

Shaanxi Xixian New Area Fengxi Development Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	17 February 2023

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Shaanxi Xixian New Area Fengxi Development Group Co., Ltd. (“SXFD” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the de facto local government of Fengxi New City of Xixian New Area of Shaanxi Province (“Fengxi”), the Management Committee of Fengxi (“Fengxi MC”), would provide strong support to SXFD if needed, in light of its direct majority ownership of SXFD, SXFD’s strategic importance as the important state-owned entity for infrastructure development, shantytown renovation, land development, as well as resettlement house construction in Fengxi, and the linkage between the Fengxi MC and SXFD, including control and supervision over the management, strategic alignment and ongoing operational and financial support. In addition, the Fengxi MC may face significant negative impact on its reputation, business and financing activities if SXFD encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that SXFD’s strategic importance would remain intact while the Fengxi MC will continue to ensure SXFD’s stable operation.

Rating Rationale

Fengxi MC’s Ownership and Supervision: The Fengxi MC directly holds the majority ownership of SXFD, it is the ultimate controller of the company. The Fengxi MC has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding decisions. In addition, the Fengxi MC has assessment mechanism over the company and it will appoint auditor to supervise the operating performance and financial position on a periodic basis.

Strategic Importance to Fengxi and Strategic Alignment: SXFD, as an important LIDC in Fengxi, is mainly responsible for infrastructure development, land consolidation and shantytown renovation, etc., with franchise advantages. In addition, SXFD is also responsible for projects related to industrial parks in the region, including the construction of the industrial parks, the subsequent investment attraction works and operation. SXFD is the main entity for the infrastructure development, especially the core entity for shantytown renovation and resettlement housing construction in Fengxi. It plays an important role in promoting the economic and social development of Fengxi. SXFD’s business operation and development have been aligned with the government’s development plans.

Ongoing Government Support: SXFD received operational and financial support from the Fengxi MC. SXFD had received a total subsidy amount of c. RMB1.1 billion from 2019 to 2021, mainly including financial interest discount and special funds for shantytown renovation. The Fengxi MC will repurchase some infrastructure and shantytown renovation projects upon completion and provide policy supports to SXFD to ensure its business operation. Given the franchise advantage in shantytown renovation projects construction and land consolidation in Fengxi, SXFD has advantages to obtain land resources and major projects. We believe SXFD is likely going to receive government support in the form of operational and/or financial subsidies to support its daily business operation.

Key Figures of Fengxi and SXFD

(RMB billion)	2020	2021
Fengxi		
GDP	13.6	13.4
GDP growth rate (%)	12.6	9.9
Budgetary revenue	1.3	2.1
Government fund	6.4	11.3
Transfer payment	1.0	0.7
Budgetary expenditure	2.1	2.9
SXFD		
Assets	24.0	26.3
Equity	7.6	8.2
Revenue	2.8	1.2

Source: Public information, SXFD and Lianhe Global’s calculations

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Applicable Criteria

China Local Investment and Development Companies Criteria (5 December 2022)

SXFD's Financial Matrix and Liquidity Position: SXFD's total assets showed a continuous growth trend in the past years and reached RMB29.1 billion at end-September 2022, mainly due to the increase in contract assets caused by the promotion of infrastructure development and shantytown-related projects. SXFD's financial leverage (total liabilities to total assets) was 72.7% and its adjusted debt increased to c. RMB16.6 billion at end-September 2022. The liquidity of SXFD was sufficient. SXFD had a cash balance and unused credit facilities of c. RMB2.1 billion and RMB4 billion at end-September 2022, respectively, compared with its debt due within one year of c. RMB3.4 billion. Besides, SXFD has access to various financing channels, including bank loans, bond issuance and non-traditional financing (e.g. trust loans), to support its debt repayment and business operations.

Economy and Fiscal Strength of Fengxi: Fengxi, as one of the five major new cities in Xixian New Area of Shaanxi Province ("Xixian"), which is a national new area located between Xi'an and Xianyang in Shaanxi Province. Fengxi's economy maintained steady growth, with GDP reaching RMB13.4 billion and year-on-year growth of 9.9% in 2021. The GDP was mainly fueled by the secondary and tertiary industries, which accounted for 36.5% and 53.7% of the aggregate GDP in 2021.

The aggregate fiscal revenue of Fengxi was mainly derived from the budgetary revenue and government fund income. Fengxi's budgetary revenue grew moderately and increased to RMB2.1 billion in 2021, where its tax revenue accounted for more than 84% of its budgetary revenue in the past three years. Besides, the government fund income was relatively large in volume compared to its budgetary revenue, which increased by 75.2% to RMB11.3 billion in 2021, mainly due to the increase in revenue from the transfer of state-owned land use rights. Its budget deficit improved in the past three years, which was -105.7%, -56.2% and -39.3% in 2019, 2020 and 2021, respectively, due to the strong growth of budgetary revenue. The debt ratio (i.e. total government debt divided by aggregate revenue) of Fengxi was c. 67% at end-2021, while the total outstanding amount of government debt increased to c. RMB9.4 billion at end-2021 from c. RMB6.8 billion at end-2019.

Rating Sensitivities

We would consider downgrading SXFD's rating if (1) there is perceived weakening in support from the local governments, particularly due to its reduced strategic importance with diminished government functions, or (2) there is a significant reduction of the Fengxi MC's ownership of SXFD, or (3) there is a downgrade in our internal credit assessment on Fengxi.

We would consider upgrading SXFD's rating if (1) there is strengthened support from the Fengxi MC, or (2) there is an upgrade in our internal credit assessment on Fengxi.

Operating Environment

Economic Condition of Fengxi

Fengxi is one of the five major new cities in Xixian, which is a national new area located between Xi'an and Xianyang. Fengxi covers 4 towns (townships), 30 administrative villages and 16 communities under the jurisdiction of Xi'an City and Xianyang City, with a total area of c. 143 square kilometers. Its residential population reached c. 0.3 million with an urbanization rate of c. 74% at end-2021. The main function of Fengxi is to build an emerging industry base and a sub-center of comprehensive service of Xi'an City, with the strategic emerging industries as the major focus. It focuses on the development of information technology, new materials, Internet of Things, biomedicine, as well as administrative business, urban agriculture and other industries.

Fengxi's economy maintained steady growth, with GDP reaching c. RMB13.4 billion and year-on-year growth of 9.9% in 2021. Its economic strength ranked high among Xixian's five new cities. The economic growth was mainly fueled by the secondary and tertiary industries, accounting for 36.5% and 53.7% of Fengxi's total GDP, respectively, in 2021. During the same period, Fengxi's GDP per capita was approximately RMB42,109. Having said that, the decline in fixed asset investment in Fengxi in 2021 was more pronounced, with its growth rate dropping from 11.6% in 2020 to -21% in 2021.

Fengxi's GDP and Fixed Asset Investment			
(RMB billion)	2019	2020	2021
GDP	10.5	13.6	13.4
-Primary industry (%)	10.6	9.2	9.8
-Secondary industry (%)	34	33.6	36.5
-Tertiary industry (%)	55.4	57.2	53.7
GDP growth rate (%)	13.3	12.6	9.9
Fixed asset investment*	18.2	20.3	16.0
Fixed asset investment growth rate (%)	13.4	11.6	(21.0)
Population (million)	0.3	0.3	0.3

**Estimated by Lianhe Global due to the insufficient information*
 Source: Public information and Lianhe Global's calculations

Fiscal Condition of Fengxi

The aggregate fiscal revenue of Fengxi was mainly derived from the budgetary revenue and government fund income. Fengxi's budgetary revenue maintained a moderately high growth rate between 2019 and 2021, from c. RMB1.1 billion in 2019 to c. RMB2.1 billion in 2021, representing a compound annual growth rate ("CAGR") of 24.1%. Over the same period, the contribution of the tax revenue stood at c. 84-91% level.

The government fund income was relatively large in volume compared to its budgetary revenue, which increased by 75.2% to RMB11.3 billion in 2021, mainly due to the increase in revenue from the transfer of state-owned land use rights. Its budget deficit improved in the past three years, which was -105.7%, -56.2% and -39.3% in 2019, 2020 and 2021, respectively, due to the relatively strong growth of budgetary revenue. At end-2021, the total outstanding amount of government debt increased to c. RMB9.4 billion from c. RMB6.8 billion at end-2019, mainly due to the increase in special debts. Yet the government debt ratio, as measured by total government debts/ aggregate revenue, was relatively high at 67% at end-2021.

Fengxi's Fiscal Condition			
(RMB billion)	2019	2020	2021
Budgetary revenue	1.1	1.3	2.1
Budgetary revenue growth rate (%)	46.4	25.91	59.1
Tax revenue	1.0	1.1	1.8
Tax revenue (% of budgetary revenue)	90.4	83.7	85.3
Government fund income	4.1	6.4	11.3
Transfer payment	0.6	1.0	0.7
Aggregate revenue	6.1	8.8	14.1
Budgetary expenditure	2.2	2.1	2.9
Budget deficit¹ (%)	105.7	56.2	39.3

¹ Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%

Source: Finance Bureau of Fengxi and Lianhe Global's calculations

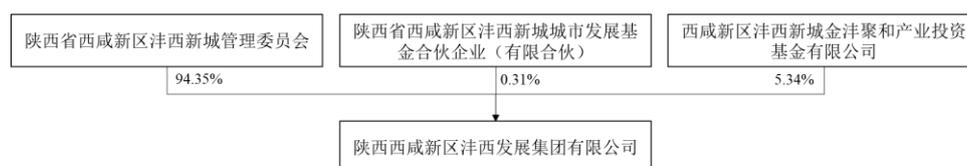
Ownership Structure

Government's Ownership

SXFD was established in 2015 with an initial registered capital of RMB3 billion fully contributed in monetary terms by the Fengxi MC. In 2016, Fengxi New Area Fengxi New City Pufeng Green Sponge Development Investment Management Partnership (limited partnership) subscribed RMB1.7 billion of SXFD's registered capital and held 56.67% equity interest in the company, but transferred back the equity interest it held to the Fengxi MC in 2019. In 2017, Fengxi New Area Fengxi New City Urban Development Fund Partnership (limited partnership) of Shaanxi Province increased SXFD's capital by RMB1 billion, of which RMB10 million was used to subscribe the registered capital and thus held 0.33% equity interest of SXFD. In 2021, Xi'an New Area Fengxi New City Golden Fengjuhe Industrial Investment Fund Co., Ltd. increased SXFD's capital by RMB500 million, of which RMB169.8 million was used to subscribe the registered capital and thus held 5.34% equity interest of SXFD. The registered capital of SXFD was RMB3.18 billion, while the paid-in capital was RMB2.81 billion at end-September 2022.

The Fengxi MC directly held 94.35% shares of SXFD at end-September 2022. It was the controlling shareholder and de facto controller at the same time.

The shareholding structure of SXFD at end-September 2022:



Source: SXFD

SXFD had 7 subsidiaries within the scope of consolidation at end-September 2022.

Strategic Importance and Government Linkage

Strategic Importance of SXFD to Fengxi

SXFD, as an important LIDC in Fengxi, is mainly responsible for infrastructure development and shantytown renovation, land management, development and utilization, public service facilities construction, etc., in the area with franchise advantages. In addition, SXFD is also responsible for the construction of industrial parks in the region and related investment attraction works to promote the industrial upgrading and transformation of Fengxi. SXFD is the core entity for the operation of state-owned assets in Fengxi. It plays an important role in promoting the economic and social development of Fengxi. SXFD's business operation and development have been aligned with the government's development plans.

Linkage with the Local Government

SXFD's linkage with the local government is strong as the Fengxi MC directly holds the majority ownership of SXFD. The Fengxi MC is the ultimate controller of the company. The Fengxi MC has the final decision-making authority and supervises the company, including management appointment, decision on its strategic development and investment plan and supervision of its major funding. In addition, the Fengxi MC has assessment mechanism over the company and it will appoint auditor to supervise the operating performance and financial position on a periodic basis.

Government Support

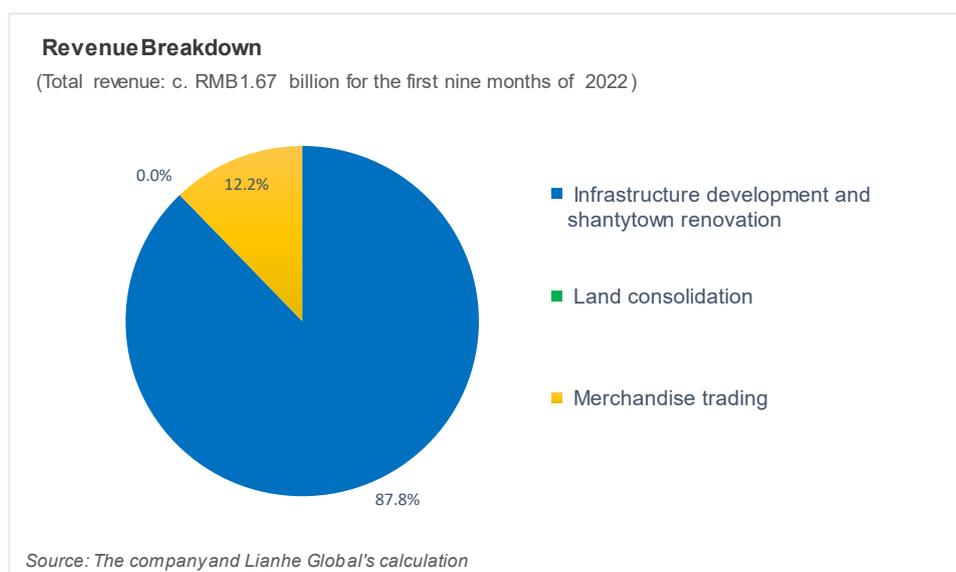
SXFD continued to receive financial subsidies, including financial discount interest and special funds for shantytown renovation, from the local government to maintain its business operation. SXFD received subsidies of c. RMB350 million, RMB290 million and RMB420 million in 2019, 2020 and 2021, respectively. The Fengxi MC will repurchase some infrastructure projects and shantytown renovation projects upon completion and provide policy supports to SXFD to ensure its business operation. Given the franchise advantage in shantytown renovation projects construction and land development in Fengxi, SXFD has advantages to obtain land resources and major projects. We believe SXFD is likely going to receive government support in the form of operational and/or financial subsidies in the future.

Business Profile

The Core Entity Responsible for Infrastructure Development, Shantytown Renovation and Land Consolidation in Fengxi

SXFD, as an important LIDC in Fengxi, is mainly responsible for infrastructure development, land consolidation and shantytown renovation, etc., with franchise advantages in the region. In addition, SXFD is also responsible for industrial park development in Fengxi, mainly including the construction of industrial parks in the region and subsequent investment attraction and operation. SXFD is the core entity for the infrastructure construction, especially the construction of shantytown renovation construction and resettlement housing construction in Fengxi. It plays an important role in promoting the economic and social development of Fengxi.

SXFD's operating income is mainly derived from its infrastructure development and shantytown renovation segment. Its revenue was volatile in the past three years, which reached c. RMB2.9 billion, RMB2.8 billion and RMB1.2 billion and RMB1.7 billion in 2019, 2020, 2021, and in the first nine months of 2022, respectively. The large revenue decline in 2021 was mainly due to the fewer shantytown renovation project settlements during the year as a result of the cyclical nature of the settlement process. Besides, the merchandise trade segment was hampered due to the impact from the epidemic. SXFD's overall gross profit margin remained relatively stable at 4.7-6.2% in 2019, 2020, 2021 and the first nine months of 2022. Per management, SXFD's gross profit margin will maintain at this level throughout 2022. Overall, SXFD's business was relatively concentrated, while its main business had certain regional advantages.



Infrastructure Development and Shantytown Renovation

As the main entity for infrastructure development and shantytown renovation in Fengxi, SXFD undertakes the demolition and relocation of shantytowns, land formation, construction or raising of subsidized housing and resettlement housing in the region. Given the important position of SXFD as the core entity that is responsible for the infrastructure development and shantytown renovation in Fengxi, SXFD has certain regional franchise advantages in this segment. The revenue generated from this segment reached RMB0.8 billion, RMB1.1 billion, RMB0.5 billion and RMB1.5 billion in 2019, 2020, 2021 and the first nine months of 2022, respectively. Due to the cyclical nature of the settlement of shantytown renovation projects, there were fewer project settlements in 2021 and thus the revenue generated in this segment declined substantially. Having said that, revenue generated from this segment increased in the first nine months of 2022, as the construction of the projects progressed and the subsequent construction settlements were completed.

Regarding the business mode, SXFD and its subsidiaries sign relevant agreements with the Fengxi MC to undertake shantytown renovation projects in the region. The initial stage of the project is financed by the company's own funds and external financings. The Fengxi MC regularly settles the payment according to the actual costs incurred and the progress of the project, while the settlement amount is based on the total construction cost plus a certain management service fee. SXFD has undertaken shantytown renovation projects such as Wangdao Village, Yanjiaqu, Majiazhai, Wenjia Village, etc., and there are still projects under construction such as Fengze Xinyuan, Songkang Xinyuan and Jiangdu Xinyuan. Considering the large scale of infrastructure development and shantytown renovation projects under construction, SXFD may face high pressure of capital expenditure.

In addition, SXFD is also responsible for the industrial park development projects in Fengxi and subsequent investment attraction and operation to promote the industrial upgrading and transformation of the region. Among the industrial park construction projects, part of Kunpeng Smart Park is expected to be delivered in 2022, while Caojiatan Innovation Center, Fengyi Modern Smart Park and other industrial parks are also under construction as scheduled. The construction mode of the company's industrial park is mainly self-operated, indicating a more uncertain cash collection and revenue recognition than those of the shantytown renovation projects.

Land Consolidation

SXFD is engaged in the land consolidation and development business in Fengxi with strong regional franchise, including land acquisition and demolition, site leveling, road paving, water supply, power supply, gas supply and other infrastructure construction of state-owned land in the area, turning the land reserve into land for construction of houses and various facilities. The entrusting party of SXFD's land consolidation business is also the Fengxi MC, which will add an additional margin of 7.0-8.5% on top of the investment cost of completed land consolidation projects as the construction fee.

The revenue generated from this segment reached RMB820 million, RMB320 million and RMB40 million in 2019, 2020 and 2021, respectively, which demonstrated an overall downward trend. As for the first nine months of 2022, no revenue was recognized in this segment. The size of the land consolidation business of SXFD is determined by the land planning of Fengxi. Per management, SXFD will continue to be responsible for the land consolidation business in the region and recognize related revenue according to the relevant government planning.

Merchandise Trading

As an important source of revenue for SXFD, merchandise trading makes the company's business more diversified and plays a complementary role to its main business. SXFD is mainly engaged in merchandise trading such as coal, methanol, electromechanical equipment and construction materials. Its business models are mainly based on sales-driven procurement, where the company purchases from upstream suppliers after signing trade contracts with downstream customers.

The revenue generated from this segment reached RMB1.2 billion, RMB1.3 billion, RMB560 million and RMB200 million, respectively, in 2019, 2020, 2021 and the first nine months of 2022 with an overall decreasing trend. The main reason for the decline is that SXFD's merchandise trading business is gradually shifting from connected transactions to market-oriented operations to improve its ability to combat uncertainties. In the process of such transformation, the gross profit margin of this segment improved, but it was still low at less than 1% and contributes a small portion to the company's overall profit. In addition, SXFD's merchandise trading business has a high concentration of suppliers and customers, with its top five major suppliers and customers accounting for more than 80% of the total in 2021.

Financial Profile

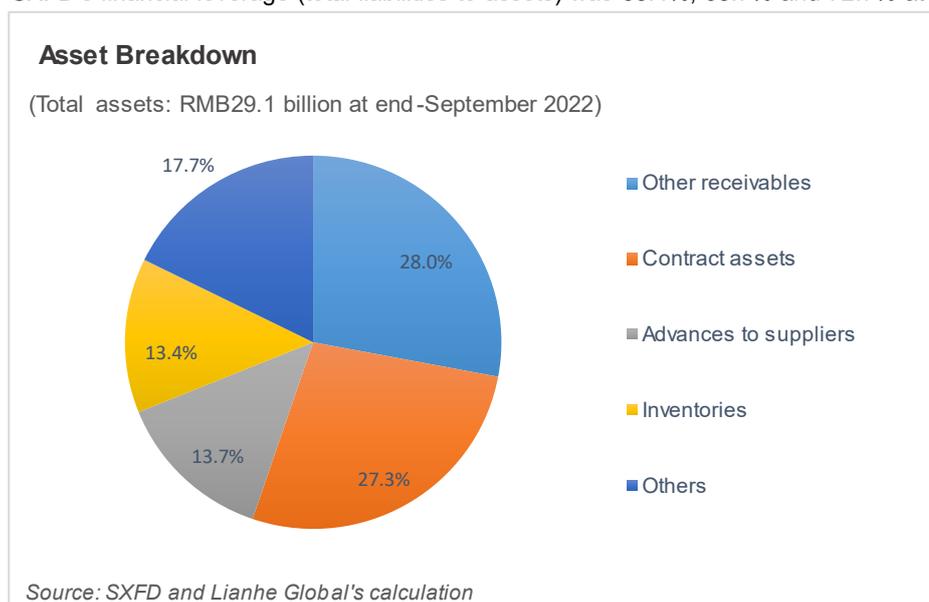
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	Sep 2022
Total Asset	22,352	24,044	26,333	29,100
Equity	6,983	7,601	8,247	7,931
Debt	7,120	10,639	14,375	16,604
Debt / (Debt + Equity) (%)	50.5	58.3	63.5	67.7
LT Debt	6,057	8,680	10,220	12,392
LT Debt / (LT Debt + Equity) (%)	46.5	53.3	55.3	61.0

Source: Company Information and Lianhe Global's calculations

SXFD's total assets showed a continuous growth in the past few years, with a growth rate of 7.6%, 9.5% and 10.5% at end-2020, end-2021 and end-September 2022, respectively, and reached RMB29.1 billion at end-September 2022. The increase of SXFD's total assets was mainly due to the increase in contract assets caused by the promotion of infrastructure development and shantytown-related projects. The asset structure of SXFD has not changed significantly in recent years and was mainly composed of other receivables, contract assets, advances to suppliers and inventories. Other receivables were mainly related party transactions between SXFD and the Fengxi MC, as well as some other related parties with controllable counterparty risks and low bad debt provision. Most of the other receivables of SXFD were non-operating receivables. Most of the contract assets were shantytown renovation projects undertaken by the company, which were recognized as contract assets because the settlement node has not been reached. Most of the counterparties of advances to suppliers were the Fengxi MC. Inventories mainly included development costs (such as engineering and construction costs) and land to be developed related to SXFD's main business, which grew in tandem with the increase in SXFD's related projects. In addition, long-term equity investment of the company decreased significantly at end-2021, mainly due to its transfer of the share of Shaanxi New Silk Road Enterprising One Investment Partnership (Limited Partnership). SXFD's current assets accounted for 90.9% of total assets at end-September 2022 with relatively low liquidity. Per management, the proportion of non-current assets will increase in the future with the carry-over of some shantytown renovation projects and industrial park development projects.

SXFD's financial leverage (total liabilities to assets) was 68.4%, 68.7% and 72.7% at end-



2020, end-2021 and end-September 2022, respectively, representing an upward trend. Given the relevant guidelines of the Fengxi MC, we expect the leverage of SXFD to decline. SXFD's adjusted total debt increased significantly from c. RMB7.1 billion at end-2019 to c. RMB16.6 billion at end-September 2022, due to the increase in long-term and borrowings and bonds payable, with long-term debt accounting for c. 74.6% of its total debt at end-September 2022. There was no significant change in the ownership equity structure of SXFD at end-September 2022, compared with that at end-2021. SXFD mainly relies on external financing to support its capital expenditures, which we expect to increase in the future given its infrastructure projects and resettlement housing projects under construction and to be constructed in the future.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	9M2022
Cash Inflows from Operation	11,487	11,696	8,034	5,080
Cash Outflows from Operation	13,148	14,484	11,893	6,346
Net CF from Operation	-1,661	-2,787	-3,859	-1,266
Cash Inflows from Investment	148	220	639	104
Cash Outflows from Investment	1,134	636	20	464
Net CF from Investment	-985	-416	618	-361
Cash Inflows from Financing	1,495	5,019	6,379	4,779
Cash Outflows from Financing	1,592	1,690	3,033	2,678
Net CF from Financing	-98	3,329	3,346	2,101
Net Increase in Cash and cash equivalent	-2,745	126	105	475

Source: SXFD's financial reports

Debt Servicing Capability

The liquidity of SXFD was sufficient. At end-September 2022, SXFD had a cash balance and unused credit facilities of c. RMB2.1 billion and RMB4 billion, respectively, compared with its debt due within one year of c. RMB3.4 billion at the same time. Besides, SXFD has access to various financing channels, including bank loans, bond issuance and non-traditional financing, to support its debt repayment and business operations.

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