Credit Opinion

14 July 2023

Ratings	
Senior Unsecured Debt Rating	BBB_g
Long-Term Credit Rating	BBB_g
Outlook	Stable
Category	Corporate
Domicile	China
Rating Type	Solicited Rating

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Xi’an Qujiang Cultural Industry Investment (Group) Co., Ltd

Initial credit rating report

CCXAP assigns first-time long-term credit rating of BBB_g to Xi’an Qujiang Cultural Industry Investment (Group) Co., Ltd, with stable outlook.

Summary

The BBB_g long-term credit rating of Xi’an Qujiang Cultural Industry Investment (Group) Co., Ltd (“QCII” or the “Company”) reflects Qujiang New District Government’s strong capacity to provide support, and very high willingness to provide support, based on our assessment of the Company’s characteristics.

Our assessment of the Qujiang New District Government’s capacity to support reflects Qujiang New District’s status as one of the earliest National Cultural Industry Demonstration, with good tourism resources and stable fiscal performance, but constrained by its relatively high debt burden.

The rating also reflects the local government’s willingness to provide support, which is based on the Company’s (1) dominant position in cultural and tourism industry of Qujiang New District, aligning with government development strategy; (2) track record of receiving government support; and (3) rich and high-quality tourism resources.

However, the rating is constrained by the Company’s (1) moderate risk exposure to property development and retail businesses; (2) relatively high refinancing needs; and (3) contingent risks associated with external guarantees.

The stable outlook on QCII’s rating reflects our expectation that the local government’s capacity to support the Company will remain stable, and the Company will maintain its dominant position in tourism infrastructure construction and operation in Qujiang New District.

Rating Drivers

- Dominant position in cultural and tourism industry of Qujiang New District, aligning with government development strategy
- Track record of receiving government support
- Moderate risk exposure to property development and retail businesses
- Relatively high refinancing needs, partially mitigated by access to diversified fundings
- Contingent risks associated with external guarantees

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the local government's capacity to provide support strengthens; and (2) changes in company's characteristics enhance local government's willingness to provide support, such as reduced operational risk to commercial activities and improved debt management.

What could downgrade the rating?

The rating could be downgraded if (1) the local government's capacity to provide support weakens; or (2) changes in company characteristics decrease the local government's willingness to provide support, such as reduced regional significance or deteriorated financing ability.

Key Indicators

	2020FY	2021FY	2022FY	2023Q1
Total Asset (RMB billion)	99.9	101.0	106.8	109.7
Total Equity (RMB billion)	20.6	21.4	20.2	19.6
Total Revenue (RMB billion)	18.6	17.4	18.0	2.2
Total Debt/Total Capital (%)	68.0	67.5	68.1	69.1

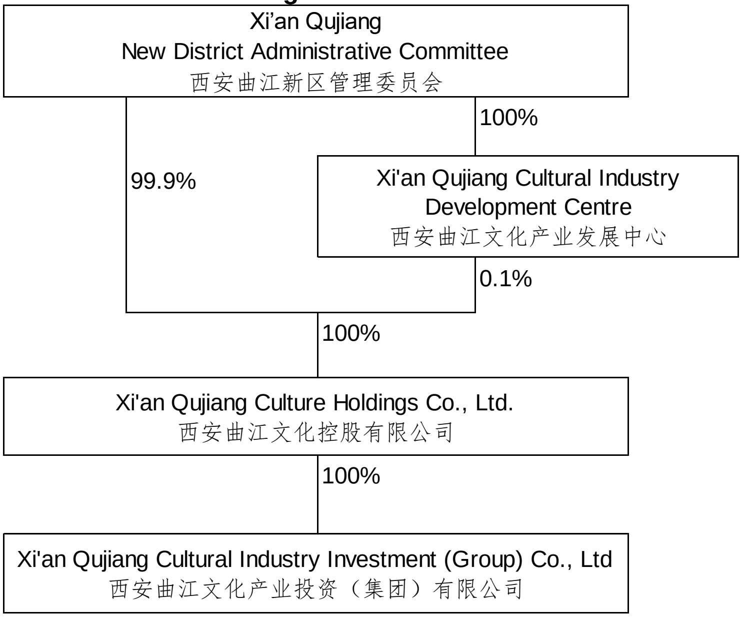
All ratios and figures are calculated using CCXAP's adjustments.

Source: CCXAP research

Corporate Profile

Founded in April 1998, QCII is a leading local infrastructure investment and financing company ("LIIFC") for the development of tourism and cultural industry in Shaanxi Province. The Company is primarily responsible for construction, development, and operation of major assets and resources in the cultural and tourism industry in Qujiang New District. It is also engaged in scenic area infrastructure construction, according to the development blueprint of the local government. Apart from public development projects, the Company also undertakes various commercial activities, such as property development and retail businesses. As of 31 March 2023, the Company was directly and wholly owned by Xi'an Qujiang Culture Holdings Co., Ltd. ("QJCH") and beneficially owned by the Xi'an Qujiang New District Administrative Committee, a government organ of the Xi'an Municipal People's Government.

Exhibit 1. Shareholding chart as of 31 March 2023



Source: Company information, CCXAP research

Exhibit 2. Revenue a Structure in 2022

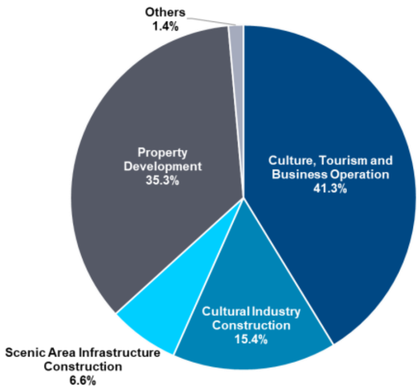
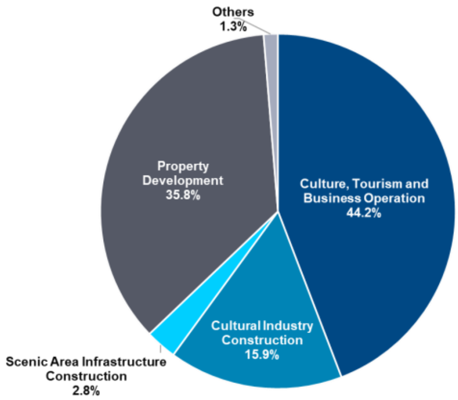


Exhibit 3. Gross Profit Structure in 2022



Source: Company information, CCXAP research

Rating Considerations

Government’s Capacity to Provide Support

We believe that the Qujiang New District Government has strong capacity to provide support for the Company, given its status as one of the earliest National Cultural Industry Demonstration, with good tourism resources and stable fiscal performance, but constrained by its relatively high debt burden.

Xi’an City is the provincial capital of Shaanxi Province and is located in the center of Shaanxi Province. It is also a Vice-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 Shannxi 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 4. 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: Statistics Bureau of Xi'an City, CCXAP research

Established by Xi'an City and Shaanxi Province, Qujiang New District was one of the most important cultural and tourist centres and the landmark of cultural and tourism industry development in Shaanxi Province. Qujiang New District has been designated as one of the earliest National Cultural Industry Demonstration, with over 51.5 sq.km. core area of cultural industry development. It is strategically focusing on the development of emerging industries consisting of culture and tourism, modern service, infrastructure construction, healthcare, cultural creative and E-sport.

Supported by its sufficient tourism resources and operation model of "culture + tourism + commercial", Qujiang New District demonstrated good fiscal performance over the past few years. From 2020 to 2022, it reported general public budgetary revenue of RMB4.1 billion, RMB4.2 billion, and RMB4.2 billion, with increasing self-sufficiency rates of 81.5%, 94.9%, and 122.0%, respectively. Taxes represented a large proportion of its revenue, which accounted for an average of 86.2% and became the stable source of revenue over the same period. The overall regional debt burden Qujiang New District is high. Among them, it had an outstanding government debt of RMB30.2 billion at end-2022, which slightly rose from RMB30.1 billion at end-2021.

Exhibit 5. Key economic and fiscal indicators of Qujiang New District

	2020FY	2021FY	2022FY
GRP (RMB billion)	30.5	30.2	-
GRP Growth (%)	2.9	0.6	-
General Budgetary Revenue (RMB billion)	4.1	4.2	4.2
General Budgetary Expenditure (RMB billion)	5.0	4.4	3.4
Local Government Debt (RMB billion)	30.0	30.1	30.2

Source: Statistics Bureau of Qujiang New District, CCXAP research

Government's Willingness to Provide Support

Dominant position in cultural and tourism industry of Qujiang New District, aligning with government development strategy

As an important LIIFC and the key subsidiary of QJCH in Qujiang New District, QCII is mainly responsible for planning, operating, and promoting the cultural and tourism industry in Qujiang New District and related infrastructure construction. The Company is the key entity in culture and tourism operation, including operation of scenic areas, travel agencies and hotels, operation of convention and exhibition, television and film investment, media and publishing business, cultural industry finance business, management and operation of art and cultural performance and other culture and tourism related business. The tourism business is adversely affected by the pandemic, as a result, its income from the tourism-related businesses reduced from 2020 to 2022. However, benefiting from the relief of pandemic prevention and control, we expect the Company's operating income from the cultural tourism business may rebound and attribute the majority of its total revenue. In 2023Q1, the revenue generated from this segment increased by 24.2% YoY to RMB2.1 billion.

As a major tourism development entity in Qujiang New District, QCII has undertaken the construction and operation of cultural industry projects and ancillary facilities, including cultural and commercial shopping malls, hotels, parks, squares convention venues, galleries, cineplexes and regional culture and history display areas. The Company is entrusted by the local government to conduct the construction of projects with self-raised funds, and it achieves financial balance through scenic operations, including ticket sales, property leasing, merchandise sales, and hotel services. The Company takes the responsibility to build Qujiang New District into a new urban complex with continuous planning and construction. As of 31 March 2023, it had 4 key projects under construction, with a total investment amount of RMB13.9 billion and an uninvested amount of RMB5.2 billion.

Moreover, in order to develop Qujiang New District into a modern tourist destination and model cultural tourism area, QCII is assigned by the local government to undertake several urban and scenic area infrastructure construction projects in Qujiang New District under the agent construction and build-and-transfer business models. It has participated in the construction, reconstruction, and restoration of roads, public facilities, scenic area infrastructures, and cultural squares in Qujiang New District. As of 31 March 2023, it had 2 major projects under construction, with a total investment amount of RMB4.9 billion and uninvested amount of RMB1.6 billion.

Leveraging its abundant resources, its full range of products and services, and the widely recognized Qujiang Brands developed and possessed by QJCH and QCII, the Company has created a unique Qujiang Model to promote the upgrading of the cultural tourism industry in China. Its diversified cultural tourism-related businesses demonstrate high strategic significance to the society and economy of Qujiang New District by implementing the local government's development strategy. We believe the Company will not be easily replaced by other local state-owned enterprises in the foreseeable future.

Moderate risk exposure to property development and retail businesses

QCII has moderate risk exposure to commercial activities such in property development and merchandise sales. These kinds of activities represent a high degree of income proportion and assets of to the Company, which may exert higher operating and financing risks on QCII.

Property development business in particular accounts for a large proportion of QCII's commercial activities, accounting for more than 35% of revenue from 2020 to 2022. The Company primarily involves in the development and sale of residential properties and commercial properties through a cooperative business model and self-develop business model. Property projects located not only in Qujiang New District, but also in other cities such as Chongqing City, Hangzhou City, and Jingzhou City, the Company's property projects distribute to several cities that we consider higher risk in sell-through of the construction projects. Moreover, the recent volatility in China's real estate market has had a negative impact on this segment, there are certain uncertainties in the sale and revenue of subsequent property development projects. As of 31 March 2023, the Company had 4 projects in Qujiang New District and 4 projects in other cities, with total investment amount of RMB30.1 billion and outstanding amount of RMB3.6 billion. The construction project funds mainly rely on external financing, which means that the Company still has large capital needs for future projects.

QCII started to conduct retail business after it acquired 21.15% shareholdings of Renrenle Commercial Group

Co., Ltd. (Stock Code: 002336.SZ,“Renrenle”) in 2019. As of 31 December 2022, Renrenle operated 113 retail stores in more than 30 cities across eight provinces, with total operating area of approximately 1.1 sq.km. The major types of retail stores that it operates include outlets, supermarkets, grocery stores, convenience stores, malls, and shopping centres. However, the business is subject to certain operating risks as it has been suffered a huge impact by the pandemic and trend of online shopping. As a result, Renrenle’s total revenue demonstrated large drop and it recorded net loss over the past three years. Moreover, the Company is planning to further acquire shareholdings of Renrenle, which may exert higher pressure on the management of this sector and higher volatility in future income arising from Renrenle’s daily operation. If its future operating conditions cannot be improved, Renrenle may face the risk of delisting from the stock exchange.

Given the large amount of construction of property development projects and further acquisition of Renrenle, we expect the Company will increase its commercial activities exposure in the future.

Track record of receiving government support

QCII has a track record of receiving support from Qujiang New District Government in various forms, such as government subsidies and capital injections. From 2020 to 2022, the Company received government subsidies of RMB181.6 million, RMB170.8 million, and RMB192.0 million, respectively. These subsidies were mainly used for the preparation of large-scale conferences, forums and special activities, TV drama creation, innovation and entrepreneurship projects, books, as well as tourism projects. As of 31 March 2023, the Company’s paid-in capital and capital reserve increased to RMB8.3 billion and RMB3.0 billion, thanks to the local government’s injection of cash and assets, as well as the transfer of equities. Moreover, the Company regularly receives repurchase payments for its public policy projects. Given its strong public policy role and important role in the cultural tourism development of Qujiang New District, we expect government support for QCII will remain good over the next 12 to 18 months.

Relatively high refinancing needs, partially mitigated by access to diversified fundings

QCII has high debt leverage, driven by continuous investment in construction projects. As of 31 March 2023, the Company’s total debt (including perpetual bonds) increased from RMB41.1 billion at end-2020 to RMB43.1 billion; while the total capitalization ratio maintained a high level of nearly 70%. The Company demonstrated a relatively weak liquidity position as its short-terms accounted for more than 50% of the total debt, indicating a high refinancing pressure. As of 31 March 2023, the Company had cash and cash equivalents of RMB3.8 billion, which was unable to cover its short-term debt of RMB22.1 billion. The Company has several onshore bonds that will be matured in the following months of 2023 including private bonds, MTN, SCP, and PPN, with total outstanding amount of more than RMB5.2 billion. Also, one of its USD bonds with outstanding amount of USD180 million will be matured on 19 November 2023.

However, QCII has good access to diversified funding channels, mainly in bank loans and direct issuances, we expect that it might partially mitigate the Company’s refinancing risk. As of 31 March 2023, the Company held total credit facilities of RMB39.5 billion and available credit facilities of RMB8.5 billion. The Company has also diversified its financing channels to the onshore and offshore capital markets. From January 2022 to June 2023, the Company raised the amount of more than RMB10 billion from different products in the onshore capital market, with coupon rates ranging from 5.8% to 6.8%. It also successfully issued two tranches of USD bonds in 2020 and 2021, raising USD240 million with reasonable coupon rates of 5.5%. Around 15% of debt financing was provided by non-standard financing, including financial leasing and trust. The Company’s overall financing cost was around 6.3%.

Contingent risks associated with external guarantees

QCII's credit profile is undermined by a relatively large number of external guarantees. As of 31 March 2023, the total amount of external guarantees was RMB6.5 billion, which accounted for 33.0% of its net assets. The majority of these external guarantees were provided to local state-owned enterprises in Qujiang New District, and small amount of guarantees were provided to private-owned enterprises with business relations. Relatively large guarantee exposures may increase the Company's contingent liability risks.

ESG Considerations

QCII assumes environmental risks through its construction of scenic area infrastructure, cultural industry construction, and property development projects. Such risks could be moderated through environmental studies and detailed planning prior to the start of the projects and close supervision during construction.

QCII is also exposed to social risks as it implements public-policy initiatives by building public infrastructure and scenic area in Qujiang New District. Demographic changes, public awareness and social priorities shape government's development strategy, and it will affect the government's propensity to support the Company.

QCII's governance considerations are also material as it is subject to oversight and reporting requirements to the local government, reflecting its public-policy role and status as a government-owned entity. The Company believes that it is in compliance in all material respects with the applicable governmental regulations, rules and executive orders in each jurisdiction in which it operates.

Structural considerations

QCII'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 dominant position in tourism infrastructure construction and operation in Qujiang New 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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