

## Credit Opinion

2 August 2023

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

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## Dezhou Deda City Construction Investment Operation Co., Ltd.

### Surveillance credit rating report

**CCXAP affirms Dezhou Deda City Construction Investment Operation Co., Ltd.'s long-term credit rating at BBB<sub>g</sub>+, with stable outlook.**

### Summary

The BBB<sub>g</sub>+

Our assessment of Dezhou Municipal Government's capacity to support reflects its status as the 9<sup>th</sup> prefecture-level city ranked by gross regional production("GRP") in Shandong Province, with its improving economic and fiscal strength and moderate debt profile.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) important strategic position in Dezhou City; (2) good access to diversified funding; and (3) good track record of receiving government payments.

However, the rating is constrained by the Company's (1) medium risk exposure to commercial activities; and (2) increasing debt burden and leverage.

The stable outlook on Deda's rating reflects our expectation that the local government's capacity to support will remain stable, and the Company will maintain its important strategic position of infrastructure construction and public utility services in Dezhou City.

## Rating Drivers

- Important strategic position in Dezhou City
- Key role in utility services and regional construction in Dezhou City
- Good track record of receiving government payments
- Medium risk exposure to commercial activities
- Rising debt leverage with an increasing debt burden
- Good access to diversified funding

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) the local government's capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as increased strategic significance, lower exposure to risky commercial activities, and improved debt management and asset quality.

### What could downgrade the rating?

The rating could be downgraded if (1) the local government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to support, such as reduced strategic significance, or increase in exposure to commercial activities.

## Key Indicators

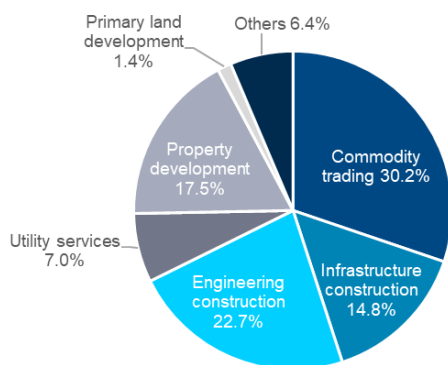
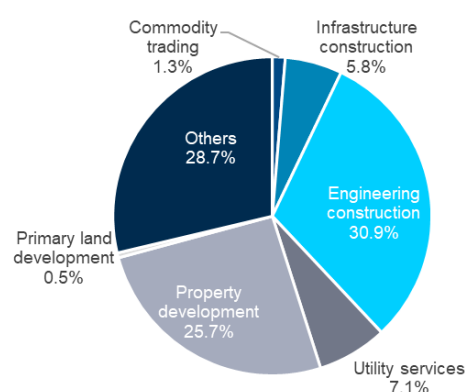
	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	43.0	44.2	59.3	61.2
Total Equity (RMB billion)	22.6	23.6	26.9	27.0
Total Revenue (RMB billion)	4.2	3.7	9.9	1.8
Total Debt/Total Capital (%)	30.1	30.7	43.6	46.1

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

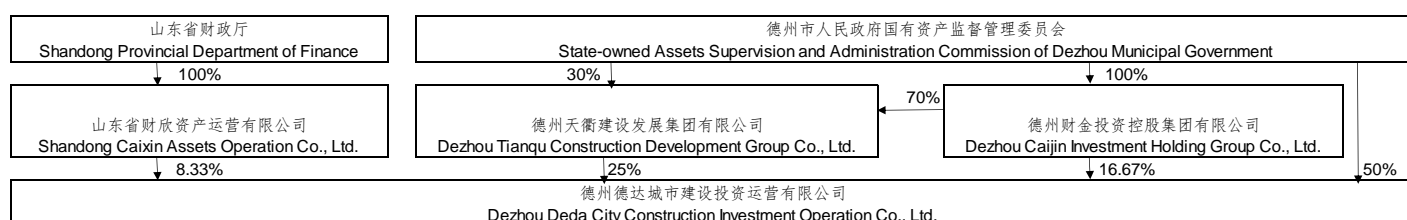
Source: CCXAP research

## Corporate Profile

Deda, formerly known as Dezhou Defa City Construction Investment Co., Ltd. ("Defa"), was founded in October 2006 by the Dezhou Finance Bureau. In July 2009, Defa merged with the former Dezhou Deda City Construction Investment Operation Co., Ltd., and changed its name to Deda. As of 31 March 2023, the State-owned Assets Supervision and Administration Commission of Dezhou Municipal Government ("Dezhou SASAC"), the ultimate controlling shareholder of the Company, directly held 50% of the Company's shares and indirectly held 41.67% via Dezhou Caijin Investment Holding Group Co., Ltd. ("Caijin") and Dezhou Tianqu Construction Development Group Co., Ltd. ("Tianqu"); while Shandong Provincial Department of Finance held the remaining 8.33% via Shandong Caixin Assets Operation Co., Ltd. ("Caixin"). Deda is one of the key local infrastructure investment and financing companies ("LIIFCs") in Dezhou City. It has an important strategic position in Dezhou City and is primarily engaged in city construction, primary land development, and provision of utility services.

**Exhibit 1. Revenue Structure in 2022****Exhibit 2. Gross Profit Structure in 2022**

Source: Company information, CCXAP research

**Exhibit 3. Shareholding As of 31 March 2023**

Source: Company information, CCXAP research

## Rating Considerations

### Government Capacity to Provide Support

We believe that the Dezhou Municipal Government has a strong capacity to provide support to the Company, given its status as the 9th prefecture-level city ranked by GRP in Shandong Province and its improving economic and fiscal strength, and moderate debt profile.

As the northwestern gate of Shandong Province, Dezhou City is located at the intersection of the Bohai Rim Economic Circle, the Beijing-Tianjin-Hebei Economic Circle, the Shandong Peninsula Blue Economic Zone, and the Yellow River Delta Efficient Ecological Economic Zone. In recent year, new generation information technology, new materials, modern medicine, high-end equipment manufacturing and new energy has developed fast and thus the industrial structure further optimized. Dezhou City is the 9<sup>th</sup> prefecture-level city ranked by GRP in Shandong Province. Dezhou City realized GRP of RMB363.3 billion with a year-over-year (“YoY”) growth of 4.4% in 2022.

In 2022, Dezhou Municipal Government’s fiscal balance is still moderate. The general budgetary revenue covered 42.5% of expenditure, suggesting reliance on transfer payments from upper-level government to achieve fiscal balance. In 2022, Dezhou Municipal Government’s debt amount increased by 21.9% to RMB112.8 billion with local government debt to total revenue ratio increasing to 158.7%.

**Exhibit 4. Key Economic and Fiscal Indicators of Dezhou City**

	2020FY	2021FY	2022FY
GRP (RMB billion)	307.9	348.9	363.3
GRP Growth (%)	3.6	8.3	4.4
General Budgetary Revenue (RMB billion)	20.9	23.4	23.3
General Budgetary Expenditure (RMB billion)	48.1	49.2	54.9
Local Government Debt (RMB billion)	77.9	92.5	112.8

Source: CCXAP research

**Government Willingness to Provide Support****Important strategic position in Dezhou City**

There are 5 major municipal LIIFCs in Dezhou City. Among them, Caijin is mainly responsible for the renovation of shantytowns; Dezhou City Construction Investment Development Group Co., Ltd. is mainly responsible for the construction of municipal roads, incubators, and other industrial parks; Tianqu is mainly responsible for water supply, sewage sludge disposal in the central area of Dezhou City, as well as infrastructure construction in Dezhou Tianqu New District; Dezhou City Transportation Investment and Development Group Co., Ltd. is mainly responsible for public transport operations and rural road construction. As one of the major state-owned capital investment operation entities in Dezhou City, Deda primarily engages in infrastructure construction, primary land development, and the provision of utility services, which are strategically important to the Dezhou Municipal Government. As such, the Company's strategic importance to Dezhou City is unlikely to change in the foreseeable future.

**Key role in the utility services and regional construction in Dezhou City**

Deda is an important platform for providing utility services, infrastructure construction, and primary land development in Dezhou City. The Company's major service areas include Decheng District, Lingcheng District, the Economic and Technological Development Zone, and the Canal Development Zone.

Deda is an important heating and gas provider in the main urban area of Dezhou City. As of 31 December 2022, the Company's heating business covered around 70% of main urban area of Dezhou City, coverage of 32.9 million square meters. It is also the sole gas provider in the main urban area of Dezhou City. Due to its public welfare nature, the selling prices of heating and gas are controlled by the local government, and the local government provides subsidies to compensate for any losses incurred. In 2022, the Company received heating subsidies of RMB11.5 million from the local government. The highest selling price for gas prices for non-residents rose to RMB4.48 per cubic meter from November 2022 while that for residents was unchanged.

The Company also operates government-funded infrastructure construction projects under the agent construction model. However, the repurchase payments from the local government are normally offset by the RMB22.7 billion debt swap funds already given to the Company from 2015 to 2017, resulting in no new cash flows generated in the Company's financial accounts from the settlement of infrastructure projects. As of 31 March 2023, there were debt swap funds of RMB2.5 billion pending for settled.

In addition, Deda participates in primary land development in the main urban area of Dezhou City. The Company hasn't taken new primary land development since 2019. As of 31 March 2023, the Company has completed and consolidated a land area of 2.3 million square meters. In 2022, the Company didn't record land transfer income. Deda also participates in land quota allocation business. In 2022, the Company allocated land quota of 10.8 thousand mu, and generated revenue of around RMB137 million, which was netted out with debt swap funds.

In 2022, there were 18 companies in the roads and bridges sector transferred into Deda, which significantly enlarged its construction and engineering business as well as highway operation business. The Company mainly engages in engineering construction of roads and bridges under the general contracting model and PPP model, and has a number of qualifications in road engineering including a top-grade qualification in general contracting for highway. In 2022, the Company consolidated revenue of RMB2.2 billion from engineering construction business, accounting for 22.7% of total revenue, with gross margin of 16.1%. Meanwhile, there were 118 newly signed engineering contracts with a total contract amount of around RMB9.0 billion. The Company also consolidated the highway toll business and contributed revenue of RMB57.2 million from two highways in 2022. As of 31 March 2023, there were two highways under construction with a total investment of RMB14.6 billion and an uninvested amount of RMB12.2 billion, which increased the pressure on future capital expenditure.

### **Good track record of receiving government payments**

Since its establishment, Deda has a proven track record of receiving government support in the form of equity transfer, capital injection, debt swap and operating subsidies. In 2022, the local government increase the Company's capital by RMB402.0 million, which came from the debt swap funds. In 2022, the Company received the 100% equity of several road and bridge companies transferred from Shandong Jinluban Group Co., Ltd. based on government reorganization documents, increasing its capital by RMB3.0 billion. In 2022 and the first quarter of 2023, the Company received government subsidies of RMB20.6 million and RMB6.0 million, respectively. The local government provides subsidies mainly for public activities such as heating and gas supply to the Company every year according to relative planning and actual situation. We believe that, given the important position of Deda and its close relationship with the local government, the local government will provide strong support to the Company in times of need.

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

Deda's commercial activities mainly involve property development, property leasing, trading and self-operated healthcare project construction. We estimated Deda's commercial exposure is medium at 20% to 25% of the total assets.

The investment needs from property development projects may exert expenditure pressure to the Company. As of 31 March 2023, the Company had five property development projects under construction in Dezhou City, with a total planned investment RMB6.3 billion and an uninvested amount of RMB1.1 billion. The relatively long development period could partly alleviate the expenditure pressure and some projects received part of pre-sale funds. However, based on the impact of the market environment and the downturn of the real estate industry, the property development business would suffer from high volatility from construction and sales progress.

The Company also leased out its self-owned properties to local government agencies and enterprises. The gross margins are relatively high for property leasing business which are above 60% during 2020 to 2022. The Company's self-operated projects completed in 2022 mainly include the Senior Citizen Demonstration City construction project and the Applied Technology Research Institute and both of them have not yet realized revenues. In the future, the Company plans to balance its investment through leasing and operating revenues, which are subject to fluctuations in demand in the local market. As of 31 March 2023, the Company also has one healthcare project under construction, with total planned investment of RMB680.0 million and uninvested investment of RMB523.0 million.

For its trading business, Deda mainly places purchase order according to sale order from its customer and charge some pre-payments in advance. The Company's commodity trading segment has enlarged from the original sales of construction materials to active trading of bulk commodities, with faster revenue growth of more than but lower profits. In 2022, sales revenue accounted for 30% of the Company's total revenue and gross profit accounted for only 1.27%.

### **Rising debt leverage with an increasing debt burden**

Deda's debt leverage has grown rapidly in 2022 mainly driven by the transfer of a large package of road and bridge sector. The Company's total debt increased from RMB10.5 billion at end-2021 to RMB23.1 billion at end-2023Q1. Accordingly, its total capitalization ratio rose from 30.7% to 46.1% during the same period. Among the total debt, the repayment of principal and interest of around RMB4.1 billion loans for shantytown projects has been arranged in the local fiscal budget. We expect the Company's debt burden to further increase in the next 12 to 18 months, given its high future financing demands such as toll highway projects. As of 31 March 2023, there were around RMB12.2 billion of the uninvested amount in two highways under construction. The financing needs may release by the Company's diversified access to funding.

In addition, Deda's liquidity has weakened in 2022. Its cash to short-term debt ratio decreased to 0.3x at end-2022 from 0.5x at end-2021 mainly due to the rapid increase in short-term debt. However, we expect the Company's liquidity risk to be manageable, supported by its good access to funding.

### **Good access to diversified funding**

Deda has good access to financing channels, including bank loans and domestic bonds. As of the end of March 2023, the Company has obtained a total of RMB41.3 billion of bank credit, and the unused bank credit was RMB13.8 billion. From 2022 to March 2023, the Company raised a total of RMB3.4 billion in the domestic market, with coupon rate ranging between 2.6% and 4.62%. The Company also finances its investment through the government special bond fund. For example, the Company has received government special bond fund for its self-operated projects and investment in highway projects.

## **ESG Considerations**

Deda is exposed to environmental risks because it has undertaken infrastructure construction, primary land development, and provision of utility services. Such risks could be moderated by conducting environmental studies and planning before the commencement of projects, and close supervision during the construction phase.

In terms of social concerns, Deda plays a crucial role in the social welfare of the residents in Deda by providing utility services, including gas, and heating. As an important state-owned entity in Dezhou city, the Company has engaged in healthcare business, improving the social welfare of the aged in Dezhou City.

In terms of corporate governance, Deda has established a corporate governance structure composed of shareholders, the board of directors, the board of supervisors and the operation management, and clarify the powers of decision-making, supervisory and management at all levels performing their duties independently and efficiently. The Company is subject to oversight and reporting requirements to the Dezhou Municipal Government, which has full control and supervision of the Company's operation.

## 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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