

Credit Opinion

3 December 2024

Zigong Construction & Engineering Co., Ltd.

Surveillance credit rating report

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

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CCXAP affirm Zigong Construction & Engineering Co., Ltd.'s long-term credit rating at BBB_g-, with stable outlook.

Summary

The BBB_g- long-term credit rating of Zigong Construction & Engineering Co., Ltd. ("ZCEC" or the "Company") reflects Zigong Municipal Government's strong capacity and very high willingness to provide support to the Company, based on our assessment of the Company's characteristics.

Our assessment of Zigong Municipal Government's capacity to provide support reflects it as a national demonstration zone for industrial transformation and upgrading of old industrial cities, which has relatively good economic fundamentals.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) high sustainability for public projects; (2) good predictability of government support; and (3) reasonable debt leverage.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities with controllable risks; (2) weak asset liquidity; and (3) relatively large exposure to high-cost non-standard financing.

The stable outlook on ZCEC's rating reflects our expectation that the local government's capacity to provide support will remain stable, and the Company will maintain its strategic importance in public policy projects in Zigong City.

Rating Drivers

- One of the major infrastructure construction entities in Zigong City
- High sustainability for public policy projects
- Good predictability of government support
- Reasonable debt leverages due to a large amount of capital injection
- Medium exposure to commercial activities with controllable risks
- Relatively large reliance on high-cost non-standard financing

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's ability to support strengthens; and (2) changes in company's characteristics enhance local government's willingness to support, such as reduced exposure to commercial activities.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's ability to support weakens; or (2) changes in company characteristics decrease the local government's willingness to support, such as reduced sustainability for public policy projects.

Key Indicators

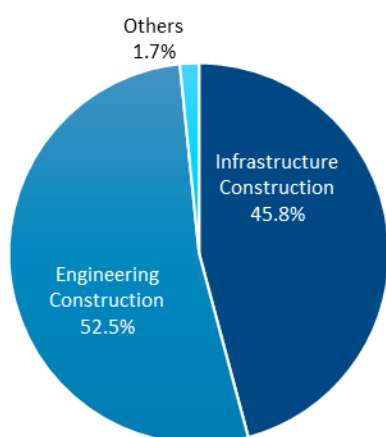
	2021FY	2022FY	2023FY	2024H1
Total Asset (RMB billion)	3.2	11.4	13.1	13.8
Total Equity (RMB billion)	1.0	8.7	8.8	8.8
Total Revenue (RMB billion)	0.3	0.8	0.7	0.2
Total Debt/Total Capital (%)	66.3	21.8	29.5	33.4

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

Source: Company information, CCXAP research

Corporate Profile

Formerly known as Sichuan Shenhai Construction Engineering Co., Ltd., ZCEC was acquired by Zigong Urban Construction Investment and Development Group Co., Ltd. ("ZUCI") in 2014. ZCEC is primarily engaged in infrastructure construction projects in Zigong City. It also undertakes commercial activities such as merchandise sales, engineering construction, and property leasing. As of 30 November 2024, the Company is wholly owned and ultimately controlled by the Zigong Municipal Government State-owned Assets Supervision and Administration Commission ("Zigong SASAC").

Exhibit 1. Revenue structure in 2023

Source: Company information, CCXAP research

Exhibit 2. Shareholding chart as of 30 November 2024

Zigong Municipal Government State-owned Assets Supervision and Administration Commission 自贡市政府国有资产监督管理委员会	
	100.00%
Zigong Construction Engineering Co., Ltd. 自贡建工建设工程有限公司	

Source: Company information, CCXAP research

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

We believe that the Zigong Municipal Government has a strong capacity to provide support for the Company given its status as a national demonstration zone for industrial transformation and upgrading of old industrial cities, which has relatively good economic fundamentals.

Sichuan Province is a leading economic province and is recognized as one of the most developed provinces in China. In 2023, Sichuan recorded a GRP of RMB6.0 trillion, with a year-on-year ("YoY") increase of 6.0%, ranking 5th in terms of GRP among all provinces in China. The general budgetary revenue of Sichuan increased to RMB522.9 billion in 2023, up by 13.3% YoY. In the first three quarters of 2024, Sichuan recorded a GRP of RMB4.5 trillion, with a YoY increase of 5.3%.

Located in the southern part of the Sichuan Province, Zigong City is a central city in the southern part of the Chengdu-Chongqing Economic Circle with rich tourism resources. Zigong's traditional industries are heavy industries, such as salt and halogen chemical industry. As the only national industrial transformation and upgrading demonstration zone for conversational industrial cities in Sichuan Province, Zigong City has actively promoted industrial transformation to develop electronic information, equipment manufacturing, food and beverage, advanced materials, energy and chemical industries. Zigong City's GRP increased from RMB163.8 billion in 2022 to RMB175.0 billion in 2023, ranking 11th among 21 cities in Sichuan Province. Its GRP growth rate was 6.2% in 2022. Due to the low base in 2022 arising from power rationing and tax refund, the Zigong Municipal Government's general budgetary revenue increased from RMB6.3 billion in 2022 to RMB8.1 billion in 2023, of which tax revenue only accounted for 43.5%. Zigong City has a relatively weak fiscal self-sufficiency,

given its fiscal balance ratio was lower than 30% over the past three years. At end-2023, Zigong City's outstanding government debt was RMB73.8 billion, accounting for 42.1% of its GRP. In 2024H1, Zigong's GRP recorded a YoY increase of 7.8% to RMB85.6 billion.

Exhibit 3. Key Economic and Fiscal Indicators of Zigong City

	2021FY	2022FY	2023FY
GRP (RMB billion)	160.1	163.8	175.0
GRP Growth (%)	8.3	0.5	6.2
General Budgetary Revenue (RMB billion)	6.8	6.3	8.1
General Budgetary Expenditure (RMB billion)	23.9	25.7	29.8
Local Government Debt (RMB billion)	52.7	61.9	73.8

Source: Statistic Bureau of Zigong City, CCXAP research

Government's Willingness to Provide Support

Major infrastructure construction entity in Zigong City with high sustainability for public projects

There are four major Local Infrastructure Investment and Financing Companies ("LIIFCs") in Zigong City, namely Zigong State-owned Capital Investment and Operation Group Co., Ltd. ("ZSCI"), Zigong High-tech State-owned Capital Investment and Operation Group Co., Ltd. ("ZHSC"), ZUCI, and ZCEC. ZSCI is mainly engaged in urban development and construction, as well as industrial investment in Zigong City; while ZHSC is responsible for the infrastructure construction and land consolidation in Zigong High-tech Zone. Positioned as the major infrastructure construction entity in Zigong City, ZUCI is mainly responsible for the shantytown renovation, resettlement housing and infrastructure construction. As of 30 November 2024, the Company is no longer a subsidiary of ZUCI but remained responsible for infrastructure construction in Zigong City. As one of the major infrastructure construction entities in Zigong City, we believe the Company will maintain its important position in local public projects in Zigong City.

Entrusted by the government, the Company conducts infrastructure projects by signing agency construction agreements with the local government and relevant departments or authorities, which would pay the construction management fee to the Company. As of 30 June 2024, the Company had 17 infrastructure construction projects under construction, with a total investment amount of RMB16.9 billion and an outstanding amount of RMB14.7 billion. In terms of project repayment, as of 30 June 2024, the receivables amount to be repaid arising from the completed projects was RMB757.2 million. Given the sufficient amount of infrastructure projects in the pipeline, we expect the infrastructure construction business has good sustainability but exerts relatively large capital expenditure pressure at the same time.

Good predictability of government support

The shareholding structure and business operations of the Company are highly correlated with Zigong Municipal Government. ZCEC has a good track record of receiving strong government support, including asset injections, project repayment, and financial subsidies. In 2023, the Company received government subsidies of RMB50 million. Meanwhile, the local government also received project repayment of RMB50 million for the completed infrastructure projects. Given the strategic role of ZCEC in Zigong City, we expect the Company will continue to receive support from the Zigong Municipal Government in the future.

Medium exposure to commercial activities with controllable risks

In addition to public activities, ZCEC is also involved in other commercial activities such as merchandise sales,

engineering construction, and property leasing. We estimate that the Company has medium commercial exposure as the proportion of commercial business assets accounts for around 30% of its total assets.

Engineering construction is the Company's major source of income, which accounted for more than half of the total revenue in 2023. The Company undertakes engineering construction projects through public bidding with self-raised funds. Most of the engineering construction projects are government-related projects, such as talent apartments, roads, and parking lots. As of 30 June 2024, the Company had 7 engineering construction projects under construction, with a total investment of RMB1.7 billion and an outstanding amount of RMB1.0 billion. The gross margin of engineering construction business dropped to around 17.4% in 2023, as more low-margin projects are constructed in 2023.

The Company also engages in the construction of self-operated projects. These projects include facilities of local tourism spots and residential units built for local professionals, with an occupancy rate of over 90%. As of end-2023, the Company has 2 self-operated projects under construction, with a total investment of RMB2.1 billion and uninvested amount of RMB 1.8 billion.

The Company also engages in merchandise sales business, including steel, water purifiers, and wood, with low customer concentration. As of 30 June 2024, the top 5 suppliers and customers accounted for around 53.3% and 52.0% of total procurement and sales, respectively. The property leasing business mainly involves the leasing of commercial shops and other properties held by the Company. In addition, the Company receives ticket income through a 4A-scenic spot operation. However, the small operating scale of these businesses limits its contribution to the Company's overall cash flow and profit.

Reasonable debt leverage

The debt leverage of the Company increased from that of 2022 and remained low. Its capitalization ratio had increased from 21.6% at end-2022 to 33.4% at mid-2024, while its total debt had increased to RMB2.6 billion over the same period. However, the Company's debt structure is relatively unbalanced, with short-term debt accounting for about 41.6% of its total debt. Meanwhile, the Company faces certain short-term repayment pressure, as its cash to short-term debt ratio was 0.5x. As of 30 June 2024, the Company had a total of 26 projects that are under construction or planning, with an expected total investment of RMB20.7 billion and an outstanding amount of RMB17.9 billion. Given the Company's relatively large capital expenditure on construction projects, we expect the Company will have fast debt growth for the next 12-18 months.

Weak asset liquidity

XCID has weak asset liquidity. As of 30 June 2024, the Company's total asset mainly consisted of inventories and receivables, accounting for 83.7% of its total asset. Inventories are construction cost, and receivables are mainly unreceived payments from local state-owned companies, all of which are considered low liquidity. At the end of 2024H1, the restricted asset was RMB218.2 million, which was mainly pledged for borrowing.

Relatively large exposure to high-cost non-standard financing

ZCEC's large investment needs could be partially supported by its good relationship with large domestic banks. Around 82.6% of the Company's debt was provided by bank loans, with an average financing cost of 6.5%. As of mid-2024, the available bank facility was RMB4.3 billion. However, the Company has a relatively large exposure to high-cost non-standard financing (mainly financial leasing). As of 30 June 2024, non-standard financing accounted for around 17.4% of its total debt, with an average financing cost of 8%. In addition, the Company has not issued any bonds in the public debt capital market.

ESG Considerations

ZCEC assumes environmental risks for its infrastructure projects. Such risks could be mitigated by conducting environmental studies and detailed planning prior to the commencement of projects and close supervision during construction. ZCEC's key operations are in material compliance with currently applicable national and local environmental, health and safety laws and regulations.

ZCEC is also exposed to social risks as it implements public-policy initiatives by building public infrastructure in Zigong City. Demographic changes, public awareness and social priorities shape government's development strategy, and it will affect the government's propensity to support the Company.

ZCEC's governance considerations are also important as it is subject to oversight and reporting requirements to the local government, 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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