

Credit Opinion

20 August 2024

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB _g -
Outlook	Stable

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Hebei Xuankong Group Co., Ltd.

Surveillance credit rating report

CCXAP affirms Hebei Xuankong Group Co., Ltd. 's long-term credit rating at BBB_g-, with stable outlook.

Summary

The BBB_g- long-term credit rating of Hebei Xuankong Group Co., Ltd. ("HBXK" or the "Company") reflects the Xuanhua District Government's relatively strong capacity to provide support and its extremely high willingness to provide support based on our assessment of the Company's characteristics.

Our assessment of the Xuanhua District Government's capacity to support reflects Xuanhua District's status as one of the top counties/districts in Zhangjiakou City in terms of economic and fiscal strength.

The rating also reflects the local government's willingness to support, which is based on the Company's (1) important position as the largest local infrastructure investment and financing company ("LIIFC") by total assets in the Xuanhua District; and (2) good track record of government support.

However, the Company's rating is constrained by its (1) increasing debt level driven by large investment needs; (2) concentrated funding sources from regional banks in Zhangjiakou City; and (3) medium risk from external guarantees.

The stable outlook on HBXK rating reflects our expectation that the Xuanhua District Government's capacity to provide support will be stable, and the Company's characteristics such as its significant role in Xuanhua District will remain unchanged over the next 12 to 18 months.

Rating Drivers

- Important regional position as the largest LIIFC in Xuanhua District
- Relatively low exposure to commercial activities
- Good track record of government support
- Increasing debt level driven by large investment needs
- Concentrated funding sources from regional banks in Zhangjiakou City
- Medium risk from external guarantees

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) Xuanhua District Government's capacity to provide support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to provide support, such as significantly improved financing ability.

What could downgrade the rating?

The rating could be downgraded if (1) Xuanhua District 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, significantly increased exposure to commercial activities or deteriorated refinancing ability.

Key Indicators

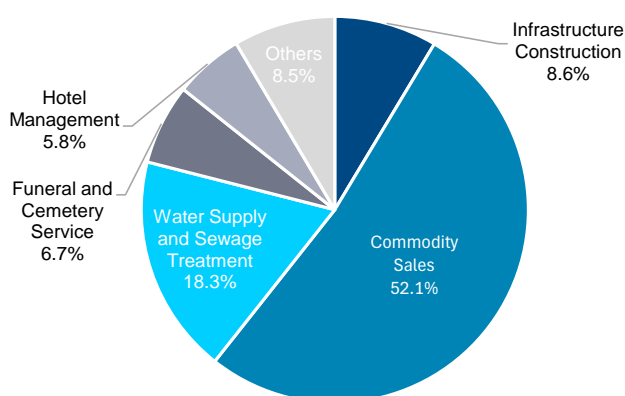
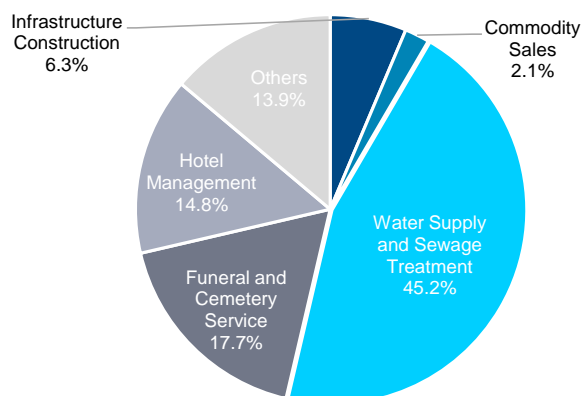
	2021FY	2022FY	2023FY
Total Asset (RMB billion)	13.5	16.0	18.3
Total Equity (RMB billion)	7.9	8.8	8.8
Total Revenue (RMB billion)	0.5	0.4	0.9
Total Debt/Total Capital (%)	30.1	34.5	39.0

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

Source: Company data, CCXAP research

Corporate Profile

Established in 2009, HBXK is the largest LIIFC in Xuanhua District in terms of asset size. It is the most important state-owned enterprise in Xuanhua District and plays an essential role in promoting the development of the local economy and society. The Company undertakes the responsibility for public infrastructure projects and welfare services, including infrastructure construction, land development, water supply and sewage treatment. HBXK also engages in some commercial activities, including commodity sales, hotel management, funeral and cemetery service. As of 30 June 2024, the State-owned Assets Supervision and Administration Bureau of Xuanhua District, Zhangjiakou City ("Xuanhua SASAB") was the ultimate controller of the Company and held 100% shares of HBXK.

Exhibit 1. Revenue structure in 2023**Exhibit 2. Gross profit structure in 2023**

Source: Company information, CCXAP research

Exhibit 3. Shareholding chart as of 30 June 2024

Source: Company information, CCXAP research

Rating Considerations

Government's Capacity to Provide Support

We believe the Xuanhua District Government has a relatively strong capacity to provide support given its status as one of the top counties/districts in Zhangjiakou City in terms of economic and fiscal strength, but constrained by relatively weak fiscal balance.

Zhangjiakou City is located in the northwest of Hebei Province, which is the central city in Northwest of Hebei Province and an important part of the Beijing-Tianjin-Hebei economic circle. Zhangjiakou City actively develops 6 industries, including sports culture tourism, ice and snow, big data, renewable energy, modern manufacturing as well as green agriculture and animal husbandry. Zhangjiakou City demonstrated ongoing economic growth over the past three years. In 2023, it reported a GRP of RMB184.3 billion, representing 5.1% year-over-year ("YoY") growth. However, the Zhangjiakou Municipal Government has moderate fiscal metrics and a high debt burden. The general budgetary revenue of Zhangjiakou Municipal Government improved from RMB16.7 billion in 2022 to RMB18.0 billion in 2023. Zhangjiakou Municipal Government's average fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was 29.4% over the past three years, indicating weak fiscal

balance. The Zhangjiakou Municipal Government highly relied on transfer income from Hebei Province Government to balance its general budgetary expenditure. The transfer payments in general budgetary revenue from high-tier was RMB33.2 billion in 2022 and RMB34.2 billion in 2021, compensating for 54% and 64% of general budgetary expenditure, respectively. Zhangjiakou Municipal Government has high debt burden. As of end-2023, its government debt balance amounted to RMB133.4 billion, accounting for 72.4% of GRP.

Exhibit 4. Key economic and fiscal indicators of Zhangjiakou City

	2021FY	2022FY	2023FY
GRP (RMB billion)	172.8	177.5	184.3
GRP Growth (%)	6.3	1.5	5.1
General Budgetary Revenue (RMB billion)	18.6	16.7	18.0
General Budgetary Expenditure (RMB billion)	53.5	60.9	69.4
Local Government Debt (RMB billion)	87.8	104.7	133.4

Source: Zhangjiakou Municipal Government, CCXAP research

Xuanhua District is located in the northwest of Hebei Province and under the administration of Zhangjiakou City with good traffic advantages and rich mineral resources. Following the development of Zhangjiakou City, Xuanhua District has focus on the 6 emerging industries, including sports culture tourism, ice and snow, big data, renewable energy, modern manufacturing as well as green agriculture and animal husbandry. In 2023, it reported a GRP of RMB18.5 billion, representing 7.8% YoY increase. It ranked top by GRP among counties/districts in Zhangjiakou City over the past three years. HBIS Group Xuansteel Company ("Xuansteel") was the largest steel company and major economic contributor in Xuanhua District. However, the fiscal revenue Xuanhua District has been greatly affected by the relocation of Xuansteel's production and the business transformation of Xuansteel in recent years. In 2023, Xuanhua District Government's general budgetary revenue decreased from RMB1.8 billion in 2022 to RMB1.3 billion. Moreover, the Xuanhua District Government's fiscal balance is relatively weak and its average ratio of general budgetary revenue to general budgetary expenditure over the past three years was 35.5%. In addition, the debt profile of Xuanhua District Government is relatively weak. As of 31 December 2023, the outstanding debt of Xuanhua District Government was RMB11.9 billion, accounting for 64.7% of its GRP.

Exhibit 5. Key economic and fiscal indicators of Xuanhua District

	2021FY	2022FY	2023FY
GRP (RMB billion)	18.0	17.4	18.5
GRP Growth (%)	1.2	-2.9	7.8
General Budgetary Revenue (RMB billion)	1.9	1.8	1.3
General Budgetary Expenditure (RMB billion)	4.6	4.4	5.0
Local Government Debt (RMB billion)	8.4	10.6	11.9

Source: Xuanhua District Government, Company information, CCXAP research

Government's Willingness to Provide Support

Important regional position as the largest LIIFC in Xuanhua District

HBXK plays an important role in the development of Xuanhua District, given its leading role in the construction of infrastructure and land development, and provision of public services. The Company is also the largest and most important LIIFC under the control of the Xuanhua SASAB, with total assets of RMB18.3 billion as of end-2023.

HBXK participates in infrastructure construction mainly through the agency construction model as well as self-construction and operation model. Under the agency construction model, the Company signs an agreement with the local governments, and the entrusting party pays based on the construction cost plus an agreed rate of return after examination of the completion of construction projects. As of 31 December 2023, there were 3 key entrusted construction projects under construction, with a total investment amount of RMB833.0 million and an invested amount of around RMB61.2 million. Under self-construction and operation model, the Company needs to raise the construction funding itself and achieve the fund balancing through sales income and ongoing operation. As of 31 December 2023, there were 5 key construction projects under construction including a water supply improvement project and a resettlement housing project, with a total investment amount of RMB1.9 billion and an uninvested amount of RMB1.5 billion. Meanwhile, there were 4 key infrastructure construction projects under planning with a total investment amount of RMB6.5 billion. The sustainability of the Company's infrastructure construction business is supported by its large project reserves. However, the large project reserves would also bring large capital expenditure pressure to the Company.

HBXK also is the only entity in Xuanhua District that engages in primary land development business. Based on the entrustment agreement, the Company is responsible for preparing the funding for demolition and land development and the local government pays it the cost of land development plus a certain markup after the sales of land. From 2021 to 2023, the Company completed land consolidation with around 55.7 mu. According to the entrustment agreement, the Company is in charge of the primary land development with 617.7 mu, covering north of Dongxin District, north of Xuanchi Road, and east of planned Changchun North Road. However, the land transfer process is largely susceptible to the local land market and government policies, which may also exert higher volatility during the downturn of China's property market. As of 31 December 2023, there was 1 land development project under construction, with a total investment amount of RMB840 million and an uninvested amount of RMB440 million.

Moreover, the Company provides essential public services in Xuanhua District, including water supply and sewage treatment. The Company was the sole entity to provide water supply services in Xuanhua District, covering residential and non-residential customers. As of 31 December 2023, the Company owned a pipeline network length of around 244.6 kilometers and 2 water plants, with a total annual water supply capacity of 21.9 million tons. Meanwhile, the Company also provides sewage treatment in Xuanhua District. However, due to the public nature of these businesses, the profitability of water supply services is relatively low and the sewage treatment recorded continuous loss for many years. In 2023, the gross profit margin of sewage treatment business turned positive due to the subsidies for the construction and operation of sewage treatment facilities. These businesses are relatively relied on government subsidies.

Relatively low exposure to commercial activities

HBXK engages in various commercial activities including commodity sales, hotel management, funeral and cemetery service. Based on our assessment, the Company's exposure to commercial activities is low as the commercial assets accounted for less than 15% of total assets.

HBXK's commodity sales business mainly includes clean coal, pure terephthalic acid, ethylene glycol, electrolytic copper, as well as tapioca starch. Clean coal is essential material for the local people's livelihood. Entrusted by the local government, the Company is responsible for purchasing clean coal, briquette and biomass fuel and providing to rural households in need. Moreover, the Company enlarged the business scope of commodity sales and added new trading products including pure terephthalic acid, ethylene glycol, electrolytic copper, as well as tapioca starch in 2023. Its revenue of commodity sales largely increased from RMB133 million

in 2022 to RMB456 million in 2023. However, the concentration of the top five upstream and downstream customers is relatively high.

HBXK also engages in hotel management business. As 31 December 2023, the Company managed 2 hotels in Xuanhua District. The revenue of hotel management business demonstrated steady growth. From 2021 to 2023, the revenue of hotel management business was RMB15.0 million, RMB50.7 million, RMB66.0 million, respectively. This business has been relatively profitable, with gross margins in excess of 50% over the last three years.

Increasing debt levels driven by large investment needs

HBXK demonstrated a relatively fast debt growth during the past three years due to continuous investment in infrastructure construction projects. As of 31 December 2023, the Company's total debt increased to RMB5.6 billion from RMB4.7 billion in 2022; the total capitalization ratio rose to 39.0% from 34.5% in 2022. Moreover, the Company bears relatively large short-term debt pressure. As of 31 December 2023, short-term debt amounted RMB2.3 billion, accounting for 41.7% of total debt. In addition, the cash to short-term debt ratio was 0.2x, which could not fully cover the short-term debt. The Company still has large investment needs for public construction projects and commercial construction projects that under construction and planning. The Company may continue to rely on external financing such as bank loans and its total debt burden would further increase over the next 12-18 months.

HBXK also has moderate asset liquidity, which may undermine its financial flexibility. Inventories (mainly forest resources) and other receivables (mainly account receivables from local government and state-owned enterprises ("SOEs")) represent a significant portion of the Company's total assets. These assets accounted for approximately 72.4% of total assets as of 31 December 2023.

Good track record of government support

HBXK has a good track record of receiving support from the local government in terms of subsidies, special bond funds, asset injection and equity transfer. From 2021 to 2023, the local government transferred equity shares with a total amount of RMB937 million, which further enlarged the Company's business scope. Moreover, from 2021 to 2023, the Company received continuous government subsidies with a total amount of around RMB913 million. In 2023, the local government transferred the project fund of sewage treatment to HBXK, increasing its capital reserve by around RMB8 million. In June 2024, Xuanhua SASAB' shareholding on HBXK increased from 90.13% to 100% due to centralized management and improvement of management efficiency. Considering its importance to local development, we expect the Company will receive ongoing support from the local government.

Concentrated funding sources from regional banks in Zhangjiakou City

HBXK has access to multiple financing channels including banks, private bond issuance and non-standard financing products, of which bank borrowing is the major financing channel. However, the funding sources of the Company were concentrated from regional banks in Zhangjiakou City, such as Bank of Zhangjiakou Co., Ltd. ("Zhangjiakou Bank"). As of 31 December 2023, the bank loans from Zhangjiakou Bank accounted for around 65.3% of total bank loans and 60.2% of total debt, respectively. The borrowing from local banks has higher costs compared to large national banks and is highly linked to the changes in the local financing environment. As the Company has participated in policy support projects, the Company has gradually obtained credit facilities and financing from other large domestic banks such as Agricultural Development Bank of China

and China Bohai Bank Co., Ltd. ("Bohai Bank"). As of 31 December 2023, the Company's available bank facilities were around RMB2.8 billion, which were mainly provided by Bohai Bank. In addition, the Company has minor exposure to non-standard financing, which accounted for less than 5% of total debt as of end-2023.

Medium risk from external guarantees to mainly the local state-owned enterprises

The Company bears moderate contingent risk resulting from large external guarantees. As of 31 December 2023, the outstanding amount of the Company's external guarantees increased from RMB2.0 billion as of 31 December 2022 to RMB4.1 billion, accounting for 46.8% of its net assets, and majority of the external guarantees was provided to local SOEs. The increased external guarantees in 2023 were mainly for the local SOEs to purchase commercial housing as affordable housing and authorized by the local government. The Company also provided external guarantees of RMB15 million to a private-owned enterprise Zhangjiakou Hesheng Trading Co., Ltd. in 2019 with no counter-guarantee measures and expiration date on December 31, 2024. In case a credit event occurs, the Company may face certain contingent liability risks and cross-default risks.

ESG Considerations

HBXK assumes environmental risks through its infrastructure projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

HBXK bears social risks as it plays an essential strategic role in the development of Xuanhua District. 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.

In terms of corporate governance, the Company is subject to oversight by Xuanhua District Government and has to meet several reporting requirements, reflecting its public-policy role and status as a government-owned entity.

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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