

Chongqing Tongnan District Construction Engineering (Group) Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	21 June 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Chongqing Tongnan District Construction Engineering (Group) Co., Ltd. (“CTDCE” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Tongnan District, Chongqing City (“Tongnan government”) would provide strong support to CTDCE if needed, in light of its full ownership of CTDCE, CTDCE’s strategic importance as the major local investment and development company (“LIDC”) that is responsible for infrastructure construction in Tongnan District, Chongqing City (“Tongnan”), (“Chongqing”), and the linkage between the Tongnan government and CTDCE, including appointment and supervision of the senior management, strategic alignment, major investment and financing plan decisions and ongoing operational and financial support. In addition, the Tongnan government may face significant negative impact on its reputation and financing activities if CTDCE encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that CTDCE’s strategic importance would remain intact while the Tongnan government will continue to ensure CTDCE’s stable operation.

Rating Rationale

Tongnan Government’s Ownership and Supervision: The Tongnan government holds the full ownership of CTDCE via the State-owned Assets Supervision and Administration Commission of Tongnan (“Tongnan SASAC”), and is the actual controller of the company. The Tongnan government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Tongnan government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Tongnan and Strategic Alignment: CTDCE is primarily responsible for infrastructure construction within the region. CTDCE plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: CTDCE received operational and financial support from the government. CTDCE received a total subsidy amount of c. RMB108.8 million from 2020 to 2022, mainly including operating subsidies. The Tongnan government also injected project fund to the company, which served as state-owned capital investment for the company’s infrastructure projects. We believe CTDCE is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

CTDCE’s Financial Matrix and Liquidity Position: CTDCE’s total assets showed a continuous growth in the past few years, with a growth rate of 13.9% and 30.4% at end-

Key Figures of Tongnan and CTDCE

(RMB billion)	2021	2022
Tongnan		
GDP	53.9	55.9
GDP growth rate (%)	9.5	3.0
Budgetary revenue	2.3	3.0
Government fund	2.9	2.7
Transfer payment	3.2	3.5
Budgetary expenditure	6.2	7.5
CTDCE	2021	2022
Assets	7.7	10.0
Equity	3.4	4.3
Revenue	0.4	0.5

Source: Public information, CTDCE and Lianhe Global’s calculations

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Applicable Criteria

[China Local Investment and Development Companies Criteria \(5 December 2022\)](#)

2021 and end-2022, respectively, and reached RMB10.0 billion at end-2022. The increase of CTDCE's total assets in 2022 was largely due to its other receivables and intangible assets. CTDCE had large proportion of non-current assets in total assets (77.3% at end-2022) and its overall asset liquidity was weak. CTDCE's financial leverage (total liabilities to assets) was 56.7% at end-2022. CTDCE's total adjusted debt increased to c. RMB2.6 billion at end-2022. The liquidity of CTDCE was tight. At end-2022, CTDCE had unrestricted cash balance and unused credit facilities of c. RMB0.05 billion and RMB0.19 billion, respectively, compared with its debt due within one year of c. RMB0.56 billion at the same time. Therefore, the company must successfully roll over its short-term bank borrowings (end-2022: c. RMB0.34 billion) and obtain additional financing sources or government support to maintain its liquidity.

Economy and Fiscal Condition of Tongnan: Tongnan is an administrative district of Chongqing, and is in the northwest of Chongqing with a total area of 1,583 square kilometers. Tongnan is an important industrial base, tourism destination and vegetable production area in the Chengdu-Chongqing economic circle. Tongnan maintained economic growth but slow down substantially in 2022. Tongnan's GDP reached c. RMB55.9 billion, representing a year-over-year growth rate of 3.0% in 2022, and its GDP ranked the 22nd among all districts and counties of Chongqing. The budgetary revenue of the Tongnan government achieved accelerated growth in the past three years, reaching c. RMB3.0 billion with a year-on-year increase of 28.8% in 2022, which was mainly contributed by the substantial growth of non-tax revenue. Meanwhile, the share of tax revenue in budgetary revenue kept decreasing, recording at 28.4% in 2022. The fiscal self-sufficiency rate of the Tongnan government was insufficient, and it recorded budget deficit of -149.8% in 2022, despite the narrowing trend in the past few years. On the other hand, the government fund income and transfer payment were relatively stable in the past few years, recording at RMB2.7 billion and RMB3.5 billion, respectively, in 2022. The debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 119.2% at end-2022 from 85.1% at end-2020, mainly due to the increase in special debt.

Rating Sensitivities

We would consider downgrading CTDCE's rating if (1) there is perceived weakening in support from the Tongnan government, particularly due to its reduced strategic importance with diminished government functions, or (2) there is a significant reduction of the Tongnan government's ownership of CTDCE, or (3) there is a downgrade in our internal credit assessment on the Tongnan government.

We would consider upgrading CTDCE's rating if (1) there is strengthened support from the Tongnan government, or (2) there is an upgrade in our internal credit assessment on the Tongnan government.

Operating Environment

Economic Condition of Tongnan

Tongnan is an administrative district of Chongqing, and is in the northwest of Chongqing. Tongnan is an important industrial base, tourism destination and vegetable production area in the Chengdu-Chongqing economic circle. Tongnan has jurisdiction over three streets and 20 towns, with a total area of 1,583 square kilometers. By the end of 2022, Tongnan had a residential population of 0.7 million, with an urbanization rate of 60.5%.

Tongnan maintained economic growth but slow down substantially in 2022. Tongnan's GDP reached c. RMB55.9 billion, representing a year-over-year growth rate of 3.0% in 2022, and its GDP ranked the 22nd among all districts and counties of Chongqing. Tongnan's economic growth was mainly fueled by the secondary and tertiary industries, which accounted for 41.7% and 42.0%, respectively, in 2022. The fixed asset investment also recorded steady growth in the past few years. Meanwhile, Tongnan's GDP per capita reached c. RMB81,445 in 2022.

Tongnan's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	47.7	53.9	55.9
-Primary industry (%)	16.2	15.6	16.3
-Secondary industry (%)	43.0	43.8	41.7
-Tertiary industry (%)	40.8	40.6	42.0
GDP growth rate (%)	4.3	9.5	3.0
Fixed asset investment	22.6	26.0	29.2
Fixed asset investment growth rate (%)	12.9	15.1	12.3
Population (million)	0.7	0.7	0.7

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Tongnan

The budgetary revenue of the Tongnan government achieved accelerated growth in the past three years, reaching c. RMB3.0 billion with a year-on-year increase of 28.8% in 2022, which was mainly contributed by the substantial growth of non-tax revenue. Meanwhile, the share of tax revenue in budgetary revenue kept decreasing, recording at 28.4% in 2022. The fiscal self-sufficiency rate of the Tongnan government was insufficient, and it recorded budget deficit of -149.8% in 2022, despite the narrowing trend in the past few years. On the other hand, the government fund income and transfer payment were relatively stable in the past few years, recording at RMB2.7 billion and RMB3.5 billion, respectively, in 2022.

The debt ratio of the Tongnan government was relatively high. At end-2022, the Tongnan government's outstanding debt was c. RMB11.1 billion, representing a year-on-year growth rate of 17.0%. The debt ratio, as measured by total government debt outstanding/aggregate revenue, had increased to 119.2% at end-2022 from 85.1% at end-2020, mainly due to the increase in special debt.

Tongnan's Fiscal Condition (RMB billion)	2020	2021	2022
Budgetary revenue	2.0	2.3	3.0
Budgetary revenue growth rate (%)	0.2	15.0	28.8
Tax revenue	1.1	1.2	0.9
Tax revenue (% of budgetary revenue)	55.3	49.9	28.4
Government fund income	3.0	2.9	2.7
Transfer payment	4.4	3.2	3.5
Aggregate revenue	9.5	8.5	9.3
Budgetary expenditure	7.2	6.2	7.5
Budget deficit¹ (%)	-256.2	-163.8	-149.8

¹ Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%

Source: Public information and Lianhe Global's calculations

Ownership Structure

Government's Ownership

CTDCE was established in December 2017, with an initial registered capital of RMB500 million. At end-2022, CTDCE's registered capital was RMB500 million and the paid-in capital was RMB223.7 million. The Tongnan SASAC, as the actual controller of the company, holds 100% shares of CTDCE, and the Tongnan government is the ultimate controller of the company.

Strategic Importance and Government Linkage

Strategic Importance of CTDCE to Tongnan

CTDCE is primarily responsible for infrastructure construction within the region. CTDCE plays an important role in promoting the economic and social development of the region. Its business operation and development have been aligned with the government's development plans.

Strong Linkage with the Local Government

CTDCE's linkage with the local government is strong as The Tongnan government holds the full ownership of CTDCE via Tongnan SASAC, and is the actual controller of the company. The Tongnan government has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Tongnan government has assessment mechanism over the company and appoints auditor to supervise the operating performance and financial position on a periodic basis.

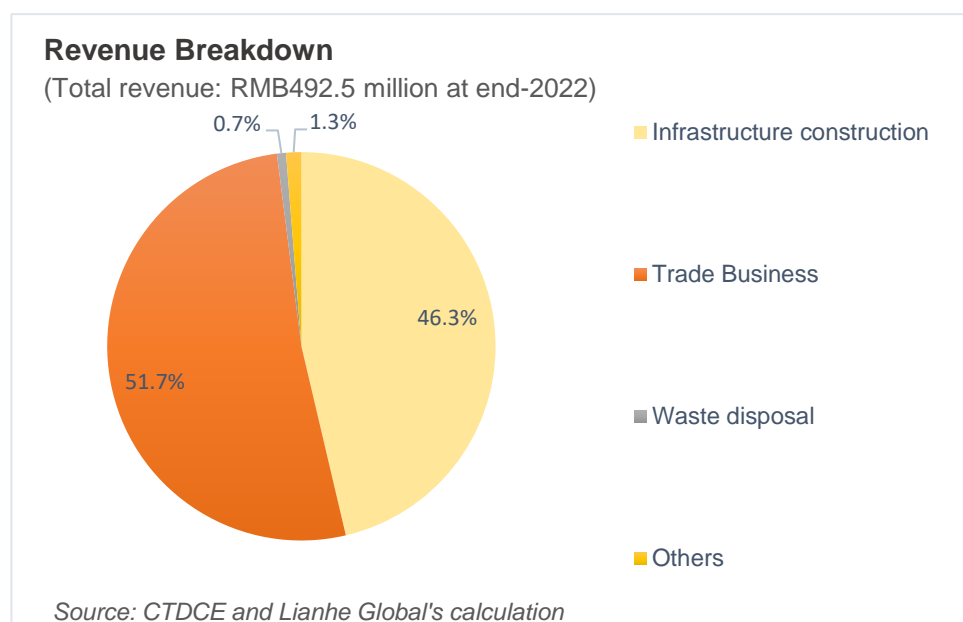
Government Support

CTDCE continued to receive financial subsidies, mainly including operating subsidies, from the local government to maintain its business operation. CTDCE received subsidies of c. RMB0.44 million, RMB9.4 million and RMB98.9 million in 2020, 2021 and 2022, respectively. In 2020, the Tongnan government allocated RMB573.7 million to the company as project funds that served as state-owned capital investment for the company's infrastructure projects. We believe CTDCE is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

Business Profile

The Major Entity Responsible for Infrastructure Construction Entity in Tongnan

As an major LIDC in Tongnan, the CTDCE's business is mainly focused on infrastructure construction, sand mining, sales, commercial concrete sales, garbage disposal and other businesses. The company is the only sand mining enterprise in Tongnan, with regional monopoly advantage in sand mining and sales. Infrastructure construction mainly includes roads, bridges, reservoirs, schools, etc.



Infrastructure Construction

CTDCE's infrastructure construction business mainly adopts agent construction model model. The company is entrusted by the Tongnan government to undertake the construction of infrastructure projects. The company signs construction agreements with relevant government departments such as the Education Commission, the town government, the water resources Bureau, etc. The agreements stipulate the minimum income, and the company receives a construction fee as the revenue in the way of construction cost plus income. The construction projects are mainly undertaken by its subsidiaries Chongqing Tongnan District Datong Construction Engineering Co., LTD and Chongqing Tongqiao Water Engineering Co., LTD. The main sources of construction funds are self-raised funds and subsidies from the local government. Currently, the company is working on several large-scale projects, thus it incurs certain capital expenditure pressure.

Trading Business

The company's trading business is mainly engaged in the sales of sand, stone and concrete. Sand mining, processing and sales are mainly carried out by its subsidiary, Tongnan Longquan Water Conservancy Development Co., LTD. Sand mining business has regional monopoly advantage. The sand mining right is obtained through bidding and signing a mining right transfer contract with Water Resources Bureau of Tongnan District, Chongqing City. The mining period is from September 1, 2022 to December 31, 2025, and the total amount of sand and gravel to be mined is 9.9851 million tons. The mining service is in the form of subcontracting, mainly including the sale of raw stone and the sale of processed

gravel, and the processing of raw stone into crushed stone is commissioned processing. Per the management of CTDCE, the sand and stone sales revenue is expected to increase significantly in 2023, due to the demand for flood control and navigation of the Fujiang River, the sand and stone dredging will increase.

Commercial concrete business model is that the company builds its own commercial concrete production factory, outsources the processing and labor of commercial concrete, and has its own commercial concrete laboratory. The company can issue testing reports on its commercial concrete products and sell them under its own name. Due to the impact of the overall environment in 2022, the revenue of this segment decreased. The customer base of this business includes roads, reservoirs, real estate construction companies, etc.

Other Businesses

The company is also engaged in waste disposal business, mainly by its subsidiary responsible for household waste disposal in Tongnan. Other businesses of the company include transportation business, housing rental, etc., with each segment accounted for a relatively small proportion of the company's total revenue. Other businesses mainly play the role of supplementing the revenue of the main business and make the revenue structure more diversified.

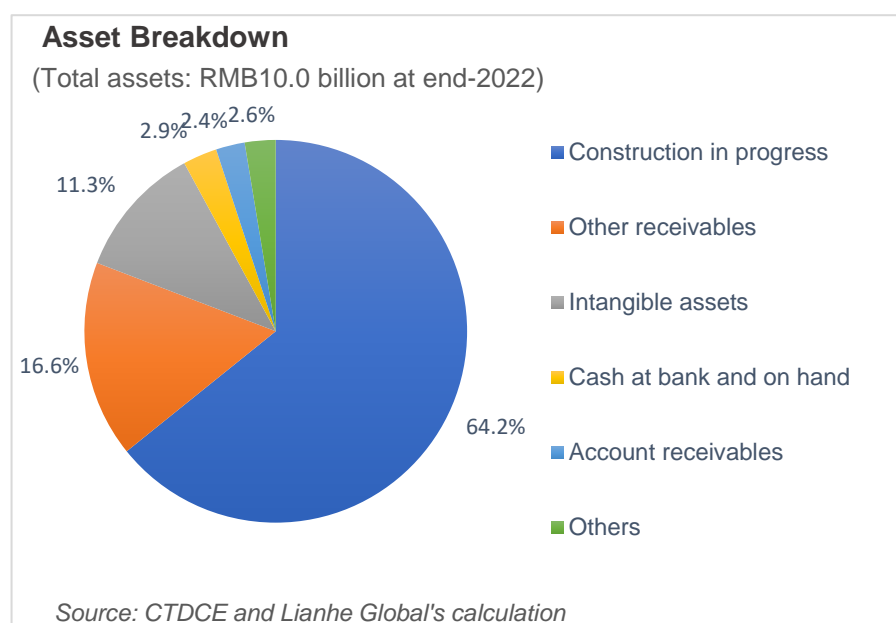
Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality			
(RMB million)	2020	2021	2022
Total Asset	6,732	7,671	10,007
Equity	3,142	3,383	4,331
Debt	850	1,109	2,641
Debt / (Debt + Equity) (%)	21.3	24.7	37.9
LT Debt	436	636	2,078
LT Debt / (LT Debt + Equity) (%)	12.2	15.8	32.4

Source: Company information and Lianhe Global's calculations

CTDCE's total assets showed a continuous growth in the past few years, with a growth rate of 13.9% and 30.4% at end-2021 and end-2022, respectively, and reached RMB10.0 billion at end-2022. The increase of CTDCE's total assets in 2022 was largely due to its other receivables and intangible assets. CTDCE's assets mainly consisted of construction in progress, other receivables, intangible assets, cash at bank and on hand and account receivables. The construction in progress mainly included the cost of S307 Ring Road, avionics hub project and Dashiqiao Reservoir. Other receivables and account receivables were mainly transactions with the Tongnan Finance Bureau, other government agencies and other LIDCs in Tongnan, which had an aging period of mostly 1-3 years, with controllable counterparty risk and low bad debt provision. Compared with 2021, other receivables increased by approximately RMB 1.2 billion, mainly due to the increase in current accounts and advance payments with Tongnan Finance Bureau and Chongqing Tongnan District Urban Construction Investment (Group) Co. LTD. The intangible assets was mainly sand mining rights, whose assessed value at end-2022 increased c. RMB1.1 billion compared with that at end-2021. CTDCE had large proportion of non-current assets in total assets (77.3% at end-2022) and its overall asset liquidity was weak.



CTDCE's financial leverage (total liabilities to assets) reached 53.3%, 55.9% and 56.7% at end-2020, end-2021 and end-2022, respectively, representing an upward trend due to the increasing long-term borrowings. CTDCE's total adjusted debt increased by 210.8% from c. RMB0.8 billion at end-2020 to c. RMB2.6 billion at end-2022, with short-term debt and long-term debt accounting for c. 21.3% and c. 78.7% of the total debt. There was no significant change in the ownership equity structure of CTDCE at end-2022, compared with that at end-2020. CTDCE mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure related projects under construction and to be constructed in the future.

Debt Servicing Capability

The liquidity of CTDCE was tight. At end-2022, CTDCE had unrestricted cash balance and unused credit facilities of c. RMB0.05 billion and RMB0.19 billion, respectively, compared with its debt due within one year of c. RMB0.56 billion at the same time. Therefore, the company must successfully roll over its short-term bank borrowings (end-2022: c. RMB0.34 billion) and obtain additional financing sources or government support to maintain its liquidity.

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