Zhongliang Holdings Group Company Limited

Surveillance Report

Lianhe Ratings Global Limited ("Lianhe Global") has affirmed 'BB' global scale Long-term Issuer and Issuance Credit Rating of Zhongliang Holdings Group Company Limited; Issuer Rating Outlook is Stable

Summary	
Issuer Rating	BB
Outlook	Stable
Location	China
Industry	Homebuilder and Real Estate
Date	11 February 2022

Summary

The Issuer Rating reflects Zhongliang Holdings Group Company Limited's ("Zhongliang" or "the company") established market position and large footprint in the Yangtze River Delta ("YRD") region. Zhongliang maintains substantial joint ventures ("JV") participation across its footprint. Zhongliang has exhibited a strong operating efficiency in terms of standardized process and products, sales execution and high cash collection rate via its decentralized projection teams but centralized financial control. Zhongliang's rating is constrained by its high financial leverage as a result of debt-funded expansion in the prior years.

The Stable Outlook reflects our expectation that Zhongliang would maintain its market position in a prudent manner. Nevertheless, Zhongliang may face challenges to its contracted sales amid tough market conditions, and heightened refinancing and liquidity pressure to manage its maturing financial obligations.

Operating Data: Zhongliang Holdings Group Company Limited

	31 Dec 2020	30 Jun 2021
Revenue (RMB: in million)	65,941	32,906
Contracted Sales (RMB: in million)	168,771	95,025
Contracted Sales ASP (RMB/square meter)	12,500	12,600
Contracted Sales GFA (million square meters)	13.5	7.5
Land Bank GFA (million square meters)	65.1	65.8

ASP: Average Selling Price
GFA: Gross Floor Area
Source: Zhongliangl's 2020 annual report and 2021 interim report

Rating Rationale

Large-Scale Property Developer with a Nationwide Presence; Strong Market Position in the YRD Region: Zhongliang was ranked 20th among all Chinese property developers in terms of gross contracted sales in 2021, according to CRIC, and it has maintained its top-20 position for three consecutive years since 2018. At end-June 2021, the company had 494 projects covering 155 cities across the nation. The large operating scale and diversified layout provide a certain extent of resilience to Zhongliang in challenging market conditions.

As a property developer headquartered in Shanghai, Zhongliang has established a strong market position and well-recognized brand name in YRD. The region contributed c. 60% of the company's contracted sales in the past three years. The relatively stable market demand in the YRD region helps the company to keep its ASP at c. RMB12,000/sq.m. and sell-through rate at c. 70%. In addition, the mortgage loan restrictions were partially relaxed since 4Q2021 in the YRD region, which improved its cash collection rate to c. 85%. We believe stable cash inflow derived from contracted sales is a crucial source of liquidity for the company under the current tightening financing environment.

Increasing Penetration of Higher-Tier Cities with High Exposure to Joint Ventures: Zhongliang further improved its penetration in higher-tier cities. In 1H2021, c. 50% of its contracted sales derived from tier-2 cities, up from 24% in 2018.

However, as Zhongliang expanded into higher-tier cities, where land costs are high, it relied more on JVs participation to share the burden. This resulted in a high percentage of non-controlling interests, which accounted for 66% and 64% of the total equity at end-June 2021 and end-2020, respectively. JVs participation helped the company to gain market share in a short

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Applicable Criteria
Chinese Property Developer Rating Criteria (31 December 2021)

time. However, it might lower the company's financial transparency and reduce its accessibility to cash balance, as a large portion of that could be trapped at project companies' level.

Contracted Sales under Pressure amid China Property Market's Downturn; Revenue Remains Stable but Gross Margin Shrinking: Zhongliang reported gross contracted sales of RMB171.8 billion in 2021. Although the company achieved considerable period-on-period growth of 40.4% in gross contracted sales in 1H2021, it missed its full-year target of RMB180 billion in 2021, as the market demand turned weak in 2H2021. Zhongliang's gross contracted sales recorded a 24.1% period-on-period decrease in the second half of 2021. We expect the property demand to remain weak which continuously putting pressure on the company's contracted sales for the next 12 months.

We expect Zhongliang to maintain stable revenue, with 4-6% year-on-year growth in 2021-2023, due to the moderate growth of contracted sales in the past three years. However, as the company faces intense competition and rising land costs as it turns to higher-tier cities, we expect its gross margin to decrease to 18%-19% in 2021-2023 from the previous level of above 20%.

Decreasing Financial Leverage but Tight Liquidity: Zhongliang repaid a considerable amount of maturing debts with internal sources in 2H2021. Therefore, we expect Zhongliang's reported interest-bearing debt would be reduced to c. RMB40 billion at end-2021 from RMB54.6 billion at end-June 2021. As the financing condition remains tough in both the onshore and offshore capital markets, we expect the company would not continue its debt-driven business model in the next 12 to 18 months. Therefore, we project Zhongliang's leverage, as measured by the debt/capitalization ratio, to decrease to c. 60% from c. 70% in the next 12 to 18 months. However, Zhongliang still has a large amount of USD notes that will mature in 2022. The company may need to continue to mobilize its cash on hand to repay all the outstanding USD notes when they come due. This put further pressure on the company's liquidity.

Zhongliang has demonstrated a solid track record of liquidity risk management. The company has reduced land acquisitions since 2H2021, despite lowering its land bank life to 2-3 years. The company also postponed the 2021 interim dividend to preserve cash. Zhongliang actively managed its incoming maturities by proceeding with multiple sizeable repurchases and remitting necessary funds to the offshore bank in advance. Nevertheless, we believe that maintaining stable contracted sales and improving access to its cash under regulatory accounts are crucial to prevent the company's liquidity from deteriorating.

Rating Sensitivities

We would consider downgrading Zhongliang's rating if it were to (1) aggressively replenish its land bank which result in an increase in its financial leverage as measured by debt/capitalization to over 75% or a decrease in its EBITDA interest coverage to below 2.0x consistently, and/or (2) its operating performance were to deteriorate such that its contracted sales and/or revenue experience a material decline or liquidity profile is worsened.

We would consider upgrading Zhongliang's rating if it were to (1) considerably increase its operating scale, and (2) maintain its financial leverage as measured by debt/capitalization at below 60% or EBITDA interest coverage at above 3.0x consistently.

Company Profile

Zhongliang is a Chinese property developer headquartered in Shanghai. The company is principally engaged in developing quality residential properties in tier 2 and tier 3 cities, targeting first-time home purchasers and first-time and second-time home upgraders. The company is also involved in developing, operating, and managing commercial properties. Zhongliang was listed on the Main Board of the Stock Exchange of Hong Kong Limited (Stock Code: 2772.HK) on 16 July 2019.

Zhongliang has achieved nationwide operating coverage by entering 155 cities in 25 provinces and municipalities across five strategic economic areas: Yangtze River Delta, Midwest China, Pan-Bohai Rim, and Western Taiwan Straits and Pearl River Delta.

The YRD region is the primary operating area of Zhongliang, contributing c. 58% of gross contracted sales to the company in 1H2021.

Zhongliang's Gross Contracted Sales Breakdown by regions (RMB: in million)

Gross Contracted Sales / % of total	FY2019		FY2020		1H2021	
Yangtze River Delta	89,986	59.0%	109,259	64.7%	55,058	58.0%
Midwest China	35,805	23.5%	36,266	21.5%	21,075	22.2%
Pan-Bohai Rim	10,374	6.8%	11,857	7.0%	9,718	10.2%
Western Taiwan Straits	13,112	8.6%	9,258	5.5%	7,924	8.3%
Pearl River Delta	3,232	2.1%	2,131	1.3%	1,250	1.3%
Total	**152,509**	**100.0%**	**168,771**	**100.0%**	**95,025**	**100.0%**

Source: Zhongliang's annual and interim reports

At end-June 2021, Mr. Yang Jian, the founder and the chairman of the company, and his spouse Ms. Xu Xiaoqun together held c. 82.94% issued capital of Zhongliang.

Zhongliang's Shareholding Structure (at end-June 2021)

Shareholder	Percentage
Yang Jian (Founder and Chairman)	81.28%
Xu Xiaoqun (Mr. Yang Jian's spouse)	1.66%
Public	17.06%
Total	**100.0%**

Source: Zhongliang's 2021 interim report

Key Financial Assumptions

- Contracted sales amount: RMB172-154 billion for 2021-2023
- Contracted average selling price: RMB12,000 for 2021-2023
- Total revenue: RMB69 - 75 billion for 2021-2023

Key Financial Metrics

2019A-2023F	Debt/Land Bank	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	25.7%	1.94x	60.38%	0.29x

Source: Zhongliang's 2019-2020 annual and 2021 interim reports, Lianhe Global's adjustments and forecasts

Full List of Issuance Ratings

A full list of affirmed issuance ratings is included below. Any rating action on Zhongliang's rating would result in a similar rating action on the USD notes:

- USD450 million 9.5% senior unsecured notes due 2022 affirmed at 'BB'

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