

## Credit Opinion

24 July 2023

Ratings	
Senior Unsecured Debt Rating	BBB <sub>g</sub> -
Long-Term Credit Rating	BBB <sub>g</sub> -
Outlook	Stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

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## Xuancheng High-tech Investment Development Group Co., Ltd.

### Initial credit rating report

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub>- to Xuancheng High-tech Investment Development Group Co., Ltd., with stable outlook.**

### Summary

The BBB<sub>g</sub>- long-term credit rating of Xuancheng High-tech Investment Development Group Co., Ltd. (“XCHT” or the “Company”) reflects the Management Committee of Xuancheng High-tech Industrial Development Zone’s (“Xuancheng HIDZ Management Committee”) (1) relatively strong capacity to provide support based on our assessment; and (2) extremely high willingness to provide support based on our assessment of the Company’s characteristics.

Our assessment of the local government’s capacity to provide support reflects Xuancheng High-tech Industrial Development Zone (“Xuancheng HIDZ”)’s status as the provincial high-tech economic zone in Xuancheng City with rapid economic development and good industrial output, which provides a good operation environment for the Company.

The rating also reflects the local government’s willingness to provide support, based on the Company’s (1) strategic role as the most important local infrastructure investment and financing company (“LIIFC”) in Xuancheng HIDZ; and (2) good track record of receiving government support.

However, the rating is constrained by the Company’s (1) medium exposure to commercial activities; (2) rapidly increasing debt level driven by ongoing investments; and (3) medium contingent liabilities risk.

The stable outlook on XCHT’s rating reflects our expectation that the local government’s capacity to provide support will remain stable, and the Company will maintain its strategic importance in the high-tech industrial development of Xuancheng District and Xuancheng City over the next 12-18 months.

## Rating Drivers

- Strategic role as the most important LIIFC in Xuancheng HIDZ
- Medium exposure to commercial activities
- Good track record of receiving government support
- Rapidly increasing debt level driven by ongoing investments
- Good access to bank borrowing
- Medium contingent liabilities risk

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) the local government's capacity to provide support strengthens; and (2) the Company's characteristics change in a way that enhances the local government's willingness to provide support, such as lower exposure to risky commercial activities and improved debt management.

### What could downgrade the rating?

The rating could be downgraded if (1) the local government's capacity to provide support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to provide support, such as reduced strategic significance, decrease in government support or higher exposure to risky commercial activities.

## Key Indicators

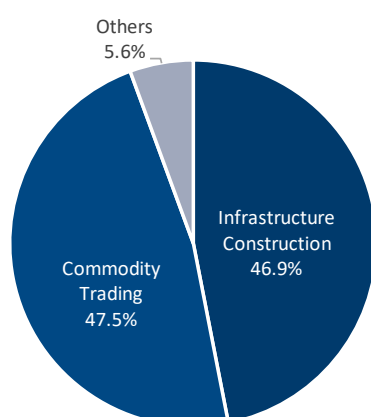
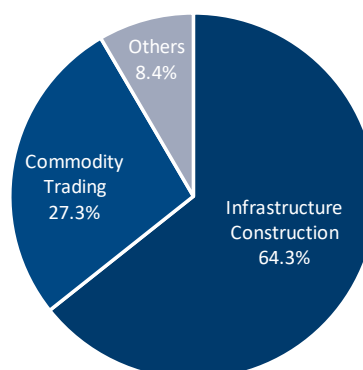
	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	5.9	6.7	8.9	10.1
Total Equity (RMB billion)	3.8	3.9	4.5	4.9
Total Revenue (RMB billion)	0.5	0.7	0.7	0.1
Total Debt/Total Capital (%)	32.8	39.9	45.9	48.5

All ratios and figures are calculated using CCXAP's adjustments.

Source: Company information, CCXAP research

## Corporate Profile

Established in 2019, XCHT is the most important LIIFC in Xuancheng HIDZ, which plays an extremely important role to promote the development of local high-tech industries. XCHT is mainly responsible for the infrastructure construction in Xuancheng HIDZ. The Company also participates in different commercial activities, such as commodity trading, industrial parks construction and operation, property leasing, as well as green engineering. As of 31 December 2022, XCHT was wholly owned and controlled by the Management Committee of Xuancheng HIDZ.

**Exhibit 1. Revenue structure in 2022****Exhibit 2. Gross profit structure in 2022**

Source: Company information, CCXAP research

## Rating Considerations

### Government's Capacity to Provide Support

We believe that the local government has a relatively strong capacity to provide support given Xuancheng HIDZ's status as the provincial high-tech economic zone in Xuancheng City with rapid economic development and good industrial output, which provide a good operation environment for the Company.

Located in the southeastern part of Anhui Province, Xuancheng City is one of the cities of the Yangtze River Delta urban agglomeration and one of the cities in the demonstration zone for industrial transfer of Wanjiang River City Belt. Xuancheng City has relatively good economic strength with fast growth rate, but moderate fiscal profile. After years of industrial development and upgrading, Xuancheng City has developed 2 pillar industries, which are new energy industry and auto parts industry, and 3 competitive industries, which are the electronic information industry, high-end equipment manufacturing industry as well as new materials and fine chemical industry. Its GRP increased to RMB191.4 billion in 2022 from RMB160.8 billion in 2020. Its economic growth rate outperformed the national average level and provincial average level over the past three years. The general budgetary revenue of Xuancheng Municipal Government also increased to RMB18.9 billion in 2022 from RMB16.8 billion in 2020. However, the fiscal balance and stability of Xuancheng Municipal Government remained moderate. In 2022, the fiscal balance ratio (calculated by general budgetary revenue/general budgetary expenditure) was 54.7% and the fiscal stability ratio (calculated by tax revenue/general budgetary revenue) was 57.2%. Xuancheng Municipal Government's debt profile is relatively weak. As of end-2022, its government debt balance amounted to RMB60.2 billion, accounting for 31.4% of GRP and 127.3% of its total fiscal revenue.

**Exhibit 3. Key economic and fiscal indicators of Xuancheng City**

	2020FY	2021FY	2022FY
GRP (RMB billion)	160.8	183.4	191.4
GRP Growth (%)	4.0	10.1	4.2
General Budgetary Revenue (RMB billion)	16.8	18.3	18.9
General Budgetary Expenditure (RMB billion)	32.5	31.5	34.6
Local Government Debt (RMB billion)	45.2	53.6	60.2

Source: Statistics of Bureau of Xuancheng City, CCXAP research

Xuanzhou District is the only district under the administration of Xuancheng City with the largest population among all districts/counties in Xuancheng City. In 2022, Xuanzhou District's GRP amounted to RMB51.9 billion, with YoY growth rate of 2.7%, ranking the 1<sup>st</sup> among all districts/counties in Xuancheng City. Xuanzhou District Government's general budgetary revenue remained increasing over the three past years, which increased to RMB3.4 billion in 2022 from RMB3.0 billion in 2020. If excluding the effect of policy tax rebates, the general budgetary revenue increased by 6.0% from the previous year in 2022. However, its fiscal metrics remained moderate over the past three years. In 2022, its fiscal balance ratio was 54.7% and stability ratio was around 57.0%. As of 31 December 2022, the outstanding debt of Xuanzhou District Government was RMB5.0 billion, accounting for 9.6% of its GRP.

#### **Exhibit 4. Key economic and fiscal indicators of Xuanzhou District**

	2020FY	2021FY	2022FY
GRP (RMB billion)	43.6	50.2	51.9
GRP Growth (%)	3.5	9.0	2.7
General Budgetary Revenue (RMB billion)	3.0	3.2	3.4
General Budgetary Expenditure (RMB billion)	5.5	5.2	6.1
Local Government Debt (RMB billion)	3.7	4.3	5.0

Source: Statistics of Bureau of Xuanzhou District, CCXAP research

Xuancheng HIDZ is a functional zone located in the north part of Xuanzhou District with planned area of around 27.5 square kilometers. As a provincial high-tech zone, it plays an extremely important strategic role in Xuancheng City's blueprint for the development and upgrading of high-tech industries. It has developed 3 pillar industries which are new materials, biomedicine, as well as the intelligent manufacturing industry. Several enterprises with highly development potential have settled in Xuancheng HIDZ, such as Luxshare Precision Industry Co., Ltd., Ningbo Menovo Pharmaceutical Co., Ltd. and Anhui Shenlanhua Color Co., Ltd. Xuancheng HIDZ will focus on the development of 5 areas in the future, including Southern Business District, Industrial Agglomeration Area, Chemical Industry Park, Intelligent Manufacturing Industrial Park, and Development Zone Wharf Phase I.

#### **Government's Willingness to Provide Support**

##### **Strategic role as the most important LIIFC in Xuancheng HIDZ**

As the sole LIIFC of the Management Committee of Xuanzhou HIDZ, XCHT plays a dominant role in the development, construction, and operation of Xuancheng HIDZ. Delegated by the local government, the Company is responsible for the infrastructure construction in Xuancheng HIDZ including municipal utility projects. In addition, the Company also engages in property development business including factories, office buildings, talent apartments in Xuancheng HIDZ, which help provide a good environment for attracting investment to settle in Xuancheng HIDZ.

XCHT carries out various infrastructure construction projects mainly by agent construction model, which mainly includes roads, green projects, and municipal projects in Xuancheng HIDZ. As of 31 March 2022, the Company had completed 20 key projects, with a total investment of RMB2.8 billion. For the projects entrusted before 2015, the Management Committee of Xuancheng HIDZ plans to repurchase within 6 years by 2024. Since 2015, the Company has adopted the agent construction model to conduct infrastructure construction projects. XCHT signs an entrusted construction contract with the Management Committee of Xuancheng HIDZ and takes responsibility for fundraising for infrastructure construction projects. The entrusted parties would pay construction costs plus a certain management fee, according to the construction progress of the project.

However, the Company will recognize the management fee instead of the investment amount as its income, therefore, the revenue from infrastructure construction sector is expected to decrease when the repurchase finished. As of 31 March 2023, the Company had 3 key projects under construction, with a total investment of RMB630 million and uninvested amount of RMB 596 million. In addition, the Company also has qualifications that allow it to engage in general contract construction of engineering projects and municipal utilities. The Company is expected to take the infrastructure construction along with the development progress of Xuancheng HIDZ.

### **Increasing exposure to commercial activities**

XCHT participates in different commercial activities mainly including commodity trading, industrial parks construction and operation, property leasing, as well as green engineering. Based on our assessment, XCHT's exposure to commercial activities is medium with the assets of commercial activities accounting for less than 30% of total assets. With the promotion of self-operated projects, the Company's exposure to these projects is expected to increase.

XCHT engages in some self-operated projects including industrial park development and commercial complex development, which aim to provide a good business environment for attracting investment and promoting local industries. As of 31 March 2022, the Company had 9 self-operated projects under construction, with a total investment amount of RMB3.9 billion and an uninvested amount of RMB2.7 billion. The Company is expected to rely on external financing for these self-operated projects, which would increase the Company's capital expenditure burden. These projects include an accelerator industrial park, intelligent manufacturing industrial park, as well as the technology innovation center, which are expected to receive cash inflow through leasing and selling after the completion of construction. The revenue from the leasing business was relatively low since the industrial parks were just completed. As of 31 March 2023, the total leasable area was 288.5 thousand square meters and all of them were occupied. The major leasable properties are industrial parks, buildings, standardized factories, apartments, and shops which are mainly constructed by XCHT.

Besides, the Company's commodity trading business mainly includes aluminum rods, cement and galvanized coil. However, the top 5 supplies and customers of commodity trading business represented 87.7% and 100% of the purchase and sales amount, respectively, at end-2022, demonstrating relatively high concentration risks. The Company adopts a supply chain financing model to help enterprises settled in Xuancheng HIDZ to purchase raw materials in a centralized manner, which may expose the Company to credit contagion risk. The main customers are the private enterprises in Xuancheng HIDZ.

### **Rapidly increasing debt level driven by ongoing investments**

The Company's debt level increased rapidly and debt maturity structure was relatively reasonable. From 2020 to 2023Q1, XCHT's total debt increased to RMB4.6 billion from RMB1.9 billion leading the total capitalization ratio to increase to 45.9% from 32.8%. The increasing debt which is driven by investment in infrastructure construction and self-operated projects is aligned with the fast development of Xuancheng HIDZ. Meanwhile, the short-term debt only accounted for 14.7% of total debt, and the ratio of cash to short-term debt more than 2.0x, reflecting sufficient cash to repay the short-term debt. Due to the large uninvested amounts of self-operation construction projects, we estimate the Company would continue to rely on external financing such as bank loans and its total debt burden would further increase over the next 12-18 months.

### **Good track record of receiving government support**

The Company has a good track record of receiving support from the local government in the form of project payments, capital contributions, cash and asset injections, and fiscal subsidies to support its investments and operation of its businesses. In 2022, the local government injected capital of RMB275 million in cash into the Company, which further strengthened XCHT's capital base. From 2020 to 2022, the local government provided operating subsidies of more than RMB387 million to the Company. In light of XCHT's strategic role in promoting the development of Xuancheng HIDZ, we expect the Company to receive support from the local government when necessary.

### **Good access to bank borrowing**

XCHT has multiple financing channels such as bank loans, domestic bond issuance, and non-standard products financing. The debt from bank loans and bond issuances accounted for the majority of total debt. The Company maintains good relationships with large domestic banks such as China Construction Bank Corporation and China Development Bank. As of 31 March 2023, the Company had total facilities of RMB6.0 billion, with the available portion being RMB1.1 billion from several banks, indicating sufficient standby liquidity. Meanwhile, the Company had a manageable exposure to non-standard financing, which accounted for around 10% of total debt as of the end-of 2022. Benefiting from the large proportion of bank loans, the average financing cost was around 5.2%.

### **Medium contingent liabilities risk from external guarantees to local state-owned enterprises**

The Company bears moderate contingent risk resulting from its external guarantees. As of 31 March 2022, the Company's external guarantees amounted to RMB1.4 billion, accounting for 28.9% of its net assets. The external guarantees were mainly provided to the state-owned enterprises ("SOEs") in Xuancheng City and Xuanzhou District. In case a credit event occurs, the Company may face certain contingent liability risks and cross-default risks. However, we estimate most of these local SOEs are likely to be supported by the local government when necessary, and therefore contingent risk would be controllable.

## **ESG Considerations**

XCHT faces environmental risks because it has undertaken major infrastructure construction projects. Such risks could be moderated by conducting environmental studies and planning prior to the start of the projects, and close monitoring during the construction phase.

The Company bears social risks as it implements public policy initiatives by building public infrastructure and industrial parks in Xuancheng HIDZ. Demographic changes, public awareness and social priorities shape the Company's development targets and ultimately affect the local government's propensity to support the Company.

XCHT's governance considerations are also material as the Company is subject to oversight by Xuancheng High-tech Management Committee and has to meet several reporting requirements, reflecting its public-policy role and status as a government-owned entity.

### **Structural considerations**

XCHT's senior unsecured debt rating is equal to its long-term credit rating. We believe that government support will flow through the Company given its strategic importance in the high-tech industrial development of

Xuancheng City, thereby mitigating any differences in an expected loss that could result from structural subordination.

## **Rating Methodology**

The methodology used in this rating is the Rating Methodology for [China's Local Infrastructure Investment and Financing Companies \(July 2022\)](#).

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