Credit Opinion

23 August 2024

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

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Chongqing Fuling Lingang Economic Zone Construction and Development Group Co., Ltd.

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g- to Chongqing Fuling Lingang Economic Zone Construction and Development Group Co., Ltd., with stable outlook.

Summary

The BBB_g- long-term credit rating of Chongqing Fuling Lingang Economic Zone Construction and Development Group Co., Ltd. ("LGCD" or the "Company") reflects the Fuling District Government's (1) strong capacity to provide support; and (2) high willingness to provide support, based on our assessment of the Company's characteristics.

Our assessment of the Fuling District Government's capacity to provide support reflects it as a national shale gas demonstration zone in China, has a good industrial foundation, and steady economic growth, but is constrained by its modest fiscal balance situation.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) status as the most important development and construction entity in the Baitao New Materials Science and Technology City ("BNST"), with good sustainability of public policy businesses; (2) solid track record of receiving government payments; and (3) relatively low debt burden and leverage.

However, the rating is constrained by the Company's (1) medium exposure to commercial activities; (2) small asset scale and weak asset liquidity; (3) limited financial flexibility; and (4) medium exposure to contingent risks with certain repayment obligations.

The stable outlook on LGCD's rating reflects our expectation that the local government's capacity to support the Company will remain stable, and the Company will maintain its strategic role in Fuling District as the land development and infrastructure construction platform in the BNST.

Rating Drivers

- Most important development and construction entity in BNST
- Good sustainability of public policy businesses
- Solid track record of receiving government payments
- Medium exposure to commercial activities
- Controllable debt repayment risk given low debt burden and leverage
- Small asset scale and weak asset liquidity
- Limited financial flexibility
- Medium exposure to contingent risks with certain repayment obligations

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) changes in Company's characteristics enhance local government's willingness to provide support, such as enhanced regional importance or reduced exposure to commercial activities.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's capacity to provide support weakens; or (2) changes in Company characteristics decrease the local government's willingness to provide support, such as reduced regional significance and reduced government payment.

Key Indicators

	2021FY	2022FY	2023FY	2024Q1
Total Asset (RMB billion)	5.1	3.4	6.2	6.3
Total Equity (RMB billion)	2.3	2.3	4.6	4.7
Total Revenue (RMB billion)	0.4	0.5	0.2	0.2
Total Debt/Total Capital (%)	-	-	4.9	4.8

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

Source: Company data, CCXAP research

Corporate Profile

Established in 2007, LGCD, formerly known as Chongqing Fuling District Longqiao Industrial Park Construction and Development Co., Ltd., is the most important development and construction entity in the BNST. it is also engaged in public utilities including water supply and sewage treatment in Fuling District. In addition, it also conducts several commercial activities, such as property leasing, seedling sales and labor service. As of 31 March 2024, the State-owned Assets Supervision and Administration Commission of Fuling District ("Fuling SASAC") was the ultimate controller of the Company, directly holding 100% stakes of the Company.

Exhibit 1. Revenue structure in 2023

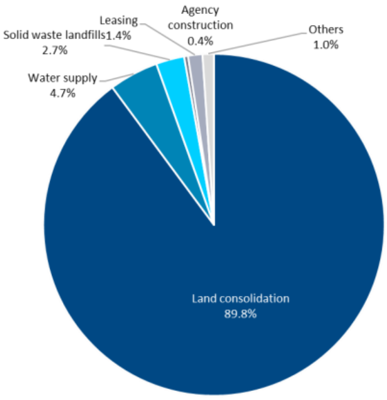
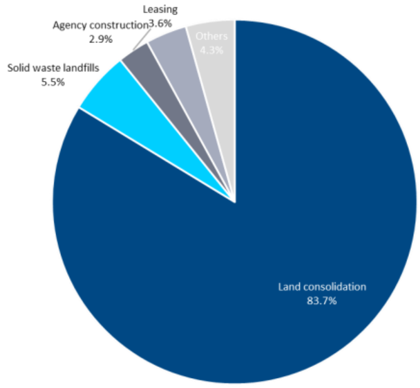


Exhibit 2. Gross profit structure in 2023



Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Fuling District Government has a strong capacity to provide support to the Company, given its good industrial foundation and steady economic growth, but constrained by its modest fiscal balance situation.

Chongqing City is one of the four municipalities in China and the only municipality in Western China. It has formed a pillar industry pattern represented by modern heavy machinery, electronics, chemical and pharmaceutical, as well as the energy industry. Chongqing City's economy has demonstrated a growth trend over the past years. In 2023, Chongqing City recorded a gross regional product ("GRP") of RMB3.0 trillion with a GRP growth rate of 6.1% year-on-year ("YoY"), ranking 5th among municipalities and prefecture-level cities in China, and becoming the first city in western China and one of the five cities in China with a GRP surpassing RMB3.0 trillion. In the first half of 2024, Chongqing's GRP recorded RMB1.5 trillion, a YoY increase of 6.1%. Meanwhile, thanks to the economic recovery, key financial indicators of Chongqing City showed a restorative uptrend in 2023. Chongqing City's tax revenue increased from RMB127.1 billion in 2022 to RMB147.6 billion in 2023, resulting in the rising general public budget revenue from RMB210.3 billion in 2022 to RMB244.1 billion in 2023, with a growth rate of 16.1% YoY. In the first half of 2024, Chongqing's general public budget revenue reached RMB130.7 billion, an increase of 12.2%, of which tax revenue was RMB80.1 billion. We consider Chongqing City to bear a relatively high debt burden owing to its relatively large scale of direct government debt and the debt burden of local state-owned enterprises. As of end-2023, the outstanding direct government debt balance of Chongqing City amounted to RMB1.2 trillion, accounting for 40.7% of its GRP for that year.

Exhibit 3. Key Economic and Fiscal Indicators of Chongqing City

	2021FY	2022FY	2023FY
GRP (RMB billion)	2789.4	2912.9	3,014.6
GRP Growth (%)	8.3	2.6	6.1
General Budgetary Revenue (RMB billion)	228.5	210.3	244.1
General Budgetary Expenditure (RMB billion)	483.5	489.3	530.4
Local Government Debt (RMB billion)	861.0	1,007.1	1,225.8

Source: Statistic Bureau of Chongqing City, CCXAP research

Fuling District is located in the central part of Chongqing City. As the first 100 billion GRP district outside the central district of Chongqing, the economy of Fuling District has continued to develop in recent years. In 2013, the National Energy Administration approved the establishment of the Fuling National Shale Gas Demonstration Zone. Fuling Shale Gas Field is the first large-scale shale gas field in China and the largest shale gas field outside North America. The proven reserve of the shale gas in Fuling has reached 900 billion cubic meters, accounting for 34% of the national shale gas proven reserve. On the back of its geographical advantages and shale gas resources, it has a good industrial base forming 6 pillar industries of materials, including equipment manufacturing, clean energy, consumer goods, biomedicine, and electronic information. In 2023, Fuling District achieved a GRP of RMB162.6 billion with a YoY increase of 8.0%, ranked 5th among 38 districts or counties in Chongqing City. Fuling District Government's fiscal strength has also improved along with the economic growth. Its general budgetary revenue increased from RMB6.1 billion in 2021 to RMB7.0 billion in 2023 with tax income contributing to over 70% of the general budgetary revenue over the past three years, indicating good fiscal stability. However, its fiscal balance ratio in 2023 was recorded at a moderate level of 50.5%. Fuling District Government's outstanding debt has shown an increasing trend, with outstanding debts of RMB34.3 billion in 2023, accounting for 21.1% of its GRP.

Exhibit 4. Key Economic and Fiscal Indicators of Fuling District

	2021FY	2022FY	2023FY
GRP (RMB billion)	140.3	150.4	162.6
GRP Growth (%)	8.7	2.6	8.0
General Budgetary Revenue (RMB billion)	6.1	6.0	7.0
General Budgetary Expenditure (RMB billion)	10.1	12.1	13.9
Local Government Debt (RMB billion)	21.1	23.4	34.3

Source: Statistic Bureau of Fuling District, CCXAP research

Located in the main urban area of Chongqing City, BNST was established in March 2024 by integrating the Lingang Economic Zone and Qingxi Industrial Park. It covers an area of 42.8 square kilometers ("km^2"), with planning built-up industrial area of 28.1 km^2. BNST relies on the logistics advantages of Chongqing Longtou Port and focuses on developing chemical and materials, energy and consumer goods industries. There were 132 settled enterprises at the end of 2023, 88 of which were above the designated size. In 2023, the industrial output value of enterprises above the designated size reached RMB103 billion, up 10.5% YoY. We believe LGCD, as the most important development and construction entity in the BNST, has great development opportunities in the development of infrastructure and supporting facilities.

Government's Willingness to Provide Support

Most important development and construction entity in BNST

The Company plays a vital role in public policy businesses, with strong regional franchise advantages in various public-related activities such as infrastructure construction, land consolidation, water supply, and sewage treatment, making great contributions to the local social and economic development, benefiting investment attraction and improving related industrial chains in the region. Although there are a number of large-scale state-owned enterprises in the area, considering the strategic importance of LGCD in the BNST, we believe that the Company's replacement cost is relatively high.

Good sustainability of public policy businesses

We believe LGCD's large pipeline of public policy projects assigned by the local government has ensured its sustainability of public policy businesses but exerted certain capital expenditure pressure. Nevertheless, funding from policy banks and government special bonds can partly alleviate the investment pressure.

The Company is entrusted by the local government to undertake land consolidation in the BNST. The Company engages in land development business mainly through agency construction and triangular cooperation models, involving land acquisition, demolition, compensation and consolidation within the planned area. Under the agency construction model, the local government would pay the Company based on the cost of land consolidation plus a certain markup after the completion of the land consolidation. Under triangular cooperation models, the Company signs tripartite agreements with state-owned enterprises in Fuling District. The Company is entrusted to carry out land development projects and receives project payments based on the cost of land consolidation plus a certain markup after completion of the land consolidation. As of 31 March 2024, the Company had 4 land development projects under construction with a total planned investment amount of RMB2.2 billion and an outstanding amount of RMB1.7 billion. Moreover, the Company's 2 planned land consolidation projects required a total planned investment of RMB433.0 million. In addition, the actual land area that can be reclaimed in the BNST is 33,100 mu. As of 31 March 2024, 17,300 mu of land has yet to be remediated. The large-scale land consolidation pipeline ensures the sustainability of the business. However, the income from land development is largely susceptible to land market conditions and government policies. From 2021 to 2023, the Company's land consolidation revenue was RMB441.0 million, RMB473.0 million, and RMB212.0 million, respectively.

Entrusted by the Fuling District Government, the Company conducts infrastructure construction business in the Fuling District, mainly through an agency construction model. Under the agency construction model, LGCD enters into an agency construction agreement with the related departments of the Fuling District Government and the related departments will pay the construction funds to the Company according to the construction progress. The Company will recognize management fees by offsetting construction funds received with actual incurred costs upon project completion. As of 31 March 2024, the Company has completed several projects, such as roads and road network upgrade projects, with an invested amount of RMB398.1 million. From the perspective of project reserves, the Company had 5 infrastructure construction projects under construction or planning, with a total planned investment of RMB2.3 billion and an uninvested amount of RMB2.0 billion.

In addition, LGCD provides public utilities services in the BNST, such as water sourcing, water supply, and sewage treatment. As of 31 March 2024, the Company had a daily water supply capacity of 18,000 tons. The water supply business benefited from increasing unit prices of water supply because the Company broadened types of water supply to domestic water in 2023. However, due to the public welfare nature of the water supply business, the profitability of this business was still at losses as the gross profit margin was -1.0% in 2023. The Company also runs a sewage treatment business with a sewage treatment volume of 95,900 tons from 2021 to 2024Q1. The profitability of the sewage treatment business is good as its gross profit margin amounted to 26.9% in 2023, which can provide supplementary cash flow to the Company but subject to its relatively small operating scale. Overall, we believe that as these public utilities services are vital to local populations, the replacement costs of the Company's role will be relatively high.

Medium exposure to commercial activities with large-scale operating assets injected from the government

LGCD's market-driven assets accounted for around 45-50% of its total assets at end-2023, we consider LGCD's commercial business exposure to be medium due to the Company's limited participation in commercial businesses, which are property leasing and self-operated project construction. We expect these activities have been a good supplement to the Company's revenue but could exert certain funding pressure and business risks.

The Company is involved in the property leasing business, mostly consisting of public rental housing and low-rent housing injected from the government. As of 31 March 2024, the total leasable area amounted to approximately 95.5 thousand sqm and an unleased area of 55.5 thousand sqm, with an occupancy rate of 41.9%. The contribution of this business accounted for only 1.4% of total revenue in 2023. In addition, the Company also engaged in the seedling sales business, as the government injected state-owned commercial greening (seedlings) assets into the Company in 2023.

The Company is also undertaking a self-operated construction project of a standard factory, with a total investment of RMB360.0 million and an uninvested amount of RMB230.1 million. After this project is completed, the Company generates profits from property leasing and property management for fund balance. Although the future investment amount is relatively large, funds from special government bonds can alleviate part of the capital pressure. However, there is uncertainty in the cash collection and investment return since self-operated projects are susceptible to market conditions.

Solid track record of receiving government payments

In recognition of its importance as an important state-owned assets operator in the BNST, LGCD has received recurring government support, including financial subsidies, asset and capital injections from the Fuling District Government. In 2022, the Company's special bonds of RMB2.0 billion were converted into capital reserves and the Fuling District Government transferred sand operating rights with a total value of about RMB2.0 billion and seedling assets of RMB306 million to the Company without compensation, significantly enhancing its capital strength and broadening its business scope. In 2023, the Company received a capital injection of RMB10 million from Fuling SASAC. The Company also received sizeable government subsidies of RMB104.0 million and special bonds of around RMB2.8 billion from 2021 to 2024Q1, supporting its project construction. Given LGCD's important strategic role in the region, we expect the Company will continue to receive support from the government in the future.

Controllable debt repayment risk given low debt burden and leverage

The Company's debt burden is low as it started raising funds in 2023. The Company's total debt was RMB259.8 million as of 31 March 2024, with a low total capitalization ratio of 4.8%. Its cash to short-term debt was 49.5x at the same time. The Company currently has minimal debt repayment pressure. However, considering its ongoing investment needs from its land development projects and infrastructure construction projects, we expect the Company's debt level will increase over the next 12-18 months.

Small asset scale and weak asset liquidity

LGCD's asset scale is small with weak asset liquidity. As of 31 March 2024, benefiting from the government's injection of assets such as seedlings, sand and gravel management rights and other assets, the Company's total assets increased significantly to RMB6.2 billion, but still at a low level. In addition, LGCD's asset liquidity is weak, which may undermine its financial flexibility. The Company's total asset mainly consists of inventories and intangible assets, which accounted for 78.4% of its total assets as of 31 March 2024. Inventories are mainly investment costs for land development projects while intangible assets mainly consist of sand and advertising space operating rights injected from local government with an estimated value of RMB2.0 billion, both of which are considered low liquidity. However, the investment properties accounted for 5.3% of total assets as of 31 March 2024, mainly public-rent housing and low-rent housing, which can provide supplementary leasing income and cash flow to the Company but are subject to their relatively small scale.

Limited financial flexibility

The Company has limited access to sources of funding as its debt financing is only provided by bank loans. In 2023, it received bank loans of RMB200 million with a loan term of 15 years and a coupon rate of 4.8% from the Agricultural Development Bank of China. LGCD has total credit facilities of RMB280 million and available credit facilities of RMB10 million as of 31 March 2024, indicating an insufficient liquidity buffer. Given the Company's limited available credit facilities amount and expanding investment needs from relatively large development pipelines, we expect the Company will continue to broaden its funding channel to fulfill its capital expenditure, such as increasing its credit facilities and issuing onshore and offshore bonds.

Medium exposure to contingent risks with certain repayment obligations

The Company bears certain repayment obligations resulting from the ill-run guaranteed enterprise, which negatively impacts its credit quality. As of 31 March 2024, the Company's external guarantees amounted to RMB8.3 million, accounting for 0.2% of its net assets. All of the external guarantees were provided to its joint stock subsidiary, Chongqing Longhai Petrochemical Co., Ltd. ("LHPC"), which has entered bankruptcy due to poor operation. Because of LHPC's default, the Company shall bear the guarantee liability totaling RMB8.7 million ruled by the People's Court of Fuling District in December 2022.

ESG Considerations

The Company is subject to environmental laws and regulations governing air pollution, noise emissions, hazardous substances, water and waste discharge and other environmental matters issued by the national governmental authorities. LGCD 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.

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

The Company's governance considerations are also material 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. LGCD believes that it is in compliance in all material respects with the applicable governmental regulations, rules and executive orders in each jurisdiction in which it operates. The Company maintains regular communication with local governments and regulatory authorities through its management team or representatives, ensuring compliance with the requirements and conditions for obtaining and maintaining the licenses, concessions, permits, or certificates.

Rating Methodology

The methodology used in this rating is the Rating Methodology for China's Local Infrastructure Investment and Financing Companies (July 2022).

Appendix

Exhibit 5. Peer Comparison

	Chongqing Fuling Industrial Development Group Co. Ltd.	Chongqing Fuling Lingang Economic Zone Construction and Development Group Co.,Ltd.
Long-Term Credit Rating	BBB_g+	BBB_g-
Shareholder	Fuling SASAC	Fuling SASAC
Positioning	Responsible for public policy projects such as land consolidation, resettlement housing, and shantytown reconstruction in Fuling District	Responsible for land consolidation, infrastructure construction, water supply and sewage treatment in the BNST
Total Asset (RMB billion)	159.0	6.2
Total Equity (RMB billion)	81.3	4.6
Total Revenue (RMB billion)	14.5	0.2
Total Debt/Total Capital (%)	44.4	4.9

All ratios and figures are calculated using CCXAP's adjustments based on the financials in 2023.

Source: Company data, CCXAP research

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