monitoring, technical service and catering, with each segment accounted for a small proportion of the company's total revenue. The leasing business grew significantly in 2022 due to the higher rentals generated from operating properties. Other businesses mainly play the role of supplementing the revenue of the main business.

## Financial Profile

### Balance Sheet Structure and Quality

<b>Balance Sheet Structure and Quality</b>			
<b>(RMB million)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Total Asset	27,344	32,720	38,296

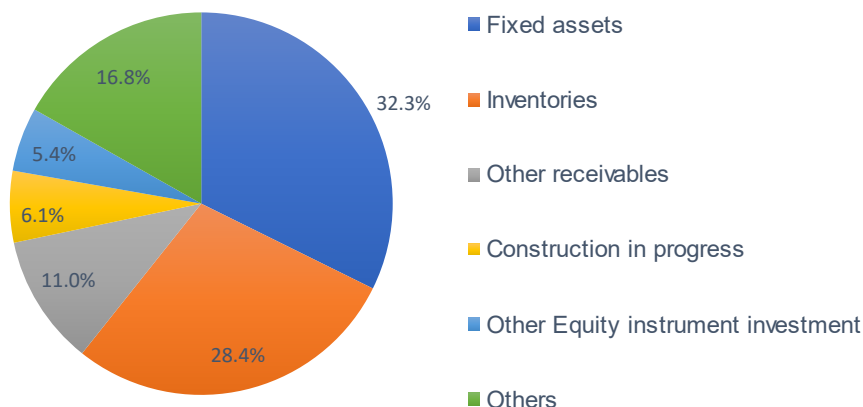
Equity	17,115	17,493	23,232
Debt	6,454	8,865	11,694
Debt / (Debt + Equity) (%)	27.4	33.6	33.5
LT Debt	4,135	5,915	8,146
LT Debt / (LT Debt + Equity) (%)	19.5	25.3	26.0

Source: Company information and Lianhe Global's calculations

ZFDG's total assets showed a continuous growth in the past few years, with a growth rate of 19.7% and 17.0% at end-2021 and end-2022, respectively, and reached RMB38.3 billion at end-2022. The increase of ZFDG's total assets in 2022 was largely due to its inventories, which has steadily increased in tandem with the company's infrastructure construction projects. ZFDG's assets mainly consisted of fixed assets, inventories, other receivables, construction in progress and other equity instrument investment. Fixed assets primarily comprised of houses and buildings related to its operation business (e.g. self-operation construction projects and leasing business), as well as some pipeline assets used for its utility supply business. Inventories included development costs associated with ZFDG's core business operations, such as agent construction costs, which increased in parallel with the growth of the relevant projects. Other receivables primarily comprised advances and transactions with local township government and other related parties in Zouping, which had an aging period of mostly 2-3 years, with controllable counterparty risk and low bad debt provision. Construction in progress included the important projects such as Zouping section of the Jinan-Qingdao high-speed railway project, Zouping city people's hospital, etc. Though ZFDG had large proportion of current assets (46.3% at end-2022), its assets were illiquid, primarily due to the significant proportion of costs associated with construction projects and receivables, as well as the large scale of fixed assets.

#### Asset Breakdown

(Total assets: RMB38.3 billion at end-2022)



Source: The company and Lianhe Global's calculation

ZFDG's financial leverage (total liabilities to assets) reached 37.4%, 46.5% and 39.3% at end-2020, end-2021 and end-2022, respectively, which fluctuated slightly but tended to be at a relatively low level. In view of the relevant guidelines of the Zouping government, we expect the financial leverage of ZFDG to stabilize at this level. ZFDG's total adjusted debt increased significantly from c. RMB6.5 billion at end-2020 to c. RMB11.7 billion at end-2022, with short-term debt accounting for c. 30.3% of the total debt. There was no significant

change in the ownership equity structure of ZFDG at end-2022, compared with that at end-2021. The capital surplus increased to RMB18.7 billion at end-2022 from RMB15.1 billion at end-2020. ZFDG mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure related projects under construction and to be constructed in the future.

## Cash Flow

<b>Cash Flow (RMB million)</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Cash Inflows from Operation	9,010	9,939	8,255
Cash Outflows from Operation	9,162	8,713	7,721
<b>Net CF from Operation</b>	<b>-151</b>	<b>1,225</b>	<b>535</b>
Cash Inflows from Investment	243	96	1,039
Cash Outflows from Investment	3,691	3,120	5,352
<b>Net CF from Investment</b>	<b>-3,448</b>	<b>-3,025</b>	<b>-4,313</b>
Cash Inflows from Financing	4,777	4,762	9,059
Cash Outflows from Financing	682	2,951	4,523
<b>Net CF from Financing</b>	<b>4,095</b>	<b>1,811</b>	<b>4,536</b>
Net Increase in Cash and cash equivalent	495	11	758

Source: ZFDG's financial reports

## Debt Servicing Capability

The liquidity of ZFDG was sufficient. At end-2022, ZFDG had a cash balance and unused credit facilities of c. RMB1.9 billion and RMB4.2 billion, respectively, but a relatively high proportion of cash of RMB0.5 billion was restricted, compared with its debt due within one year of c. RMB3.1 billion at the same time. Besides, ZFDG has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.





## Disclaimer

Credit rating and research reports published by Lianhe Ratings Global Limited (“Lianhe Global” or “the Company” or “us”) are subject to certain terms and conditions. Please read these terms and conditions at the Company’s website: [www.lhratingsglobal.com](http://www.lhratingsglobal.com)

A credit rating is an opinion addresses the creditworthiness of an entity or security. Credit ratings are not a recommendation to buy, sell, or hold any security. Credit ratings do not address market price, marketability, and/or suitability of any security nor its tax implications or consequences. Credit ratings may be subject to upgrade or downgrade or withdrawal at any time for any reason at the sole discretion of Lianhe Global.

All credit ratings are the products of a collective effort by accredited analysts through rigorous rating processes. No individual is solely responsible for a credit rating. All credit ratings are derived by credit committee vesting processes. The individuals identified in the reports are solely for contact purpose only.

Lianhe Global conducts its credit rating services based on third-party information which we reasonably believe to be true. Lianhe Global relies on information including, but not limited to, audited financial statements, interviews, management discussion and analysis, relevant third-party reports, and publicly available data sources to conduct our analysis. Lianhe Global has not conducted any audit, investigation, verification or due diligence. Lianhe Global does not guarantee the accuracy, correctness, timeliness, and/or completeness of the information. Credit ratings may contain forward-looking opinions of Lianhe Global which may include forecasts about future events which by definition are subject to change and cannot be considered as facts.

Under no circumstance shall Lianhe Global, its directors, shareholders, employees, officers and/or representatives or any member of the group of which Lianhe Global forms part be held liable to any party for any damage, loss, liability, cost, expense or fee in connection with any use of the information published by the Company.

Lianhe Global receives compensation from issuers, underwriters, obligors, or investors for conducting credit rating services. None of the aforementioned entity nor its related party participate in the credit rating process aside from providing information requested by Lianhe Global.

Credit ratings included in any rating report are solicited and disclosed to the rated entity (and its agents) prior to publishing. Credit rating and research reports published by Lianhe Global are not intended for distribution to, or use by, any person in any jurisdiction where such use would infringe local laws and regulations. Any user relies on information available through credit rating and research reports is responsible for consulting the relevant agencies or professionals accordingly to comply with the applicable local laws and regulations.

All published credit rating and research reports are the intellectual property of Lianhe Global. Any reproduction, redistribution, or modification, in whole or parts, in any form by any means is prohibited unless such user has obtained prior written consent from us.

Lianhe Global is a subsidiary of China Lianhe Credit Rating Co., Ltd. The credit committee of Lianhe Global has the ultimate power of interpretation of any methodology or process used in the Company’s independent credit ratings and research.

Copyright © Lianhe Ratings Global Limited 2023.