

Heze Cultural Tourism Investment Group Co., Ltd.

Initial Issuer Report

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BBB-’ global scale Long-term Issuer Credit Rating with Stable Outlook to Heze Cultural Tourism Investment Group Co., Ltd. (“HCTI” or “the company”)

Summary

The Issuer Credit Rating reflects a high possibility that the People’s Government of Heze City (“the Heze government”) would provide moderately strong support to HCTI if needed. This mainly considers the Heze government’s indirectly full ownership of HCTI, HCTI’s strategic importance as an important local investment and development company (“LIDC”) responsible for infrastructure construction and operation in Heze City (“Heze”), especially in the Caozhou Peony Garden and the linkage between the Heze government and HCTI, including the appointment of senior management, strategic alignment, supervision of major investment and financing decisions and ongoing operational and financial support. In addition, the Heze government may face negative impact on its reputation and financing activities if HCTI encounters any operational and financial difficulties.

The Stable Outlook reflects our expectation that HCTI’s strategic importance would remain intact while the Heze government will continue to ensure HCTI’s stable operation.

Rating Rationale

Government’s Ownership and Supervision: The Heze government indirectly holds the full ownership of HCTI through the State-owned Assets Supervision and Administration Commission of Heze City (“Heze SASAC”), via Heze Caijin Investment Group Co., Ltd. (“HCIG”). The Heze government has control over the company through its shareholder, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government formulates a performance assessment policy for the company, and regularly appoints auditors to review the company’s operating performance and financial position.

Strategic Importance and Strategic Alignment: HCTI, as the key LIDC in Heze, is primarily responsible for infrastructure construction and operation in the Caozhou Peony Garden, which is a famous tourist attraction in Heze. Serving as the sole LIDC in charge of infrastructure projects in the Caozhou Peony Garden, HCTI focuses on development and operation of scenic spots, and land consolidation and development in the Caozhou Peony Garden. Its business operations and strategic planning have been aligned with the local government’s economic and social development policies.

Ongoing Government Support: The local government provided ongoing support to HCTI. The company received assets with a total value of RMB14.0 billion from the local government in 2020-2022. We expect HCTI to receive ongoing support from the local government in the coming years considering its strategic importance in Heze.

Economy and Fiscal Condition of Heze: Heze realized a GDP of RMB420.5 billion in 2022, representing a year-on-year growth of 4.2%, which was higher than the growth rate of the GDP of China (3.0%) and that of Shandong Province (3.9%). Yet its absolute amount of GDP was still low. It was ranked 8th in Shandong Province in 2022 (out of the 16 prefecture-

Summary

Issuer Rating	BBB-
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	18 October 2023

Key Figures of Heze and HCTI (RMB billion)

Heze	2021	2022
GDP	397.7	420.5
GDP growth rate (%)	8.8	4.2
Budgetary revenue	28.4	29.0
Government fund	47.2	36.5
Transfer payment	36.8	40.3
Budgetary expenditure	63.3	65.4
HCTI	2021	2022
Asset	23.7	28.3
Equity	18.3	21.6
Revenue	1.4	1.6

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

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Applicable Criteria

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

level cities). At the same time, Heze's GDP per capita was RMB48,431, which was ranked 15th in Shandong Province, and it was below the province's average of RMB85,973.

Heze's budgetary revenue growth bounced back in 2021 but slowed in 2022, with a growth rate of 19.3% and 7.0%, respectively. Affected by the value-added tax credit refund policy, the tax revenue as a percentage of its budgetary revenue decreased from 77.0% in 2021 to 66.7% in 2022, a record low in recent years. On the other hand, the government fund income of Heze decreased by 22.7% to RMB36.5 billion in 2022, mainly due to the decline in land-transferring fees. In addition, Heze's government debt and budget deficit were high. Its government debt increased to RMB131.2 billion at end-2022 from RMB110.8 billion at end-2021, representing year-on-year growth of 18.4%, and the budget deficit increased to 125.9% in 2022. It is noteworthy to mention that the Heze government's fiscal debt ratio (total government debt outstanding/aggregate revenue) exceeded 100% in 2022, which was mainly due to the significant increase in its special purpose debt.

HCTI's Financial and Liquidity Position: HCTI' total assets were RMB28 billion at end-2022, increased by c. 19.5% year-on-year, and further climbed to RMB33 billion at end-June 2023. HCTI relied on borrowings to finance its businesses. The total debts of the company rushed to RMB2.0 billion at end-June 2023. Consequently, the total debt ratio and long-term debt ratio elevated to 7.5% and 6.0%, respectively.

HCTI's liquidity was moderate. At end-June 2023, the company had cash of RMB795.6 million (including restricted cash of RMB527.9 million), compared with its debt due within one year of RMB449.5 million. HCTI has access to various financing channels, including bank borrowings, to support its debt repayments and business operations. At end-June 2023, the company had unused credit lines of RMB3.0 billion.

Rating Sensitivities

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

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

Operating Environment

Economic Condition of Heze

Heze is located in the southwest of Shandong Province, bordering Jiangsu, Henan, and Anhui provinces. It administrates two districts (Mudan District and Dingtao District), seven counties, one provincial-level economic development zone and one provincial-level high-tech zone, with a population of 8.7 million at end-2022. Heze's main industries include food, textiles, forestry products processing, chemicals, pharmaceuticals, electricity and machinery.

Heze realized a GDP of RMB420.5 billion in 2022, representing a year-on-year growth of 4.2%, which was higher than the growth rate of the GDP of China (3.0%) and that of Shandong Province (3.9%). Heze's economic growth was mainly fueled by the secondary

and tertiary industries, accounting for 41.3% and 48.9% of its total GDP, respectively, in 2022.

Heze's absolute amount of GDP was still low. It was ranked 8th in Shandong Province at end-2022 (out of the 16 prefecture-level cities). At the same time, Heze's GDP per capita was RMB48,431, which was ranked 15th in Shandong Province and it was below the province's average of RMB85,973.

Heze's GDP and Fixed Asset Investment			
(RMB billion)	2020	2021	2022
GDP	348.3	397.7	420.5
-Primary industry (%)	9.9	9.8	9.8
-Secondary industry (%)	40.2	41.6	41.3
-Tertiary industry (%)	49.9	48.6	48.9
GDP growth rate (%)	3.9	8.8	4.2
Fixed asset investment	166.1	192.4	227.6
Fixed asset investment growth rate (%)	7.5	15.8	18.3
Population (million)	8.8	8.7	8.7

Source: Public information and Lianhe Global's calculations

Fiscal Condition of Heze

Heze's budgetary revenue growth bounced back in 2021 but slowed in 2022, with a growth rate of 19.3% and 7.0%, respectively. Affected by the value-added tax credit refund policy, the tax revenue as a percentage of its budgetary revenue decreased from 77.0% in 2021 to 66.7% in 2022, a record low in recent years. On the other hand, the government fund income of Heze decreased by 22.7% to RMB36.5 billion in 2022, which is mainly due to the decline in land-transferring fees.

Heze's government debt and budget deficit were high. Its government debt increased to RMB131.2 billion at end-2022 from RMB110.8 billion at end-2021, representing year-on-year growth of 18.4%, and the budget deficit increased to 125.9% in 2022. It is noteworthy to mention that the Heze government's fiscal debt ratio (total government debt outstanding/aggregate revenue) exceeded 100% in 2022, which was mainly due to the significant increase in its special purpose debt.

Heze's Fiscal Condition			
(RMB billion)	2020	2021	2022
Budgetary revenue	23.8	28.4	29.0
Budgetary revenue growth rate (%)	7.2	19.3	7.0*
Tax revenue	17.9	21.9	19.3
Tax revenue (% of budgetary revenue)	75.2	77.0	66.7
Government fund income	44.8	47.2	36.5
Transfer payment	40.7	36.8	40.3
Aggregate revenue	109.5	112.9	106.0
Budgetary expenditure	63.0	63.3	65.4
Budget balance ¹ (%)	-165.0	-122.9	-125.9

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

*Note: Excluding the influence of value-added tax credit refund

Source: Public information and Lianhe Global's calculations



Ownership Structure

Full Government Ownership

HCTI was established in August 2018 with an initial registered capital of RMB0.5 billion, funded by Heze Bureau of Culture, Broadcasting, Television, Press and Publication. In December 2019, HCTI's shareholder was changed to Heze Culture and Tourism Bureau, and the registered capital was increased to RMB2.0 billion. The shareholder of the company was changed to Heze SASAC in November 2020, and then to HCIG in December 2020.

At end-June 2023, HCTI's registered and paid-in capital were both RMB2.0 billion. The company had a shareholding structure in which HCIG, which is wholly owned by Heze SASAC, held 100% of the company's equity.

Strategic Importance and Government Linkage

Strategic Importance of HCTI to Heze

HCTI, as the key LIDC in Heze, is primarily responsible for infrastructure construction and operation in the Caozhou Peony Garden, which is a famous tourist attraction in Heze. Serving as the sole LIDC in charge of infrastructure projects in the Caozhou Peony Garden, HCTI focuses on development and operation of scenic spots, and land consolidation and development in the Caozhou Peony Garden. Its business operations and strategic planning have been aligned with the local government's economic and social development policies.

Strong Linkage with the Local Government

The Heze government holds 100% shares of HCTI indirectly through HCIG. The Heze government has strong control over the company through its shareholder, including the appointment of senior management and supervision of development strategy, major financing plan and investment decisions. In addition, the local government formulates a performance assessment policy for the company, and regularly appoints auditors to review the company's operating performance and financial position.

Ongoing Government Support

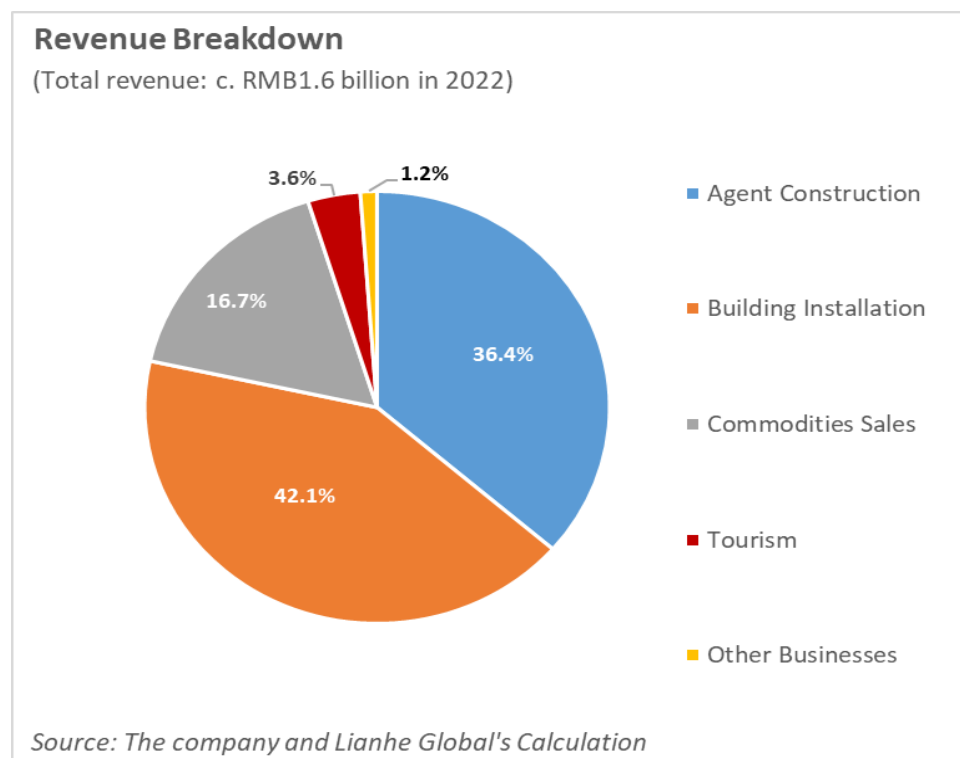
The local government provided ongoing support to HCTI. The company received assets including mining rights, investment properties and roads, etc., with a total value of RMB14.0 billion from the local government in 2020-2022. We expect HCTI to receive ongoing support from the local government in the coming years considering its strategic importance in Heze.

Business Profile

The Key Entity Responsible for Infrastructure Construction and Operation in the Caozhou Peony Garden

HCTI, as the key LIDC in Heze, is primarily responsible for infrastructure construction and operation in the Caozhou Peony Garden, which is a famous tourist attraction in Heze. The primary sources of operating revenue for HCTI are building installation, agent construction and commodities sales. The company's total revenue reached RMB1.0 billion, RMB1.4 billion and RMB1.6 billion in 2020, 2021 and 2022, respectively, representing a steady growth trend. The overall gross profit margin of HCTI ranged between 38.5% and 46.3%

from 2020 to 2022. In general, HCTI's business was well diversified, and it has regional advantages in its major businesses.



Agent Construction

HCTI is designated by the Heze government to undertake the infrastructure construction business within the districts and counties under Heze. The projects in this segment are generally conducted under the agent construction model, where the revenue recognition includes construction costs incurred plus a certain percentage of profit. Its revenue in this segment increased over the past years, with c. RMB0.4 billion, RMB0.5 billion and RMB0.6 billion in 2020, 2021 and 2022, respectively. The gross profit margin in this segment was relatively stable, remaining at 37-38% in 2020-2022. Currently, the company's projects under construction and to be constructed still require a large scale of investment, thus it incurs high pressure on capital expenditure.

Building Installation

As the most important source of revenue, building installation business is handled by the company's subsidiary, Heze Culture Investment Industrial Co., Ltd. ("HCII"), which mainly undertakes projects in the form of construction contracting. Due to the COVID's disruption, the construction progress of some projects was slower than expected in recent years, leading to the slower growth in newly signed contract number and value. The revenue derived from this segment remained stable in recent years, recording at c. RMB0.4 billion, RMB0.6 billion and RMB0.7 billion in 2020, 2021 and 2022, respectively, with a gross profit margin of c.41%-47%.

Merchandise Sales

The merchandise sales business of the company plays an important role in safeguarding the security of the local food supply system. HCTI is mainly engaged in the sales of food and agricultural products, including wheat, corn, flour, oilseeds, meat, etc. The business model includes commodity grain sales as well as policy grain storage. The revenue generated from this segment reached c. RMB0.2 billion, RMB0.2 billion and RMB0.3 billion in 2020, 2021 and 2022, respectively, representing a steady trend. The gross profit margin of the segment was relatively high, fluctuating between 37-42% in 2020-2022.

Other Businesses

Other businesses of HCTI include tourism and vehicle rental, etc., with each segment accounted for a relatively small proportion of the company's total revenue. Other businesses mainly play the role of supplementing the revenue of the main business and make the revenue structure more diversified.

Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality (RMB million)	2020	2021	2022	2023.6
Total Asset	19,302	23,686	28,312	33,117
Equity	14,643	18,315	21,618	24,598
Debt	501	869	1,076	2,007
Debt / (Debt + Equity) (%)	3.3	4.5	4.7	7.5
LT Debts	414	768	937	1,557
LT Debt / (LT Debt + Equity) (%)	2.7	4.0	4.2	6.0

Source: HCTI and Lianhe Global's calculations

HCTI' total assets were RMB28 billion at end-2022, increased by c. 19.5% year-on-year, and further climbed to RMB33 billion at end-June 2023. HCTI relied on borrowings to finance its businesses. The total debts of the company rushed to RMB2.0 billion at end-June 2023. Consequently, the total debt ratio and long-term debt ratio elevated to 7.5% and 6.0%, respectively.



The current asset contributed c. 64.3% of HCTI's total assets at end-June 2023, which mainly consisted of inventory, including completed but not yet settled projects, land to be developed as well as construction costs. At end-June 2023, HCTI had inventories of RMB15.0 billion, representing 45% of HCTI's total assets.

At the same time, HCTI had account receivables and other receivables of RMB1.3 billion and RMB2.8 billion, respectively, mainly due from local governments and state-owned enterprises. In addition, HCTI had non-current assets of RMB11.8 billion at end-June 2023, representing 35.7% of the company's total assets.

Due to the long construction, recognition and payment period, HCTI's project-related assets could take a prolonged period to convert to cash.

Debt Servicing Capability

HCTI's liquidity was moderate. At end-June 2023, the company had cash of RMB795.6 million (including restricted cash of RMB527.9 million), compared with its debt due within one year of RMB449.5 million. HCTI has access to various financing channels, including bank borrowings, to support its debt repayments and business operations. At end-June 2023, the company had unused credit lines of RMB3.0 billion.

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