China Engineering & Construction Sector 2025 Outlook:

Difficult Industry Conditions Could Tighten Rating Headroom

Stephen Chan
Associate Director

Torisa Tan
Senior Analyst

China Manufacturing Team
Corporate Ratings

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This report does not constitute a rating action

Key Takeaways

What do we expect over the next 12-24 months?

- **Growth of fixed asset investment (FAI) to moderate** in 2025 in China on sluggish real estate investment and slowing manufacturing investment.
- **Stagnant revenue growth** of rated E&C companies **at 1%-3%** in 2025, versus about 0%-2% in 2024.
- **Modest improvement in funding conditions** of engineering and construction (E&C) project owners flowing from supportive government policies.

Credit implications

- **Margin pressure remains high** due to intense competition and elevated receivables impairment ratios among entities.
- The **operating cashflow** of rated E&C companies could **moderately improve** on shorter receivables collection cycle.
- Rated E&C companies to **slightly deleverage** as their EBITDA expands and debt growth slows.
- The **key risks to our base case** are intensifying pricing pressure, and the possibility that the funding conditions of project owners may not improve as we now expect.

Rating trends

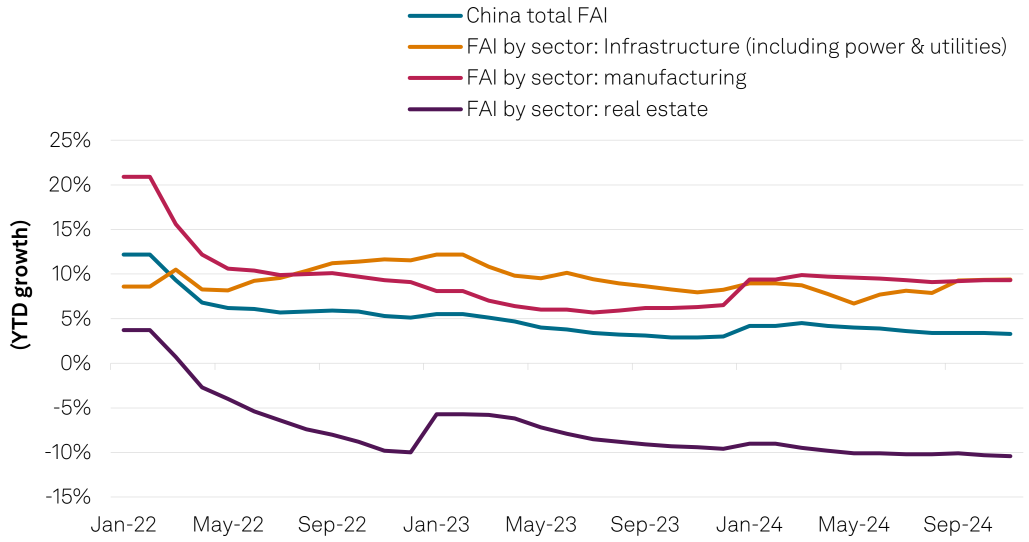
- **Diverging rating headroom** of rated E&C companies. Some of their financial headroom (such as BCEG, PCCC, CSCEC, CRCC*) narrowed in 2024 on prolonged receivables turnover.

*See page 11 of this report for full names.

Growth Of Fixed Asset Investment Is Slowing

- We expect growth in FAI to moderate in 2025, constraining construction demand. Government policies will continue to support spending on major infrastructure spending, but real estate investment will stay depressed as that market remains in the doldrums. Additionally, likely hikes to U.S. tariffs on Chinese exports could slow manufacturing investment growth during the year.
- Weak real estate investment hindered growth of Chinese FAI in the first 11 months of 2024, rising 3.3% in the period (on year), scarcely up from the 3.0% expansion seen in 2023.
- The Chinese government will likely continue to use stimulus to support investment into highly strategic infrastructure over the next six to 12 months. Stimulus measures could include the issuance of long-dated sovereign bonds and special purpose bonds (SPBs) (to fund infrastructure), more flexible investment guidelines for local governments, wider project scopes, etc.

Infrastructure to drive FAI growth in 2025



FAI--Fixed asset investment. YTD--Year to date. Sources: Wind, National Bureau of Statistics, S&P Global Ratings.

Projects eligible for equity funding from SPBs

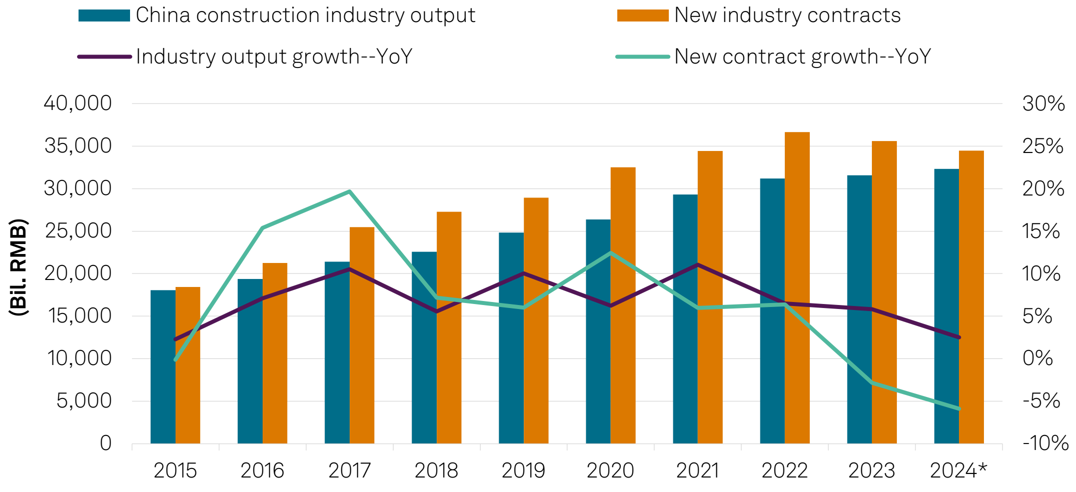
Qualified projects:	
Infrastructure for emerging industries	Including: • Information technology; • New materials; • Bio-manufacturing; • Nanotechnology; • Commercial aerospace etc.
Digital transformation of traditional infrastructure	Including: • Highways; • Airports, etc.
Infrastructure for healthcare, elderly care, and childcare	
Provincial-level industrial parks	

SPB--Special purpose bond. Sources: The State Council, S&P Global Ratings.

Growth In China's E&C Market To Remain Muted In 2025

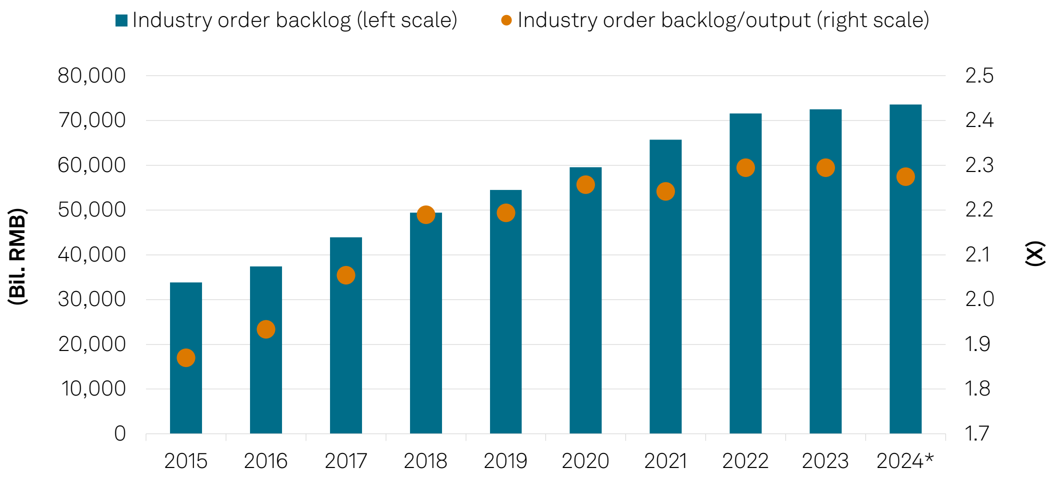
- We expect growth in output for China's E&C sector will only be in the low single digits in 2025. This is mainly due to a high base of comparison, weak demand for housing construction, heightened control on public private partnership (PPP) projects and a general tightening in the fiscal capacity of local governments.
- Growth in E&C sector output slowed to 2.5% (on year) in the 12 months ending September 2024, compared with 5.8% in 2023. The 5.9% year-on-year decline in new contracts in the 12 months ending September 2024 suggests growth in 2025 will be low.
- Nevertheless, we believe the backlog of industry orders remains sufficient. It was Chinese renminbi (RMB) 73.8 trillion in September 2024, equal to 2.3 times industry output in the 12 months to September 2024, similar to levels seen in 2022 and 2023.

Industry output and new-contract growth are slowing...



*Last 12 months ending September 2024. YoY--Year on year. RMB--Renminbi. Sources: Wind. National Bureau of Statistics. S&P Global Ratings.

...but the order backlog remains sufficient

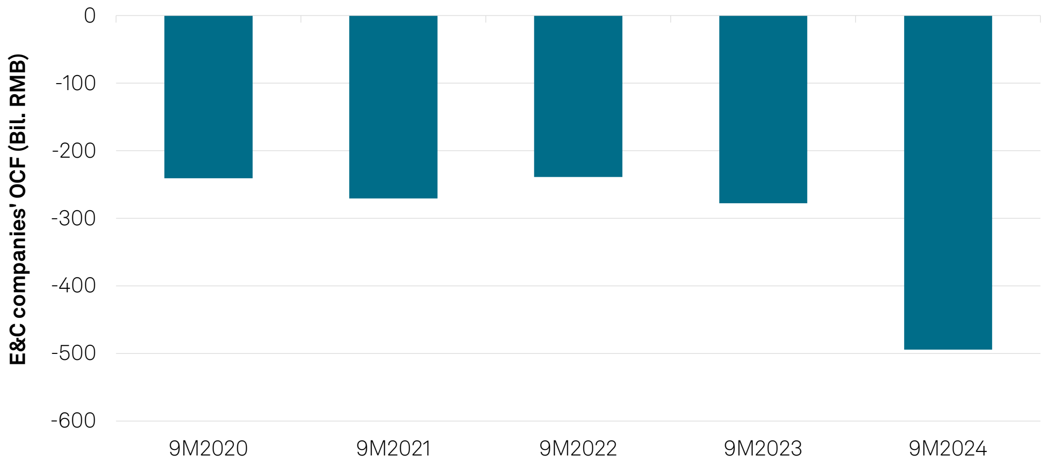


*Last 12 months ending September 2024. Sources: Wind, National Bureau of Statistics. S&P Global Ratings.

Cash Collection Could Improve Moderately In 2025

- E&C companies saw higher operating cash outflow in 2024's first nine months, amid delays in the collection of receivables. This was mainly due to the financial constraints of project owners (e.g. local governments and their state-owned enterprises (SOEs) amid elevated debt levels. High receivables impairment ratios may have also hindered improvement in the margins of major E&C companies in 2024.
- Nevertheless, we expect the operating cash flow of E&C companies will gradually improve in the next 12-24 months. Proposed relief measures on hidden debts could release the spending power of local governments and their SOEs. This could accelerate E&C companies' cash collection.
- In addition, we believe oversight from Beijing will encourage entities to maintain healthy working capital practices during the period. We base this view from a policy paper published by the central government in October 2024, titled "Opinion On Addressing Corporates' Overdue Accounts Receivable".

Prolonged receivables collection is weighing on the operating cash flow of the E&C industry



OCF--Operating cash flow. RMB--Renminbi. 9M—First nine months of a given year. Sources: CITIC Securities Index, composed of 154 listed E&C companies, Wind, S&P Global Ratings.

Latest measures to address local governments' hidden debt could release financial resources

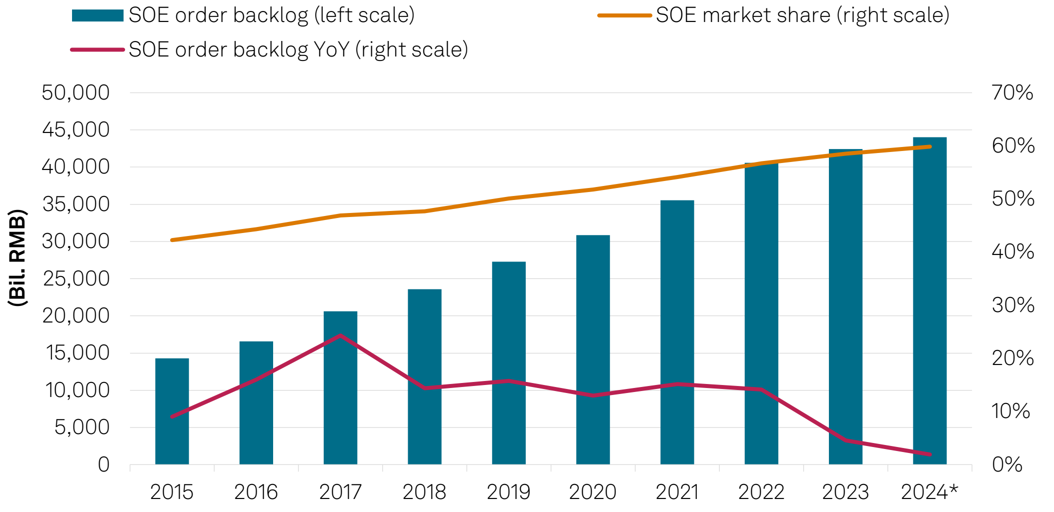
Measures to address hidden debt	Amount (RMB)
Increase in local governments' debt limit	6 trillion
Issuance of additional special purpose bonds for debt swaps at the local-government level	4 trillion
Repayment of hidden debt for shantytown reconstruction previously announced and due in or after 2029	2 trillion
Total scale	**12 trillion**
Original yearly burden on local governments' hidden debt till 2028 (before the relief measures)	2.86 trillion
Current yearly burden after the relief measures till 2028	0.46 trillion

RMB--Renminbi. Sources: public information, S&P Global Ratings.

SOEs Will Likely Continue To Dominate The E&C Market

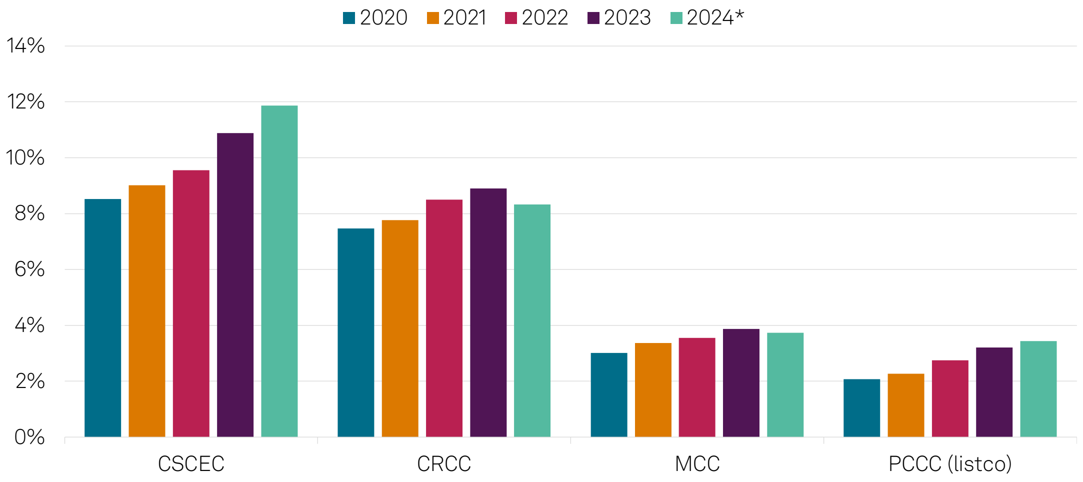
- By total order backlog, the market share of state-owned E&C firms rose to 61% in first nine months of 2024, up from 59% in 2023.
- Their market share will continue to rise in 2025 due to:
  - SOEs' stronger financial stability and better access to funding, particularly in comparison with small, privately owned E&C players, which will likely remain under liquidity stress;
  - SOEs have solid project execution records with more advanced construction technology for complex infrastructure projects;
  - SOEs have better relationships with central and local governments to obtain new contracts, especially on large-scale initiatives within Beijing's "three major projects" policy program (aimed at promoting the development of affordable housing, the redevelopment of shantytowns and the construction of recreational facilities that can be easily converted into emergency structures).

SOEs have been taking market share from POEs



*Last 12 months ending September 2024. POEs—Privately owned enterprises. RMB—Renminbi. YoY—Year on year. Sources: Wind. S&P Global Ratings.

The market share of most rated SOEs will likely grow

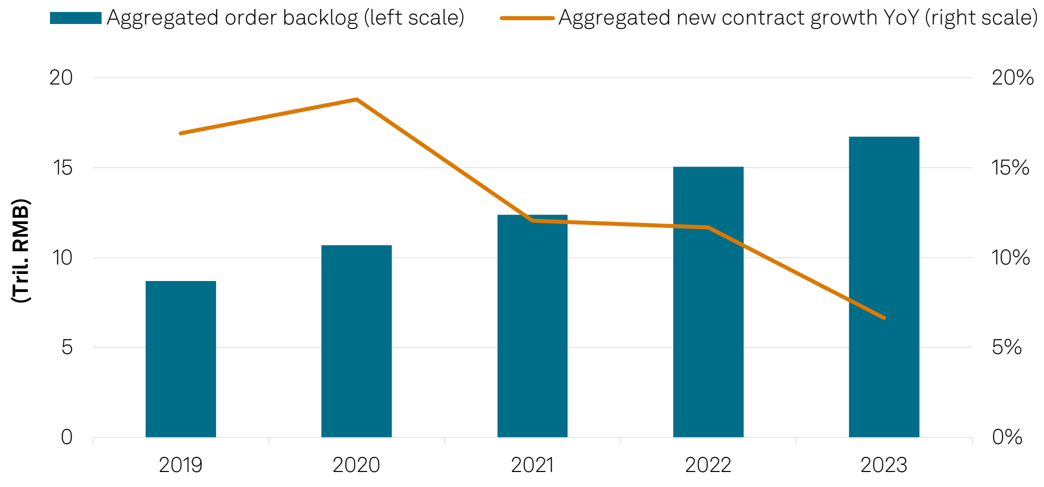


*Last 12 months ending September 2024. See page 11 of this report for the full names of entities abbreviated here. Market share in terms of new orders. Sources: Wind. National Bureau of Statistics. S&P Global Ratings.

Rated E&C Companies To See Limited Revenue Growth

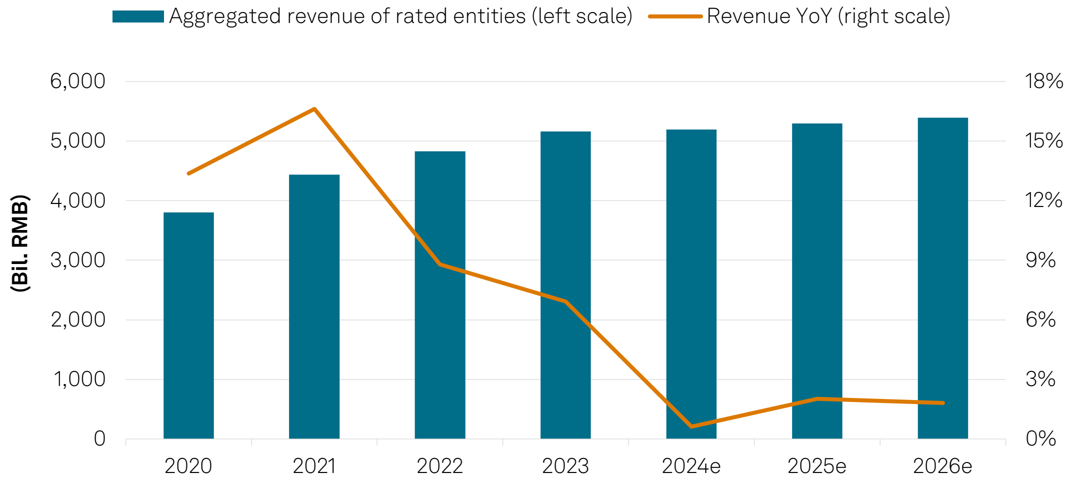
- We expect the revenue growth of rated E&C companies will hover around 1%-3% in 2025, after expanding 0%-2% in 2024.
- Weak sentiment in the property market has hindered housing construction. Meanwhile, Beijing's controls on local government debt constrains growth in infrastructure investment. These factors have led to a slowdown in business growth in 2024 and will continue to take effect in 2025.
- Meanwhile, rated companies become more cautious in their project selection to improve receivables collection. New contract growth of rated issuers fell 3.5% in the first nine months of 2024, compared with the same period in 2023.
- In addition, we expect stalling or negative growth in entities' property development business, which accounts for 3%-14% of the total revenue of our rated E&C companies.

Growth is slowing for new contracts and order backlog



Aggregated order backlog includes CSCEC, CRCC, PCC Listco, MCC, SCG, and BCEG. Aggregated new contract include CSCEC, CRCC, PCCC, MCC, SCG, and BCEG. See page 11 for full names of entities abbreviated here. YoY--Year on year. RMB—Renminbi. Sources: Company disclosures, S&P Global Ratings.

Rated entities' revenue to grow 1%-3% annually in 2025-2026

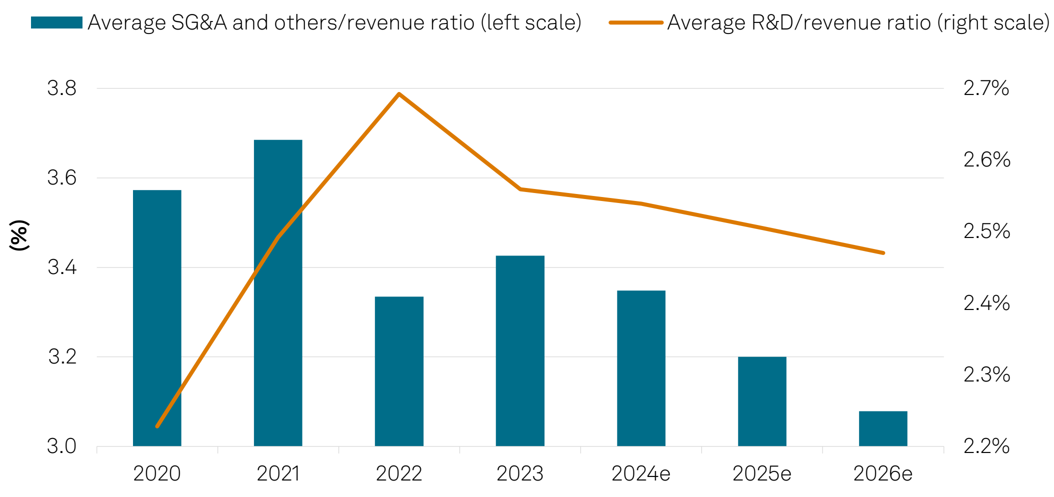


Aggregated revenue includes CSCEC, CRCC, PCCC, MCC, SCG, and BCEG. See page 11 for full names of entities abbreviated here. RMB--Renminbi. e--Estimate. Sources: Company disclosures, S&P Global Ratings.

Improving Cost Control And Operating Efficiency Support Margin Recovery

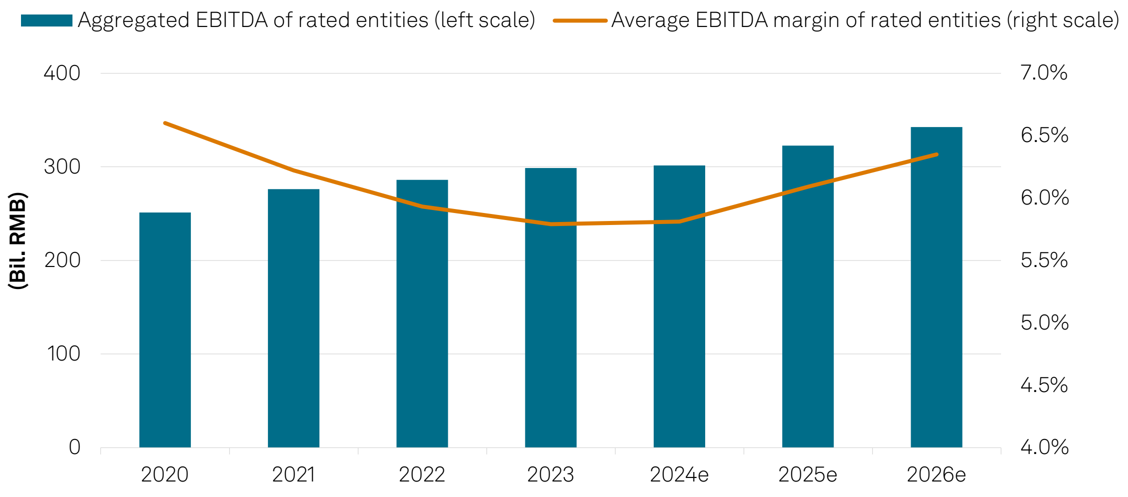
- We expect the EBITDA margins of most rated E&C companies to improve modestly in 2025, after a likely stable performance in 2024. Positive factors include:
  - Cautious project selection and tighter control on project management;
  - Improving operating efficiency with lower selling, general and administrative expenses, and research & development expense ratios;
  - Declining impairment provisions. Rated E&C companies have reduced exposure to private property developers. Most receivables at risk from property customers should have been impaired in the past three years. That said, impairment provision ratios will likely stay high because of escalating risk of delayed payments from project owners in general, particularly these with narrowed financial resources; and
  - Stabilizing performance of property development segment.

Expense ratios to decline on tighter cost controls



Rated companies include CSCEC, CRCC, PCCC, MCC, SCG, and BCEG. See page 11 for full names of entities abbreviated here. R&D—Research and development. SG&A--Selling, general and administrative expenses. Sources: Company disclosures, S&P Global Ratings.

Rated issuers to see moderate EBITDA margin expansion

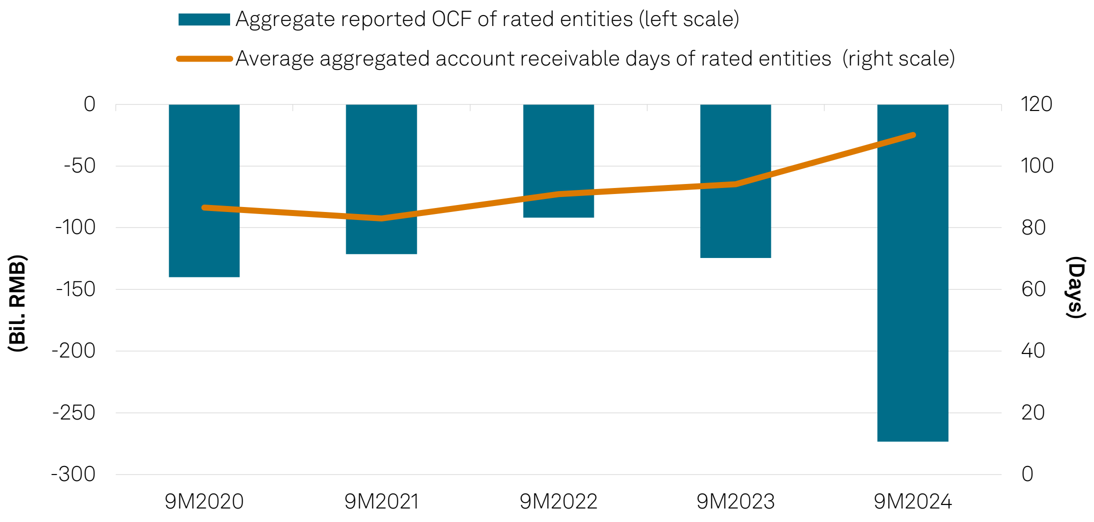


Aggregated EBITDA include CSCEC, CRCC, PCCC, MCC, SCG, and BCEG. See page 11 of this report for the full names of entities abbreviated here. RMB--Renminbi. Sources: Company disclosures. S&P Global Ratings.

Policy Support And Financial Discipline May Enhance Cash Flows

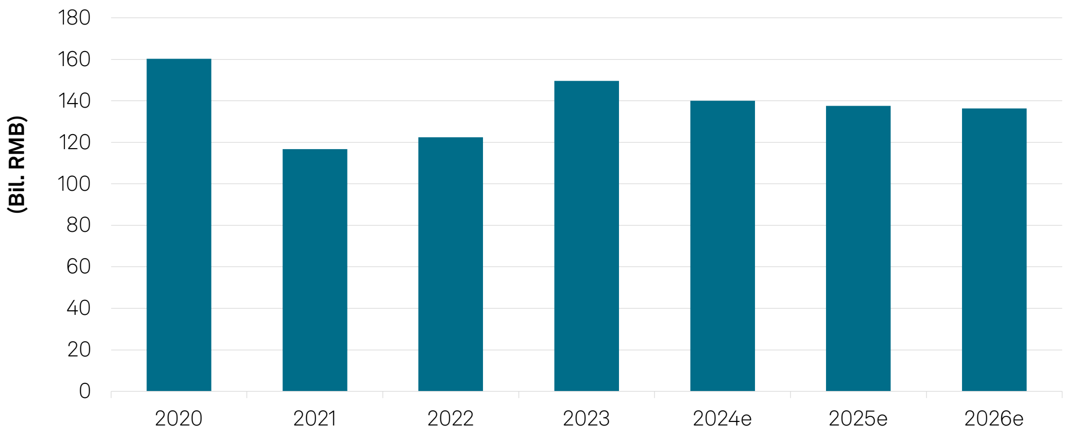
- Receivables collection will remain the top challenge for E&C companies this year. With tighter funding resources at project owners, rated issuers experienced larger working capital outflow in the first nine months of 2024.
- We expect the operating cash flow of rated entities to improve in 2025. Positive factors include policy support aimed at improving the finances of local governments, and companies' efforts to speed up cash conversion through asset securitization and asset sales.
- State-owned E&C firms will continue to focus on operating cash flow improvement under new one-profit and five-ratios targets set by the State-owned Assets Supervision and Administration Commission of the State Council.
- Meanwhile, we also expect their capex will decline modestly given a high debt base and tightened control on PPP projects.

While working capital strains are building for rated issuers...



Aggregated OCF includes CSCEC, CRCC, PCC Listco, MCC, SCG and BCEG. See page 11 for the full names of entities abbreviated here. 9M--The first nine months of a given year. OCF---Operating cash flow. RMB--Renminbi. Sources: Company disclosures, S&P Global Ratings.

....capex should decline moderately

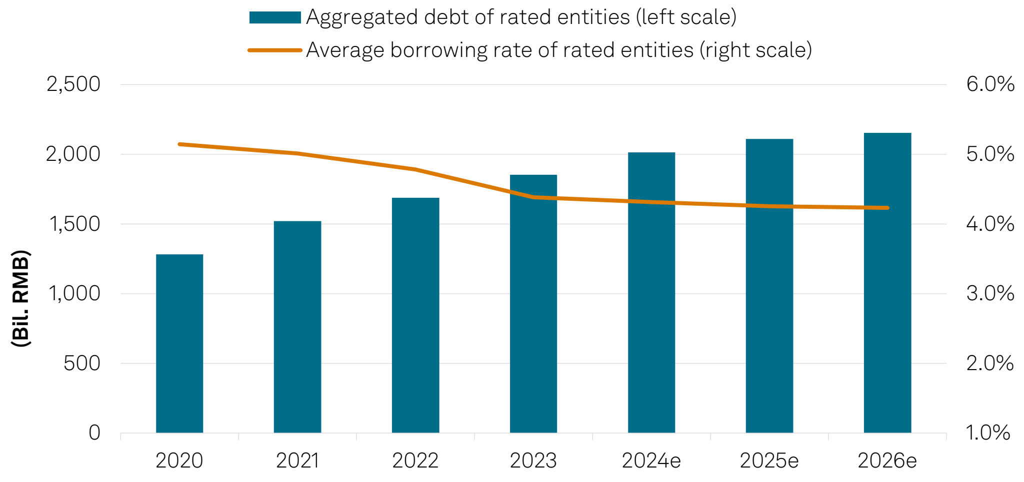


Aggregated capex includes CSCEC, CRCC, PCCC, MCC, SCG and BCEG. See page 11 for the full names of entities abbreviated here. The above data are based on disclosed information from companies' annual reports. Capex--Capital expenditure. RMB--Renminbi. e--Estimate. Sources: Company disclosures, S&P Global Ratings.

Rating Buffers Are Tight

- Rated entities are entering 2025 with generally tight financial headroom, following limited profit growth and high working capital and capex cash outflow in 2024.
- Our base case factors in a slight leverage improvement from 2025 onwards. This is based on our expectation of improving funding condition at project owners stemming from policy support.
- Some rated E&C companies (such as BCEG, PCCC, CSCEC, CRCC) may face rating pressure if their working capital turnover doesn't improve as we expect, or their EBITDA margins underperform our base case by 0.5-1.0 percentage points in 2024-2025 (see pages 12-13 for data, and page 11 for the full names of entities abbreviated here). Worsening funding conditions at project owners or intensifying pricing pressure due to market competition may cause this.

Falling rates and slower debt growth to ease leverage strains



Aggregated adjusted debt include CSCEC, CRCC, PCCC, MCC, SCG, and BCEG. See page 11 for the full names of entities abbreviated here. RMB--Renminbi. e--Estimated. Sources: Company disclosures, S&P Global Ratings.

Rated issuers exhibit different levels of rating headroom

Rating downgrade triggers for MCC is based on its ultimate parent--China Minmetals Corp.'s EBITDA interest coverage. CSCI, PCCC, BCEG and their downgrade triggers are based on EBITDA interest coverage ratio. SCG, CSCEC and their downgrade triggers are based on debt-to-EBITDA ratio. CRCC also has a downside trigger on FFO/debt. See page 11 for details. FFO--Funds from operations. Sources: Company disclosures, S&P Global Ratings.

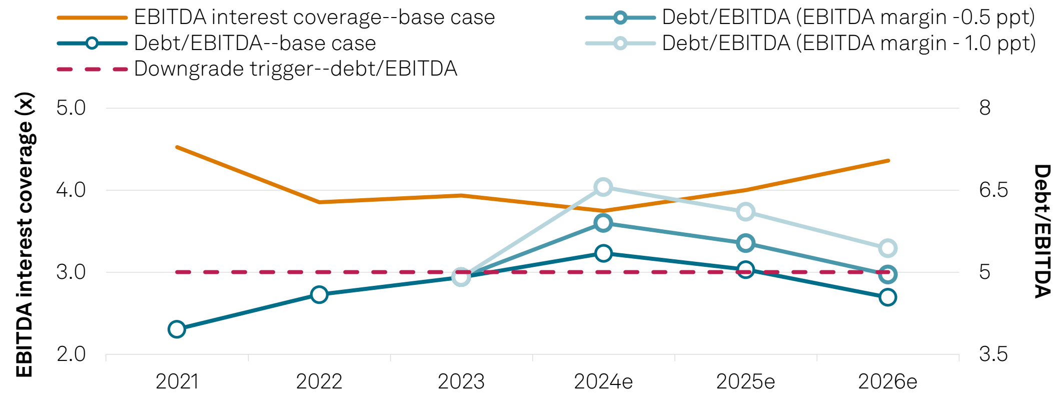
Margin, Working Capital, And Investment Appetite Are Key Drivers

Company	Rating	Rating downgrade triggers		Latest performance					Key Rating Drivers
		Leverage	EBITDA interest coverage	New contract growth	Revenue growth	EBITDA margin (our estimate)	Leverage (our estimate)	EBITDA interest covwerage (x)	
China State Construction Engineering Corp. Ltd. (CSCEC)	A/Stable/--	Debt/ EBITDA: close to 5.0x	N.A.	11M 2024: 4.6% 11M 2024: 11.7%	9M 2024: -2.7% 9M 2023: 8.8%	9M 2024: 6.1% 9M 2023: 6.1%	Debt/EBITDA: Sept. 2024: 5.8x Sept. 2023: 4.9x	9M 2024: 3.6 9M 2023: 3.9	• Revenue and margin expansion of E&C businesses to moderate pressure from property segment; • Working capital management and investment discipline.
CSCEC International Construction Co. Ltd. (CSCEC International)	A-/Stable/--	CSCEC's Debt/ EBITDA: close to 5.0x	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	• Leverage trend of its parent, CSCEC.
China State Construction International Holdings Ltd. (CSCI)	BBB/Stable/--	N.A.	< 3.0x	9M 2024: 19.7% 9M 2023: 11.7%	9M 2024: 12.3% 9M 2023: 8.3%	1H 2024: 14.6% 1H 2023: 14.9%	Debt/EBITDA: June 2024: 4.5x June 2023: 4.4x	1H 2024: 5.0 1H 2023: 4.7	• Ability to improve profitability amid business mix changes; • Working capital management.
China Railway Construction Corp. Ltd. (CRCC)	A-/Stable/--	FFO/Debt: < 12% ; or	~3.0x	9M 2024: -17.5% 9M 2023: -3.1%	9M 2024: -6.0% 9M 2023: 1.0%	9M 2024: 6.4% 9M 2023: 6.2%	FFO/Debt: Sept. 2024: 10.2% Sept. 2023: 14.7%	9M 2024: 3.6 9M 2023: 4.3	• Ability to improve business mix or tighten cost control to enhance profitability; • Working capital management.
Metallurgical Corp. of China Ltd. (MCC)	BBB+/Stable/--	N.A.	Minmetal's < 2.0x	9M 2024: -9.2% 9M 2023: 5.0%	9M 2024: -11.7% 9M 2023: 17.7%	9M 2024: 3.0% 9M 2023: 3.7%	Debt/EBITDA: Sept 2024: 11.6x Sept 2023: 7.4x	9M 2024: 2.3 9M 2023: 2.9	• Cost control for margin improvement; • Working capital management.
Power Construction Corp. of China (PCCC)	BBB+/Stable/--	N.A.	< 2.0x	PCC (List co): 9M 2024: 5.4% 9M 2023: 5.7%	2023: 3.2% 2022: 7.0%	N.A.	Debt/EBITDA: Dec 2023: 10.1x Dec 2022: 10.6x	2023: 2.2 2022: 2.1	• Working capital management and capex control on power projects; • Margin pressure from project mix change.
Shanghai Construction Group Co. Ltd. (SCG)	BBB/Stable/--	Debt/ EBITDA: > 4.0x	N.A.	9M 2024: -9.2% 9M 2023: 19.9%	9M 2024: -4.0% 9M 2023: 20.7%	9M 2024: 3.3% 9M 2023: 3.4%	Debt/EBITDA: Sept 2024: 3.6x Sept 2023: 4.7x	9M 2024: 2.5 9M 2023: 2.5	• Ability to improve margin amid intensive competition and property market stress; • Working capital management and appetite on land acquisition.
Beijing Construction Engineering Group Co. Ltd. (BCEG)	BBB/Negative /--	N.A.	< 2.0x	2023: 5.0% 2022: 4.7%	9M 2024: 0.1% 9M 2023: 0.2%	9M 2024: 3.8% 9M 2023: 4.3%	Debt/EBITDA: Sept. 2024: 15.6x Sept. 2023: 13.7x	9M 2024: 1.6 9M 2023: 1.6	• Ability to improve margin; • Investment appetite.

N.A.--Not available. M--Month. E&C--Energy and construction. PPP—Public-private partnerships. Int. Cov.--Interest coverage. Source: S&P Global Ratings.

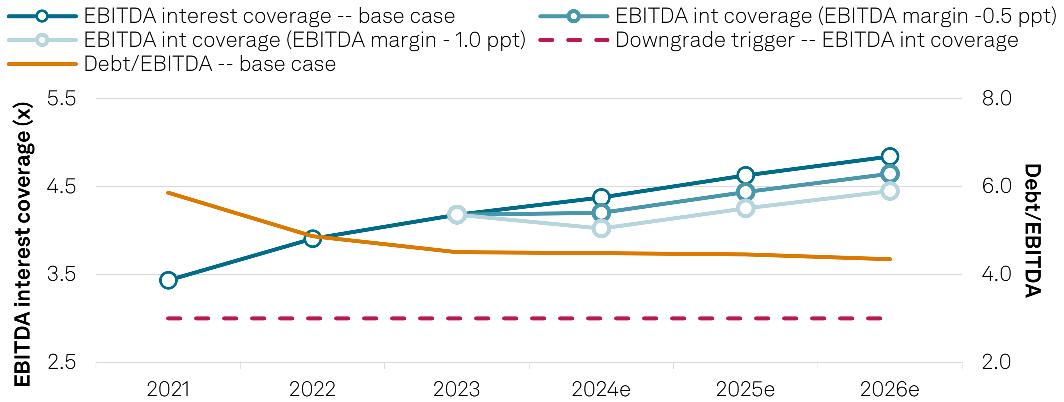
Rating Buffers Vary

CSCEC & CSCEC International



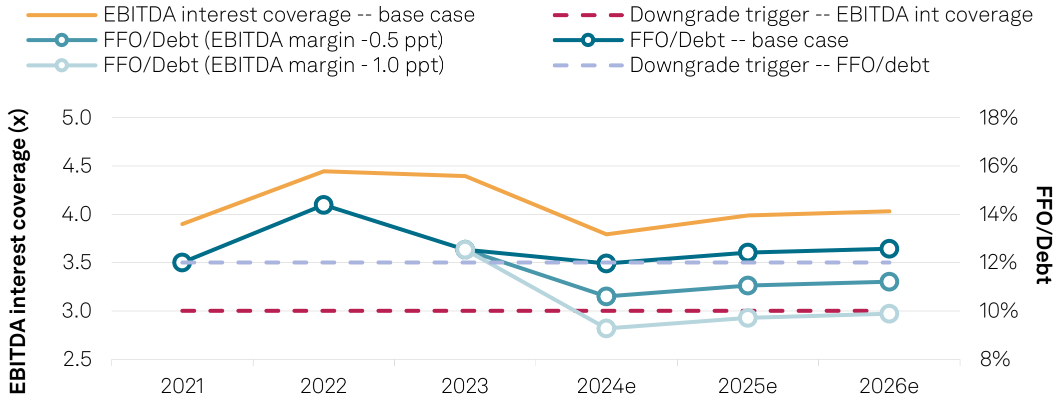
Ppt--Percentage points. Triggers and financial data for both companies are CSCEC's numbers. e--Estimate.
Sources: Company data, S&P Global Ratings.

CSCI



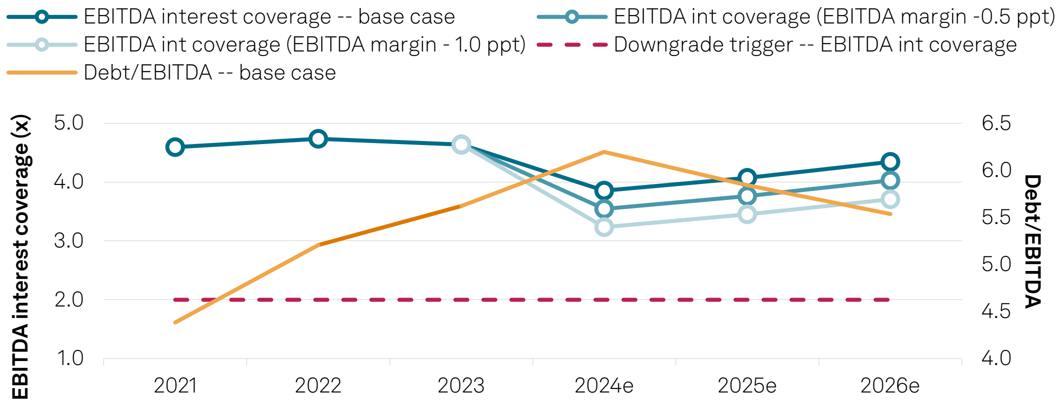
Ppt—Percentage points. e--Estimates. Sources: Company disclosures. S&P Global Ratings.

CRCC



Ppt—Percentage points. e--Estimates. Sources: Company disclosures. S&P Global Ratings.

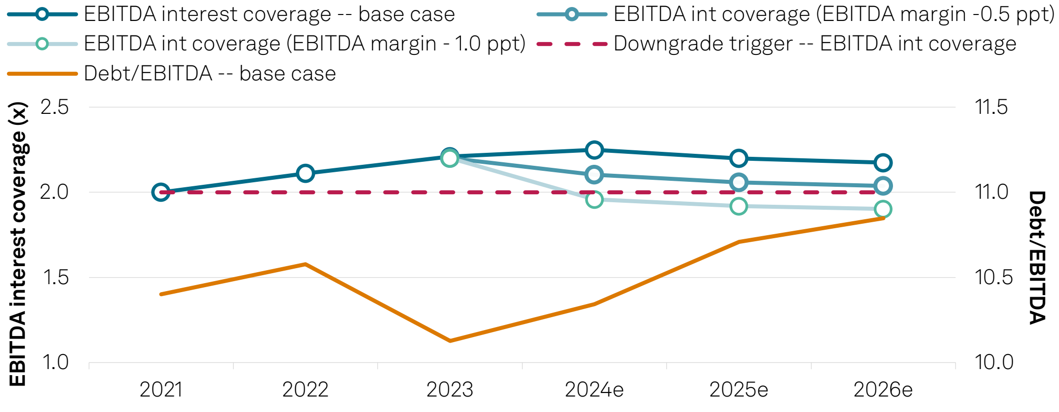
MCC



Ppt-percentage points. Trigger and financial data for the company is China Minmetal's numbers. e—Estimate. Sources: Company disclosures. S&P Global Ratings.

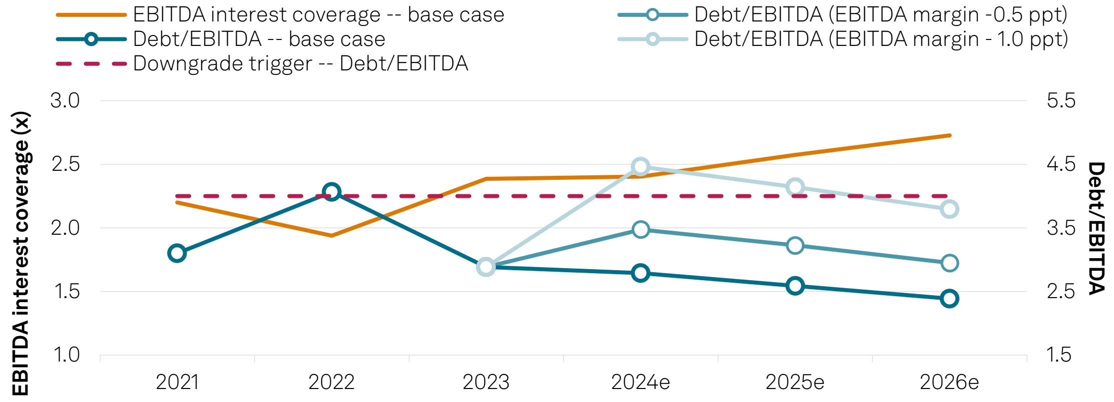
Rating Buffers Vary (continued)

PCCC



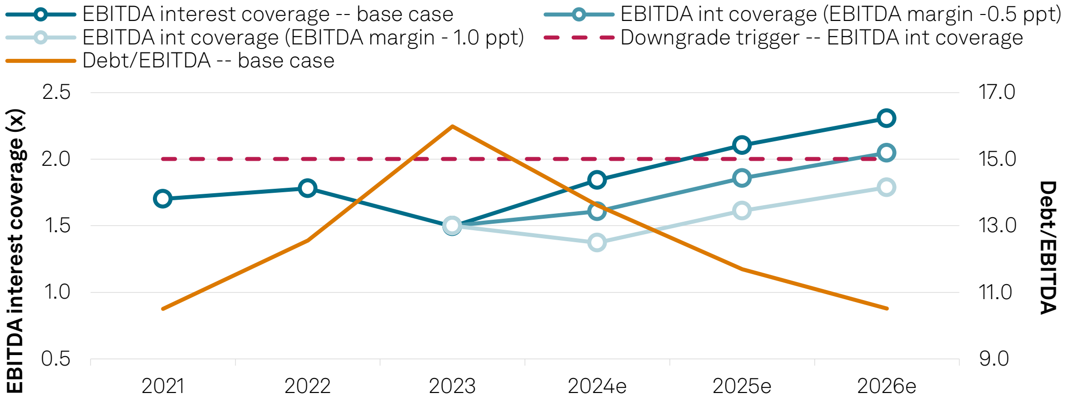
Ppt—Percentage points. e--Estimates. Sources: Company data. S&P Global Ratings.

SCG



Ppt—Percentage points. e--Estimates. Sources: Company disclosures. S&P Global Ratings.

BCEG



Ppt—Percentage points. e--Estimates. Sources: Company disclosures. S&P Global Ratings.

Related Research

- LGFV Brief: China's RMB10 Trillion Debt-Swap Scheme Is A Good Start, Nov. 12, 2024
- China Brief: More Transparency Means More Official Debt For Local Governments, Nov. 11, 2024
- Will China's Latest Stimulus Initiatives Achieve Lift-Off?, Oct 25, 2024
- Global Engineering and Construction 2024 Outlook Update, July 24, 2024
- SLIDES: China Engineering & Construction To Ride Through The Speed Bump, Jan. 24, 2024

Analytical Contacts

Stephen Chan
Associate Director
+852 2532-8088
stephen.chan@spglobal.com

Torisa Tan
Senior Analyst
+ 86 21 3183 0642
torsia.tan@spglobal.com

Claire Yuan
Director
+852 2533-3542
claire.yuan@spglobal.com

Danny Huang
Managing Director
+852 2532-8078
danny.huang@spglobal.com

Crystal Ling
Senior Analyst
+852 2533-3586
crystal.ling@spglobal.com

Rhett Wang
Senior Analyst
+86 10 6569 2730
rhett.wang@spglobal.com

Xueming Yuan
Ratings Analyst
+86 571 8191 5160
xueming.yuan@spglobal.com

spglobal.com/ratings