Lianhe Global has assigned 'BB' global scale Long-term Issuer Credit Rating with Stable Outlook to Zhongliang Holdings Group Company Limited

HONG KONG, 28 February 2020 – Lianhe Ratings Global Limited ("Lianhe Global"), an international credit rating company, has assigned 'BB' global scale Long-term Issuer Credit Rating to Zhongliang Holdings Group Company Limited ("Zhongliang"). The Outlook is Stable.

The Issuer Rating reflects Zhongliang's established market position and a nationwide footprint in lower-tier cities of the Yangtze River Delta Region. Zhongliang's rating is constrained by its elevated financial leverage as a result of its debt-funded expansion in the prior years.

The Stable Outlook reflects our expectation that Zhongliang would expand its operating scale in a prudent manner especially regarding land acquisitions, while continuing maintaining its stable growth.

Key Rating Rationales

Strong market position and coverage in lower-tier cities although with low margin: Zhongliang has established a strong market position and a well-recognized brand name as a result of robust contracted sales growth, underpinning by strong housing demand in lower-tier cities over the past three years. Zhongliang reported gross contracted sales of RMB 152.5 billion and improved its ranking to the 19th place in 2019 from the 40th in 2016 in terms of gross contracted sales according to CRIC. Nevertheless, Zhongliang's focus on lower-tier cities with a quick asset turnover strategy resulted in gross margins of low 20% in the past three years.

As the momentum of shantytown redevelopment recedes (in terms of both government subsidies and remaining units), Zhongliang has turned its focus back to tier-2 cities in the five economic regions since 2H2018. Its primary focus on the Yangtze River Delta Region makes the strategic shift to tier 2 cities within the region easier. We expect its average selling price to increase as Zhongliang shifts its focus to tier 2 cities. Zhongliang increased its land purchase proportion in the tier 2 cities to 53% for the full year of 2019. At end-June 2019, Zhongliang had 385 projects in 139 cities in 23 provinces and municipalities across five strategic economic areas. The diversified geographic coverage helps mitigate potential regional economic and policy shocks as well as externalities.

Strong execution supports business growth and cash collection: Zhongliang has adopted a quick asset turnover strategy primarily targeting first-time home buyers and first-time upgraders in less sought-after cities with latent demands while avoiding competitions on land purchase and home price. It keeps individual project size relatively small (i.e. project GFA of less than 120,000 sq.m or total land costs of less than RMB500 million) to avoid

execution risk and keep inventory levels low. In addition, Zhongliang manages development projects and keeps costs in check by adopting a decentralized operation approach but a centralized procurement process.

High financial leverage for land replenishment: Zhongliang needs to keep purchasing land to sustain its contacted sales growth as it adopts a quick asset turnover strategy with its land bank only sufficient to support its contracted sales in the next 2-3 years. We expect Zhongliang to continue to increase debt borrowing to finance its development projects and its leverage as measured by debt/capitalization ratio to remain high at above 70% in the next 12 to 24 months. Its reported debt/capitalization ratio was 75.4% at end-1H 2019 compared to 80.0% at end-2018.

Funding structure should improve on the reduction of trust loans and short-term debt: We expect Zhongliang to improve its funding structure by reducing debts from non-bank financing channels which usually have short duration but high cost. Short-term debts accounted for 50.2% of Zhongliang's total debt at end-1H2019. Zhongliang raised RMB2.6 billion of new capital through its IPO in the Hong Kong stock exchange in July 2019 with 30% of the net proceeds to be used to prepay its trust loans, while the IPO also broadened its funding channels. In addition, Zhongliang had been relying on capital contributions from its non-controlling shareholders for financing its business expansion, with total non-controlling interests accounting for 62% and 58.7% of total equity as of end-2018 and 1H2019, respectively. We expect the ratio to drop to below 45% after the issuance of new shares by equity owners in July 2019.

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 80% 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 3x consistently.

About Lianhe Global

Lianhe Global is an international credit rating company that provides credit ratings to corporations, banks, non-bank financial institutions, local government financing vehicles, and other asset classes around the globe. Lianhe Global also provides credit risk research and other services related to credit ratings.

Rating Methodology

The principal methodology used in this Zhongliang's rating is Lianhe Global's General Corporate Rating Criteria published on 16 July 2018 which can be found at the website www.lhratingsglobal.com.

Note: The above Issuer/Issuance Credit Ratings are solicited at the request of the rated entity or a related third party.

Contact Information

Primary Analyst
Alex Kung
Senior Director
(852) 3462 9577
alex.kung@lhratingsglobal.com

Secondary Analyst
Joyce Huang
Senior Director
(852) 3462 9578
joyce.huang@lhratingsglobal.com

Wu Rundong
Analyst
(852) 3462 9579
rundong.wu@lhratingsglobal.com

Committee Chairperson
Stan Ho
Chief Executive Officer
(852) 3462 9568
stan.ho@lhratingsglobal.com

Business Development Contact
Joyce Chi
Managing Director
(852) 3462 9569
joyce.chi@lhratingsglobal.com

Disclaimer

Credit rating and research reports published by Lianhe Ratings Global Limited ("Lianhe Global" or "the Company" or "us") are subject to certain terms and conditions. Please read these terms and conditions at the Company's website: www.lhratingsglobal.com

A credit rating is an opinion which addresses the creditworthiness of an entity or security. Credit ratings are not a recommendation to buy, sell, or hold any security. Credit ratings do not address market price, marketability, and/or suitability of any security nor its tax implications or consequences. Credit ratings may be subject to upgrades or downgrades or withdrawal at any time for any reason at the sole discretion of Lianhe Global.

All credit ratings are the products of a collective effort by accredited analysts through rigorous rating processes. No individual is solely responsible for a credit rating. All credit ratings are derived by a credit committee vesting process. The individuals identified in the reports are solely for contact purpose only.

Lianhe Global conducts its credit rating services based on third-party information which we reasonably believe to be true. Lianhe Global relies on information including, but not limited to, audited financial statements, interviews, management discussion and analysis, relevant third-party reports, and publicly available data sources to conduct our analysis. Lianhe Global has not conducted any audit, investigation, verification or due diligence. Lianhe Global does not guarantee the accuracy, correctness, timeliness, and/or completeness of the information. Credit ratings may contain forward-looking opinions of Lianhe Global which may include forecasts about future events which by definition are subject to change and cannot be considered as facts.

Under no circumstances shall Lianhe Global, its directors, shareholders, employees, officers and/or representatives or any member of the group of which Lianhe Global forms part be held liable to any party for any damage, loss, liability, cost, expense or fees in connection with any use of the information published by the Company.

Lianhe Global receives compensation from issuers, underwriters, obligors, or investors for conducting credit rating services. None of the aforementioned entities nor its related parties participate in the credit rating process aside from providing information requested by Lianhe Global.

Credit ratings included in any rating report are solicited and disclosed to the rated entity (and its agents) prior to publishing. Credit rating and research reports published by Lianhe Global are not intended for distribution to, or use by, any person in any jurisdiction where such use would infringe local laws and regulations. Any user relying on information available through credit rating and research reports is responsible for consulting the relevant agencies or professionals accordingly to comply with the applicable local laws and regulations.

All published credit rating and research reports are the intellectual property of Lianhe Global. Any reproduction, redistribution, or modification, in whole or part, in any form by any means is prohibited unless such user has obtained prior written consent from us.

Lianhe Global is a subsidiary of Lianhe Credit Information Service Co., Ltd. The credit committee of Lianhe Global has the ultimate power of interpretation of any methodology or process used in the Company's independent credit ratings and research.