

Chengdu Vartaim Cultural Tourism Development Co., Ltd.

Initial Issuer Report

Summary

Issuer Rating	BBB+
Outlook	Stable
Location	China
Industry	Local Investment and Development Companies
Date	20 December 2023

Key Figures of Chenghua District and Vartaim (RMB billion)

Chenghua District	2021	2022
GDP	127.3	136.1
GDP growth rate (%)	9.9	5.0
Budgetary revenue	8.7	9.0
Government fund	3.5	2.9
Transfer payment	4.7	6.2
Budgetary expenditure	7.7	8.9
Vartaim	2022	2022.9
Total Asset	20.3	25.7
Equity	12.8	13.1
Revenue	0.98	0.77

Source: Public information, Vartaim and Lianhe Global's calculations

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'BBB+' global scale Long-term Issuer Credit Rating with Stable Outlook to Chengdu Vartaim Cultural Tourism Development Co., Ltd.

Summary

The Issuer Credit Rating reflects a high possibility that The People's Government of Chenghua District ("the Chenghua government") would provide strong support to Chengdu Vartaim Cultural Tourism Development Co., Ltd. ("Vartaim" or the company) if needed. This mainly considers the Chenghua government's indirect majority ownership of Vartaim, Vartaim's strategic position as an important investment and development company responsible for urban renewal, as well as development and operation of cultural tourism in Chengdu's Chenghua District, and the strong linkage between the Chenghua government and Vartaim, including management supervision, strategic alignment, and ongoing operational and financial support. In addition, the Chenghua government may face significant negative impact on its reputation and financing activities should Vartaim encounter any operational or financial difficulties.

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

Key Rating Rationales

Government's Ownership and Supervision: The State-owned Assets Supervision, Administration and Financial Bureau of Chenghua District ("Chenghua SASAFB") indirectly owns 90% ownership of Vartaim through Chengdu Chenghua Urban Area Reconstruction Investment Co., Ltd. ("CURI"), one of five major Local Investment and Development Companies ("LIDC") under Chengdu Chenghua Development Group Co., Ltd. ("CCD"; 'A-/Stable'), the flagship platform in Chenghua District. The Chenghua government, as the company's ultimate controller, has strong control over Vartaim through its shareholder, including the supervision of senior management, development strategy, major financing plan and investment decision. In addition, the local government has formulated a performance assessment policy for the company, and regularly reviews the company's operating performance and financial position through the Audit Bureau.

Strategic Alignment and Importance: Vartaim's business operation and strategic planning have been aligned with the local government's economic and social policies. Vartaim is an important LIDC in Chenghua District that is mainly responsible for urban renewal projects. The company also develops and operates cultural tourism projects within the region. It plays a significant role in Chenghua District's urban development and cultural tourism industry development. Especially, promoting the development of cultural tourism is one of the local government's key tasks in the coming years.

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Applicable Criteria

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

Ongoing Government Support: Vartaim receives ongoing support in forms of financial subsidies and asset/capital injections from the local government to support its business operations. Between 2020 and end-September 2023, the Chenghua government and its shareholder injected cash amounting to RMB3.0 billion, and assets, including state-owned properties, projects and equipment valued at RMB9.3 billion, into Vartaim. Over the same period, the local government provided financial subsidies totaling RMB262 million to Vartaim. We expect Vartaim to receive ongoing support from the local government in the coming years considering its strategic importance in Chenghua District.

Economic and Fiscal Conditions of Chenghua District: Chenghua District's GDP reached RMB136.1 billion in 2022, representing a year-on-year growth rate of 5.0%, slowing down from 9.9% in 2021 due to the Covid's impact. Fixed asset investment growth rate of Chenghua District also slowed to 0.9% in 2022 from 19.0% in 2021, mainly due to the significant drop in infrastructure investment. Nevertheless, as the central area of Chengdu city, Chenghua District has a well-developed economic structure, with secondary and tertiary industry accounting for 38.4% and 61.6% of its total GDP in 2022. At the same time, its GDP scale and growth rate was ranked 6th and 5th among 23 jurisdictions of Chengdu, respectively.

The Chenghua government's aggregate revenue increased steadily to RMB18.4 billion in 2022 from 17.1 billion in 2021. Its budgetary revenue increased by 3.7% to RMB9.0 billion in 2022, and kept a budget surplus of 1.0% in 2022, despite the narrowing trend compared with the previous year. At the same time, the Chenghua government received substantial transfer payments from the higher-level government, increasing to RMB6.2 billion in 2022 from RMB4.6 billion in 2020. However, the revenue from the government-managed fund, which was mainly generated by land use rights transfer, decreased to RMB2.9 billion in 2022 from RMB3.5 billion in 2021, owing to weak property market.

The Chenghua government's debt was manageable. At end-2022, the Chenghua government's outstanding debt was RMB6.1 billion. Its fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, stayed at manageable level of 34% in the past three years.

Vartaim's Financial and Liquidity Position: Vartaim's asset size surged in the past three years, as the local government and its shareholder transferred an array of assets to the company. Yet its financial leverage, as measured by debt capitalization ratio, was fluctuant. It dropped to 34.4% at end-2022 from 64.5 at end-2021 owing to the asset and capital injections during the year. Then it increased to 45.8% at end-September 2023, as the company borrowed heavily to support its urban renewal and cultural tourism projects. We expect its total debt and financial leverage to keep increasing in the next two to three years, considering that Vartaim has a lot of projects to be completed.

Vartaim's asset liquidity was relatively weak. As the company actively participated in urban renewal and cultural tourism projects in Chenghua District, it accumulated sizeable inventories (mainly construction costs and land to be developed). These assets usually take a long time to monetize due to the protracted construction and payment collection period.

Vartaim's pressure of short-term debt was manageable, as long-term debt contributed 87.2% to its total debt at end-September 2023. At the same time, Vartaim had cash balance of RMB1.8 billion, as compared with its short-term debts of RMB1.4 billion. The company has access to various financing channels, including bank borrowing and other non-traditional financing channels to support its operation and debt repayment. Vartaim had unused bank line of RMB16.4 billion at end-September 2023.

Rating Sensitivities

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

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

Operating Environment

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. At end-2022, Chenghua District's residential population reached 1.4 million, accounting for 6.6% of Chengdu's residential population.

Chenghua District's GDP reached RMB136.1 billion in 2022, representing a year-on-year growth rate of 5.0%. Its GDP scale and growth rate was ranked 6th and 5th 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 38.4% and 61.6% of its total GDP in 2022, respectively. Fixed asset investment growth rate of Chenghua District slowed down to 0.9% in 2022 from 19.0% in 2021, mainly due to the significant drop in infrastructure investment.

Chenghua District's GDP and Fixed Asset Investment

(RMB billion)	2020	2021	2022
GDP	110.3	127.3	136.1
-Primary industry (%)	0.0	0.0	0.0
-Secondary industry (%)	28.6	30.1	38.4
-Tertiary industry (%)	71.4	69.9	61.6
GDP growth rate (%)	3.2	9.9	5.0
Fixed asset investment	47.7	56.7	57.3
Fixed asset investment growth rate (%)	8.9	19.0	0.9
Residential population (million)	1.38	1.40	1.40

Source: public information and Lianhe Global's calculation

The Chenghua government's aggregate fiscal revenues were mainly derived from budgetary revenue and transfer payment. Its budgetary revenue increased by 3.7% to RMB9.0 billion in 2022, mainly due to the strong growth in tax revenue, which contributed 76.8% of the budgetary revenue in 2022, up from 74.4% in 2021. In addition, the Chenghua government kept a budget surplus of 1.0% in 2022, despite the narrowing trend compared with the previous year.

The revenue from the government-managed fund, which was mainly generated by land use rights transfer, decreased to RMB2.9 billion in 2022 from RMB3.5 billion in 2021, owing to weak property market. At the same time, the Chenghua government received substantial transfer payments from the higher-level government, increasing to RMB6.2 billion in 2022 from RMB4.6 billion in 2020.

The Chenghua government's debt was manageable. At end-2022, the Chenghua government's outstanding debt was RMB6.1 billion, including RMB1.2 billion of general obligations and RMB4.9 billion of special debt. the Chenghua government's fiscal debt ratio, as measured by total government debt outstanding/aggregate revenue, stayed at 34% in the past three years.

the Chenghua government's Fiscal Conditions			
(RMB billion)	2020	2021	2022
Budgetary revenue	7.9	8.7	9.0
Budgetary revenue growth rate (%)	-3.6	9.5	3.7
-Tax revenue	5.6	6.4	6.9
-Tax revenue (% of budgetary revenue)	70.7	74.4	76.8
Government fund income	0.4	3.5	2.9
Transfer payment	4.6	4.7	6.2
Aggregate revenue	13.0	17.1	18.4
Budgetary expenditure	7.5	7.7	8.9
Budget balance ¹ (%)	4.9	10.8	1.0

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

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

Ownership Structure and Profile

Full Government Ownership

Vartaim was established in May 2017 with an initial registered capital of RMB30 million, funded by the CURI, which is one of five major LIDC under CCD, the flagship platform in Chenghua District. After an array of capital injections, the Vartaim's registered and paid-in capital were enlarged to RMB3.5 billion and RMB3.4 billion at end-September 2023, respectively. Vartaim was wholly owned by CURI and ultimately controlled by Chenghua SASAB.

Strategic Importance and Government Linkage

The Strategic Importance and Alignment of Vartaim to the Chenghua government

Vartaim's business operation and strategic planning have been aligned with the local government's economic and social policies. Vartaim is an important LIDC in Chenghua District that is mainly responsible for urban renewal projects. The company also develops and operates cultural tourism projects within the region. It plays a significant role in Chenghua District's urban development and cultural tourism industry development. Especially, promoting the development of cultural tourism is one of the local government's key tasks in the coming years.

Strong Linkage with the Chenghua government

Vartaim's linkage with the local government is strong as Chenghua SASAFB indirectly owns 90% shares of Vartaim through CCD and CURI, and is the company's ultimate controller. The Chenghua government has strong control over Vartaim through its shareholder, including the supervision of senior management, development strategy, major financing plan and investment decision. In addition, the local government has formulated a performance assessment policy for the company, and regularly reviews the company's operating performance and financial position through the Audit Bureau.

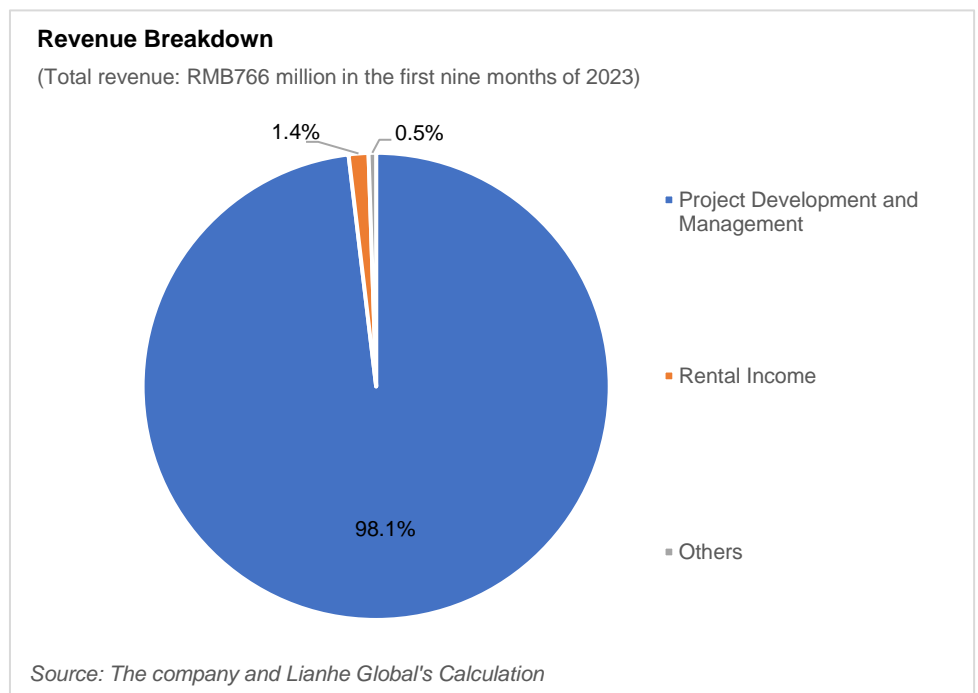
Ongoing Government Support

Vartaim receives ongoing support in forms of financial subsidies and asset/capital injections from the local government and its shareholder to support its business operations. Between 2020 and end-September 2023, the Chenghua government and its shareholder injected cash amounting to RMB3.0 billion and assets, including state-owned properties, projects and equipment valued at RMB9.3 billion, into Vartaim. Over the same period, the local government provided financial subsidies totaling RMB262 million to Vartaim. We expect Vartaim to receive ongoing support from the local government in the coming years considering its strategic importance in Chenghua District.

Business Profile

An Important LIDC Responsible for Urban Renewal and Cultural Tourism Development in Chenghua District

Vartaim, as an important LIDC in Chenghua District, is mainly responsible for urban renewal and cultural tourism development within the region. As Chenghua District accelerated its pace of urban renewal and actively promoted the development of cultural tourism industry, the company's total revenue grew rapidly in the past few years, recording at RMB9 million, 309 million, 984 million and 766 million in 2020, 2021, 2022 and the first nine months of 2023, respectively.



Project Development and Management

Vartaim is designated by Chenghua government to undertake urban renewal projects, including demolition, land consolidation and infrastructure construction, etc., within Chenghua District. The company mainly adopts cost mark-up model to conduct these projects. Under the agent construction model, Vartaim is responsible for fund raising and construction of entrusted projects, then settles construction costs plus 18% of margin annually with the entrusting party according to the project's progress.

In addition, CURI transferred an array of projects under construction to Vartaim in 2022. The company should handle the injected projects' subsequent investment, management and construction and charge management fee amounting to 1% incremental investment annually.

Vartaim had a strong project pipeline with total planned investment of RMB36.4 billion at end-2022, of which RMB22.5 billion was scheduled to be invested in the coming years. This could support the segment's ongoing development yet bring a high capital expenditure pressure on Vartaim.

Rental Income

Vartaim's rental income was mainly generated by its cultural tourism projects. The income scale was limited in the past three years, as the cultural tourism business was at a premature stage with only a few projects in operation. Yet cultural tourism is Vartaim's priority in the coming years. By end-2022, Vartaim had six cultural tourism projects under construction with total planned investment totaling RMB6.4 billion. We expect Vartaim's cultural tourism related incomes, such as leasing, selling and property management, to increase as the company complete these projects gradually.

Financial Profile

Balance Sheet Structure and Quality

Balance Sheet Structure and Quality				
(RMB million)	2020	2021	2022	Sept. 2023
Total Asset	2,868	6,296	20,277	25,656
Equity	1,190	2,033	12,802	13,135
Debt	500	3,687	6,699	11,083
Debt/(Debt+Equity) (%)	29.6	64.5	34.4	45.8
LT Debt	500	3,687	6,369	9,667
LT Debt/ (LT Debt+Equity) (%)	29.6	64.5	33.2	42.4

Source: The company and Lianhe Global's calculation

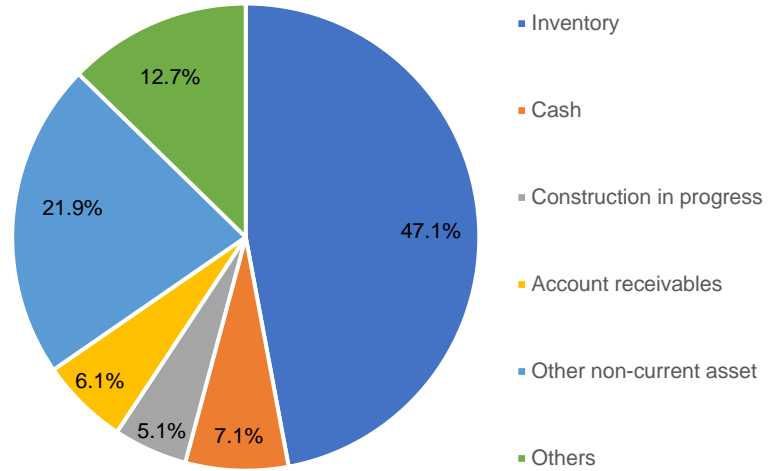
Vartaim's asset size surged to RMB25.7 billion at end-September 2023 from RMB2.9 billion at end-2020, as the local government and its shareholder transferred an array of assets to the company between 2022 and the first nine months of 2023. Vartaim's financial leverage, as measured by debt capitalization ratio, was fluctuant in the past three years. It dropped to 34.4% at end-2022 from 64.5 at end-2021 owing to the asset and capital injections during the year. Then it increased to 45.8% at end-September 2023, as the company borrowed heavily to support its urban renewal and cultural tourism projects. We expect its total debt and financial leverage to keep increasing in the next two to three years, considering that Vartaim has a lot of projects to be completed.

Vartaim's asset liquidity was relatively weak. As the company actively participated in urban renewal and cultural tourism projects in Chenghua District, it accumulated sizeable inventories (mainly construction costs and land to be developed), which amounted to RMB12.1 billion at end-September 2023, accounting for 47.1% of the company's total assets. These assets usually take a long time to monetize due to the protracted construction and payment collection period. Besides, the company had other non-current assets of RMB5.6 billion at end-September 2023, which mainly comprised of a series of projects under construction that Vartaim took over from CURI.



Asset Breakdown

(Total Assets: RMB25.7 billion at end-September 2023)



Source: The company and Lianhe Global's calculation

Debt Servicing Capability

Vartaim's pressure of short-term debt was manageable, as long-term debt contributed 87.2% to its total debt at end-September 2023. At the same time, Vartaim had cash balance of RMB1.8 billion, as compared with its short-term debts of RMB1.4 billion. The company has access to various financing channels, including bank borrowing and other non-traditional financing channels to support its operation and debt repayment. Vartaim had unused bank line of RMB16.4 billion at end-September 2023.

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