

## Credit Opinion

25 October 2023

Ratings	
Senior Unsecured Debt Rating	BBB <sub>g</sub> -
Long-Term Credit Rating	BBB <sub>g</sub> -
Outlook	stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

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### Client Services

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## Zigong Construction & Engineering Co., Ltd.

### Initial credit rating report

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub>- to Zigong Construction & Engineering Co., Ltd., with stable outlook.**

### Summary

The BBB<sub>g</sub>- 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 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) great capital expenditure pressure for project construction; 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

	2020FY	2021FY	2022FY
Total Asset (RMB billion)	3.0	3.2	11.4
Total Equity (RMB billion)	1.0	1.0	8.7
Total Revenue (RMB billion)	0.4	0.3	0.8
Total Debt/Total Capital (%)	62.3	65.2	21.6

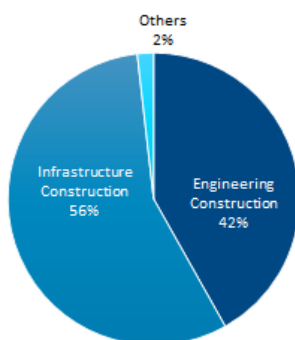
All ratios and figures are calculated using CCXAP's adjustments.

Source: 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 31 December 2022, the Company is wholly owned by ZUCI and ultimately controlled by the Zigong Municipal Government State-owned Assets Supervision and Administration Commission ("Zigong SASAC").

### Exhibit 1. Revenue structure in 2022



Source: Company information, CCXAP research

### Exhibit 2. Shareholding and organization chart as of 31 December 2022

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	
	63.37%
Zigong Urban Construction Investment and Development Group Co., Ltd. 自贡市城市建设投资开发集团有限公司	
	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 relatively good economic fundamentals, but moderate financial condition.

Sichuan Province is a leading economic province and is recognized as one of the most developed provinces in China. In 2022, Sichuan recorded a gross regional product ("GRP") of RMB5.6 trillion, with a GRP growth rate of 2.9% year on year ("YoY"), ranking 6<sup>th</sup> in terms of GRP among all provinces in China. Its general budgetary revenue increased to RMB488.2 billion, up 2.3% YoY. In 2023H1, Sichuan recorded a GRP of RMB2.8 trillion.

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 in recent years. It mainly focused on electronic information, equipment manufacturing, food and beverage, advanced materials, energy and chemical industries. Zigong City's GRP increased from RMB145.8 billion in 2020 to RMB163.8 billion in 2022, ranking 11<sup>th</sup> among 21 cities in Sichuan Province. Its GRP growth rate was 0.5% in 2022. Affected by the power rationing and tax refund, the Zigong Municipal Government's general budgetary revenue decreased from RMB6.8 billion in 2021 to RMB6.3 billion in 2022, of which tax revenue only accounted for 28.7%. 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-2022, Zigong City's outstanding government debt was RMB61.9 billion, accounting for 37.8% of its GRP. In 2023H1, Zigong's GRP

reached RMB79.8 billion, with a YoY increase of 3.8%, while its general budgetary revenue amounted to RMB4.2 billion.

### **Exhibit 3. Key Economic and Fiscal Indicators of Zigong City**

	2020FY	2021FY	2022FY
GRP (RMB billion)	145.8	160.1	163.8
GRP Growth (%)	3.9	8.3	0.5
General Budgetary Revenue (RMB billion)	6.3	6.8	6.3
General Budgetary Expenditure (RMB billion)	23.9	23.9	25.7
Local Government Debt (RMB billion)	40.1	52.7	61.9

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 three 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"), and ZUCI. 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. The Company is one of the subsidiaries of ZUCI. In December 2022, ZUCI injected a large amount of infrastructure projects with a total book value of RMB2.7 billion to the Company. Since then, the Company becomes 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. The construction management fee is based on the construction cost plus around 30% return. As of 31 December 2022, the Company had 18 infrastructure construction projects under construction, with a total investment amount of RMB24.0 billion and an outstanding amount of RMB21.7 billion. Given the sufficient amount of infrastructure projects in the pipeline, we expect the infrastructure construction business will have good sustainability but relatively large capital expenditure pressure at the same time.

### **Good predictability of government support**

ZCEC has received strong support from the Zigong Municipal Government including asset injections, cash injections, and financial subsidies. In 2022, the Company received a total capital injection of RMB7.6 billion, including RMB3.7 billion of lands, RMB2.7 billion of infrastructure construction projects, and RMB1.2 billion of cash. The capital injection has significantly increased the Company's business strength and broadened its business structure. In addition, the Company received RMB32.0 million in government financial subsidies. In terms of project payments, ZCEC received RMB464.6 million for its infrastructure construction 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 41.8% of the total revenue in 2022. 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 31 December 2022, the Company had 11 engineering construction projects under construction, with a total investment of RMB3.6 billion and an outstanding amount of RMB2.1 billion. The engineering construction business also provides good profit to the Company, with the gross profit margin maintained at over 25% over the past three years.

The Company also engaged in merchandise sales business, including steel, water purifiers, and wood, with low customer concentration. 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 leverages due to large amount of capital injection

Due to the large amount of capital injection by the Zigong Municipal Government in 2022, ZCEC's debt leverage was significantly eased. Its capitalization ratio had decreased from 62.3% at end-2020 to 21.6% at end-2022, while its total debt had increased from RMB1.6 billion to RMB2.4 billion over the same period. However, the Company's debt structure is relatively unbalanced, with short-term debt accounting for about 46.0% of its total debt. As of 31 December 2022, the Company had a total of 29 projects that are under construction, with an expected total investment of RMB27.6 billion and an outstanding amount of RMB23.8 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.

#### Exhibit 4. Major Projects under Construction as of 31 December 2022

Project Types	No. of Projects	Budgeted	Invested	Outstanding
		Amount	Amount	Amount
		(RMB million)	(RMB million)	(RMB million)
<b>Projects Under Construction</b>				
Infrastructure Construction	18	23,999	2,309	21,690
Engineering Construction	11	3,619	1,529	2,090
<b>Total</b>	<b>29</b>	<b>27,618</b>	<b>3,838</b>	<b>23,780</b>

Source: Company information, CCXAP research

### Relatively large reliance on high-cost non-standard financing

ZCEC's large investment needs could be partially supported by its good relationship with large domestic banks. Around 70.5% of the Company's debt was provided by bank loans in 2022, with an average financing cost of 6.4%. However, the Company demonstrated limited outstanding credit facilities which may constrain its liquidity position over the short to medium term. Moreover, the Company has a relatively high exposure to high-cost non-standard financing (mainly financial leasing). As of 31 December 2022, non-standard financing accounted for

around 29.5% of its total debt, with an average financing cost of 8.5%. In addition, the Company has not issued any bonds in the public debt capital market, and it plans to issue offshore bonds to improve its debt structure.

## 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.

## Structural considerations

ZCEC's senior unsecured debt rating is equivalent to its long-term credit rating. We believe that government support will flow through the Company given its key role in local infrastructure construction in Zigong City, thereby mitigating any differences in an expected loss that could result from structural subordination.

## 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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