

Yuzhou Properties Company Limited

Initial Issuer Report

Summary

Issuer Rating	BB
Outlook	Stable
Location	China
Industry	Homebuilder and Real Estate
Date	8 January 2019

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned a ‘BB’ global scale Long-term Issuer Credit Rating to Yuzhou Properties Company Limited (“Yuzhou”). The Outlook is Stable.

Summary

The Issuer Rating reflects Yuzhou’s established market position in the Chinese property market, which is evident by its strong contracted sales growth, a higher-than-peer gross margin, and high-quality land bank primarily located in tier 1 and 2 cities in China. However, Yuzhou’s rating is constrained by its elevated financial leverage as compared with its peers.

The Stable Outlook reflects our expectation that Yuzhou would continuously maintain a gross margin above 30% and expand its operating scale through active land acquisitions to sustain its contracted sales growth while managing its debt growth at a moderate level.

Operating Data:

Yuzhou Properties Company Limited

	31 Dec 2017	30 June 2018
Revenue (RMB: in million)	21,701	9,233
Contracted Sales (RMB: in million)	40,306	21,494
Contracted Average Selling Price (RMB/square meter)	16,929	13,623
Contracted Sales GFA (million square meters)	2.38	1.58
Land Bank GFA (million square meters)	11.84	17.25

GFA: Gross Floor Area
Source: Yuzhou’s 2017-2018 annual and interim report

Rating Rationale

Expanding Scale and Diversified Land Bank: Yuzhou has exhibited a robust sales momentum. It recorded a year-on-year contracted sales growth of 73.7% and 65.5% for 2017 and 2016, respectively, reaching RMB40 billion in 2017.

Yuzhou has also been expanding its geographic coverage beyond its home base in the West Strait Economic Zone and Yangtze River Delta by including some satellite cities in coastal regions as well as provincial capital cities in Central China. Yuzhou’s land bank was diversified with 118 projects in 25 cities across 6 metropolitan areas as of end-1H2018.

We expect the inclusion of more regions will help Yuzhou increase its annual revenue base to RMB37-48 billion and support its year-on-year contracted sales growth in the range of 33%-28% in the next 12-24 months.

Above Average Gross Margin: Yuzhou maintained a higher-than-peer gross margin of around 35%-36% in 2015-2017 as a result of its land cost control. During this period, Yuzhou pursued a conservative land acquisition strategy that focused on satellite cities in coastal regions apart from tier 1 & 2 cities and managed its land cost to ensure a headroom at a minimum of 30% gross margin. Yuzhou also has a strong track record for mergers and acquisitions (“M&A”) execution capability in acquiring low-cost land.

Quality Land Bank: Yuzhou had a total land bank of 17.25 million square meters at end-June 2018, of which over 80% was located in tier 1 and 2 cities including Shanghai, Beijing, Tianjin, Nanjing, Xiamen, Hangzhou, Suzhou, Wuhan, Hefei, and Shenyang. As Yuzhou delivered a robust contracted sales growth in the past two years, it increased land replenishment pace in the first six months of 2018 and acquired 16 pieces of land totalling 2.23 million square meters. The sizeable land bank is able to sustain Yuzhou’s property development plan for the next 4-6 years.

Elevated Leverage: Yuzhou’s financial leverage was relatively high as measured by its debt/land bank ratio at above 70% in 2016-2017. As Yuzhou acquired more land in 1H2018, its reported debt level increased to RMB36.5 billion at end-June 2018 from RMB27.6 billion in 2017. However, Yuzhou’s elevated leverage was mitigated by its RMB23.6 billion unrestricted cash on hand,

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Applicable Criteria

[General Corporate Rating Criteria \(16 July 2018\)](#)

RMB11.3 billion undrawn credit facility from various banks at end-June 2018 and its high-quality land bank mostly in tier 1 and 2 cities.

Strategic Shareholder Creates Synergies: In August 2018, Yuzhou entered into a strategic agreement with Overseas Chinese Town (Asia) Holdings Limited (“OCT Asia”) and took it as a strategic shareholder. OCT Asia is a listed subsidiary of Overseas Chinese Town Group, which is a Chinese Central Government-owned conglomerate with businesses across tourism, cultural and real estate industries. We believe that OCT Asia as its second-largest shareholder will bring synergies for Yuzhou in terms of opening more financing channels, obtaining a lower cost of fund and acquiring lower cost land, in the future.

Rating Sensitivities

We would consider downgrading Yuzhou’s rating if it were to (1) report a below industry average gross margin, or (2) increase its financial leverage as measured by an EBITDA interest coverage ratio at below 3.0x as a result of its expansion plan.

We would consider upgrading Yuzhou’s rating if it were to (1) report a sustained growth both in scale and diversity while maintaining its leverage as measured by a debt over land bank ratio at below 70% and (2) maintain an EBITDA interest coverage ratio at above 5.0x persistently.

Company Profile

Yuzhou Properties Company Limited is a Hong Kong-listed (01628.HK) but China-based property developer that mainly focuses on residential property development in the West Strait Economic Zone and Yangtze River Delta Region. It was established by Mr. Lam Lung On (the current Chairman) in 1994.

Yuzhou is majority owned (56.04%) by Mr. Lam Lung On and his wife, Ms. Kwok Ying Lan as of 2 Oct 2018. On 31 August 2018, the company issued new shares to Overseas Chinese Town (Asia) Holdings Limited (“OCT Asia”). OCT Asia became the company’s second largest strategic shareholder after the transaction. OCT Asia now holds 9.9% shares of Yuzhou (EXHIBIT 1). OCT Asia is a listed overseas subsidiary (3366.HK) of Overseas Chinese Town Group (70.94% holdings in OCT Asia), which is a conglomerate with businesses across tourism, cultural and real estate industries, and it is wholly owned by the Chinese Central Government’s State-owned Assets Supervision and Administration Commission (“SASAC”).

Yuzhou’s business coverage extends from property development and investment to property management and hotel operations. The property development segment had been the major revenue contributor for Yuzhou in 2015-1H 2018, which contributed over 90% revenue to Yuzhou (EXHIBIT 2).

Yuzhou had a total land bank of 17.25 million square meters at end-June 2018. It was ranked 47th in terms of attributable land bank value at end-2017 as per China Real Estate Information Corporation’s (“CRIC”, 中房研协) 2017 statistics.

Yuzhou started to venture into the property management sector in 2015 to complement its property development segment, which helped diversify Yuzhou’s business risk to a certain degree. The revenue from property management increased rapidly to RMB329 million in 2017 from RMB122 million in 2015. Yuzhou currently manages 44 out of 118 projects it owns as indicated by Yuzhou. The company plans to continue to grow its revenue from this segment and expand to other projects owned by other companies in the future.

Exhibit 1: Yuzhou's Shareholder Structure as of 2 October 2018

Shareholder	Percentage
Mr. Lam Lung On and Ms. Kwok Ying Lan	56.04%
OCT Asia	9.90%
Mr. Lin Conghui #	0.11%
Public	33.95%
Total	100.00%

Note: #Mr. Lin Conghui is the Executive Director of Yuzhou.

Source: Yuzhou's 2018 interim report and company announcement

Exhibit 2: Yuzhou's Revenue Breakdown by Business Segment (RMB: in million)

Revenue / % of total	FY2015		FY2016		FY2017		1H2018	
Sales of properties	10,158	97.90%	13,345	97.61%	21,213	97.76%	8,973	97.09%
Rental income from investment properties	80	0.77%	124	0.91%	140	0.65%	102	1.10%
Property management fee income	122	1.18%	182	1.33%	329	1.52%	158	1.71%
Hotel operations & others	16	0.15%	20	0.15%	18	0.08%	9	0.10%
Total	10,376	100.00%	13,671	100.00%	21,700	100.00%	9,242	100.00%

Source: Yuzhou's 2015-2018 annual and interim reports

Business Profile

Market Position

In terms of contracted sales and land bank scale, Yuzhou was ranked in the middle range of the top 100 Chinese property developers (EXHIBIT 3&4) during 2015-2017, which also included Times China Holdings Ltd (1233.HK) and Yuexiu Property Company Limited (0123.HK).

Yuzhou had exhibited a robust sales momentum in 2015-2017. It reported strong contracted sales of RMB40.3 billion in 2017 which represented a 73.7% year-on-year growth. The strong sales growth enabled the company to expand its scale in terms of both revenue and land bank. Yuzhou reported a revenue of RMB21 billion from property sales in 2017 and a total of 7.5 million square meters of new land acquisition during 2015-2017.

Exhibit 3: Yuzhou's Rankings by Contracted Sales Among the Chinese Property Developers

Amount / Ranking	FY2015		FY2016		FY2017		YTD 30Sep2018		Ranking Changes (2018 vs 2015)
Contracted sales amount *	17.02	62 nd	28.38	59 th	36.11	56 th	29.86	60 th	+2
Contracted sales by GFA #	1.58	53 rd	2.25	53 rd	2.44	57 th	3.55	40 th	+13

Note:

*The contracted sales amount is based on statistics from CRIC. Differences may exist between the company's reported amount as a different calculation method was applied. The amount is in RMB billions.

The contracted sales GFA is based on statistics from CRIC. Differences may exist between the company's reported amount as a different calculation method was applied. The amount is in million square meters.

Source: CRIC Information Centre

Exhibit 4: Yuzhou's Rankings by Land Bank and New Land Acquisition Among the Chinese Property Developers

Amount / Ranking	FY2017		YTD 30Nov2018	
Attributed land bank by value	RMB185 bn	47 th	N/A	N/A
Land bank by GFA	11.8m sqm	52 nd	N/A	N/A
New acquisition land bank by value	RMB61.95 bn	42 nd	RMB38.01 bn	52 nd
New land acquisition by GFA	3.1m sqm	51 st	2.99m sqm	52 nd

Note: The amount is based on statistics from CRIC. Differences may exist between company's reported amount as a different calculation method was applied.

Source: CRIC Information Centre

Expanding Scale and Diversified Land Bank

Backed by strong contracted sales growth in 2017, Yuzhou expanded its scale by increasing land acquisitions in 1H2018. It acquired 7 pieces of land from Coastal Greenland Limited (01124.HK) at a consideration of RMB3.8 billion. Yuzhou's total land bank area was enlarged to 17.25 million square meters at end-June 2018 from 11.84 million square meters at end 2017 (EXHIBIT 5).

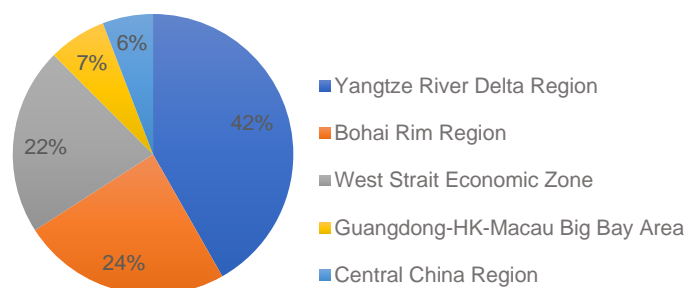
After the acquisition, Yuzhou's land bank was diversified with 118 projects in 25 cities across 6 metropolitan areas at end-June 2018. Most of its projects are residential units whilst commercial projects accounted for less than 20%. In addition, over 90% of Yuzhou's projects were located in the developed coastal areas of China and over 80% of its land bank in terms of saleable gross floor area ("GFA") was located in tier 1 and tier 2 cities (EXHIBIT 5&6).

Yuzhou's projects are located along developed coastal cities. Yuzhou is expanding its operating and diversifying revenue sources which partly reduce its concentration and sales execution risks. As a result, Yuzhou's completed but unsold gross floor area only accounted for approximately 5% of its total saleable area at end-June 2018.

Exhibit 5: Yuzhou's Land Bank Distributions by City Tier at End-June 2018 (in square meters)

Land bank	Saleable GFA	% of total	Major cities
Tier 1 cities	802,270	4.65%	Beijing, Shanghai etc.
Tier 2 cities	13,805,570	80.04%	Shenyang, Tianjin, Wuhan, Hangzhou, Suzhou, Xiamen etc.
Tier 3 cities	2,638,126	15.30%	Bengbu, Tangshan etc.
Hong Kong	2,214	0.01%	Hong Kong
Total	17,248,180	100.00%	N/A

Source: Yuzhou's 2018 interim report and Lianhe Global

Exhibit 6: Yuzhou's Land Bank Distributions by Saleable Area at End-June 2018


Source: Yuzhou's 2018 interim report

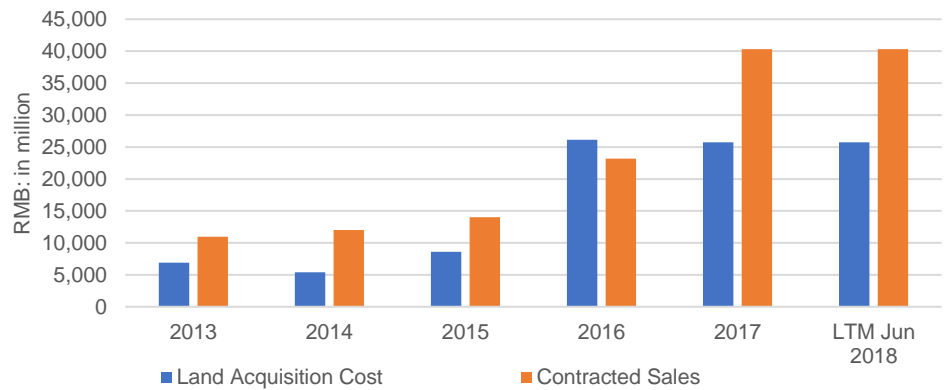
Quality Land Bank Sufficient to Support Contracted Sales for the Next 4-6 Years

Propelled by robust contracted sales growth in the last five years (EXHIBIT 7), Yuzhou was active in acquiring new land bank via M&A and joint ventures ("JV") activities. Yuzhou increased its new land bank acquisition in terms of gross floor area to 3.79 million square meters, which represented a 42% increase, in 2017. However, the acquisition cost remained flat in 2016-1H2018 as Yuzhou took most new projects through JV cooperation. The attributable percentage of new land acquisition in terms of total gross floor area decreased to 54% in 1H2018 from 72% in 2016.

Yuzhou owned a high-quality land bank of 17.25 million square meters (attributable GFA at 12.22 million square meters) at end-June 2018, of which over 80% is located in tier 1 and tier 2 cities and is sufficient to support its contracted sales for the next 4-6 years. As per Yuzhou, it usually allocates 50%-60% of cash received from the previous year's contracted sales proceeds to fund its annual capital expenditure plan.



Exhibit 7: Yuzhou Maintained Land Acquisition Amount in Tandem with Contracted Sales



Note: LTM: Last twelve months
Source: Yuzhou's 2013-2018 annual and interim report

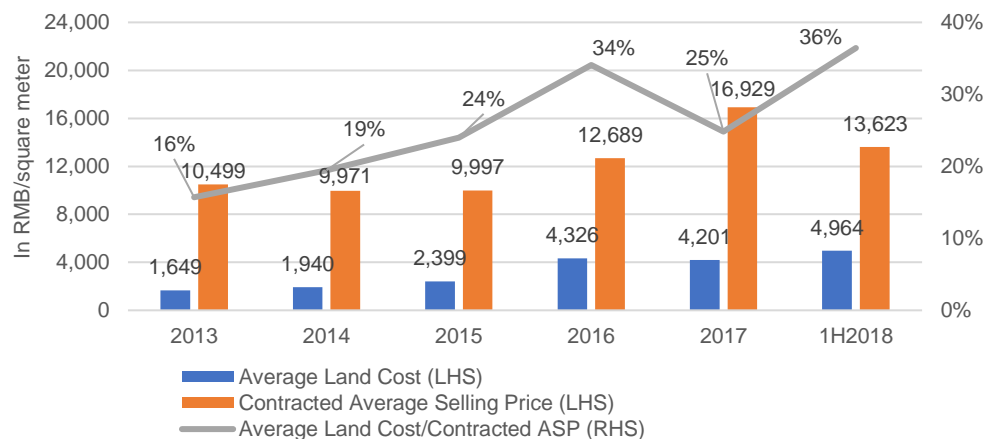
Financial Profile

Low Land Cost Secured Yuzhou's Competitive Gross Margin

Yuzhou had a proven track record in M&A execution capability by acquiring low-cost new land in the past years. The land acquisition through M&A activities enabled the company to keep land cost in check which resulted in a higher gross margin of over 30% when compared to its peers, in 2015-2017. In the first six months of 2018, nearly 60% of Yuzhou's new land addition was through acquisition activities and the remaining 40% was through open bid auctions.

In addition, Yuzhou pursued a land acquisition strategy that it only focused on satellite cities in coastal areas for lower tier cities (apart from tier 1&2 cities) which kept land acquisition cost in check to ensure a headroom for over 30% gross margin. Yuzhou maintained a low average land cost at around 16% to 36% of its contracted average selling price in 2013-1H2018 (EXHIBIT 8).

Exhibit 8: Yuzhou Maintained a Low Average Land Cost in 2013-1H2018



Source: Yuzhou's 2013-2018 annual and interim reports and Lianhe Global

As Yuzhou expands its coverage to more new regions which incorporates more satellite cities, we expect that Yuzhou's gross margin will be under pressure and drop to below 35% in the next 12 to 18 months. However, we believe that the company will continue to pursue its expansion cautiously and manage its operating scale while maintaining an above-average profitability.

Elevated Financial Leverage

Yuzhou's financial leverage was relatively high compared with peers as measured by its debt/EBITDA which reached 4.4x-5.3x in 2015-2017. As Yuzhou acquired more land in 1H2018 due to its strong contracted sales growth, its reported debt level increased to RMB36.5 billion at end-June 2018 from RMB27.6 billion in 2017. However, Yuzhou's elevated leverage was mitigated by its RMB23.6 billion unrestricted cash on hand, RMB11.3 billion undrawn credit facility from banks at end-June 2018 and a high-quality land bank mostly in tier 1 and 2 cities.

Yuzhou had reported a 66% and 74% contracted sales growth rate in 2016 and 2017, respectively. We expect Yuzhou's contracted sales growth rate will decelerate due to a tightened financing channel. We expect Yuzhou would likely to seek additional funding for its planned land acquisition in 2019 and 2020 which would result in an elevated debt level. Nevertheless, we anticipate Yuzhou to manage its debt growth in tandem with its contracted sales and revenue growth for the next 12-24 months.

Key Assumptions

- Contracted sales amount: RMB75-97 billion for 2019-2020
- Average contracted selling price: 5% decrease for 2019-2020
- Land acquisition: RMB35-42 billion for 2019-2020
- Total debt growth: 20%-7% increase for 2019-2020
- Land bank GFA/contracted sales GFA: 5.0x-5.3x for 2019-2020
- Percentage of pre-sold GFA delivered from total land bank: 11.0%-11.5% for 2019-2020

Key Financial Metrics

2016A-2020F	Debt/Land Bank	EBITDA/Interest	Debt/Capitalisation	Quick Ratio
Weighted Average	86.38%	4.32x	73.52%	0.50x

Source: Yuzhou's 2016-2018 annual and interim reports and Lianhe Global's adjustments and forecasts

Liquidity

Yuzhou's liquidity position is enough to cover its RMB17.4 billion debt due within one year at end-June 2018 as it held RMB23.6 billion unrestricted cash on hand and RMB11.3 billion undrawn facilities (EXHIBIT 9).

As a listed company, Yuzhou also has access to different financing channels, which is not limited to bank lending, bond offering and equity issuance in both onshore and offshore markets.

Yuzhou's average cost of funding was in the range of 6%-6.6% in 2016-1H2018. In August 2018, it took OCT Asia as its second largest shareholder (9.9%). We believe that taking OCT Asia as its strategic shareholder will strengthen Yuzhou's overall financing and liquidity position, such as opening more financing channels and obtaining competitive low-cost funding in the future.

Exhibit 9: Debt Maturity Profile as of 30 June 2018

(RMB: in million)	Amount	Percentage
2Q2018-2Q2019	17,406	47.6%
2Q2019-2Q2020	5,334	14.6%
2Q2020-2Q2021	7,712	21.1%
2Q2021-2Q2022	3,034	8.3%
2Q2022-2Q2023	800	2.2%
Thereafter	2,261	6.2%
Total	36,547	100.0%

Source: Yuzhou

Peer Comparisons

Times China Holdings Ltd (“Times China”) is a close peer of Yuzhou both in terms of revenue and contracted sales (EXHIBIT 10&11). As Yuzhou actively acquired more land in 1H2018, its total land bank was comparable to Times China after the acquisition at end-June 2018. However, Times China’s land bank portfolio is more concentrated than that of Yuzhou as all of its projects are located in Great Bay Area in Guangdong Province while Yuzhou’s are distributed in 25 cities across 6 metropolitan areas.

Both of the companies showed strong M&A ability in the property market as their average land cost were lower than other peers (1H2018: Yuzhou: RMB4,964/square meter; Times China: RMB3,623/square meter). Nevertheless, Yuzhou’s gross margin is higher than Times China. In addition to property development and sales, Times China is also involved in primary land redevelopment projects for the local government. At end-June 2018, Times China built redevelopment projects of 5.6 million square meters which are expected to be delivered for property development in 2020. Times China’s role as a primary land redeveloper for the local government entail a risk of uncertainty for its profit conversion and expected margin level.

Both Yuzhou and Times China are conservative on new land acquisitions which are different from other property developers that pursue a massive expansion and high turnover rate strategy while sacrificing high margin. However, Yuzhou’s financial leverage was lower than Times China and Yuzhou held more cash on hand as evidenced by a lower net debt/EBITDA level. However, Times China showed a slower inventory turnover rate than Yuzhou.

Future Land Development Holdings Ltd (“Future Land”) is much larger than Yuzhou in terms of contracted sales and attributable land bank scale (EXHIBIT 10&11). Future Land and Yuzhou both focus on satellite cities in lower tier cities and tier 1 and 2 cities. However, Future Land has started to expand aggressively into lower tier cities since 2016, around half of its land bank GFA are clustered in tier 3 and 4 cities.

Yuzhou and Future Land both reported a higher than 30% gross margin in 2017 and 1H2018, which benefited from the recent property price increase as they had acquired the land at lower prices in the previous years. Due to Future Land’s more aggressive land replenishment, its financial leverage elevated quickly as measured by the debt/capital at 70.7% at end-June 2018. This higher leverage was mitigated by Future Land’s strong attributable contracted sales growth.

Exhibit 10: Key Financial Metrics

Period	Yuzhou		Times China Holdings Ltd		Future Land Development Holdings Ltd	
	1628.HK		1233.HK		1030.HK	
	FY 2017	LTM June 2018	FY 2017	LTM June 2018	FY 2017	LTM June 2018
Revenue	21,701	23,697	23,110	24,861	40,820	45,428
Gross Margin (%)	35.51	34.74	27.91	28.58	33.27	34.61
Operating Margin (%)	31.43	30.76	22.89	25.34	27.27	29.14
EBITDA Margin (%)	31.81	31.10	23.47	25.82	28.10	30.00
Net Debt/EBITDA (x)	1.73	1.75	3.51	3.65	2.51	3.26
EBITDA/Interest (x)	4.06	2.12	2.43	1.77	4.59	1.47
Total Debts to Total Capital (%)	61.25	66.75	54.36	57.77	66.72	70.71
Debt/EBITDA (x)	3.99	4.96	6.14	6.32	4.30	5.00
Quick Ratio (x)	0.32	0.37	0.39	0.38	0.16	0.14
Inventory Days	743	745	883	970	777	1,020

Source: Bloomberg

Exhibit 11: Key Operating Metrics

Period	Yuzhou		Times China Holdings Ltd		Future Land Development Holdings Ltd	
	1628.HK		1233.HK		1030.HK	
	FY 2017	1H 2018	FY 2017	1H 2018	FY 2017	1H 2018
Contracted sales (RMB million)	40,306	21,494	41,629	26,002	126,472	95,311
Contracted sales GFA	2.38	1.58	2.82	1.51	9.28	7.75
Total land bank GFA	11.84	17.25	16.84	18.2	67.40	86.44
Attributable land Bank GFA	8.8	12.2	N/A	N/A	35.03	43.65

Source: Company's 2017-2018 annual and interim reports

Moreover, Future Land's track record is relatively short. Its credit profile has improved as margin widened and contracted sales has been growing rapidly since 2017. Before 2017, it reported a lower than 30% gross margin (2016: 23.4%; 2015: 20.4%) and a revenue of RMB28.2 million in 2016, which was about half of the amount in 2017. However, Yuzhou maintained a stable gross margin and pursued a moderate expansion pace in the market.



Appendix I: Yuzhou's Organization Chart



Yuzhou Properties Company Limited (01628.HK) - Issuer 禹洲地產股份有限公司 Incorporated in Cayman Island	
As of 31Dec2017(Reported)	As of 30Jun2018(Reported)
Revenue: CNY21,701m	Revenue: CNY9,243m
Contracted sales: CNY40,306m	Contracted Sales: CNY21,494m
Gross Profit/GPM: CNY7,683m/35.4%	Gross Profit/GPM: CNY2,914m/31.5%
Net Profit/NPM: CNY3,127m/14.4%	Net Profit/NPM: CNY1,391m/15.0%
Total Asset: CNY79,905m	Total Asset: CNY103,728m
Total Liability: CNY62,462m	Debt: CNY36,548m
Debt: CNY27,567m	Land Bank: CNY17.25m sqm
	Attributable Land Bank: CNY12.21m sqm

Property Development		Property Investment		Property Management		Hotel Operation		Others	
As of 31Dec2017	% of segment total	As of 31Dec2017	% of segment total	As of 31Dec2017	% of segment total	As of 31Dec2017	% of segment total	As of 31Dec2017	% of segment total
Revenue: CNY21,235m	97.4%	Revenue: CNY176m	0.8%	Revenue: CNY329m	1.5%	Revenue: CNY19m	0.09%	Revenue: CNY49m	0.2%
Segment Result: CNY6,382m	93.8%	Segment Result: CNY388m	5.7%	Segment Result: CNY3k	0.04%	Segment Result: -CNY19m	-0.3%	Segment Result: CNY52m	0.8%
Total Asset: CNY49,760m	75.7%	Total Asset: CNY8,527m	13.0%	Total Asset: CNY567m	0.9%	Total Asset: CNY242m	0.4%	Total Asset: CNY6,675m	10.0%
Total Liability:	73.9%	Total Asset: CNY8,527m	3.1%	Total Liability: CNY658m	1.9%	Total Liability: CNY103m	0.3%	Total Asset: CNY6,675m	20.8%
	4.5%		49.0%	Capex: CNY2m	0.2%	Capex: CNY394m	44.5%		1.8%

Note:

- * Mr. Lam Lung On and Ms. Kwok Ying Lan are spouse
- # The subscriber is OCT(Asia)

Source:

1. Company's 20181H Interim Report&Company's Announcement
2. Lianhe Global



Appendix II: Yuzhou's Rating Factors

Rating Factors	Weight	Initial Rating
I. Market Demand Analysis	15.0%	a-
II. Business Analysis¹	45.0%	bbb-
III. Financial Analysis²	40.0%	b
IV. Base Score	100.0%	bb
V. Industry Risk		bbb
VI. Qualifiers		
Liquidity		Neutral
Corporate Governance		Neutral
Debt Structure and Financial Policy		Neutral
Idiosyncratic Analysis		Neutral
Stand-Alone Creditworthiness (SAC)		bb
VII. External Support		
Corporate Entity Support		Not Applicable
Issuer Credit Rating		BB

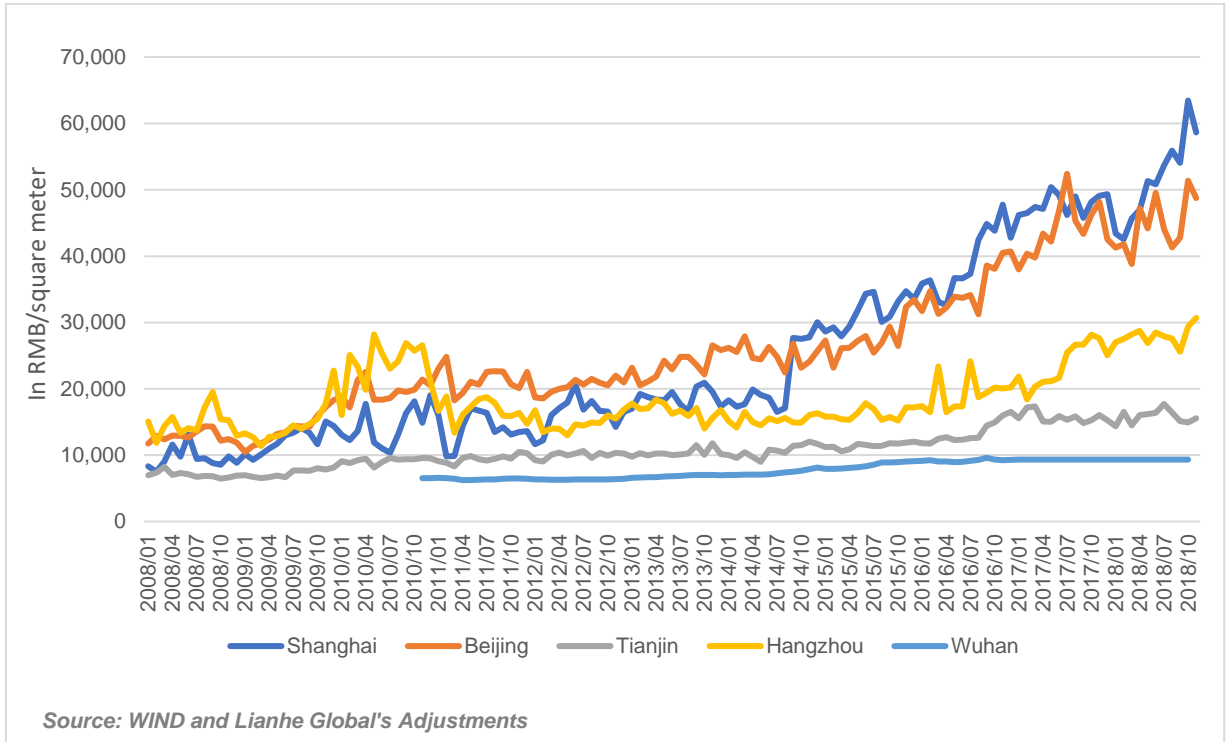
Source: Lianhe Global

¹ Business Analysis contains sub-factors of market position, diversification, competitive position, operating efficiency and profitability.

² Financial Analysis contains sub-factors of debt/land bank, EBITDA interest coverage, debt/capitalization and quick ratio.



Appendix III: Major Chinese Cities' Monthly Contracted Average Selling Price



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