Jianzhong Construction Development Limited
建中建設發展有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock code: 589)

INSIDE INFORMATION
FURTHER INFORMATION ON IMPAIRMENT AND CONNECTED TRANSACTION

This announcement is made by Jianzhong Construction Development Limited (the "**Company**") pursuant to Rule 13.09(2)(a) of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "**Listing Rules**") and the Inside Information Provisions (as defined in the Listing Rules) under Part XIVA of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong).

Reference is made to the annual report 2020 (the "**Annual Report**") of the Company dated 30 April 2021. Unless otherwise defined herein, capitalised terms used in this announcement shall have the same meanings as defined in the Annual Report.

The Board wishes to provide to the shareholders and potential investors of the Company (i) further information regarding the impairment losses on assets arising from contracts with customers of approximately RMB114.8 million for the year ended 31 December 2020 (the "**Impairment**"); and (ii) clarification regarding the nature of the connected transaction in relation to the tenancy agreements with Conch Venture Henghai.

THE IMPAIRMENT

Background

The amount of impairment losses on assets arising from contracts with customers increased significantly from approximately RMB20.8 million for the year ended 31 December 2019 to approximately RMB114.8 million for the year ended 31 December 2020, which represented over 100% of the Company's net profit for the year ended 31 December 2020. The Impairment mainly represents an increase in the loss allowance for expected credit losses ("**ECLs**") in respect of trade receivables, bills receivable and contract assets during the year, which has primarily arisen from the Group's contracts with the customers in its ordinary course of business. Such increase in loss allowance in respect of trade receivables, bills receivable and contract assets was primarily due to delay in progress payments due from the customers to the Group as the result of the prolonged outbreak of COVID-19.

Trade receivables, bills receivable and contract assets

As part of the ordinary course of business, the Group enters into contracts with its customers in connection to (a) construction service; and (b) leasing services of construction machinery, equipment and tools. Such customers are mainly real estate companies or main contractors in mainland China. According to the payment terms in the contracts, the Group is entitled to request for progress payments that are usually measured by reference to a prescribed percentage of the certified amount of work completed. Retention money may be retained by the customers in order to secure the due performance under the contract. Accordingly, the Group's credit risk is primarily attributable to trade receivables, bills receivable and contract assets.

The following table sets out the breakdown of trade receivables, bills receivable and contract assets of the Group as at the dates indicated, respectively:

	As at 31 December 2019 *RMB'000*	**As at 31 December 2020** *RMB'000*
Contract assets *(as disclosed in the consolidated statement of financial position)*	490,201	581,612
Trade receivables, net of loss allowance		
— third parties	350,740	769,360
— related parties *(as disclosed in note 16 to the financial statements of the Annual Report)*	3,402	3,322
Bills receivable *(as disclosed in note 16 to the financial statements of the Annual Report)*	73,700	64,623
Net carrying amount of trade receivables, bills receivable and contract assets	918,043	1,418,917
Add: loss allowance for ECLs	48,323	163,079

	As at 31 December 2019	As at 31 December 2020
	RMB'000	*RMB'000*
Gross carrying amount of trade receivables, bills receivable and contract assets used under the provision matrix in relation to the calculation of the loss allowance for ECL	966,366	1,581,996
Add: individual loss allowance for a customer	686	686
Gross carrying amount of trade receivables, bills receivable and contract assets	967,052	1,582,682

As indicated below, among the gross carrying amount of trade receivables, bills receivable and contract assets of approximately RMB1,582.7 million as at 31 December 2020, approximately RMB955.6 million was past due. In particular, two of the Group's major customers, namely Customer A and Customer B, contributed approximately 68.4% and 8.9% of the total gross carrying amount of trade receivables, bills receivable and contract assets which was past due, respectively. The following sets out the breakdown of the gross carrying amount of trade receivables, bills receivable and contract assets which was past due by customers:

	Listing status (Y/N)	Gross carrying amount of trade and bills receivables and contract assets which was past due as at 31 December 2020	
		RMB'000	*%*
State-owned enterprises			
Customer A	Y	653,950	68.4
Other state-owned customers[1]		67,697	7.1
Sub-total		721,647	75.5
Non-state-owned enterprises			
Customer B	Y	85,050	8.9
Other non-state owned customers[2]		148,925	15.6
Sub-total		233,975	24.5
Total		955,622	100.0

Notes:

(1) Other state-owned customers included a total of 33 enterprises, each of which accounted for less than 3.1% of the total gross carrying amount of trade and bills receivables and contract assets as at 31 December 2020.

(2) Other non-state owned customers included a total of 135 enterprises, each of which accounted for less than 1.5% of the total gross carrying amount of trade and bills receivables and contract assets as at 31 December 2020.

The following sets out the background information of Customer A and Customer B:

Customer A	A state-owned enterprise which mainly carries out business management activities through a company listed on the Shanghai Stock Exchange ("**Customer A's Principal Operating Subsidiary**"), which in turn has seven subsidiaries which are listed on the Hong Kong Stock Exchange or Shenzhen Stock Exchange, as well as more than 100 investment-holding subsidiaries. To the best knowledge of the Directors after making reasonable enquiries, for the year ended 31 December 2020, Customer A's Principal Operating Subsidiary recorded a total revenue and net profit attributable to equity owners which amounted to approximately RMB1.6 trillion and RMB44.9 billion, respectively.
Customer B	A group of companies which are subsidiaries of a company listed on the Shanghai Stock Exchange which is engaged in real estate development, property management and construction of public infrastructure. To the best knowledge of the Directors after making reasonable enquiries, for the year ended 31 December 2020, such parent company recorded a total revenue and net profit amounting to approximately RMB14.8 billion and RMB522.9 million, respectively.

Loss allowance for ECL

The Group measures loss allowances for trade receivables, bills receivable and contract assets at an amount equal to lifetime ECLs, which is calculated using a provision matrix. Such loss allowances on trade and bills receivables, and contract assets only reflect the Group's credit risk as at the reporting date, and were subject to subsequent remeasurement reflecting the developments thereafter.

The following briefly illustrates the Group's calculation of the loss allowance for ECLs:

Step 1 — Ageing analysis and categorisation of trade receivables into time bands

Based on the ageing report as at the reporting date, the Group's trade receivables were categorised into three time bands, i.e. "trade receivables within the extended payment period", "trade receivables exceeding the extended payment period by less than 1 year" and "trade receivables exceeding the extended payment period by more than 1 year" [Note].

Note: The Group is entitled to request for progress payments that are usually measured by reference to a prescribed percentage of the certified amount of work completed according to the payment terms in the contracts. However, in practice, it normally takes months to complete the settlement of trade receivables due to the administrative process of different customers. Therefore, the Group generally grants an extended payment period based on the background of its customers — for stated-owned enterprises, 6 months from the issuance of progress certificates; for private entities, 3 months from the issuance of progress certificates.

Step 2 — Determination of expected loss rate for trade receivables

The Group first determined the expected loss rate for trade receivables exceeding the extended payment period by more than one year, which was derived from historical observed default rates, adjusted by certain forward-looking estimates which reflected the probability of a worsening economic environment within the next year. The forward-looking factors adopted by the Group included the growth rate of the consumer price index published by the National Bureau of Statistics of China, the growth rate of non-performing loans in the construction sector as published by the China Banking and Insurance Regulatory Commission (中國銀行保險業監督管理委員會) and the decrease rate of land purchase area (土地購置面積) in China as published by the National Bureau of Statistics of China.

The expected loss rates for trade receivables in the other time bands were further determined based on the expected loss rate for the trade receivables exceeding the extended payment period by more than one year and roll rates. The Group derived roll rates based on historical ageing data, which represented the percentages of trade receivables that are not received in a time band and thus have rolled to the next time band, and reflected the probability of loss for trade receivables in each time band.

Step 3 — Construct the provision matrix to calculate the loss allowance for ECLs

With all parameters fixed, the Group constructed a provision matrix by applying the expected loss rate of each time band to the respective outstanding balances of trade receivables to compute the loss allowance for ECL for trade receivables as at the reporting date.

As at the reporting date, the expected credit losses for bills receivable and contract assets were calculated by applying the expected loss rate of trade receivables within the extended payment period to the outstanding balances of bills receivables and contract assets, as they have similar credit risk characteristics.

The following tables (as extracted from note 26(a) to the consolidated financial statements in the Annual Results) sets out information about the Group's exposure to credit risk and ECLs for trade receivables, bills receivable and contract assets as at the dates indicated:

	As at 31 December 2019		
	Expected loss rate	**Gross carrying amount of trade receivables, bills receivable and contract assets**	**Loss allowance**
	%	*RMB'000*	*RMB'000*
Current (not past due)	3.9	510,147	(19,946)
Less than 12 months past due	5.6	433,314	(24,282)
More than 12 months past due	17.9	22,905	(4,095)
		966,366	(48,323)

	As at 31 December 2020		
	Expected loss rate	**Gross carrying amount of trade receivables, bills receivable and contract assets**	**Loss allowance**
	%	*RMB'000*	*RMB'000*
Current (not past due)	7.1	626,374	(44,762)
Less than 12 months past due	10.0	814,365	(81,095)
More than 12 months past due	26.4	141,257	(37,222)
		1,581,996	(163,079)

In particular, the loss allowance for ECL made in respect of Customer A and Customer B as at 31 December 2020 amounted to approximately RMB85.1 million and RMB8.9 million, respectively, representing approximately 52.2% and 5.5% of the total loss allowance made, respectively.

In addition to above provision matrix, the Group has made individual loss allowance for a certain customer. As at 31 December 2020, the accumulated individual loss allowance was RMB686,000 (2019: RMB686,000) with the carrying amounts before loss allowance of RMB686,000 (2019: RMB686,000). Such individual loss allowance of RMB686,000 was made for one particular customer and represents the outstanding amount that was awarded to the Group in a legal proceeding between the Group and the customer in respect of a failure of payment by the customer. Save for the individual loss allowance of RMB686,000, the Directors confirmed that there was no existing business relationship nor outstanding amounts of trade receivables, bills receivable and contract assets with the particular customer as at 31 December 2020 and the date of this announcement.

The Impairment

The following table (as extracted from note 26(a) to the consolidated financial statements of the Annual Report) sets out the movement in the loss allowance account in respect of trade receivables, bills receivable and contract assets during the year:

	For the year ended 31 December	
	2020	**2019**
	RMB'000	*RMB'000*
Balance at 1 January	49,009	28,201
Amounts written off during the year	(11)	—
Impairment losses recognised in profit or loss during the year	114,767	20,808
Balance at 31 December	163,765	49,009

As indicated in the above table, whilst approximately 99.99% of the Impairment (being approximately RMB114.8 million) relates to an increase in the loss allowance for ECLs in respect of trade receivables, bills receivable and contract assets during the year, which has primarily arisen from the Group's contracts with the customers in its ordinary course of business, an amount of RMB11,000 of trade and bill receivables and contract assets were written off during the year ended 31 December 2020. Such write off of RMB11,000 of the trade receivables was made for one particular customer because such customer failed to settle the outstanding amount of RMB11,000 to us in respect of a construction services contract. Having considered the legal costs to recover the amount would be proportionally higher, the Directors considered that the Group should not take any legal action to recover the amount and accordingly the Group has no reasonable expectations of recovering the amount. Save for the written-off amount of RMB11,000, the Directors confirmed that there were no existing business relationship nor outstanding amounts of trade receivables, bills receivable and contract assets with the customer as at 31 December 2020 and the date of this announcement.

Factors, events and circumstances leading to the Impairment

The Group reviewed the then conditions as to delay of payments by its customers compared to historical data. Based on such review, the amount of loss allowance for ECLs on assets arising from contracts with customers increased significantly from approximately RMB48.3 million as at 31 December 2019 to approximately RMB163.1 million as at 31 December 2020.

The Impairment, i.e. the increase in loss allowance in respect of trade receivables, bills receivable and contract assets, was primarily due to delay in progress payments due from the customers to the Group as the result of the prolonged outbreak of COVID-19. The pandemic has severely affected the progress and cash flow of projects of customers. In order to preserve more cash to combat the adverse impact of the pandemic, the property developers and project owners slowed down their payment to the Group's customers which, in turn, delayed their payment to the Group. The delay in payment from customers resulted in more long-aged trade receivables of the Group being recorded as at 31 December 2020. As a result, the amount of impairment losses on assets arising from contracts with customers increased significantly from approximately RMB20.8 million in the year ended 31 December 2019 to approximately RMB114.8 million in the year ended 31 December 2020, which was particularly due to (i) delay in payment from the Group's customers, which increased the amounts of trade receivables, bills receivable and contract assets recorded as at 31 December 2020 (i.e. the volume effect); and (ii) the higher loss expectations (as at the reporting date, i.e. 31 December 2020 for the given time bands reflecting the outbreak of COVID-19 having a more severe development than that reflected in the historical data (i.e. the severity effect).

Subsequent Settlement in respect of Trade Receivables, Bill Receivable and Contract Assets

Despite the increase in the loss allowance for ECLs in respect of trade receivables, bills receivable and contract assets made as at 31 December 2020 which led to the Impairment, during the period from 1 January 2021 to 31 May 2021, there was settlement of the trade and bills receivables that amounted to approximately RMB543.6 million, which represented approximately 56.9% of the gross trade and bills receivables balance as at 31 December 2020. All of the subsequent settlements were in cash.

In particular, in respect of Customer A and Customer B, approximately RMB271.5 million and RMB65.6 million, representing approximately 41.5% and 77.1% of their respective gross trade and bills receivables balance as at 31 December 2020 was settled during the period from 1 January 2021 to 31 May 2021, respectively. In view of such subsequent settlement and that Customer A and Customer B are state-owned enterprises and/or member of listed companies with good financial standing, the Directors are of the opinion that there is no change in business relationship with these major customers, and believe that a considerable amount of the trade receivables and contract assets can be recovered.

Measures Taken by the Group in respect of the Matter

After the Directors became aware of the impact of COVID-19 and particularly the increasing exposure of the Group to ECLs, when the Group entered into agreements with customers during the ordinary course of business, the Group has adopted a more prudent approach in tendering for new construction projects. The Group has established a credit risk management policy under which credit evaluations are performed on each of the customers. These evaluations focus on the customer's history of making payments and current ability to pay. The Group's customers are mainly real estate companies or main contractors in the PRC. Before tendering for contracts with new customers, the Group performed background check (e.g. shareholders' background) and credit assessment (e.g. financial information of publicly listed companies) to evaluate the creditworthiness of the new customers. Accordingly, for the year ended 31 December 2020, the Group entered into business relationships with several state-owned or listed companies which are new customers that the Directors consider to have good financial standing.

In addition, the Group has its debt collection policy, under which it is the responsibility of the finance and accounts department, the business administration department and the respective project management units to confirm and follow up the outstanding debts with the customers. The amounts of construction work performed are assessed and confirmed by the business administration department and respective project management units on a monthly basis. Taking into account the progress payment, if any, made by each of the individual customers, a written payment request and official invoice are issued to each customer to request for payment of the remaining balance. The business administration department and respective project management units will continue to follow up the outstanding debts. If the debt is outstanding for 90 days or more, the project manager of the relevant project management unit is advised for review and follow up. If payment is not received after 180 days past due, the following factors will be considered before proceeding with any legal action:

— financial position of the debtor;

— alternative to legal action;

— time and legal cost to recover the amount; and

— long-term relationship with the customer.

Impact on the Group's operation and financial position

Based on the above, after careful and due consideration, the Directors are of the view that the business, financial conditions and result of operations of the Group would not be materially affected by the Impairment, having considered the following factors:

— the Impairment mainly represents an increase in the loss allowance for ECLs in respect of trade receivables, bills receivable and contract assets during the year which was primarily due to delay in progress payments due from the customers to the Group as the result of the prolonged outbreak of COVID-19 and the Directors consider that there is no indication that the outbreak of COVID-19 will affect the economy development of the PRC on a long-term basis;

— the loss allowances on trade and bills receivables, and contract assets only reflect the Group's credit risk as at the reporting date, i.e. 31 December 2020, and were subject to subsequent remeasurement reflecting the developments thereafter. During the period from 1 January 2021 to 31 May 2021, there was settlement of the trade and bills receivables that amounted to approximately RMB543.6 million, which represented approximately 56.9% of the gross trade and bills receivables balance as at 31 December 2020;

— approximately 52.2% and 5.5% of the total loss allowance made as at 31 December 2020 was loss allowance for ECL made in respect of Customer A and Customer B, respectively. During the period from 1 January 2021 to 31 May 2021, approximately RMB271.5 million and RMB65.6 million, representing approximately 41.5% and 77.1% of the gross trade and bills receivables balance of Customer A and Customer B as at 31 December 2020 was settled, respectively. In view of such subsequent settlement and that Customer A and Customer B are state-owned enterprises and/or member of listed companies with good financial standing, the Directors are of the opinion that there is no change in business relationship with these major customers, and believe that a considerable amount of the trade receivables and contract assets can be recovered;

— save for the loss allowance for ECLs calculated using the provision matrix, the Group has only made individual loss allowance of RMB686,000 for a certain customer, which the Directors confirmed that there was no existing business relationship nor other outstanding amounts of trade receivables, bills receivable and contract assets with the particular customer as at 31 December 2020 and the date of this announcement;

— save for the increase in the loss allowance for ECLs, only an amount of RMB11,000 of trade and bill receivables and contract assets for one particular customer were written off during the year ended 31 December 2020 and the Directors confirmed that there were no existing business relationship nor other outstanding amounts of trade receivables, bills receivable and contract assets with the customer as at 31 December 2020 and the date of this announcement; and

— the Group has taken measures to the mitigate its credit risk attributable to trade receivables, bills receivable and contract assets. It has established a credit risk management policy and adopted a more prudent approach in tendering for new construction projects. For the year ended 31 December 2020, the Group entered into business relationships with several state-owned or listed companies which are new customers that the Directors consider to have good financial standing. The Group also has its debt collection policy in relation to following up outstanding debts with the customers.

THE CONNECTED TRANSACTION IN RELATION TO THE TENANCY AGREEMENTS WITH CONCH VENTURE HENGHAI

The Directors would like to provide a clarification to the Shareholders and potential investors of the Company that the transaction in relation to the tenancy agreements with Conch Venture Henghai should be regarded as a one-off connected transaction entered into by the Group prior to the Listing, rather than a continuing connected transaction subject to the reporting, announcement and annual review requirements but are exempted from the circular and independent shareholders' approval requirements under Chapter 14A of the Listing Rules. Therefore, the reporting, announcement, annual review and independent shareholders' approval requirements in Chapter 14A of the Listing Rules should not be applicable to the transaction.

Save as disclosed above, all other information and content set out in the Annual Report remain unchanged. This supplemental announcement is supplemental to and should be read in conjunction with the Annual Report. Shareholders and potential investors are advised to exercise caution when dealing in the securities of the Company and to read carefully the Annual Report.

By order of the Board
Jianzhong Construction Development Limited
Xun Minghong
Chairman and executive Director

Hong Kong, 29 June 2021

As at the date of this announcement, the board of Directors of the Company comprises Mr. Xun Minghong, Mr. He Wenlin and Ms. Zheng Ping as Executive Directors; Mr. Yang Kaifa, Mr. Wang Wei and Mr. Xun Liangbao as Non-executive Directors; and Mr. Sze Irons, Mr. Wong Kun Kau and Mr. Zhu Diwu as Independent Non-executive Directors.