Jiangsu Zhongnan Construction Group Co., Ltd.

Surveillance Report

Summary	
Issuer Rating	B
Outlook	N/A (Rating Watch Negative)
Location	China
Industry	Homebuilder and Real Estate
Date	23 May 2022

Operating Data:
Jiangsu Zhongnan Construction Group Co., Ltd.

	31 Dec 2020	31 Dec 2021
Revenue (RMB: in million)	78,601	79,211
Contracted Sales (RMB: in billion)	223.8	197.4
Contracted Average Selling Price (RMB/square meter)	13,281	13,439
Contracted Sales GFA (million square meters)	16.85	14.69
Land Bank GFA (million square meters)	44.72	41.35

GFA: Gross Floor Area
Source: Zhongnan

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

Lianhe Ratings Global Limited ("Lianhe Global") downgrades Jiangsu Zhongnan Construction Group Co., Ltd.'s global scale Long-term Issuer Credit Rating to 'B' from 'BB'; On Rating Watch Negative

Summary

The Issuer Rating downgrade to 'B' from 'BB' reflects Jiangsu Zhongnan Construction Group Co., Ltd.'s (000961.SZ) ("Zhongnan" or "the company") deteriorating contracted sales, profitability and financial metrics, which are worse than our previous expectations. Also, Zhongnan's weakened cash position and access to financing channels put pressure on its liquidity and financial flexibility. Zhongnan's current liquidity position does not commensurate with the 'BB' rating category. We believe Zhongnan will face challenges to its contracted sales, liquidity and access to refinancing channels amid the challenging market conditions.

The RWN reflects the increasing refinancing risk of Zhongnan on its maturing USD notes, which could lead to further downgrade to the company's ratings.

Rating Rationale

Deteriorating Contracted Sales Despite Sizable and Diversified Land Bank: Zhongnan's contracted sales weakened in 2021. The company's total contracted sales reached RMB197.4 billion in 2021, representing a year-on-year decrease of 11.8%. In comparison, Zhongnan recorded contracted sales growth of 52.2%, 33.7% and 14.2% in 2018-2020, respectively. Besides, the company reported contracted sales with a year-on-year decline of 69.1% to RMB21.2 billion for the first four months of 2022, mainly due to the recent resurgence of the COVID-19 variant cases in the Yangtze River Delta (YRD) region. We expect the company's contracted sales to drop by 20-30% in the next 12 months.

Zhongnan had a sizable and diversified land bank portfolio with a total GFA of 41.3 million sq.m across 123 cities in China at end-2021. Zhongnan has deep penetration and brand awareness in the YRD region, particularly Jiangsu province, and gradually expands to central and western, the Bohai Rim region and the Pearl River Delta region in China. However, Zhongnan's land bank was primarily located in tier 2 and 3 cities, which accounted for over 95% of its land bank at end-2021. Moreover, given the tight liquidity and challenging financing conditions, Zhongnan has stayed cautious and temporarily halted land acquisition since the second half of 2021. The company prioritizes liquidity management over geographical expansion and land replenishment. We believe the company's current land bank on hand is adequate for development in the next two to three years.

Weak Profitability due to the Destocking Strategy and Low-Margin Construction Segment: Zhongnan's property development segment's gross margin dropped to 10.7% in 2021, compared with 17-20% in 2018-2020, mainly due to the inventory destocking and price cut strategies implemented in the fourth quarter of 2021. The segment gross margin was below the industry average level. In order to accelerate contracted sales and asset turnover, we expect the segment's gross margin to remain low at 10-15% in the next 12 months.

Apart from the property development, Zhongnan has an established construction segment which is expected to aid its property development segment's expansion, especially outside of Jiangsu province. Contributing c. 27.9% of Zhongnan's total revenue in 2021, the construction segment's gross margin was low at c. 8-12% in 2018-2020 and further declined to 6.4% in 2021. We expect this segment to exhibit moderate revenue growth with a gross margin of 6-9% in the next 12 months. Overall, we expect Zhongnan's gross margin to remain low and below the industry average level in the next 12 months.

Deteriorating Liquidity due to Weakened Refinancing Capability: We believe Zhongnan's refinancing capability has weakened since the second half of 2021. The outstanding amount of non-traditional banking products, such as trust loans which typically carry higher funding costs, increased in 2021, while that of bank loans and bonds decreased during the same period. As a result, exposure to non-traditional banking products, increased to c. 35% of Zhongnan's total debt at end-2021, compared with c. 27% and 22% at end-2019 and end-2020, respectively.

As Zhongnan used the internal fund to repay maturing bonds and loans amid the challenging financing conditions, its reported total debt decreased from RMB79.9 billion at end-2020 to RMB62.3 billion at end-2021. Given the weakened access to refinancing channels, we believe Zhongnan will continue to rely on internal resources to repay its debt and lower its total debt level in the next 12 months. However, Zhongnan's EBITDA interest coverage ratio deteriorated to c. 1.4x at end-2021 due to the decline in gross margin, as compared with c. 1.7x at end-2020. Given the aforementioned expectation of a low profit margin, we expect Zhongnan's EBITDA interest coverage ratio to remain low in the next 12 months.

Zhongnan's liquidity deteriorated with cash on hand of RMB22.4 billion (including RMB14.5 billion unrestricted cash) and undrawn bank line of c. RMB154 billion at end-2021 to cover its RMB24.2 billion debt due within one year. Zhongnan's total cash dropped to RMB22.4 billion at end-2021 from RMB32.9 billion (including RMB24.4 billion unrestricted cash) at end-2020, mainly because the company used the internal fund to repay maturing bonds and loans amid the challenging financing conditions. Accordingly, the company's unrestricted cash/short-term debt declined to 60% at end-2021 from 104% at end-2020. Moreover, as a portion of the unrestricted cash is at the operating project company level, we expect a lower cash level available for debt repayments. Zhongnan has c. USD223 million USD senior notes maturing in June 2022. Overall, we expect Zhongnan's liquidity to remain tight in the next 12 months.

Rating Sensitivities

We would consider downgrading Zhongnan's rating if (1) it were to fail to meet its near and medium term financial obligations when they become due, or (2) its operating performance and working capital management were to deteriorate such that its revenue experiences a material decline or operating cash flow shows sign of worsening.

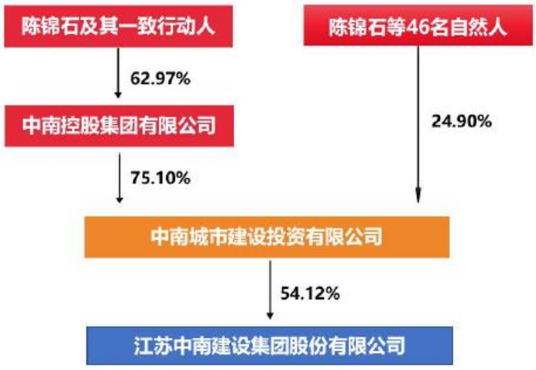
An upgrade is unlikely given the RWN on Zhongnan. We will resolve the RWN as soon as practicable.

Company Profile

Zhongnan is a Chinese property developer that focuses on mass residential property development and construction in China. Mr. Chen Jinshi, the chairman of Zhongnan, commenced his business and established the predecessor of the company in 1988. Zhongnan focused on construction business at the beginning of foundation. Taking the advantage of the reform in China, the company gradually diversified its business and entered the property development market. Zhongnan is listed on the Shenzhen Stock Exchange (000961.SZ).

Zhongnan is majority owned (54.12%) by 中南城市建设投资有限公司, which in turn is majority held by Mr.Chen Jinshi and his persons acting in concert directly and indirectly through 中南控股集团有限公司。

Exhibit 1: Zhongnan's Shareholding Structure at end-2021



Source: Zhongnan

Key Assumptions

- Contracted sales growth: c. -30% growth for 2022 and c. 5% growth for 2023-2024
- Contracted average selling price: c. 0% growth for 2022-2024
- Total land acquisition expenditures: RMB11-20 billion for 2022-2024

Key Financial Metrics

2020A-2024F	Debt/Land Bank	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	30.6%	1.31x	60.6%	0.08x

Source: Zhongnan's annual reports, Lianhe Global's adjustments and forecasts

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