China Engineering & Construction 2023 Industry Outlook:

Rated Companies To Expand With Slimmed Rating Buffers

S&P Global
Ratings

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This report does not constitute a rating action

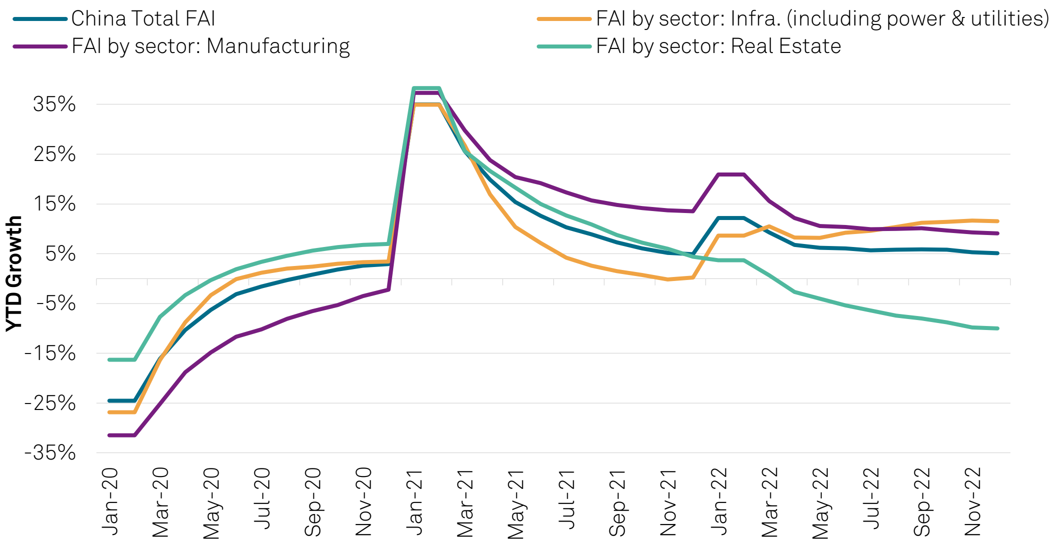
Key Takeaways

- The credit profiles of most rated E&C companies will be stable in 2023. Earnings growth will tend to keep interest coverage ratios (our usual rating trigger) steady.
- We expect the revenue of most rated E&C companies to grow by 8%-11% in 2023, supported by solid order backlogs and continuous expansion of infrastructure investment.
- Moderating raw material costs, and a potentially lower receivables-to-revenue impairment ratio, could gradually help the profitability of our rated companies to recover in 2023.
- That said, the financial headroom of some of these companies has shrunk due to debt growth and leverage hikes during business expansion.
- Rating pressure on some of them (such as BCEG and PCCC) could heighten if the property development sector continues to drag on profits, or if cash collection is prolonged due to deteriorating financial conditions at local governments or their financing vehicles (LGFVs).

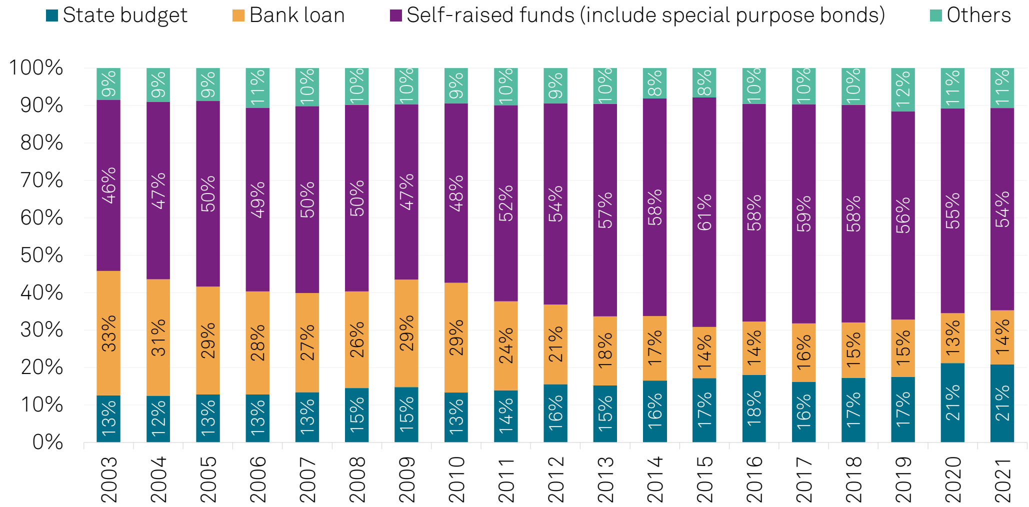
Infrastructure Investment To See Healthy Growth In 2023

- Total infra. investment (including power & utilities) grew 11.5% in 2022.
- We expect total infra. investment to stay high in 2023, supported by government policies ahead of China's full economic recovery.
- China's government is likely to continue stimulus measures to encourage new investment, as partially indicated by consistently high issuance of special purpose bonds (SPBs) at Chinese renminbi (RMB) 3 trillion-RMB4 trillion annually during 2020-2022.
- The scope of projects that qualify for the use of SPB proceeds extends to new energy and new infra. projects (e.g. infra. for big data and artificial intelligence) from the government's original nine priority investment categories (see footnote), as announced in 2022.

Infra. Investment On Course For Healthy Growth In 2023



About 50% of Infra Investment Is Funded By Self Raised Funds

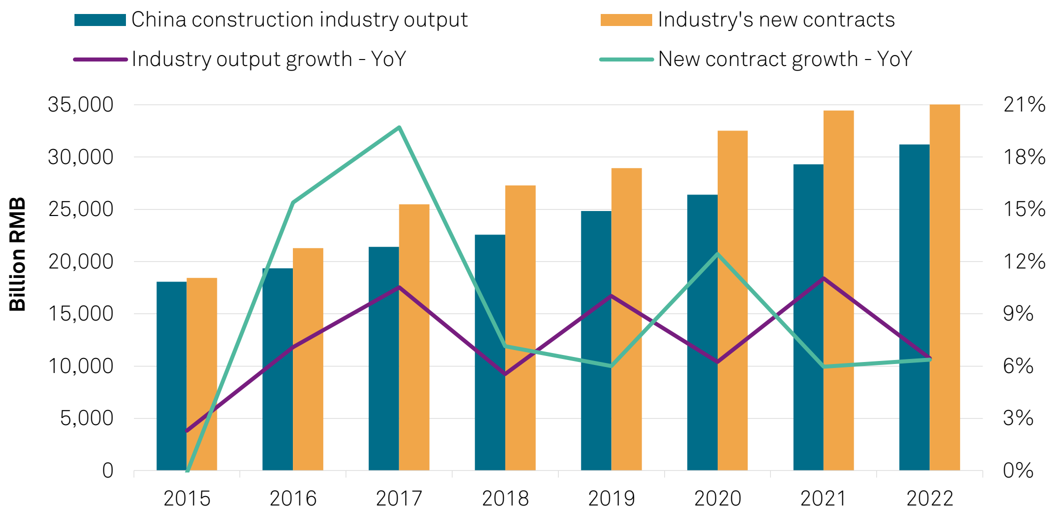


Note: The nine original investment categories are: 1) transportation infrastructure 2) energy 3) forestry and water conservancy 4) agriculture, ecological and environmental protection 5) social programs 6) urban and rural cold chains and other logistics infrastructure 7) municipal and industrial park infrastructure 8) strategic government projects 9) affordable housing projects.. FAI –Fixed asset investment. Source: Wind, National Bureau of Statistics, S&P Global Ratings.

China's E&C Market To See Healthy Growth in 2023

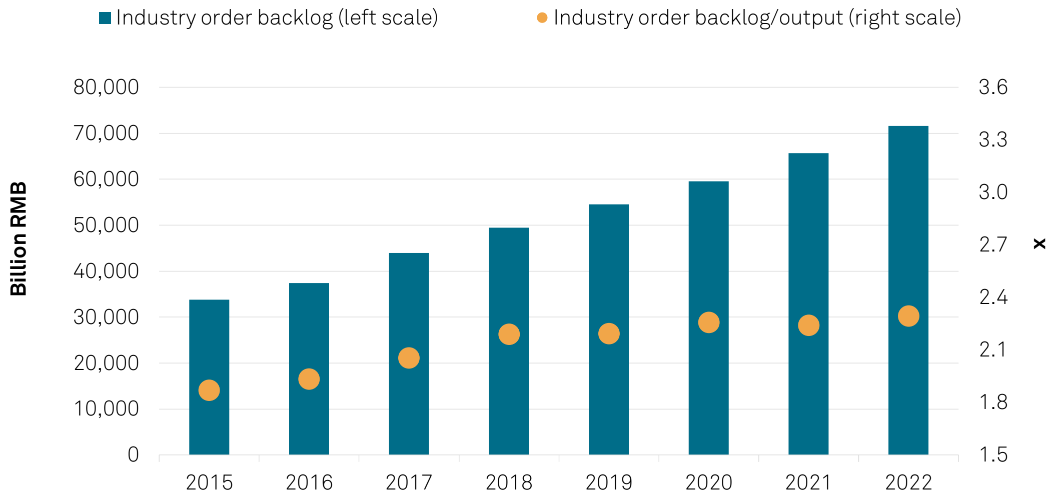
- Project execution rates in the E&C sector are likely to accelerate as the impact of the pandemic subsides in 2023, supporting healthy industry growth.
- New contracts in China's E&C industry grew 6.4% year-on-year in 2022, as the government's infrastructure push offset the impact of the property slowdown.
- The industry order backlog reached RMB71.6 trillion as of end 2022, 2.3 times industry output. This indicates good growth prospects for the next 12-24 months.
- A potential recovery in homebuyer confidence due to government support measures and subsiding pandemic impact could reduce the year-on-year decline in new housing construction in 2023.
- In 2022, the gross floor area of total housing under construction (incl. residential, commercial, industrial housing, etc.) declined 0.7%.

Infrastructure Push Supports New Contract Growth



Source: Wind, National Bureau of Statistics, S&P Global Ratings.

Solid Order Backlog Supports Healthy Growth



Source: Wind, National Bureau of Statistics, S&P Global Ratings.

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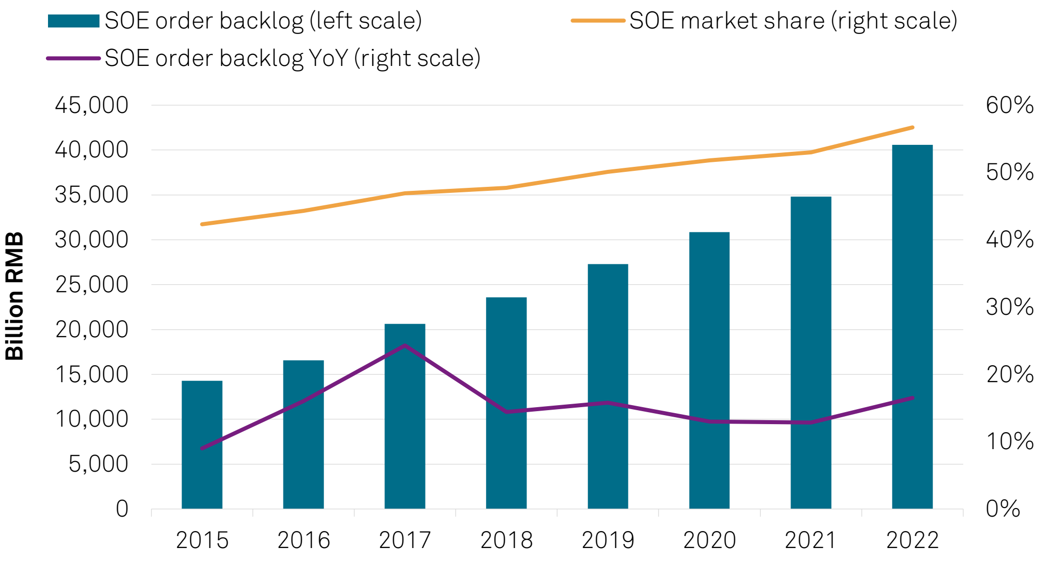
SOEs To Gain Share

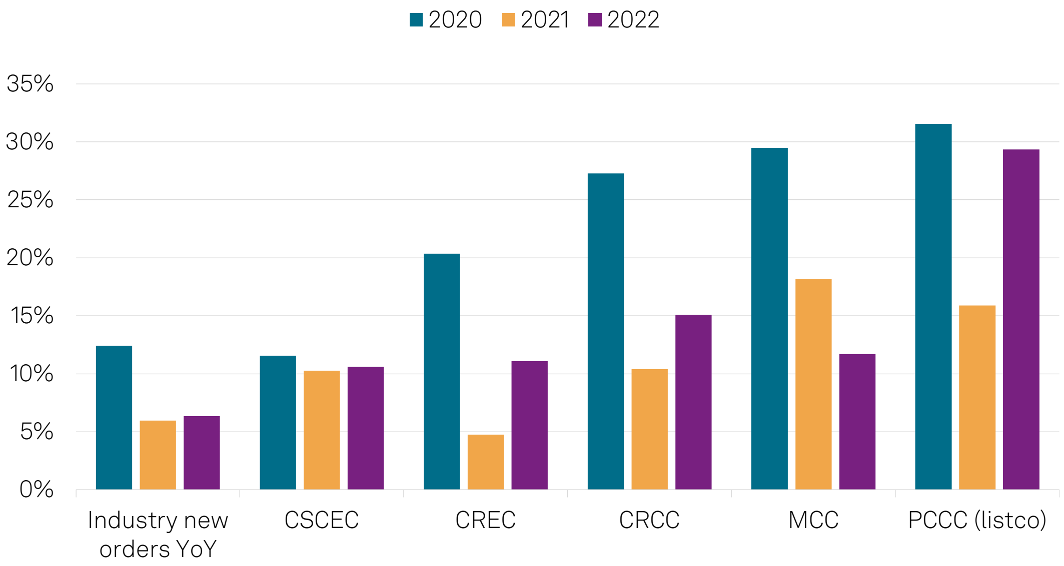
- E&C state-owned enterprise (SOE) market share increased to 57% for 2022, measured by total order backlog. It was 53% in the same period of 2021.
- The trend will likely continue in 2023 because SOEs have: (1) financial stability and good access to funding; (2) solid project execution track records; and (3) more advanced construction technology for complex infra. investment projects.
- Privately owned E&C enterprises will continue to underperform the overall E&C industry. Most focus on residential housing construction. Narrow business scope, deteriorating financial strength, and inferior access to finance means they are less well-placed to capture growth opportunities.

SOEs Are Taking Market Share From POEs



Source: Wind, S&P Global Ratings.

Growth In New Orders: Rated Entities Outpace Broader Market

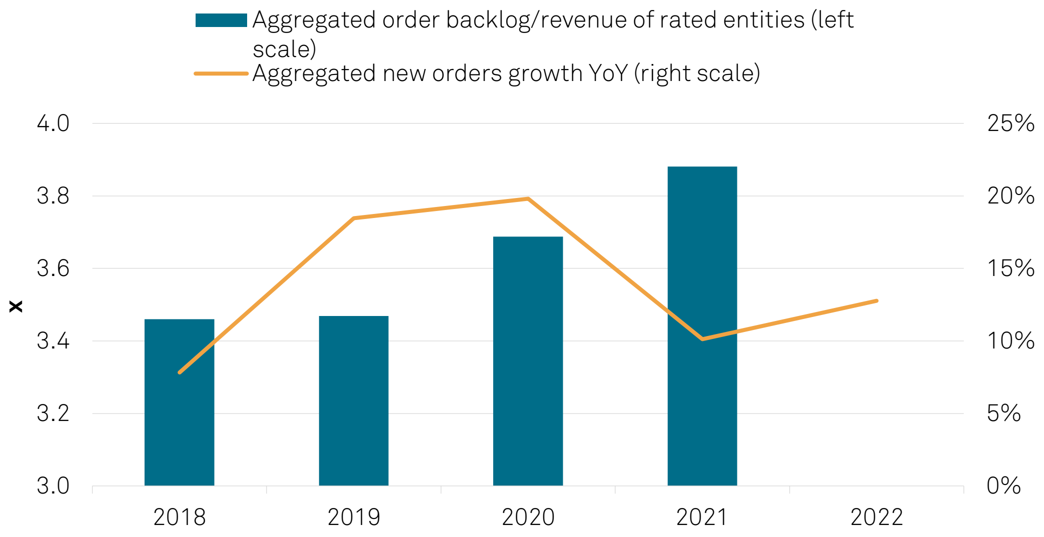


Note: See page 9 of this report for full names. Source: Wind, National Bureau of Statistics, S&P Global Ratings.

Rated E&C Companies To See Stable Business Expansion

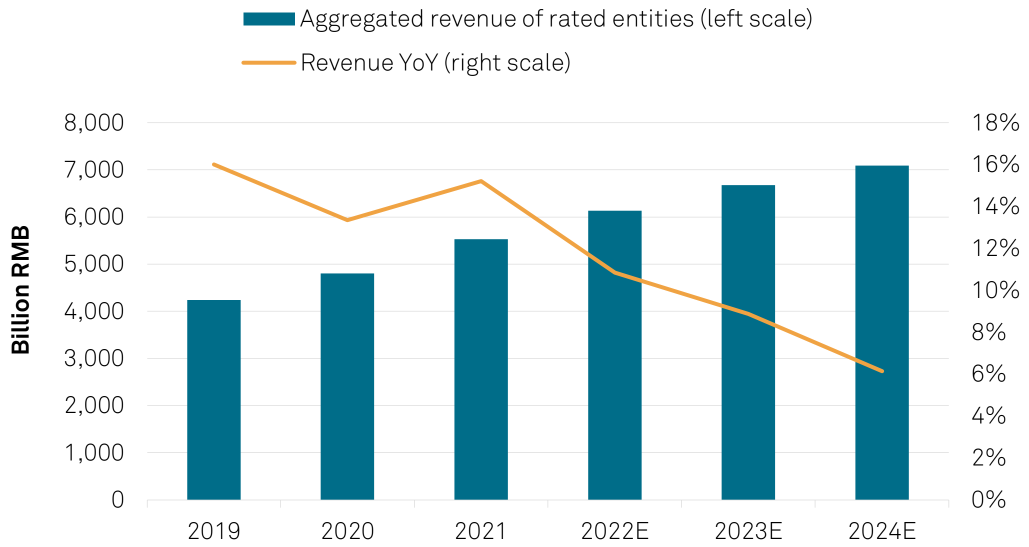
- We expect the revenue of rated E&C companies to grow 8%-11% in 2023 after an estimated 9%-12% growth in 2022. Average backlog is 3.9 times 2021 revenue, indicating visibility for growth. New orders have seen healthy growth of 13% in 2022, after 10% in 2021.
- We expect property sales volumes in China will gradually stabilize in 2023, due to potential government demand stimulus measures and subsiding pandemic impact. However, property sales will still likely decline 5%-8% on a value basis due to lower prices.
- Some of our rated E&C companies have 4%-18% of revenue exposed to property development businesses. Even so, their E&C business growth should continue to mitigate against lackluster property development businesses in 2023.

Healthy Order Backlog Indicates Likely Revenue Expansion



Note: Aggregated new orders includes CSCEC, CREC, CRCC, PCCC, MCC, SCG, Chalieco. Aggregated order backlog and revenue includes all the preceding entities except CSCEC; CSCEC is not included due to lack of data for some years and 2022 backlog data is not yet available. See page 9 for full names. Source: Company disclosures, S&P Global Ratings.

Rated Entity Revenue To Grow 5%-11% In 2023-2024

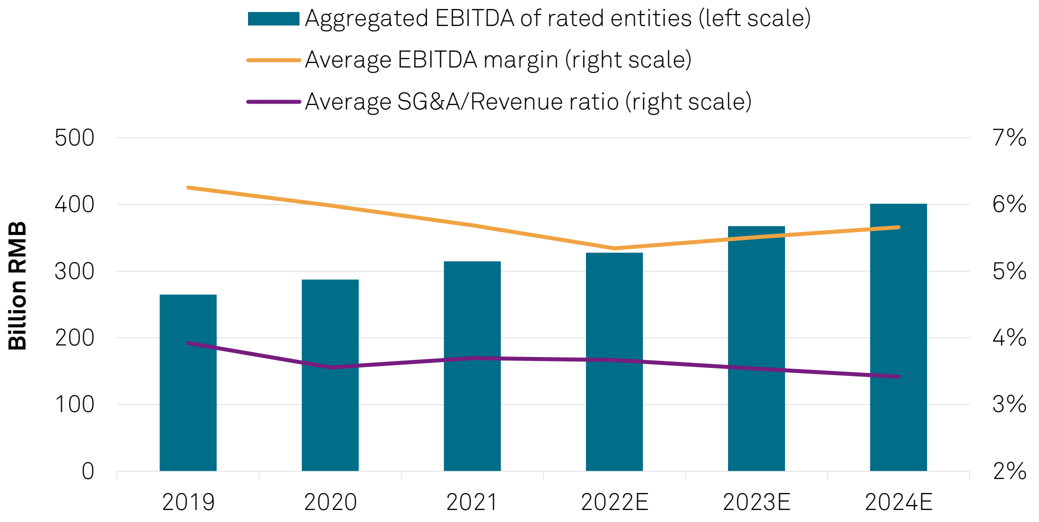


Note: Aggregated revenue includes CSCEC, CREC, CRCC, PCCC, CMGC, SCG, Chalieco and BCEG. See page 9 for full names. Source: Company disclosures, S&P Global Ratings.

Profitability May Improve Slightly

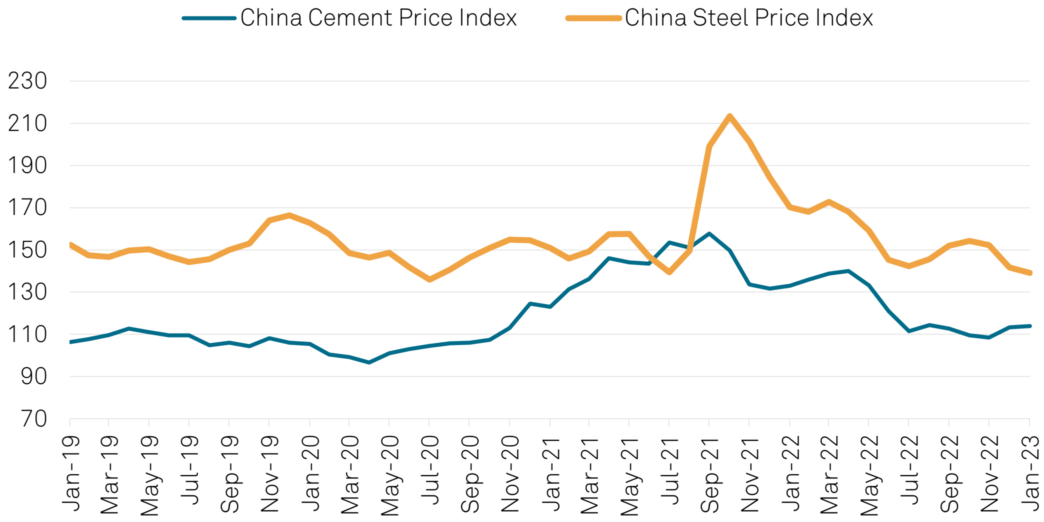
- We expect the EBITDA margins of most rated E&C companies to trend up modestly in 2023, after a dip in 2022. Positive factors include:
  - cautious E&C project selection with better margin;
  - moderating raw materials costs and improving operating efficiency (a lower expense ratio) due to less pandemic related disruption; and
  - lower impairment provisions in 2023. Most receivables at risk from property customers should have been impaired in 2021 and 2022.
- That said, impairment provision ratios will likely stay high because of downside risk to cash collection from LGFVs in 2023. We expect the impairment ratio to stay at an average of 0.5%-0.6% of total revenue in 2023. That compares with an anticipated 0.7%-0.8% in 2022 and 0.7% in 2021.

Margins Of Rated Entities May Trend Up After 2022



Note: Aggregated EBITDA include CSCEC, CREC, CRCC, PCCC, CMGC, SCG, Chalieco and BCEG. See page 9 of this report for full names. Source: Company disclosures, S&P Global Ratings.

Raw Material Costs Are Dropping From Peaks

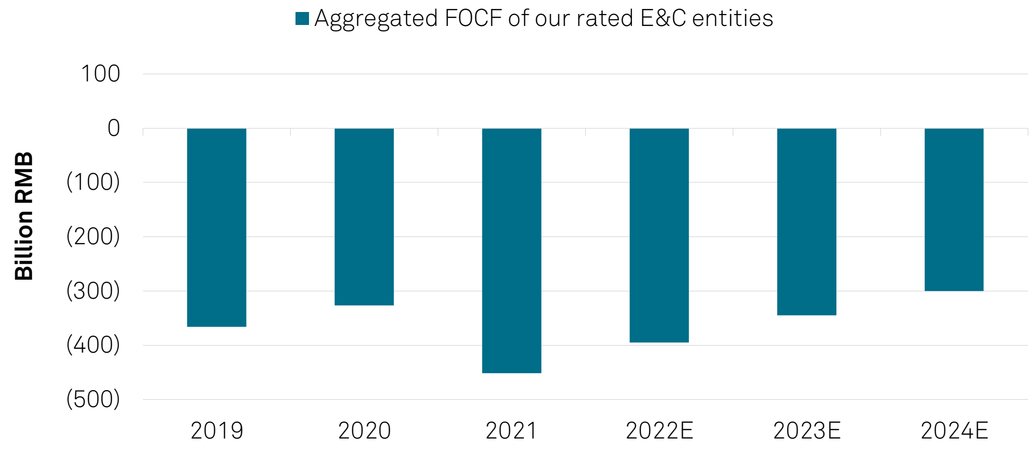


Source: Wind, S&P Global Ratings

Expansion Appetite And Profitability Drive Rating Buffer

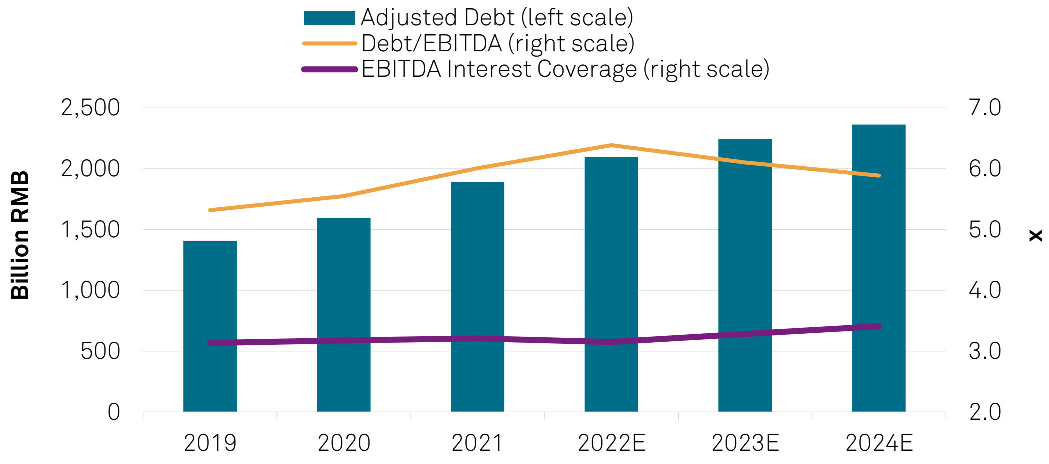
- We expect rated entities' leverage to remain at a relatively high level on a continuous free cash outflow. In addition to earnings growth, companies have adopted different measures to control leverage, such as asset disposal, debt to equity swap, etc.
- Their EBITDA interest coverage ratio should be stable in 2022 and 2023 as financing costs are likely to stay low in China. This ratio is the rating trigger for most E&C entities. We view it as reflective of SOE E&C companies' underlying financial risk. This takes into account the SOE issuers' refinancing track record and wide funding sources.
- Some rated E&C companies (such as BCEG and PCCC) could see meaningful rating pressure if their EBITDA margins underperform our base case by 0.5-1.0 percentage points in 2022-2024 (see page 10-12). This could be driven by a worse-than-expected margin performance of property businesses or a higher impairment provision ratio.

Sustained Negative FOCF Will Drive Up Debt



Note: Aggregated FOCF include CSCEC, CREC, CRCC, PCCC, CMGC, SCG, Chalieco and BCEG. See page 9 of this report for full names. FOCF –Free operating cash flow. Source: Company disclosures, S&P Global Ratings.

Interest Coverage Should Remain Stable For Most Rated Issuers



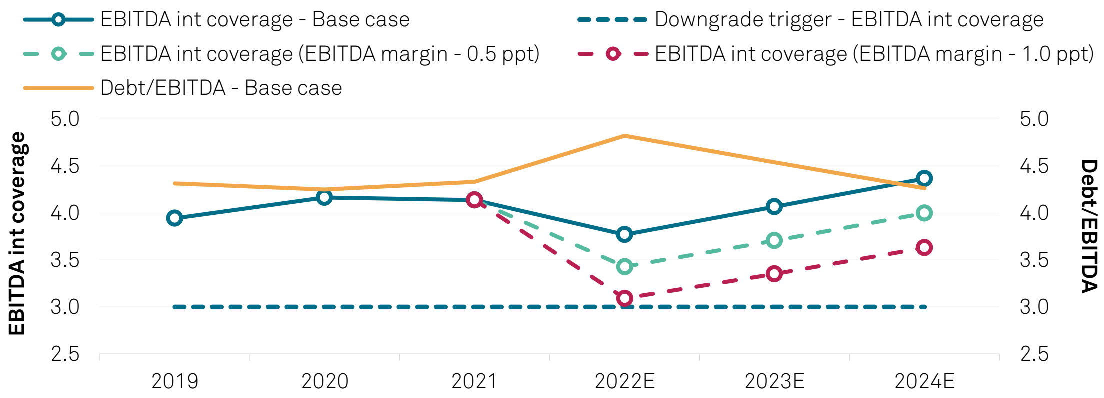
Note: Aggregated Adjusted Debt include CSCEC, CREC, CRCC, PCCC, CMGC, SCG, Chalieco and BCEG – see page 9 of this report for their full name. Source: Company disclosures, S&P Global Ratings.

Margin, Working Capital, And Investment Appetite Are Key Drivers

Company	Rating	Rating Downgrade Triggers		Latest performance					Key Rating Drivers
		Leverage	EBITDA Int. Cov	New contract growth	Revenue growth	Est. EBITDA margin	Est. Leverage	Est. EBITDA Int. Cov (x)	
China State Construction Engineering Corp. Ltd. (CSCEC)	A/Stable	N.A.	< 3.0x	2022: 10.6% 2021: 10.3%	9M 2022: 14.8% 9M 2021: 24.3%	9M 2022: 6.0% 9M 2021: 6.5%	Debt/EBITDA: 9M 2022: 5.3x 9M 2021: 4.6x	9M 2022: 3.7 9M 2021: 3.7	• Revenue and margin expansion of E&C businesses to moderate pressure from property segment; • Leverage control amid business growth.
CSCEC International Construction Co. Ltd. (CSCEC International)	A-/Stable	N.A.	CSCEC's: < 3.0x	N.A.	N.A.	N.A.	N.A.	N.A.	• Leverage and profitability trend of its parent, CSCEC.
China State Construction International Holdings Limited (CSCI)	BBB/Stable	N.A.	< 3.0x	9M 2022: 20% 9M 2021: 36%	9M 2022: 38.9% 9M 2021: 25.1%	1H 2022: 12.8% 1H 2021: 15.9%	Debt/EBITDA: 9M 2022: 4.4x 9M 2021: 4.9x	1H 2022: 4.3 1H 2021: 4.1	• Ability to moderate margin pressure amid business mix changes; • Operating cashflow and leverage improvement.
China Railway Construction Corp. Ltd. (CRCC)	A-/Stable	FFO/Debt: < 12% ; or	~3.0x	2022: 15.1% 2021: 10.4%	9M 2022: 8.6% 9M 2021: 17.9%	9M 2022: 5.8% 9M 2021: 5.6%	FFO/Debt: 9M 2022: 13.1% 9M 2021: 15.6%	9M 2022: 3.9 9M 2021: 3.7	• Investment appetite towards PPP projects; • Ability to improve profitability.
China Railway Group Ltd. (CREC)	BBB+/Stable	N.A.	< 2.0x	2022: 11.1% 2021: 4.7%	9M 2022: 10.4% 9M 2021: 11.8%	1H 2022: 5.1% 1H 2021: 5.1%	Debt/EBITDA: 9M 2022: 6.0x 9M 2021: 5.6x	1H 2022: 3.3 1H 2021: 3.4	• Working capital managment; • Investment appetite towards PPP projects.
China Metallurgical Group Corp. (CMGC) and Metallurgical Corp. of China Ltd. (MCC)	BBB+/Stable	N.A.	Minmetal's < 2.0x	2022: 11.7% 2021: 18.1%	9M 2022: 13.6% 9M 2021: 30.4%	9M 2022: 3.8% 9M 2021: 4.1%	Debt/EBITDA: 9M 2022: 7.1x 9M 2021: 7.3x	9M 2022: 2.8 9M 2021: 2.8	• Cost control for margin improvement; • Ability to maintain positive FOCF.
Power Construction Corp. of China (PCCC)	BBB+/Stable	N.A.	< 2.0x	PCCC (list co): 2022: 29.3% 2021: 15.9%	2021: 14.9% 2020: 16.4%	2021: 6.9% 2020: 7.5%	Debt/EBITDA: 2021: 9.8x 2020: 9.4x	2021: 1.9 2020: 1.8	• Working capital and capex control on investment-linked projects. • Margin pressure from project mix change.
Shanghai Construction Group Co. Ltd. (SCG)	BBB/Stable	Debt/ EBITDA: > 4.0x	N.A.	2022: 2.1% 2021: 11.7%	9M 2022: -11.4% 9M 2021: 26.1%	9M 2022: 4.1% 9M 2021: 4.2%	Debt/EBITDA: 9M 2022: 5.0x 9M 2021: 3.7x	9M 2022: 2.0 9M 2021: 2.3	• Margin improvement during business recovery; • Appetite on investment-linked projects and land acquisitions.
Beijing Construction Engineering Group Co. Ltd. (BCEG)	BBB/Stable	N.A.	< 2.0x	2021: -2.3% 2020: 28.1%	9M 2022: 14.0% 9M 2021: 7.5%	9M 2022: 4.2% 9M 2021: 4.6%	Debt/EBITDA: 9M 2022: 12.0x 9M 2021: 14.1x	9M 2022: 1.5 9M 2021: 1.3	• Profitability and leverage trend amid project mix changes; • Capex and other investment control.
China Aluminum International Engineering Corp. Ltd. (Chalieco)	BB-/Stable	N.A.	< 1.0x	2022: -13.8% 2021: 13.0%	9M 2022: 0.9% 9M 2021: -2.6%	9M 2022: 3.7% 9M 2021: 4.3%	Debt/EBITDA: 9M 2022: 41.0x 9M 2021: 26.3x	9M 2022: 1.2 9M 2021: 1.4	• Project mix change and impairment uncertainties could weigh on margin; • Cautiousness on participation of PPP projects.

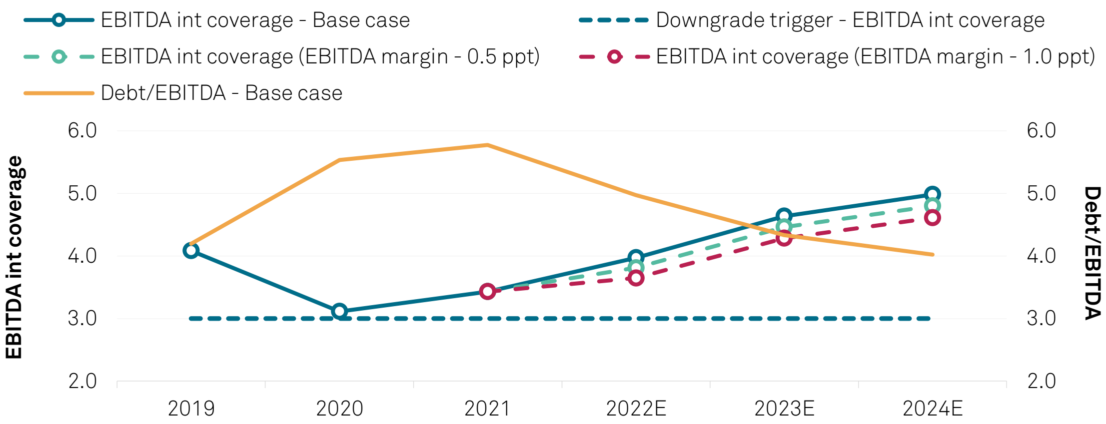
Rating Buffer Varies

CSCEC (A/Stable/--) & CSCEC International (A-/Stable/--)

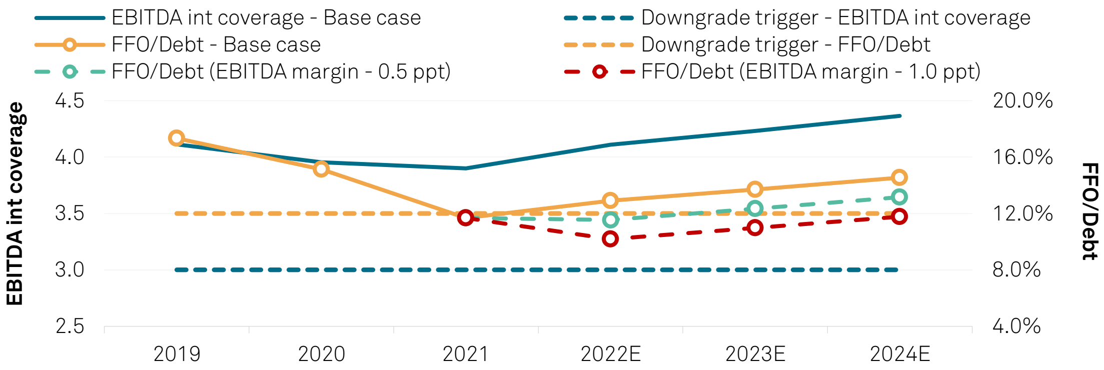


Note: Trigger and financial data for both companies are CSCEC's numbers.

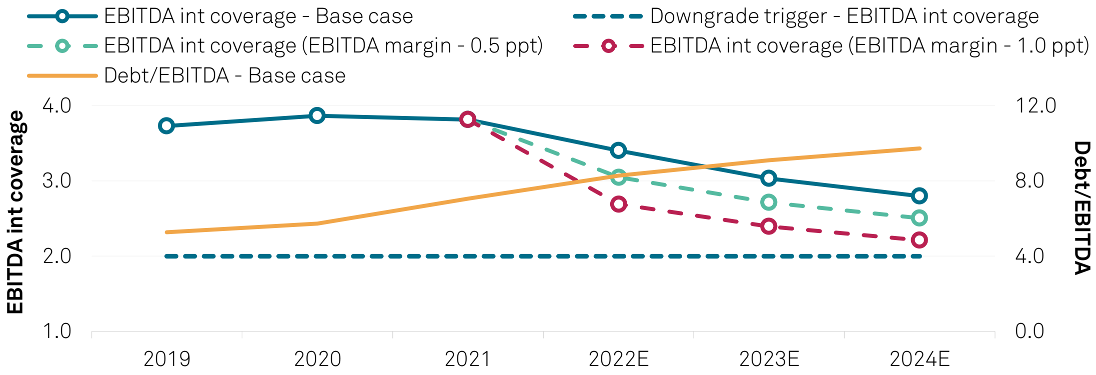
CSCI (BBB/Stable/--)



CRCC (A-/Stable/--)



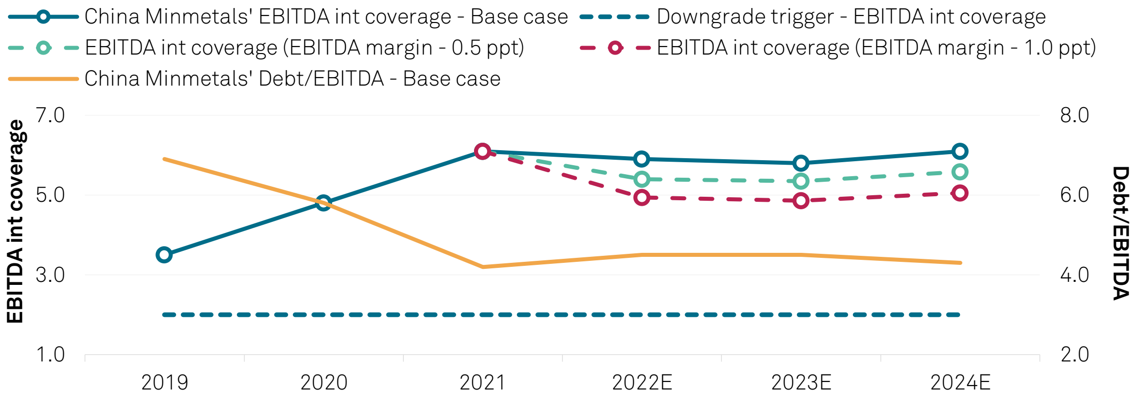
CREC (BBB+/Stable/--)



Source: Company disclosures, S&P Global Ratings.

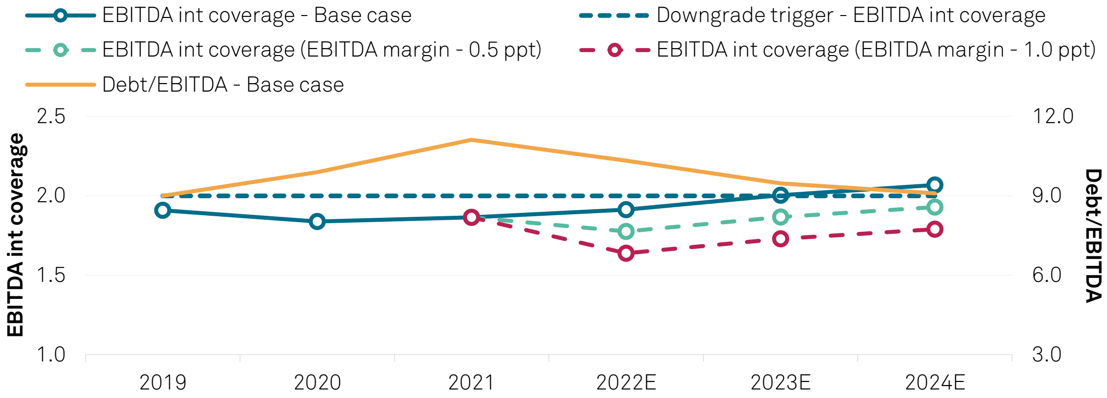
Rating Buffer Varies (Continue)

CMGC (BBB+/Stable/--) & MCC (BBB+/Stable/--)

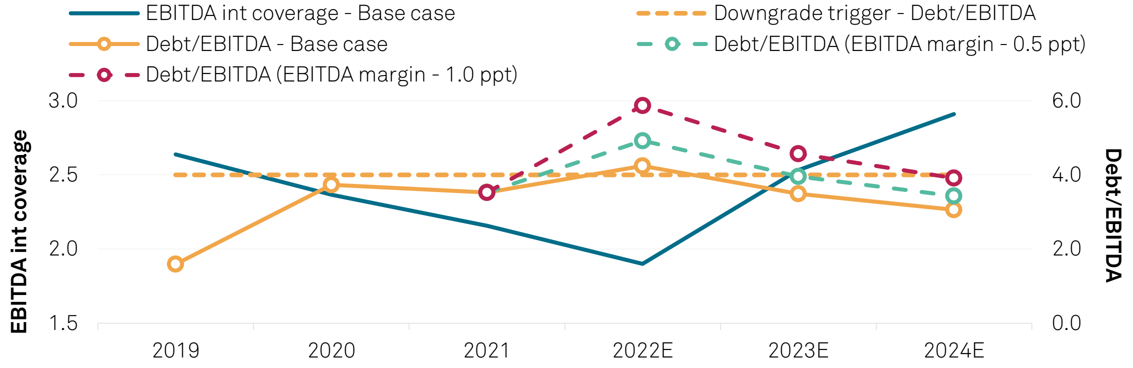


Note: Trigger and financial data for both companies are China Minmetal's numbers.

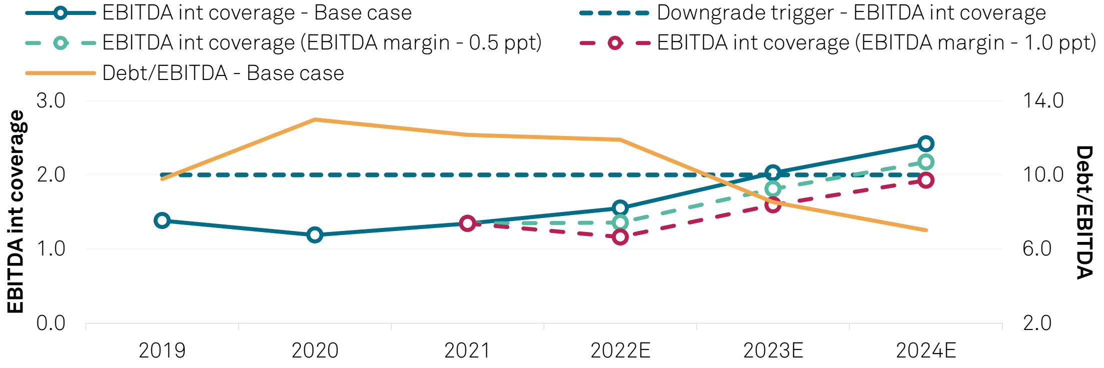
PCCC (BBB+/Stable/--)



SCG (BBB/Stable/--)



BCEG (BBB/Stable/--)



Source: Company disclosures, S&P Global Ratings.

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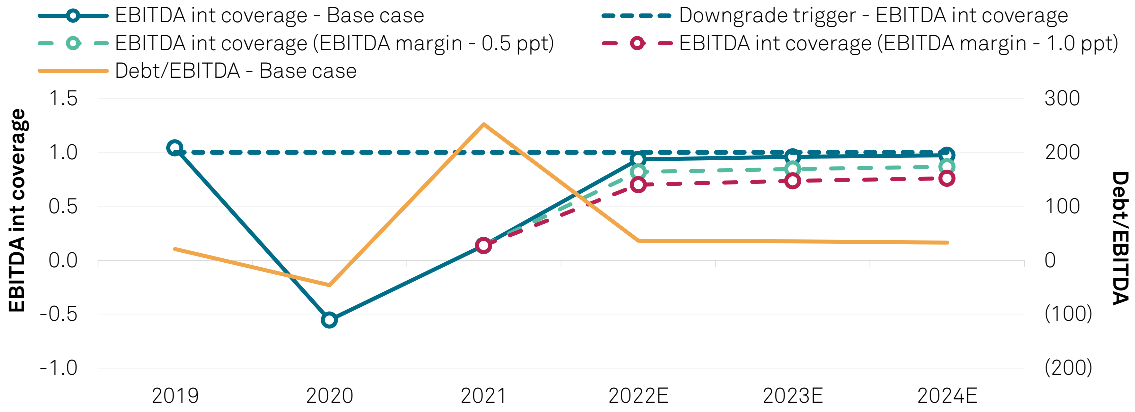
Rating Buffer Varies (Continue)

Chalieco (BB-/Stable/--)



Source: Company disclosures, S&P Global Ratings.

Related Research

- China Property Is On The Cusp Of A Recovery, Jan 11, 2023
- China's COVID Wave: Q1 2023 Will Be Critical, Dec 22, 2022
- China Local Governments: Fiscal Expansion To Continue To Support Growth, Nov 28, 2022
- Economic Research: Global Slowdown Will Hit, Not Halt, Asia-Pacific Growth, Nov 28, 2022
- Chalieco's Proposed Disposal Of Miyu Highway Project Will Strengthen Its Rating Headroom, Sep 28, 2022
- China Railway Construction's Debt-Funded Growth Tightens Financial Headroom, Sep 07, 2022
- Growth Ambition May Hinder Beijing Construction Engineering's Deleveraging, Sep 02, 2022
- High-Growth China Railway Group On Track For More Leverage, Sep 01, 2022
- CSCEC Has Buffer To Ride Through Property Market Uncertainties, Aug 31, 2022
- Chalieco Downgraded To 'BB-' On Slow Deleveraging Prospects; Outlook Stable, Aug 29, 2022
- CSCI's Business Transformation To Support Gradual Deleveraging, Aug 23, 2022

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