

Chengdu Chenghua Development Group Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB+
Outlook	Stable
Location	China
Industry	Local Government Financing Vehicle
Date	27 September 2022

Key Figures of Chenghua District and CCD

(RMB billion)	2020	2021
Chenghua District		
GDP	110.3	127.3
GDP growth rate (%)	3.2	9.9
Budgetary revenue	7.9	8.5
Government fund	0.4	2.4
Transfer payment	4.5	4.2
Budgetary expenditure	7.5	7.9
CCD		
Total Asset	126.8	150.2
Equity	58.0	65.6
Revenue	4.7	5.7

Source: Finance Bureau of Chenghua District, Statistical Bureau of Chenghua District, CCD and Lianhe Global's calculations

Analysts

Alex Kung
 +852 3462 9577
alex.kung@lhratingsglobal.com

Ben Yau
 +852 3462 9586
ben.yau@lhratingsglobal.com

Applicable Criteria

China Local Government Financing Vehicle Criteria (31 December 2021)

Lianhe Global has assigned 'BBB+' global scale Long-term Issuer Credit Rating with Stable Outlook to Chengdu Chenghua Development Group Co., Ltd.

Summary

The Issuer Credit Rating reflects a high possibility that The People's Government of Chenghua District ("Chenghua Government") would provide strong support to Chengdu Chenghua Development Group Co., Ltd. ("CCD" or the company) if needed. This mainly considers Chenghua Government's 90% ownership of CCD (with the other 10% owned by the Sichuan Provincial Department of Finance to subsidize the provincial Social Security Fund), CCD's strategic position as the flagship LGFV consolidating major development and investment entities of Chenghua District in Chengdu City, as well as the strong linkage between Chenghua Government and CCD, including management supervision, strategic alignment, and ongoing operational and financial support. In addition, Chenghua Government may face significant negative impact on its reputation and financing activities should CCD encounter any operational or financial difficulties.

The Stable Outlook reflects our expectation that CCD's strategic importance would remain intact while the Chengdu district government will continue to ensure CCD's stable operation.

Key Rating Rationales

Strong Linkage and Strategic Alignment with the Government: Chenghua Government has 90% ownership of CCD, while the remaining 10% was owned by the Sichuan Provincial Department of Finance to subsidize the provincial Social Security Fund. It also has strong control and supervision over CCD, including control of the board of directors, senior management appointments, as well as major strategic, investment and financing planning. In addition, Chenghua Government has comprehensive performance assessment policies for CCD. The company's strategic planning and development have been aligned with the local government's economic and social policies. It carries out the directions and policies of urban development and industry investment designated by Chenghua Government to support the local economic growth.

High Strategic Importance: As Chenghua Stated-owned Assets Supervision, Administration and Finance Bureau ("Chenghua SASAFB") transferred 100% ownership of five major LGFV to CCD, it has become the flagship LGFV in Chenghua District. We believe that Chenghua Government is willing to extend support to CCD in view of its strategic important role in Chenghua District's urban development, including primary land development, infrastructures and public facilities construction, resettlement housings development, shantytown renovations and comprehensive development for transit-oriented-development projects.

Ongoing Government Support: CCD's five subsidiaries received continuous support from the local government for their business operation, including capital injection, financial subsidies, allocation of land resources or assets, etc. Chenghua Government plans to inject RMB500 million to RMB1 billion to CCD per year in the coming five years to support its future

development, and CCD is responsible for allocating all financial subsidies from the government to its subsidiaries. The company received capital injection of RMB140 million in the first half of 2022.

Moderate Economic and Fiscal Conditions of Chenghua District: Chenghua District's GDP scale (RMB127.3 billion) and growth rate (9.9%) were ranked 6th and 4th among 23 jurisdictions of Chengdu in 2021, respectively. As the city's central area, Chenghua District's GDP was mostly fueled by secondary and tertiary industries, accounting for 30.1% and 69.9% of its total GDP. Chenghua District experienced relatively high GDP growth in the past few years (except 2020), supported by its urban development and industry upgrade plans.

Chenghua Government's fiscal revenue growth rates in the past three years were uneven due to the high fluctuation of its non-tax revenue. Its budgetary revenue decreased by 0.6% and 3.6%, in 2019 and 2020, respectively, but grew by 8% in 2021. Over the same period, incomes from government-managed fund and transfer payments accounted for 9.4%, 2.7% and 15.7%, and 12.8%, 35% and 27.4% of CCD's aggregate revenue, respectively. Nevertheless, Chenghua Government maintained its fiscal balance. The budget surplus was 6.7%, 4.9% and 7.7% in 2019, 2020 and 2021, respectively, while the fiscal debt ratio (total government debt outstanding / aggregate revenue) stayed at a manageable level during the same period.

Moderate Financials of CCD: CCD has experienced a rapid debt-funded expansion. The company's total asset reached RMB166.5 billion at end-June 2022, up from RMB109.7 billion at end-2019, while its debt surged to RMB74.8 billion from RMB34 billion during the same period. As a result, CCD's financial leverage as measured by total liability/total asset increased to 59.9% at end-June 2022, from 49.1% at end-2019.

Nevertheless, CCD's short-term debt was manageable. At end-June 2022, CCD had short-term debt of RMB18.8 billion, accounting for 25.2% of the company's total borrowings. At the same time, CCD had cash of RMB10.6 billion, covering 56.3% of its short-term maturities. In addition, CCD has access to multiple financing channels, including bank loans and bond issuances, etc., to support its debt repayment and business operation.

Limited Operating History: CCD was established in 2021 through the consolidation of five previously independently operating LGFVs in Chenghua District. They still enjoy a considerable degree of autonomy in terms of debt raising and business operation. We believe an effective consolidation, including centralized strategic and financial planning, risk management as well as resource allocation to support its subsidiaries' development, is vital for CCD to maintain its strategic importance.

Rating Sensitivities

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

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

Operating Environment

Moderate Economy and Fiscal Condition of Chenghua District

Chenghua District is one of five districts in Chengdu's central area, with a total land area of 109.3 square kilometers. According to the 7th National Census held in 2020, Chenghua District's residential population reached c. 1.4 million, accounting for 6.7% of Chengdu's residential population. Chenghua District realized GDP of RMB127.3 billion in 2021, representing a year-on-year growth rate of 9.9%. Its GDP scale and growth rate were ranked 6th and 4th among 23 jurisdictions of Chengdu, respectively. As a city central area, Chenghua District's GDP was entirely fueled by secondary and tertiary industry, accounting for 30.1% and 69.9% of its total GDP in 2021, respectively.

Chenghua District's urban development strategy has recently focused on urban renewal and transportation upgrades. It has adopted the concept of Transit-Oriented-Development ("TOD") to develop communities containing residential and commercial properties, hospitals, schools, parks, and sports and cultural centers within ten minutes' walking distance from the transportation hub. Chenghua has launched two TOD projects, namely Longtan Temper East Station [龙潭寺东站长] TOD and Chengdu East Station [成都东站长] TOD.

Looking forward, Chenghua Government attempts to continuously upgrade its industry by attracting advanced manufacturing and financial companies to set up production bases and regional hubs in Chenghua District. The government also plans to further develop its cultural tourism industry by taking advantage of the two "AAAA" grade national tourist attractions in Chenghua District, namely Chengdu Research Base of Giant Panda Breeding and Eastern Suburb Memory. The first is a well-known conservation and research institution for rare and endangered animals. The second is a music park reconstructed from the former site of the state-run Hongguang electron tube factory.

Chenghua District's GDP and Fixed Asset Investment

(RMB billion)	2019	2020	2021
GDP	106.0	110.3	127.3
-Primary industry (%)	0.0	0.0	0.0
-Secondary industry (%)	28.9	28.6	30.1
-Tertiary industry (%)	71.1	71.4	69.9
GDP growth rate (%)	7.9	3.2	9.9
Fixed asset investment	43.8	47.7	56.7
Fixed asset investment growth rate (%)	10.5	8.9	19.0
Residential population (million)	1.0	1.4	1.4

Source: Statistical Bureau of Chenghua District and Lianhe Global's calculation

Chenghua Government's fiscal revenue fluctuated in the past three years. Its budgetary revenue decreased by 0.6%, 3.6% in 2019 and 2020, respectively, but grew by 8% 2021, mainly due to the high fluctuation of its non-tax revenue. Whereas the tax revenue grew steadily to RMB6.3 billion at end-2021 from RMB5.3 billion at end-2019, representing a compound annual growth rate ("CAGR") of 9.0%. The tax revenue contributed 73.3% of the budgetary revenue in 2021, up from 64.4% in 2019. Despite the volatility of budgetary revenue, Chenghua Government maintained a budget surplus of 6.7%, 4.9% and 7.7% in 2019, 2020 and 2021, respectively.

The revenue from the government-managed fund, which was mainly generated by land use rights transfer, increased sharply to RMB2.4 billion in 2021 from RMB0.4 billion in 2020. At the same time, Chenghua Government received substantial transfer payments from the

higher-level government in 2020 and 2021. However, we believe the sustainability of government-managed fund and transfer payments are less predictable and subject to changes in relevant policies such as regulators' stance towards the property market, higher governments' subsidy policies, land transfer planning, etc.

Chenghua Government's debt was manageable. The fiscal debt ratio stayed at c. 35% in the past three years.

Chenghua Government's Fiscal Conditions			
(RMB billion)	2019	2020	2021
Budgetary revenue	8.2	7.9	8.5
Budgetary revenue growth rate (%)	-0.6	-3.6	8.0
-Tax revenue	5.3	5.6	6.3
-Tax revenue (% of budgetary revenue)	64.4	70.7	73.3
Government fund income	1.0	0.4	2.4
Transfer payment	1.4	4.5	4.2
Aggregate revenue	10.6	13.0	15.3
Budgetary expenditure	7.7	7.5	7.9
Budget deficit ¹ (%)	6.7	4.9	7.7

¹ Budget deficit = (1-budgetary expenditure / budgetary revenue) * 100%
 Source: Finance Bureau of Chenghua District and Lianhe Global's calculations

Ownership Structure and Profile

Full Government Ownership

CCD was established in 2021 and is wholly owned by Chenghua Government through the Chenghua SASAFB. After its establishment, the Chenghua SASAFB transferred 100% ownership of five major LGFV to CCD under Chenghua Government's instruction to build a flagship LGFV in Chenghua District.

In August 2022, Chenghua SASAFB transferred 10% of CCD's shares to the Sichuan Provincial Department of Finance to subsidize the provincial Social Security Fund. Despite the transfer, Chenghua Government maintains in direct control over CCD.

Strategic Importance and Government Linkage

The Strategic Importance of CCD to Chenghua Government

As Chenghua SASAFB transferred 100% ownership of five major LGFVs to CCD, it has become the flagship investment and development platform in Chenghua District. We believe that Chenghua Government is willing to extend support to CCD in view of its strategic important role in Chenghua District's urban development, including primary land development, infrastructures and public facilities construction, resettlement housings development, shanty town renovations and comprehensive development for TOD projects.

Although CCD's operating history is relatively short, it was established amid the policy backdrop of LGFV consolidations. CCD now takes the responsibility of supervising the strategic and financial management of five previously independently operating LGFVs in Chenghua District. The company also assists Chenghua SASAFB in senior management appointments and performance reviews for its subsidiary companies.

Nevertheless, we believe an effective consolidation, including centralized strategic and financial planning, risk management as well as resource allocation to support its subsidiaries' development, is vital for CCD to maintain its strategic importance.

Strong Linkage and Strategic Alignment with Chenghua Government

CCD's linkage with the local government is strong as it is mainly owned by Chenghua Government through the Chenghua SASAFB. Chenghua Government has strong control and supervision over CCD, including control of the board of directors, senior management appointments, as well as major strategic, investment and financing planning. In addition, Chenghua Government has comprehensive performance assessment policies for CCD.

CCD's strategic planning and development have been aligned with the local government's economic and social policies. It carries out the directions and policies of urban development and industry investment designated by Chenghua Government to support the local economy growth.

Ongoing Government Support including Capital Injections and Financial Subsidies

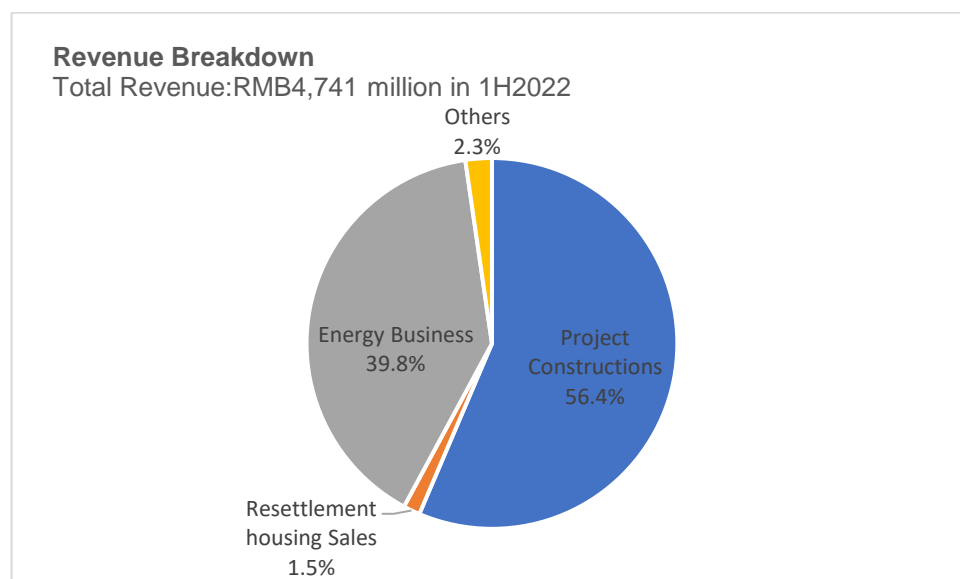
Prior to the consolidation, CCD's five subsidiaries received continuous support from the local government for their business operation, including capital injection, allocation of land resources or assets, etc. They also received financial subsidies from the local government to support projects related to public infrastructures.

Chenghua Government plans to inject RMB500 million to RMB1 billion to CCD per year in the coming five years to support its future development, and CCD is responsible for allocating all financial subsidies from the government to its subsidiary companies. In the first half of 2022, CCD received a capital injection of RMB140 million and financial subsidies of RMB35 million.

Business Profile

The Flagship LGFV Responsible for Urban Development Projects in Chenghua District

CCD undertakes most urban development projects in Chenghua District through its five subsidiaries. The project scope mainly includes primary land development, infrastructures and public facilities construction, resettlement housing developments, shantytown renovations and comprehensive development for TOD projects.



Source: CCD's 2022 unaudited interim report and Lianhe Global's calculation

Project Constructions

Project constructions were the major revenue contributor of CCD, accounting for 90% of CCD's total revenue in the past three years. The company entered agent construction agreements with the different departments of Chenghua Government. These agreements can be classified into two types based on the revenue recognition method. The first type recognizes construction costs plus an agreed-upon margin (14%-20%) as revenue. The second type recognizes management fees amounted to an agreed-upon percentage (usually 1%) of the annual project expenditures as revenue, and the entrusting parties reimburse total expenditures to CCD upon completion.

Although the project constructions' share in total revenue decreased to 56.4% in the first half of 2022, mainly due to the consolidation of the energy business, we expect this segment to remain CCD's most important activity, as it requires a substantial amount of investment in the next three years. At end-June 2022, CCD had more than 400 projects under construction or scheduled to be constructed, with a total investment of c. RMB85.2 billion, and RMB54.4 billion had been invested. CCD is responsible for the fundraising of c. 85% of the abovementioned projects, and it plans to invest RMB4.8 billion and RMB9.0 billion in project constructions in the second half of 2022 and 2023, respectively.

Resettlement House Sales

CCD also developed resettlement houses for sales in addition to developing for entrusting parties according to agent construction agreements. Its revenue contribution was relatively small and volatile due to the limited project number and scale. Yet the segment's gross margin was stable at c. 40% in the past three years. This was because most houses were sold to 成都市跃华房屋经营开发有限公司, a wholly owned entity of the Chenghua SASAFB, which paid RMB2.5 billion in advance in 2018 to buy resettlement houses with a total GFA of 235.4 thousand square meters from CCD. By end-June 2022, CCD had recognized revenue of c. RMB1.7 billion from the above-mentioned resettlement house project.

In addition, CCD is developing 4 resettlement house projects under the government's instruction and to be sold to residents affected by urban development projects at prices

agreed upon with the government. The total investment amounts to c. RMB 5.5 billion and c. RMB3.4 billion million had been invested by end-June 2022. CCD schedules to invest RMB700 million and RMB740 million to develop resettlement houses in the second half of 2022 and 2023, respectively.

Energy Business

CCD has participated in the energy business since the first half of 2022 by consolidating Sichuan Yuesheng Energy Group Limited Company (“Yuesheng Energy”). On 1 April 2022, Chenghua SASAFB transferred its controlling right over Chengdu Dongguang Energy Limited Company (“Dongguang Energy”), which owns 51% shareholding of Yuesheng Energy, to CCD. CNPC Chuanqing Drilling Engineering Company Limited, a wholly owned subsidiary of CNPC Group, owns the remaining 49% shareholding of Yuesheng Energy.

Yuesheng Energy was established in 1991. It mainly engages in sales of petrochemical products and provides technical and logistics services such as drilling and equipment leasing for the energy industry. In the first half of 2022, Yuesheng Energy recorded revenue of RMB1,888 million, representing 44.4% of CCD’s overall revenue.

Others

CCD’s other businesses mainly include property leasing, property management, catering and labour dispatching. CCD plans to engage in industry investments, tourism and health care businesses. These businesses only accounted for a small percentage of CCD’s total revenue.

Financial Profile

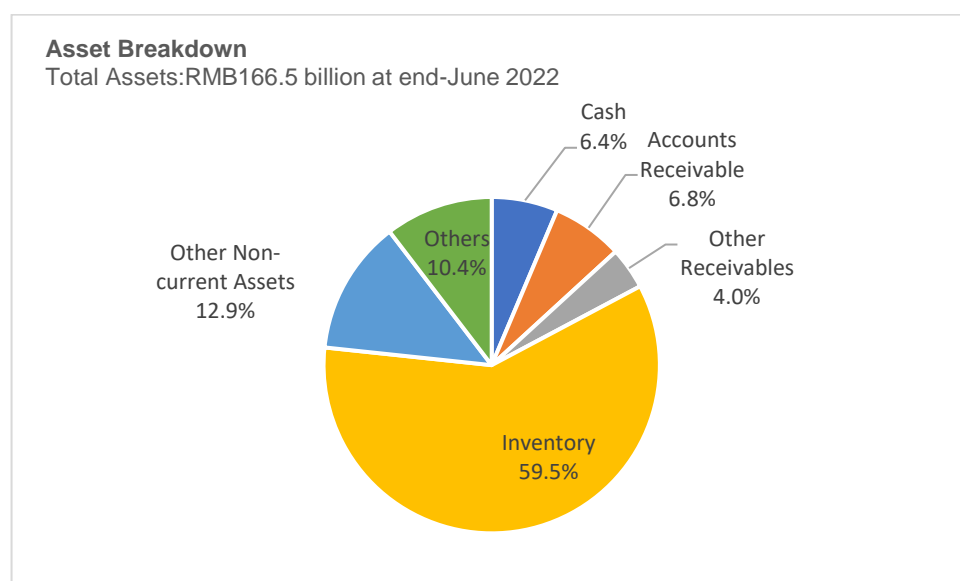
Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2019	2020	2021	June 2022
Total Asset	109,727	126,805	150,203	166,529
Equity	55,808	58,008	65,618	66,809
Debt	34,034	48,792	68,613	74,775
Debt/(Debt+Equity) (%)	37.9	45.7	51.1	52.8
LT Debt	27,038	40,836	54,198	55,961
LT Debt/ (LT Debt+Equity) (%)	32.6	41.3	45.2	45.6

Source: CCD’s 2022 unaudited interim report, 2021 audited annual report, 2018-2020 audited proforma reports and Lianhe Global’s calculation

CCD’s asset size has experienced a rapid expansion since 2019 due to the company’s intensive engagement in the project constructions business. The company’s total asset increased to RMB150.2 billion at end-2021 from RMB109.7 billion at end-2019, representing a CAGR of 17%. It further increased by 10.9% to RMB166.5 billion at end-June 2022.

CCD has chiefly relied on borrowings to fund its expansion. The total debt of the company surged to RMB68.7 billion at end-2021, up from RMB34.1 billion at end-2019, representing a high CAGR of 42.0%. The company continued to borrow heavily in the first half of 2022, lifting its total debt to RMB74.8 billion at end-June 2022. As a result, CCD’s financial leverage as measured by total debt/capitalization increased to 52.8% from 37.9% during the period. Over the same period, CCD’s total liability to total asset ratio increased to 59.9% from 49.1%. The company targets to maintain the ratio at below 70% level.



Source: CCD's 2022 unaudited interim report and Lianhe Global's calculation

Although the current asset contributed c.80% of CCD's total assets, the company's liquidity was weak. This was because CCD's current assets mainly consisted of inventory, including completed but not yet settled projects, land to be developed as well as construction costs. At end-June 2022, CCD had inventories of RMB99.0 billion, representing 59.5% of CCD's total asset.

At the same time, CCD had account receivables and other receivables of RMB11.4 billion and RMB6.7 billion, respectively, mainly due from government departments of Chenghua District, without specified cash collection schedules.

In addition, CCD had other non-current assets of RMB21.5 billion at end-June 2022, representing 12.9% of the company's total asset. They were construction costs under the management fee model of construction projects.

Due to the long construction, recognition and payment period, CCD's project-related assets could take a prolonged period to convert to cash. Whereas, we expect Chenghua Government to pay CCD accordingly to ensure that CCD is able to meet its financial obligations when they become due.

Cash Flow

Cash Flow (RMB million)	2019	2020	2021	1H2022
Cash Inflows from Operation	9,107	7,774	23,283	13,540
Cash Outflows from Operation	10,430	10,007	27,422	14,134
Net CF from Operation	-1,323	-2,233	-4,139	-595
Cash Inflows from Investment	1,099	281	1,204	1,257
Cash Outflows from Investment	3,827	4,465	5,131	2,303
Net CF from Investment	-2,728	-4,184	-3,927	-1,046
Cash Inflows from Financing	12,490	25,450	32,365	12,555
Capital Contribution	1,512	964	1,222	181
Borrowings and Bond Issuances	10,593	23,070	29,685	9,992
Others	385	1,415	1,458	1,680
Cash Outflows from Financing	9,338	17,507	21,000	9,196
Net CF from Financing	3,152	7,942	11,366	3,360
Net Increase in Cash and cash equivalent	-918	1,448	3,291	1,773

Source: CCD's 2022 unaudited interim report, 2021 audited annual report, 2018-2020 audited proforma reports and Lianhe Global's calculation

Debt Servicing Capability

Debt Maturity Profile at end-June 2022

(RMB million)	Amount	%
2H2022	10,386	13.89%
1H2023	8,428	11.3%
2H2023	5,032	6.73%
2024	11,771	15.74%
2025	10,334	13.82%
2026	5,784	7.73%
2027 and thereafter	23,040	30.81%
Total	74,775	100.00%

Source: CCD and Lianhe Global's calculations

At end-June 2022, CCD had short-term debt of RMB18.8 billion, accounting for 25.2% of the company's total borrowing. At the same time, CCD had cash of RMB10.6 billion, covering 56.3% of its short-term maturities. In addition, CCD has access to multiple financing channels, including bank borrowings and bond issuances, etc., to support its debt repayment and business operation.

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