

## Credit Opinion

24 November 2023

## Xi'an Gaoke Group Co., Ltd

Initial credit rating report

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

**CCXAP assigns first-time long-term credit rating of BBB<sub>g</sub>+** to Xi'an Gaoke Group Co., Ltd, with stable outlook.

### Summary

The BBB<sub>g</sub> long-term credit rating of Xi'an Gaoke Group Co., Ltd ("XAGK" or the "Company") reflects (1) the government of Xi'an Hi-tech Industrial Development Zone's ("Xi'an HIDZ") very strong capacity to provide support; and (2) the local government's very 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 Xi'an HIDZ's status as one of the national-level high-tech zones with good high-tech industrial fundamentals and increasing economic strength, ranking first-tier among national-level high-tech zones in China.

The rating also reflects the local government's willingness to provide support, which is based on the Company's (1) important role in the development and urban operations of Xi'an HIDZ; (2) good track record of receiving government support; and (3) good access to funding with sufficient bank facilities.

However, the rating is constrained by the Company's (1) high exposure to commercial activities especially in property development; and (2) high debt leverage with heightened debt burden and refinancing needs; and (3) moderate asset liquidity.

The stable outlook on XAGK's rating reflects our expectation that the local government's capacity to provide support will remain stable, and the Company will maintain its important role in the development of Xi'an HIDZ over the next 12-18 months.

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*\*The first name above is the lead analyst for this rating and the last name above is the person primarily responsible for approving this rating.*

### Client Services

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## Rating Drivers

- Important role in the development and urban operations of Xi'an HIDZ
- High exposure to commercial activities especially in property development
- Good track record of receiving government support
- High debt leverage and moderate asset liquidity
- Good access to funding, with sufficient bank facilities

## Rating Sensitivities

### What could upgrade the rating?

The rating could be upgraded if (1) the local government's ability to provide support strengthens; or (2) the Company's characteristics change in a way that strengthens local government's willingness to provide support, such as materially decreased exposure to commercial activities.

### What could downgrade the rating?

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

## Key Indicators

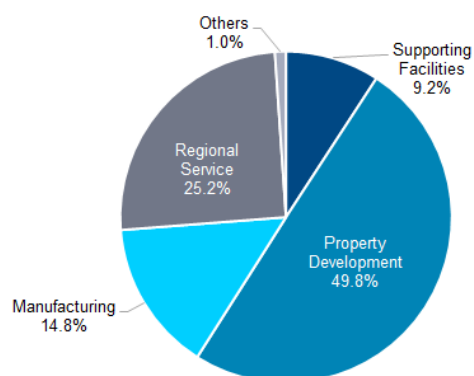
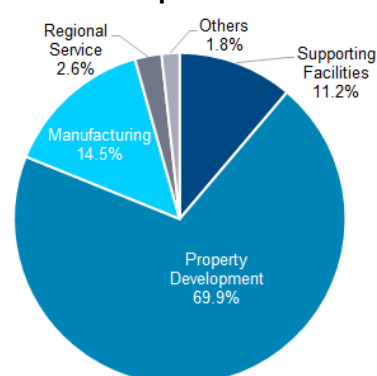
	2020FY	2021FY	2022FY	2023H1
Total Asset (RMB billion)	150.1	183.6	213.8	224.3
Total Equity (RMB billion)	17.3	20.2	23.9	22.7
Total Revenue (RMB billion)	22.8	29.2	34.5	16.0
Total Debt/Total Capital (%)	85.6	85.7	85.4	85.9

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

Source: Company information, CCXAP research

## Corporate Profile

Founded in 1992, XAGK is one of the three major state-owned enterprises directly owned by the Management Committee of Xi'an HIDZ. XAGK is positioned as an industry and urban investment operator, responsible for regional infrastructure construction and provision of public services. XAGK also engages in diversified commercial activities, such as property development, industrial parks development and operation, manufacturing, as well as trading. As of 30 June 2023, the Company was directly and wholly owned by the Management Committee of Xi'an 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 Xi'an HIDZ Government has very strong capacity to provide support for the Company, given Xi'an HIDZ's status as one of the national-level high-tech zones with good high-tech industrial fundamentals and increasing economic strength, ranking first-tier among national-level high-tech zones in China in terms of comprehensive strength.

Xi'an City is the provincial capital of Shaanxi Province and is located in the center of Shaanxi Province. It is also a Sub-provincial City and a National Central City approved by the State Council. On the back of its geographical advantages, Xi'an City has developed six pillar industries, including electronic information manufacturing, automobiles, aerospace, high-end equipment manufacturing, new materials and new energy, as well as biomedicine. Xi'an City is the biggest city in Shaanxi Province in terms of economic size and its gross regional products ("GRP") ranked first in Shaanxi Province over the past five years. In 2022, Xi'an City reported GRP of over RMB1.1 trillion, representing a year-over-year ("YoY") growth of 4.4% and accounting for approximately 35% of Shaanxi Province's GRP. It also has good fiscal stability with tax income contributing to over 70% of the general budgetary revenue over the past three years. However, its fiscal balance ratio (calculated by general budgetary revenue/general budgetary expenditure) was 53.0% in 2022, which was at a relatively weak level. Xi'an City also had a relatively high debt burden as its outstanding government debt was RMB362.6 billion as of 31 December 2022, accounting for 31.6% of its GRP.

**Exhibit 3. Key economic and fiscal indicators of Xi'an City**

	2020FY	2021FY	2022FY
GRP (RMB billion)	1,002.0	1,068.8	1,148.7
GRP Growth (%)	5.2	4.1	4.4
General Budgetary Revenue (RMB billion)	72.4	85.6	83.4
General Budgetary Expenditure (RMB billion)	134.8	147.5	157.3
Local Government Debt (RMB billion)	281.0	323.1	362.6

Source: Xi'an Municipal Government, CCXAP research

Formed in 1991, Xi'an HIDZ is one of the first batch of national-level high-tech industrial development zones approved by the State Council, ranking first-tier among all the national-level high-tech zones since 1994. After years of development, Xi'an HIDZ has formed 3 pillar industries, including electronic information, advanced

manufacturing, as well as modern service. There are a large number of high-tech enterprises settled in Xi'an HIDZ, such as Intel Corporation, Samsung Electronics Co., Ltd., Huawei Technologies Co., Ltd., Alibaba Group Holding Limited, and BYD Co. Ltd, becoming one of the largest flash memory chip production base and the largest new energy vehicle production base globally.

Supported by its comprehensive industrial structure and sound industrial fundamentals, Xi'an HIDZ has maintained a rapid economic growth in recent years. In 2022, Xi'an HIDZ's GRP was RMB310.4 billion, representing a YoY growth of 10.1% and accounting for 27% of Xi'an City's GRP. The local government's fiscal strength has been increasing over the past three years. From 2020 to 2022, its general budget revenue increased from RMB11.5 billion to RMB13.8 billion, ranking 1<sup>st</sup> among all counties or districts of Xi'an City since 2017. Tax, a relatively stable income source, amounted to RMB12.5 billion in 2022, accounting for 90.9% of Xi'an HIDZ's general budget revenue and 20.7% of Xi'an City's tax revenue. Xi'an HIDZ's fiscal balance ratio (general budgetary revenue/general budgetary expenditure) demonstrated a downward trend, decreasing from 107.1% in 2020 to 81.5% in 2022, but still maintained at a relatively high level. As of end-2022, Xi'an HIDZ's outstanding government debt amounted to RMB27.9 billion, accounting for about 9.0% of GRP. As an important engine to promote the development of Xi'an City, we expect Xi'an HIDZ would continue to make contributions to Xi'an City.

#### **Exhibit 4. Key economic and fiscal indicators of Xi'an HIDZ**

	2020FY	2021FY	2022FY
GRP (RMB billion)	241.0	268.1	310.4
GRP Growth (%)	12.3	6.4	10.1
General Budgetary Revenue (RMB billion)	11.5	13.9	13.8
General Budgetary Expenditure (RMB billion)	10.7	14.0	16.9
Local Government Debt (RMB billion)	23.2	25.8	27.9

Source: Management Committee of Xi'an HIDZ, CCXAP research

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

#### **Important role in the development and urban operations of Xi'an HIDZ**

As one of the three major state-owned enterprises in Xi'an HIDZ, XAGK plays an important role in regional development of Xi'an HIDZ. The Company is mainly responsible for the urban operation services and supporting facilities construction of industrial parks in Xi'an HIDZ. Considering the large number of projects undertaken by the Company, we expect that the important role of XAGK is unlikely to be replaced in the foreseeable future.

As the major entity for the urban construction, XAGK engages in supporting facilities construction of industrial parks, infrastructure construction, resettlement housing and affordable rental housing construction in Xi'an HIDZ. Currently, the Company is mainly participating in the construction of resettlement housing and affordable housing through agency construction model, government purchase model, and self-operated model. Under agency construction model, the Company signs entrusted agreements with the local government and is responsible for planning, organization of construction, and bidding of the projects. The initial construction costs of the projects were borne by the entrusting parties and XAGK would receive certain management fees. Under government purchase model, the Company would receive projects repayments since the repurchase agreements were signed with the local government. As of 30 June 2023, all the projects under government purchase model were completed, with a total investment amount of RMB4.6 billion. At the same time, there was no projects under construction or planning under agency construction model and government purchase model.

XAGK now mainly undertakes resettlement housing and affordable rental housing constructions under self-operated model, and is responsible for financing of the projects. For the resettlement housing projects, the Company would achieve fund balance by selling the resettlement housing to resettlement households. The selling price is generally lower than the market price. For the affordable rental housing projects, the investment is expected to be balanced through rental income. The local government would also provide subsidies of RMB1,500 per square meter for the affordable rental housing. As of 30 June 2023, there were 14 projects under construction, with a total investment of RMB41.4 billion and uninvested amount of RMB21.7 billion.

XAGK also provides heat supply service for the enterprises and residents in Xi'an HIDZ. The Company is responsible for the design, installation, repairment, maintenance, and renovation of the main heating equipment and pipelines in Xi'an HIDZ. As of 31 December 2022, the Company owned 4 thermal centers, 28 distributed heat sources, and steam and hot water pipe network of 150 kilometers, with a total heating coverage of 40.4 million square meters. As of 30 June 2023, the Company also had one heating pipe network project under construction, with an uninvested amount of RMB185 million.

### **High exposure to commercial activities especially in property development**

XAGK also engages in diversified commercial activities, such as property development, manufacturing, as well as trading. We consider the Company's exposure to commercial businesses to be high, especially in property development during the downturn of China's real estate market. Moreover, there was certain recovery risk arising from its manufacturing and trading businesses.

XAGK conducts property development business mainly through its subsidiaries Tande Co., Ltd. ("Tande", stock code: 600665.SH), Xi'an High-tech Industrial Development Zone Real Estate Development Company, and Xi'an Ziwei Real Estate Development Co., Ltd. The property development business is mainly commercial residential housings that were concentrated in Xi'an City. As of 30 June 2023, most of the completed commercial housings were sold. However, during the downturn of the real estate market, the total amount of contracted sales declined to RMB14.7 billion in 2022 from RMB17.9 RMB in 2021, and is not expected to be fully recovered in the short term. As of 30 June 2023, the projects under construction had a total investment of RMB113.5 billion and an outstanding investment of RMB39.0 billion. The Company also had more than 10 projects under planning, with a total investment of RMB22.0 billion. The large amount of uninvested projects poses large capital expenditure pressure to the Company, which will be largely relied on external financing. Moreover, increasing investment in property development may bring more operating uncertainties and financial risks to the Company as the property sales are easily affected by the market conditions.

XAGK engages in industrial parks development and operation to promote the development of local high-tech industries. The Company undertakes the responsibilities of financing, construction, operation of industrial parks and is expected to achieve fund balance through leasing income. As of 30 June 2023, the Company had a total leasable area of 1.6 million square meters, including software research and development base, high-tech medical industrial park, new generation artificial intelligence park, and digital economy industrial park, with high overall occupancy rates, which could provide supplementary revenue to XAGK. The main tenants are high-tech enterprises settled in Xi'an HIDZ. As of 30 June 2023, there was one industrial park project under construction, with a total investment of RMB1.2 billion and uninvested amount of RMB1.0 billion. However, the Company's investments require long holding periods, which may expose the Company to larger investment and execution risks.

The Company's manufacturing segment mainly consists of building materials, curtain walls, doors and windows, concrete and medicine, increasing the business diversify of XAGK. The Company is also actively integrating

the concept of intelligent manufacturing and green development, and has become a modern green and environmentally friendly material supplier. Moreover, the Company's building material, curtain wall, door and window products are sold to more than 25 provinces and municipalities, owning certain advantages in market competition. However, affected by the downturn in the real estate market, the revenue from curtain walls, doors and windows segment decreased from RMB2.9 billion in 2021 to RMB2.0 billion in 2022. The Company's subsidiary, Xi'an Gaoke Curtain Wall Doors and Windows Co., Ltd. ("GKCD"), is charge of the manufacturing of curtain walls, doors and windows and is listed as dishonest judgment debtor for several times due to the dispute case arising from the overdue payments from China Evergrande Group ("Evergrande"). As of 30 June 2023, GKCD had bill receivable of RMB65 million from Evergrande, indicating certain recovery risk. GKCD is negotiating and resolving the bill disputes through various methods such as collateral assets or reconciliation.

In addition, the Company participates in trading business, including supply of steel, concrete, and supporting equipment. The Company adopts demand-on-purchase mode which means orders to upstream suppliers would be placed only when the sale contracts are signed with downstream customers. The Company usually make upfront payments to suppliers before receiving goods. However, one of the suppliers, Xi'an Maike Metal International Group Co. Ltd. ("MK Group"), has encountered financial difficulties in business operation. As of 31 May 2023, the outstanding prepayment to MK Group was RMB251 million. The Company has stopped the trading business with MK Group since August 2022.

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

XAGK has a good track record of receiving support from the local government, such as operating subsidiaries, capital injection, equity transfer, government payment, as well as asset injection. From 2020 to 2022, the local government provided operating subsidiaries of around RMB300 million. Over the same period, the Company received capital injection from the local government, including cash and asset injection, and equity transfer of some state-owned entities in Xi'an HIDZ, increasing capital reserve by around RMB4.0 billion and further enhancing the business scope and capital strength of XAGK. Apart from that, the Company also received project repayments of RMB3.4 billion for its infrastructure construction projects as of 30 June 2023. Considering the Company's important role in regional development and urban operations of Xi'an HIDZ, we expect XAGK will continue to receive support from the local government.

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

With the continuous financing for construction projects, XAGK's debt leverage remains high, and its refinancing pressure is still large. As of 30 June 2023, the Company's total debt increased to RMB123.8 billion from RMB86.7 billion as of end-2020. The Company has also maintained a high debt leverage over the past three years. As 30 June 2023, its total capitalization ratio, as measured by total debt to total capital, was recorded at 85.9%. Moreover, the Company's short-term debt was RMB34.1 billion, accounting for 27.6% of total debt, indicating short-term refinancing pressure. Considering the large number of uninvested amount in resettlement housing and property development projects, we estimate the Company would continue to rely on external financing such as bank loans to support its business, and its total debt would maintain at a high level over the next 12-18 months.

XAGK's asset liquidity was relatively weak. As of 30 June 2023, XAGK's inventories, receivables, investment properties, and construction in progress accounted for 76% of the total assets. Majority of these assets were considered low liquidity. Inventories accounted for more than half of the total assets, which were mainly construction costs of real estate and infrastructure construction projects. Meanwhile, the total restricted assets of XAGK were RMB21.0 billion, including inventories, investment properties, cash, fixed assets, and long-term

equity investment, accounting for 92.3% of net assets. The restricted assets were mainly assets pledged for loans.

### **Good access to funding with sufficient bank facilities**

XAGK has a good access to funding channels such as bank loans, onshore bonds, and non-standard financing. Bank loans contribute the most of total debts, which accounted for more than 50% as of 30 June 2023. The Company has built long-term and close relationships with policy banks, major state-owned banks and national joint-stock commercial banks in China, including China Development Bank, Agricultural Development Bank of China, Bank of China Limited, and China CITIC Bank Corporation Limited. As of 30 June 2023, it received total bank credit facilities of RMB118.9 billion and the available portion being RMB28.3 billion. The Company also has a track record for fund-raising activities in capital market. For example, from January to September 2023, the Company issued one tranche of MTN, raising RMB800 million. The Company also has certain exposure to non-standard products such as financial leasing and trust loans, accounting for more than 30% of the total debts. The Company now has a clear internal control over high-cost financing channels, such as no acceptance of financing channels with cost higher than 9%.

### **ESG Considerations**

XAGK faces environmental risks because it has undertaken urban infrastructure construction and property development 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.

XAGK bears social risks as it is engaged in provision of public services in Xi'an 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.

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

### **Structural Considerations**

XAGK'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 important role in the development of Xi'an HIDZ, 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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