

## Credit Opinion

11 August 2023

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

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## Hebei Shunde Investment Group Company Limited

### Initial credit rating report

**CCXAP assigns long-term credit rating of BBB<sub>g</sub>+ to Hebei Shunde Investment Group Company Limited, with stable outlook.**

### Summary

The BBB<sub>g</sub>+ long-term credit rating of Hebei Shunde Investment Group Company Limited (“HBSD” or the “Company”) reflects (1) Xingtai Municipal Government’s strong capacity to provide support; and (2) the local government’s extremely high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of Xingtai Municipal Government’s capacity to support reflects Xingtai City’s status as one of the prefectural-level cities in Hebei Province, with relatively good economic foundations.

The rating also reflects the local government’s willingness to support, which is based on the Company’s (1) important role in the urban development of Xingtai City; (2) good track record of receiving government support; and (3) diversified funding channels.

However, the rating is constrained by the Company’s (1) high financial leverage and increasing debt level driven by its large investment needs; and (2) moderate asset liquidity.

The stable outlook on HBSD’s rating reflects our expectation that the local government’s capacity to support will remain stable, and the Company will maintain its important position in the urban development of Xingtai City in the next 12-18 months.

## Rating Drivers

- Important role in the urban development of Xingtai City
- Good track record of receiving government support
- Increasing exposure to commercial activities
- High financial leverage and moderate asset liquidity
- Diversified funding channels

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) the Xingtai Municipal Government's capacity to support strengthens; and (2) the Company's characteristics change in a way that strengthens the local government's willingness to support, such as improved debt management and asset liquidity.

### What could downgrade the rating?

The rating could be downgraded if (1) the Xingtai Municipal Government's capacity to support weakens; or (2) the Company's characteristics change in a way that weakens the local government's willingness to support, such as reduced regional significance or deteriorated refinancing ability.

## Key Indicators

	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	34.1	36.9	38.8	39.0
Total Equity (RMB billion)	11.5	11.9	12.4	12.5
Total Revenue (RMB billion)	2.4	3.5	3.6	0.9
Total Debt/Total Capital (%)	59.8	65.2	65.6	66.1

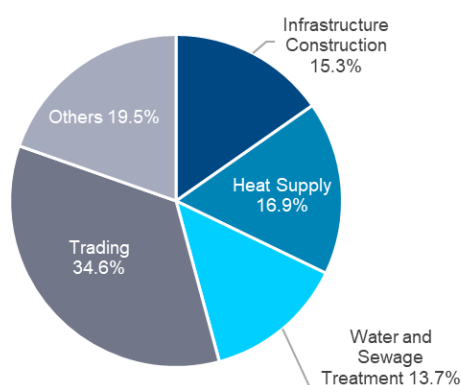
All ratios and figures are calculated using CCXAP's adjustments.

Source: Company information, CCXAP research

## Corporate Profile

Established in 2009, HBSD is one of the major local infrastructure investment and financing companies ("LIIFCs") in Xingtai City, responsible for urban development and construction, as well as the operation of state-owned assets in Xingtai City. The Company is primarily engaged in infrastructure construction and public utility services such as water supply, sewage treatment and heat supply. It also diversified its businesses into other commercial activities including trading, leasing and fund investments. As of 31 March 2023, the Company is fully and directly owned by the State-owned Assets Supervision and Administration Commission of Xingtai Municipal Government ("Xingtai SASAC").

## Exhibit 1. Revenue Structure in 2022



Source: Company information, CCXAP research

## Rating Considerations

### Government's Capacity to Provide Support

We believe the Xingtai Municipal Government has a strong capacity to provide support given its status as one of the prefectural-level cities in Hebei Province, with relatively good economic foundations. However, its fiscal metrics are moderate.

Hebei Province is a northern province of China with a good location and rich resources such as coal, steel and marine resources. Together with the Bohai Sea, it encloses the direct-administered municipalities of Beijing and Tianjin. Although affected by the policy to reduce capacity in the coal and steel industries, Hebei Province's economic scale has steadily increased over the past five years. In 2022, Hebei Province recorded a gross regional production ("GRP") of RMB4,237.0 billion with a year-over-year ("YoY") growth rate of 3.8%, ranking 12<sup>th</sup> among all provinces in China. Hebei Province is expected to benefit from the promotion of national strategies including the coordinated development of the Beijing-Tianjin-Hebei region and the construction of Xiong'an New District in the future. Hebei Province's fiscal income also increased steadily, however, its fiscal self-sufficient ratio, as calculated by general budgetary revenue over general budgetary expenditure, was moderate and its fiscal income relies on support from high-tier government. In 2022, its general budgetary revenue amounted to around RMB408.4 billion, decreasing from RMB416.8 billion in 2021 due to the tax rebate policy.

Xingtai City is a prefecture-level city in Hebei Province and one of the cities located in the Bohai economic region. On the back of its rich mineral resources including coal mines, iron ore, gypsum mines, ceramic clay and rock salt, it is the most important energy base in North China. Its pillar industries include steel deep processing, coal chemical industry, equipment manufacturing, food and medicine, textile and clothing, new building materials and new energy. On the back of Xingtai City's steady economic growth, the general budgetary revenue increased year by year. In 2022, Xingtai City recorded a GRP of RMB254.7 billion with a YoY growth rate of 3.6%, and its general budgetary revenue amounted to RMB21.0 billion. However, the fiscal metrics remained moderate. In 2022, the percentage of tax revenue to the general budgetary revenue decreases to 50.4% mainly due to the decrease in tax revenue. The fiscal self-sufficient ratios were below 35% over the past three years, reflecting reliance on support from high-tier governments. As of the end of 2022, the local government's outstanding debt amounted to RMB95.0 billion, accounting for about 37.3% of GRP.

**Exhibit 2. Key Economic and Fiscal Indicators of Xingtai City**

	2020FY	2021FY	2022FY
GRP (RMB billion)	220.0	242.7	254.7
GRP Growth (%)	3.7	6.2	3.6
General Budgetary Revenue (RMB billion)	17.6	19.1	21.0
General Budgetary Expenditure (RMB billion)	61.1	57.3	61.6
Local Government Debt (RMB billion)	60.4	79.2	95.0

Source: Statistics Bureau of Xingtai City, CCXAP research

### **Government's Willingness to Provide Support** **Important role in the urban development of Xingtai City**

HBSD is one of the key LIIFCs of Xingtai Municipal Government, responsible for the construction and operation of infrastructure and public utilities in Xingtai City. The Company had completed a number of large-scale projects since its establishment, including water plant construction, municipal road projects and affordable housing projects, which were important for the urbanization of Xingtai City. In addition, HBSD provides essential public utility services with strong regional monopolistic advantages in the city.

Infrastructure construction is HBSD's core business. Delegated by the local government, the Company is mainly responsible for the construction of the central area of Xingtai City with an area of 95 square kilometers. Since 2017, HBSD has shifted its business mode to self-operation and Public-Private Partnership ("PPP") from Build-and-Transfer ("BT") and agency construction. All the projects under BT or agency model were completed, including affordable housing projects, shantytown projects, municipal road projects and the water plant. As of 31 March 2023, all the PPP projects were under construction with a total investment of RMB2.8 billion and an uninvested amount of around RMB683 million, most of which within Xingtai City and rely on government repayment to achieve revenue. Meanwhile, the Company had self-operated projects with a total investment of RMB4.9 billion and an uninvested amount of around RMB1.5 billion, including the museum, kindergarten, heat supply pipeline, parking lots and commercial buildings. Most of the self-operated projects are shifted from agency construction mode and rely on operating revenue to cover their initial investment. The sustainability of the infrastructure construction is highly related to the local government's planning and the degree of urbanization of Xingtai City.

HBSD provides public utility services in Xingtai City and has strong regional monopolistic advantages, which mainly include water supply, wastewater treatment and heat energy supply. The Company takes the majority shares of heat supply and installation of pressure pipes in the center of Xingtai City. As of 31 March 2023, the Company provides heat supply services to around 344.5 thousand households and owned around 405.2 kilometers of heating pipes, covering around 39 million square meters. Meanwhile, it provides water supply, sewage treatment and installation and maintenance of water pipes mainly for residential within the central area of Xingtai City as well as some districts and counties. Its daily water supply capacity maintained at around 310 thousand tons over the past three years, and the serving population increased to 923.5 thousand as of 31 March 2023 with the increase in pipeline and demand. As the phase I sewage treatment project in Xingdong New District was put into operation, the Company's daily treatment capacity increased to 275 thousand tons as of 31 March 2023. At the same time, the phase II sewage treatment project in Xingdong New District with a designed daily treatment capacity of 25 thousand tons was under construction. The Company will maintain its market position in sewage treatment with its 25-year franchise obtained in 2020. Considering its public nature and strong market position, the public utilities business is relatively stable and generates recurring income.

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

HBSD has a good track record of receiving government support in various forms such as equity transfer, operating subsidies, and government payment for construction projects. For example, from 2020 to 2023Q1, the Company received a total of around RMB263 million in subsidies. In addition, the Company is expected to receive ongoing government payments considering the pending payments of around RMB4.5 billion for completed projects under BT and agency construction mode as of 31 March 2023. However, these government payments have a close linkage with its fiscal position, which would be volatile, and thus forms relatively large receivables due from the local government. In addition, the Company is expected to receive government payments when its PPP projects are put into operation. At present, all the PPP projects depend on government payments to achieve profit, which will be included in the fiscal budget of the related government. Given its important position in the development of Xingtai City, we expect the Company to receive government support in the next 12-18 months.

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

HBSD diversified into other business segments such as trading, property leasing, financial investment and advertising. Based on our assessment of its assets, its exposure to commercial activities is small but increasing such as investment in commercial buildings and financial investment.

The Company's trading business mainly includes coal, steel and mineral and gradually expanded but its profit remained weak. The revenue from trading increased to RMB1.2 billion in 2022 from RMB928.3 million in 2020, accounting for 34.6% of total revenue, but the gross profit of trading recorded 0.1% of loss due to the depreciation of charging stations. In addition, there are certain concentration risks in trading business given its concentration of suppliers and customers.

HBSD engages in financial investment business through fund investment or direct investment. As of 31 March 2023, the Company has invested in 8 funds with subscribed capital of around RMB953 million, and these funds had exited from 19 projects with a total return of RMB1.5 billion. The Company also directly invests in banks such as Bank of Xingtai, which generate certain investment earnings each year. For example, Bank of Xingtai generated an investment income of RMB80.3 million in 2022. The financial investment business brings higher commercial risks to the Company than its public utility and infrastructure business, and its actual return fluctuates along with the market condition.

In addition, the Company has leased its house buildings and land to the local government, which is considered relatively low commercial risks. However, as ongoing investment in some commercial buildings, the exposure to the leasing business is expected to increase. The rental of such commercial building relies on local investment attraction and lead to higher commercial risks.

### **High financial leverage and moderate asset liquidity**

HBSD had a high debt burden given its high financial leverage. The debt level continuously increased over the past three years mainly due to ongoing financing for construction projects. As of 31 March 2023, the total debt increased to RMB24.3 billion from RMB17.2 billion in 2020 and the financial leverage, measured by the total capital ratio, increased to 66.1% from 59.8% in 2020. Among the total debt, there were around RMB4.8 billion in loans for on-lending to shanty town projects, which were planned to be repaid by the fiscal income of Xiangdu District and Xindu District.

The Company's debt structure is manageable with long-term debt accounting for more than 70% of total debt. The debt mainly consists of bank borrowing and bonds. Considering the uninvested amount of around RMB3.8 billion from its projects under construction and planning and slow repayment from infrastructure construction, we expect the Company to rely on external financing to fulfill its investment needs and its debt leverage to remain at a high level in the next 12-18 months.

HBSD had moderate asset liquidity. As of 31 March 2023, the inventories accounted for around 25.5% of total assets and were mainly land transferred from the local government as well as construction costs of PPP projects and construction engineering, which were considered as low liquidity. In addition, a large amount of receivables which were mainly from the local government or related units also had certain cash occupations.

### **Diversified funding channels**

HBSD's investment needs are high given its large uninvested amount especially in construction projects. In addition, the cash to short-term debt ratio is weak over the past three years. As of 31 March 2023, the cash to short-term debt ratio was 0.4x, indicating a relatively high refinancing need to cover its short-term debt.

The Company's diversified funding channels which include banks, domestic and offshore capital markets as well as non-standard financing may release the pressure on refinancing and capital expenditure. The Company has built long-term and close relationships with different banks such as policy banks, state-owned commercial banks, and city commercial banks including China Development Bank, China Construction Bank and Bank of Communications. As of 31 March 2023, it obtained bank credit facilities of around RMB25.4 billion and an undrawn amount of RMB10.5 billion of which RMB6.1 billion was intended to be used for PPP projects and shantytown projects. Besides, the Company has good access to the domestic capital market and has issued various products including MTNs, PPNs and ABS. For example, The Company issued a tranche of 3-year MTN with a coupon rate of 4.1% in July 2023 to raise RMB400 million. The Company also has a track record of offshore bond issuance. In 2021, it issued two offshore bonds to raise a total USD125 million. The Company also had manageable exposure to non-standard financing, which accounted for less than 10% of total debt as of 31 March 2023.

### **ESG Considerations**

HBSD is exposed to environmental risks because it has undertaken construction projects. Such risks could be moderated by conducting environmental studies and planning before the commencement of projects, and close monitoring during the construction phase.

HBSD bears social risks as it plays a crucial role in the social welfare of the residents in the Xingtai City. 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.

HBSD's governance considerations are also material as the Company is subject to oversight and reporting requirements to the Xingtai Municipal 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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