Credit Opinion

8 December 2023

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

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Sanming City Construction and Development Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g+ to Sanming City Construction and Development Group Co., Ltd., with stable outlook.

Summary

The BBB_g+ long-term credit rating of Sanming City Construction and Development Group Co., Ltd. ("SCCD" or the "Company") reflects (1) Sanming Municipal Government's very strong capacity to provide support, and (2) the local government's very high willingness to provide support, based on our assessment of the Company's characteristics.

Our assessment of Sanming Municipal Government's capacity to provide support is reflected by its comprehensive industrial system, with ongoing economic growth and moderate fiscal stability.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) strong position in municipal infrastructure construction and affordable housing development of Sanming City; (2) high business sustainability in public policy projects; and (3) good track record of receiving government support.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities; (2) moderate debt growth and relatively high debt leverage; and (3) moderate access to funding, with relatively large proportion of non-standard financing.

The stable outlook on SCCD's rating reflects our expectation that the local government's capacity to provide support will remain stable, and the Company will maintain its strong position in municipal infrastructure construction and affordable housing development of Sanming City.

Rating Drivers

- Strong position in municipal infrastructure construction and affordable housing development of Sanming City
- Good track record of receiving government support
- Medium exposure to commercial activities
- Moderate debt growth and relatively high debt leverage
- Moderate access to funding, with high proportion of non-standard financing

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government’s capacity to provide support strengthens; and (2) the Company's characteristics change in a way that strengths the local government’s willingness to provide support, such as improvement in debt management.

What could downgrade the rating?

The rating could be downgraded if (1) the local 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 decrease in its strategic significance; decrease in government payments; or increase in exposure to commercial activities.

Key Indicators

	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	34.0	42.3	44.2	46.3
Total Equity (RMB billion)	12.7	13.9	14.2	14.3
Total Revenue (RMB billion)	2.0	3.4	3.7	1.8
Total Debt/Total Capital (%)	52.6	52.3	53.5	55.7

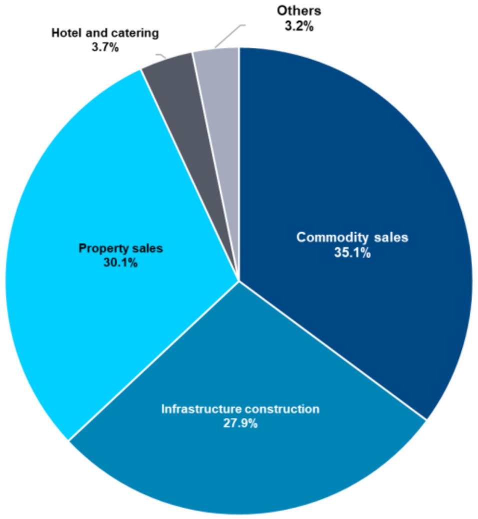
All ratios and figures are calculated using CCXAP’s adjustments.

Source: CCXAP research

Corporate Profile

Established in 2019, SCCD is an important local infrastructure investment and financing platform (“LIIFC”) in Sanming City, mainly responsible for municipal infrastructure construction and affordable housing construction. The Company is also engaged in property development, commodity sales, as well as hotel and catering businesses. As of 30 June 2023, State-owned Assets Supervision and Administration Commission of the Sanming Municipal Government (“Sanming SASAC”) held 100% equity interests of SCCD, and was its ultimate controlling shareholder.

Exhibit 1. Revenue structure as of June 2023



Source: Company information, CCXAP research

Rating Considerations

Government Capacity to Provide Support

We believe that Sanming Municipal Government has a very strong capacity to provide support as reflected by its comprehensive industrial system, with ongoing economic growth and moderate fiscal stability.

Fujian Province is a highly economic developed province in Southeast China. With the support of its structural transformation and upgrading, Fujian Province's GRP steadily grew from RMB4.4 trillion in 2020 to RMB5.3 trillion in 2022, ranking 8th among all the provinces in China in 2022. In the first three quarters of 2023, Fujian Province recorded a YoY growth of 4.1% in GRP, reaching RMB3.9 trillion.

Located in the middle part of Fujian Province, Sanming City is an emerging industrial city with a comprehensive industrial system, including industries of metallurgy, chemicals, coal, plastics, papermaking, forestry, building materials, electronics and medicine. The economy of Sanming City has been growing steadily over the past three years. From 2020 to 2022, its GRP grew from RMB270.2 billion to RMB311.0 billion. In the first three quarters of 2023, its GRP further increased to RMB213.6 billion, with a YoY growth rate of 1.3%. Due to the tax refund and reduction policy, Sanming Municipal Government's general budgetary revenue slightly declined from RMB11.4 billion in 2021 to RMB11.1 billion in 2022. In the first three quarters of 2023, its general budgetary revenue saw a YoY growth of 6.4%, mainly attributed to a strong rebound in export. In addition, it has a moderate fiscal stability, with tax income accounting for about 66% on average for the past three years. However, its fiscal balance has been modest, with average general budgetary revenue to general budgetary expenditure ratio of 33.9% over the past three years. Sanming Municipal Government's has an increasing debt burden and high debt ratio. As of end-2022, it has outstanding government debt of RMB70.5 billion, accounting for 22.7% of its GRP and 182.9% of its total fiscal revenue.

Exhibit 2. Key Economic and Fiscal Indicators of Sanming City

	2020FY	2021FY	2022FY
GRP (RMB billion)	270.2	295.3	311.0
GRP Growth (%)	4.1	5.8	3.1
General Budgetary Revenue (RMB billion)	11.1	11.4	11.1
General Budgetary Expenditure (RMB billion)	33.4	31.0	35.0
Local Government Debt (RMB billion)	59.0	70.0	70.5

Source: Statistics Bureau of Sanming City, CCXAP research

Government Willingness to Provide Support

Strong position in municipal infrastructure construction of Sanming City

There are two key LIIFCs in Sanming City, namely Sanming Investment Development Group Co., Ltd. ("SIDG") and SCCD, each with clear positioning in the development of Sanming City. SIDG is the largest LIIFC in Sanming City, mainly responsible for transportation infrastructure construction and utilities services in Sanming City. As the important infrastructure construction entity in Sanming City, SCCD mainly is responsible for the municipal infrastructure construction and affordable housing construction of Sanming City, with strong market business position. The Company has undertaken and completed a large number of construction projects in Sanming City, making great contributions to the urbanization of the region. We believe that the Company is unlikely to be replaced by other state-owned enterprises in the foreseeable future.

High business sustainability

SCCD has abundant construction projects in the pipeline, which can ensure the sustainability of its public policy businesses, but exert certain capital expenditure pressure on the Company. Besides, the progress of project repayment from the local government is prolonged, causing capital occupation to the Company.

The municipal projects undertaken by the Company mainly include roads, bridges, schools, hospitals, and parks. The Company signs construction agreements with the entrusting parties, mainly Sanming Municipal Housing and Urban-Rural Development Bureau and other local state-owned enterprises, which will repurchase the completed projects with payment based on the construction cost plus an agreed return, typically more than 10%. As of 30 June 2023, the Company had large amount of municipal projects under construction or planning, with estimated total investment of RMB9.2 billion and uninvested amount of RMB2.1 billion.

The Company also undertakes affordable housing construction under self-operation model. The Company acquires the lands in public auction market, and conducts the construction by self-raised funds. As of 30 June 2023, the Company's affordable housing projects under construction or planning required estimated total investment of RMB3.8 billion, with uninvested amount of RMB1.3 billion.

Medium exposure to commercial activities

In addition to public activities, SCCD is also engaged in commercial businesses, mainly including property development and commodities sales businesses. We consider the Company's exposure to commercial businesses to be medium, accounting for 15% to 20% of its total assets.

The Company participates in construction and sale of residential and commercial properties. The revenue of this segment has recorded steady growth over the past few years, increasing from RMB730.0 million in 2020 to RMB1.2 billion in 2022, mainly because the number of completed projects has steadily increased. However, influenced by the increase in the sales of parking space with lower gross profit margin, the gross profit margin of the property development business has shown a downward trend, which dropped from 23.1% in 2021 to 16.8% in 2022. As of 30 June 2023, the projects under construction have a total saleable floor area of 1.7 million square meters, of which 1.1 million square meters have been sold out. Given no property projects under planning, the sustainability of this segment is subject to uncertainty. In addition, the property development is susceptible to local property market conditions and policies.

The Company's commodity sales business is operated via its subsidiary under demand driven model, mainly covering cement and steel. The settlement between the Company and upstream suppliers is generally payment upon delivery, while the settlement cycle with downstream customers is generally 4 to 6 months after delivery, resulting in certain capital occupation. Besides, this business is subject to concentration risk, as the Company has high reliance on its top 5 suppliers (49.2%) and customers (54.0%). From 2020 to 2022, the revenue from commodity sales business fluctuated between RMB355 million and RMB1.4 billion, with low gross margin of 2.4% in 2022.

The Company also participates in hotel and catering, and property leasing businesses. However, the scale of these businesses is small, making limited contribution to the Company's income and profit.

Moderate debt growth and relatively high debt leverage

SCCD's total debt has increased moderately in the past three years due to ongoing financing needs. The total debt increased from RMB14.1 billion at end-2020 and RMB18.1 billion at mid-2023, with relatively high total capitalization ratio of 55.7%. Given the large number of projects and high reliance on external financing, we expect the Company's debt burden will continue to increase in the foreseeable future. The Company has a reasonable debt structure, as reflected by its short-term debt to total debt ratio of 21.5% at mid-2023.

Furthermore, SCCD's asset liquidity is moderate, which may undermine its financing flexibility. The Company's total asset mainly consists of receivables and inventories, which accounted for 60.7% of its total asset at mid-2023. Receivables are mainly unreceived projects payments from the local government, while inventories are mainly development costs for its construction projects, all of which are considered low liquidity.

Moderate access to funding, with high proportion of non-standard financing

SCCD has moderate access to funding. The Company's standby liquidity is modest, with available credit facilities of RMB2.8 billion at mid-2023. It has good access to onshore bond market. From January 2020 to June 2023, the Company's subsidiary had raised RMB6.9 billion from the onshore bond market via issuance of MTNs, PPNs, and corporate bonds, with coupon rate ranging from 3.2% to 5.5%. However, the scale of non-standard borrowings is large. As of 30 June 2023, the non-standard debts accounted for more than 25% of the total debt, with costs ranging from 5.8% to 7.8%. The Company plans to broaden its financing channels by issuing offshore bonds.

Good track record of receiving government support

As the key infrastructure construction entity in Sanming City, SCCD has a good track record of government support, such as subsidies, special bond funds, and asset injections. From 2020 to 2022, the Company has received asset injection from the local government, increasing its capital reserves by about RMB900 million. From 2020 to mid-2023, the local government provided subsidies of RMB922.8 million to the Company to support its operations and project construction. In 2021, the local government also provided special bond funds of RMB1 billion to the Company to support its infrastructure construction. In light of the Company's important position in Sanming City, we expect the Company to receive ongoing support from the local government in the foreseeable future.

ESG Considerations

SCCD bears environmental risks through its infrastructure projects. Such risks could be mitigated by conducting environmental studies and detailed planning before the commencement of the projects and close supervision during construction.

SCCD bears social risks as it implements public policy initiatives by building public infrastructure in the Zone. 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.

SCCD’s governance considerations are also material as the Company is subject to oversight by Sanming Municipal 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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