Zhukuan Group Holding Co., Ltd. of Zhuhai City

Initial Issuer Report

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'A-' global scale Long-term Issuer Credit Rating to Zhukuan Group Holding Co., Ltd. of Zhuhai City ("Zhukuan Group"); Outlook is Stable

Summary	
Issuer Rating	A-
Outlook	Stable
Location	China
Industry	General Corporate
Date	19 September 2023

Summary

The Issuer Rating reflects Zhukuan Group's important strategic position as the window liaison state-owned enterprise stationed in Macau by the People's Government of Zhuhai ("Zhuhai government") and the sole enterprise with dual headquarters in Zhuhai City, Guangdong Province ("Zhuhai") and Macau, the strong financial performance in terms of increasing asset size, revenue and profit, as well as the strong debt servicing ability. Moreover, Zhukuan Group has a long history of conducting business in both Zhuhai and Macau, which has advantages in terms of obtaining external government support and overall business development. However, the rating is constrained by Zhukuan Group's limited market position and fluctuating profit margins.

The Stable Outlook reflects our expectation that Zhukuan Group will maintain its operation efficiency and high profitability, further diversify its business profile, while the Zhuhai government will continue to ensure the company's stable operation.

Key Rating Rationales

The Sole Window Liaison State-Owned Enterprise Stationed in Macau by the Zhuhai Government: Zhukuan Group, as a state-owned enterprise with dual headquarters in Zhuhai and Macau, is primarily owned by the Zhuhai State-owned Assets Supervision and Administration Commission ("Zhuhai SASAC"). Serving as the exclusive window liaison company representing Zhuhai in Macau, Zhukuan Group holds a unique and strategically vital position in fostering economic ties between these two cities. As the economic collaboration between Zhuhai and Macau continues to deepen, Zhukuan Group is poised to receive increasingly support for the expansion of its cross-border business. The company has great advantages in terms of government support and overall business development.

Improved Revenue Diversification with Expanding Cross-border Business: Zhukuan Group is mainly engaged in property development, labor service, and other cross-border business (mainly including cross-border labor service, engineering and financing service). The increasing contributions from trading and hotel services led the diversification of Zhukuan Group's revenue mix, with the contribution from property development and labor services decreasing from 87% in 2020 to 77% in 2022. Benefiting from the supportive policies of the Zhuhai government, the company is actively pursuing cross-border business expansion, particularly through the development of the cross-border human resources service platform. Additionally, the company has recently established cross-border finance lease and fund investment business to further utilize its regional advantages and broaden the capital flow channels between Zhuhai and Macau.

Stable Property Sales with Adequate Land Bank but High Concentration Risk: Zhukuan Group experienced continuous growth in its real estate development business income from 2020 to 2022, with a compound annual growth rate (CAGR) of 53.2%. As one of the pioneering property development companies in Zhuhai, Zhukuan Group possesses a substantial land bank with competitive costs. The primary focus of Zhukuan Group's property development is in Zhuhai,

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Applicable Criteria
General Corporate Rating Criteria (31 December 2021)
General Corporate Rating Criteria: Addendum (30 August 2022)

which consists of over 95% of its land bank portfolio, demonstrating a high level of concentration risk. Besides, the contracted sales amount and GFA have experienced fluctuations starting from 2020. Given the current challenging conditions in the real estate market, the company may face potential adverse pressure on the overall sales performance.

Improved Financial Metrics and High Profit Margin: Zhukuan Group's asset showed a steady growth in the past few years and reached RMB9.1 billion at end-June 2023, representing an increase of 16.3% from end-2022. Its revenue also recorded a stable growth, recognizing RMB1.7 billion in the first half of 2023. The gross profit margin remains relatively high at 36%-40% from 2020 to 2022, mainly driven by the low land cost of its property projects. However, its gross margin decreased to 25.5% in the first half of 2023, due to the increasing proportion of labor service and merchandising sales. The EBITDA interest coverage (EBITDA/Interest) also improved from 4.9x in 2021 to 6.5x in 2022, as the company continued to improve its profitability.

Increasing Leverage and Sufficient Liquidity: Zhukuan Group's total debt increased to RMB2.7 billion at end-June 2023 from RMB854.4 million and RMB1.8 billion at end-2021 and end-2022, respectively, due to the expansion of its business scale. Its debt to capitalization ratio also increased to 42.2% at end-June 2023 from 20.4% and 32.5% from end-2021 and end-2022. The minority interest increased significantly from RMB1.6 million at end-2021 to RMB207.8 million at end-June 2023. Zhukuan Group's financial leverage, as measured by adjusted debt over EBITDA, increased slightly but remained relatively low at 3.1x in 2022, compared with 2.1x in 2020. The impact from the total debt increase was partially offset by the EBITDA growth in 2022. The short-term debt contributed a proportion of 34%-41% of its total debt from end-2021 to end-June 2023. At end-June 2023, Zhukuan Group had RMB2.8 billion of cash (RMB2.6 billion of unrestricted cash) and unutilized credit line of RMB3.5 billion to fully cover its short-term debt of RMB1.1 billion.

Strong External Support from the Zhuhai Government: Zhuhai is a prefecture city of Guangdong Province and it is one of the five Independent Planning Status cities under the National Social and Economic Development Plan. The Zhuhai government has 90% ownership of Zhukuan Group via the Zhuhai SASAC, while the remaining 10% is held by the Guangdong Provincial Finance Department ("Guangdong FB"). The Zhuhai 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. As the exclusive window liaison company representing Zhuhai in Macau, Zhukuan Group undertakes certain government functions in these two cities, including infrastructure-related projects construction, labor service supply and cross-border capital asset investment and operation. Zhukuan Group plays an important role of accelerating in-depth cooperation between Zhuhai and Macau. It has a proven track record of receiving supports from the local government, including operation subsidies, equity transfer, tax breaks, policy support and guidance from the government. Following the equity transfer of 100% stake of Zhuhai Southern Human Resource Service Co., Ltd in 2020, Zhukuan Group has further strengthened its government function as the largest labor service provider in Macau and western Guangdong Province.

Rating Sensitivities

We would consider downgrading Zhukuan Group's rating if (1) it were to increase its financial leverage as measured by its EBITDA interest coverage to consistently below 5x or debt over EBITDA leverage consistently to above 3.5x, or (2) it were to suffer a significant deterioration in operating performance in terms of revenue, profit margin or cash flow generation, or its liquidity profile is worsened, or (3) there is a decrease in support from or function for the local government.

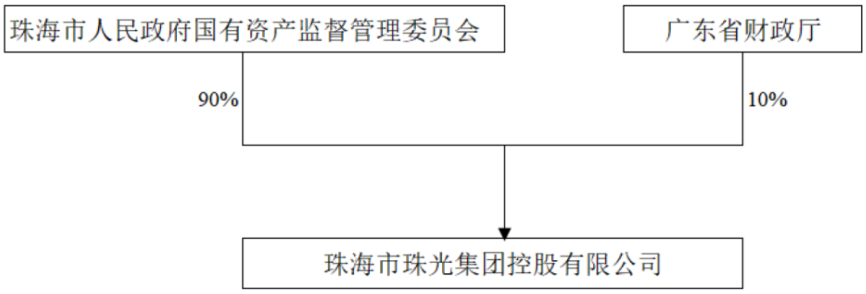
We would consider upgrading Zhukuan Group's rating if (1) it were to significantly improve its operating performance, and/or (2) it were to improve its financial leverage and liquidity consistently, and/or (3) there is an increase in support from or function for the local government.

Company Profile

Zhukuan Group was first established in Macau in 1980 under the approval of the Zhuhai government. In accordance with the requirements of the Guangdong Provincial Government, Zhuhai SASAC transferred 10% of the company's equity to Guangdong FB in December 2020.

At end-2022, the company's registered capital and paid-in capital were RMB150 million. Zhuhai SASAC holds 90.00% of its equity interest, making it the actual controller of the company.

Zhukuan Group's ownership structure at end-June 2023:



Source: Lianhe Global

Business Profile

Improved Revenue Diversification with Expanding Cross-border Business

Zhukuan Group is mainly engaged in property development, merchandise sales, and other cross-border business (mainly including labor service, engineering and financing service). The property development and labor services were the main sources of the company's revenue. The proportion of these two segments in the company's total revenue demonstrated a decreasing trend, decreasing from 87% in 2020 to 77% in 2022 and 55% in the first half of 2023, due to the increasing contributions from trading and hotel services, which were recognized as the merchandise sales and other revenue, respectively. Zhukuan Group also diversifies its business by involving into property leasing, property management and hotel services.

Initially incorporated in Macau, Zhukuan Group plays a pivotal role in several significant construction projects in Macau, encompassing the land reclamation project, the construction of major facilities such as Macau Airport and Lotus Bridge. The overall scale of engineering construction projects in Macau is relatively limited, with only two tenders in Macau in 2022. Having said that, benefiting from the supportive policies of the Zhuhai government, the company is actively pursuing cross-border business expansion, particularly through the development of the cross-border human resources service platform. With the injection of Zhuhai Southern Human Resource Service Co., Ltd in 2020, Zhukuan Group has further strengthened its government function as the largest labor service provider in Macau and western Guangdong Province. Additionally, the company has recently established cross-border finance lease and fund investment business to further utilize its regional advantage and broaden the capital flow channels between Zhuhai and Macau.

Stable Property Sales with Adequate Land Bank but High Concentration Risk

Zhukuan Group's property development primarily focuses on revitalizing existing projects. As one of the pioneering state-owned enterprises engaged in real estate development in Zhuhai, the company acquired land through acquisitions and debt auctions during the 1990s at a low cost. However, the development of a significant portion of these lands is restricted due to debt issues and legal disputes stemming from the company's debt restructuring process. The company's completed projects are mainly under rejuvenation initiatives, which are carried out under the guidance of the Zhuhai government, such as Zhuhai International Building and Zhuguang Qiancheng Huayuan. At end-June 2023, the company has three projects either under development or for future development, requiring a proposed total investment of RMB2.2 billion in the coming years, signifying a large capital expenditure. Simultaneously, the company possesses substantial land banks, totalling approximately 0.3 million GFA, providing ample coverage for its upcoming development plans over the next 4-5 years. Over 95% of Zhukuan Group's land banks is located in Zhuhai, rendering them susceptible to the influence of government planning adjustments and fluctuations in the regional market dynamics.

The property development segment has maintained a relatively high gross profit margin, ranging from 64% to 72% between 2020 and the first half of 2023, supported by the advantageous historical land acquisition costs. Consequently, this segment represents the majority of the company's profits. Having said that, the contracted sales amount and GFA have experienced fluctuations and a decrease in overall performance starting from 2020. Given the current challenging conditions in the real estate market, the company may face potential adverse pressure on the overall sales performance.

The revenue generated from merchandising sales segment kept increasing in the past three years. The proportion of revenue in this segment increased significantly from 5.7% in 2021 to 40.4% in the first half of 2023. The company is mainly engaged in the trading of ethylene glycol. The profit in this segment is mainly generated from the trade balance, indicating a relatively narrow profit margin of less than 1% in the past few years.

In terms of geographical advantage, Zhuhai, located in the South China, is the only city in China that is connected to both Hong Kong and Macau by land and bridge. Zhuhai is one of the five Independent Planning Status cities under the National Social and Economic Development Plan and acts as a political and economic gateway to Macau.

Revenue (RMB in million) / % of total	**FY2020**		**FY2021**		**FY2022**		**1H2023**	
Property Development	614	50.9%	1,158	53.6%	1,441	54.3%	631	36.9%
Labor Services	438	36.3%	644	29.8%	601	23.0%	309	18.1%
Merchandising Sales	1	0.1%	124	5.7%	509	19.2%	689	40.4%
Engineering Construction	42	3.4%	144	6.7%	31	1.1%	41	2.4%
Others	113	9.4%	90	4.2%	65	2.4%	38	2.2%
Total	**1,208**	**100.0%**	**2,159**	**100.0%**	**2,655**	**100.0%**	**1,707**	**100.0**

Source: Zhukuan Group and the company's annual reports

Financial Profile

Improved Financial Metrics and High Profit Margin

Zhukuan Group's revenue grew steadily at a compound annual growth rate of 30.6% in 2020-2022, mainly driven by the promotion in the carry-over process and the rise in average sales price in its property development segment. In addition, the increase in labor dispatch fees also contributed to the revenue growth during the period. Moreover, as the company is expanding its trading scale, the merchandising sales further supported Zhukuan Group's revenue growth in 2020-2022. Its gross margin also demonstrated an upward trend over the same period, reaching 40.3% in 2022, up from 36.7% in 2020. However, as the merchandising sales segment, which typically yields lower margins, continues to represent a growing proportion of the overall business, there may be downward pressure on the company's overall gross margin in the future.

Zhukuan Group's EBITDA, due to the revenue growth as mentioned before, recorded a stable growth from 2020 to 2022. Therefore, the EBITDA interest coverage (EBITDA/Interest) improved from 4.9x in 2021 to 6.5x in 2022, as the company continued to improve its profitability. Zhukuan Group's total adjusted debt increased to RMB2.7 billion at end-June 2023 from RMB854.4 million and RMB1.8 billion at end-2021 and end-2022, respectively, due to higher capital expenditure. Its debt to capitalization ratio also increased to 42.2% at end-June 2023 from 20.4% and 32.5% from end-2021 and end-2022. The minority interest increased significantly from RMB1.6 million at end-2021 to RMB207.8 million at end-June 2023.

Increasing Leverage and Sufficient Liquidity

Zhukuan Group's financial leverage, as measured by adjusted debt over EBITDA, increased slightly but remained relatively low at 3.1x in 2022, compared with 2.1x in 2020. The impact from the total debt increase was partially offset by the EBITDA growth in 2022. The short-term debt contributed a proportion of 34%-41% of its total debt from end-2021 to end-June 2023.

Zhukuan Group has sufficient liquidity as it had RMB2.8 billion cash on hand (of which unrestricted cash of c. RMB2.6 billion) and available credit line of approximately RMB3.5 billion at end-June 2023, compared with its short-term debt of RMB1.1 billion at the same time. The company has access to a wide range of financing channels such as bank borrowings and other non-traditional financing (leasing and trust loan, etc.). Besides, Zhukuan Group is proactive in expanding its financing channels, including domestic and foreign debt financing, etc.

Key Financial Metrics

2020A-2022A	Debt/EBITDA	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	2.9x	5.9x	29.7%	0.6x

Source: Zhukuan Group's 2020-2022 annual reports, Lianhe Global's adjustments

External Support

Strong External Support from the Zhuhai Government

Full Government's Ownership

The Zhuhai government has 90% ownership of Zhukuan Group via the Zhuhai SASAC, which is appointed by the local government to supervise state-owned enterprises. The other 10% is held by the Guangdong FB. The Zhuhai government has the final decision-making authority and supervises the company, including management appointment (4 outside directors and the Chief Financial Officer etc.), decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Zhuhai SASAC audits (both internal and external audits) the financial of Zhukuan Group (i.e., leverage ratio) in a periodical basis and has an assessment mechanism over the senior management of the company.

Ongoing Government Support

Zhukuan Group has proven track record of receiving supports from the local government, such as financial subsidies, project funds, equity transfer, tax breaks, policy support and guidance from the government, to support its business operation and management. Zhukuan Group received subsidies of c. RMB5.5 million, RMB3.6 million, RMB7.6 million in 2020, 2021 and 2022, respectively, mainly including operational subsidies and special subsidies. With the injection of Zhuhai Southern Human Resource Service Co., Ltd. from the Zhuhai government in 2020, Zhukuan Group has further strengthened its government function as the largest labor service provider in Macau and western Guangdong Province. We believe Zhukuan Group will continue to receive government supports in the form of policy support, asset injection and operational and financial subsidies.

Government Function

Zhukuan Group is one of the most important state-owned companies in Zhuhai. As the exclusive window liaison company representing Zhuhai in Macau, Zhukuan Group undertakes certain government functions in these two regions, including infrastructure related projects construction, labor service supply, merchandising trading and cross-border capital asset investment and operation. Zhukuan Group plays an important role of accelerating in-depth cooperation between Zhuhai and Macau. As the Greater Bay Area experiences robust economic growth and increasingly economic and financial policy integration between Hong Kong, Macau and China, Zhukuan Group is strategically positioned to capitalize on these opportunities. We believe that the government functions of Zhukuan Group are hard to be replaced and will not change significantly in the near future.

Economic and Fiscal Condition of Zhuhai

Zhuhai is a prefecture city of Guangdong and it is one of the five Independent Planning Status cities under the National Social and Economic Development Plan. It acts as a political and economic gateway to Macau and an important port for import and export trade. Zhuhai's GDP reached approximately RMB404.6 billion, representing a year-over-year growth rate of 2.3% in 2022. The aggregate fiscal revenue of the Zhuhai government was mainly derived from the budgetary revenue and government fund income, which reached RMB4.4 billion and RMB3.7 billion in 2022, respectively.

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