

## Credit Opinion

28 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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## Hebei Xuankong Group Co., Ltd.

### Initial credit rating report

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub>- to Hebei Xuankong Group Co., Ltd., with stable outlook.**

### Summary

The BBB<sub>g</sub>- 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) the 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) the 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

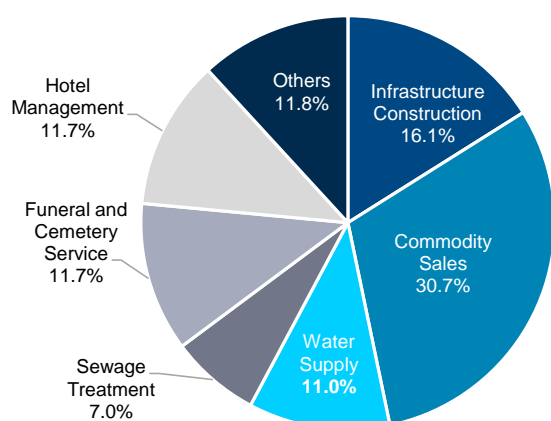
	2020FY	2021FY	2022FY
Total Asset (RMB billion)	6.6	13.5	16.0
Total Equity (RMB billion)	5.1	7.9	8.8
Total Revenue (RMB billion)	3.9	5.2	4.3
Total Debt/Total Capital (%)	18.3	28.7	33.4

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

Source: 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 2023, the State-owned Assets Supervision and Administration Bureau of Xuanhua District, Zhangjiakou City ("Xuanhua SASAB") was the ultimate controller of the Company and held 90.13% shares of HBXK. The remaining 9.87% shares were held by 3 local state-owned enterprises in Xuanhua District, which were directly held by the local government.

**Exhibit 1. Revenue structure in 2022**

Source: Company information, CCXAP research

**Exhibit 2. Shareholding chart as of 30 June 2023**

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.

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 2022, it reported a GRP of RMB177.5 billion, representing 1.5% 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 decreased from RMB18.6 billion in 2021 to RMB17.0 billion in 2022 due to the tax refund policy. Zhangjiakou Municipal Government's fiscal balance ratio (general budgetary revenue/general budgetary expenditure) was with the range of 27% to 35% over the past three years. 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 RMB36.8 billion in 2021 and RMB37.0 billion in 2020, compensating for 69% and

58% of general budgetary expenditure, respectively. As of end-2022, its government debt balance amounted to RMB104.6 billion, accounting for 58.9% of GRP.

### Exhibit 3. Key economic and fiscal indicators of Zhangjiakou City

	2020FY	2021FY	2022FY
GRP (RMB billion)	160.0	172.8	177.5
GRP Growth (%)	3.6	6.3	1.5
General Budgetary Revenue (RMB billion)	17.5	18.6	17.0
General Budgetary Expenditure (RMB billion)	64.3	53.5	60.3
Local Government Debt (RMB billion)	76.2	87.8	104.6

Source: Statistics of Bureau of Zhangjiakou City, 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 2022, it reported a GRP of RMB17.4 billion, representing 2.9% YoY decrease, owing to the production relocation and transformation of local steel companies including HBIS Group Xuansteel Company. Although there was a decrease in Xuanhua District's GRP in 2022, it ranked first-tier by GRP among counties/districts in Zhangjiakou City over the past three years. Xuanhua District Government's general budgetary revenue has recorded 5 consecutive years of growth. The Xuanhua District Government's fiscal balance is moderate but improving, with the ratio of general budgetary revenue to general budgetary expenditure being 42.6% in 2022, compared to 33.2% in 2020. However, the debt profile of Xuanhua District Government is relatively weak. As of 31 December 2022, the outstanding debt of Xuanhua District Government was RMB10.6 billion, accounting for 60.7% of its GRP.

### Exhibit 4. Key economic and fiscal indicators of Xuanhua District

	2020FY	2021FY	2022FY
GRP (RMB billion)	17.5	18.0	17.4
GRP Growth (%)	0.6	1.2	-2.9
General Budgetary Revenue (RMB billion)	1.7	1.9	1.9
General Budgetary Expenditure (RMB billion)	5.2	4.6	4.4
Local Government Debt (RMB billion)	5.3	8.4	10.6

Source: Statistics of Bureau of Xuanhua District, 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 around RMB16 billion as of end-2022.

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 March 2023, there were 9 key

entrusted construction projects under construction, with a total investment amount of RMB1.5 billion and an invested amount of around RMB30 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 March 2023, there were 2 key construction projects under construction including a wellness center and a resettlement housing project, with a total investment amount of RMB1.6 billion and an uninvested amount of RMB1.4 billion. Meanwhile, there were 4 key infrastructure construction projects under planning with a total investment amount of RMB1.1 billion, which were expected to start construction in 2023. The sustainability of the Company's infrastructure construction business is supported by its large project reserves.

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 2020 to 2022, the Company completed land consolidation with 281.1 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 March 2023, there was 1 land development project under construction, with a total investment amount of RMB274 million and an uninvested amount of RMB118 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 March 2023, the Company owned a pipeline network length of 243.6 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 records a loss over the past years. These businesses are highly relied on government subsidiaries.

### **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, which 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. From 2021 to 2022, the Company won two procurement projects for clean coal in Xuanhua District and distributed nearly 150,000 tons of clean coal. HBXK also engages in hotel management business. As 31 December 2022, the Company managed 2 hotels in Xuanhua District. The revenue of hotel management business significantly increased from RMB15.0 million in 2021 to RMB50.7 million in 2022 due to the demand for quarantine hotels. With the release of the pandemic measures, the hotels would not be widely used as quarantine hotels and the revenue of this business may decrease in the future.

### **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 2022, the Company's total debt increased to RMB4.4

billion from RMB1.1 billion in 2020; the total capitalization ratio rose to 33.4% from 18.3% in 2020. The Company maintained a reasonable debt structure with relatively low debt leverage compared to its peers. As of 31 December 2022, short-term debt amounted RMB1.1 billion, accounting for 25.4% of total debt. However, 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.

### **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 2020 to 2022, the local government totally injected capital of RMB1.8 billion in cash into the Company, which further strengthened XCHT's capital strength. Meanwhile, the local government transferred equity shares with a total amount of RMB1.1 billion, which further enlarged the Company's business scope. Moreover, from 2020 to 2023Q1, the Company received continuous government subsidies with a total amount of around RMB901.1 million. Regarding 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 2022, the bank loans from Zhangjiakou Bank accounted for around 61.3% of total bank loans and 52.3% 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. As of 31 March 2023, the Company's available bank facilities were around RMB6.4 billion, which were mainly provided by large domestic banks such as Agricultural Development Bank of China and China Bohai Bank Co., Ltd. The loans from the Agricultural Development Bank of China have lower costs and longer borrowing terms. In addition, the Company has manageable exposure to non-standard financing, which accounted for around 10% of total debt as of end-2022.

### **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 March 2023, the Company's external guarantees amounted to RMB2.0 billion, accounting for 23.1% of its net assets, and were provided to state-owned enterprises ("SOEs"). 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 contingent risk would be controllable.

## **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.

### **Structural Considerations**

HBXK'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 importance of the Company to the development of Xuanhua District, 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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