聯合評級國際
Lianhe Ratings Global

Rating Report
17 March 2020

Zhongliang Holdings Group Company Limited

Initial Issuer Report

Summary

Issuer Rating	BB
Outlook	Stable
Location	China
Industry	Homebuilder and Real Estate
Date	17 March 2020

Operating Data:
Zhongliang Holdings Group Company Limited

	31 Dec 2018	30 Jun 2019
Revenue (RMB: in billion)	30.2	20.6
Contracted Sales (RMB: in billion)	101.5	63.7
Contracted Average Selling Price (RMB/square meter)	10,004	10,565
Contracted Sales GFA (million square meters)	10.1	6.0
Land Bank GFA (million square meters)	47.0	53.0

GFA: Gross Floor Area
Source: Zhongliang's IPO document and 2019 interim report

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Applicable Criteria
General Corporate Rating Criteria (16 July 2018)

Lianhe Ratings Global Limited ("Lianhe Global") has assigned a 'BB' global scale Long-term Issuer Credit Ratings to Zhongliang Holdings Group Company Limited; The Outlook is Stable.

Summary

The Issuer Rating reflects Zhongliang Holdings Group Company Limited's ("Zhongliang" or "the company") 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.

Rating Rationale

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 RMB152.5 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 turns its focus back to tier-2 cities in the five economic regions. Its primary focus on the Yangtze River Delta Region makes the strategic shift to tier 2 cities within the region easier. Zhongliang increased its land purchase proportion in the tier 2 cities to 53% in 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 replenishing 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[1] ratio to remain high at above 70% in the next 12 to 24 months.

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 durations but high interest costs. 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 repay 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.

Company Profile

Zhongliang is headquartered in Shanghai and principally engages in real estate development in China with a national footprint. It was listed on the Main Board of the Hong Kong Stock Exchange (Stock Code: 2772.HK) on 16 July 2019. Zhongliang strives to develop quality residential properties targeting first-time home purchasers and first-time and second-time home upgraders. It also engages in the development, operation and management of commercial properties and holds a portion of such commercial properties for future investment purpose.

The company adopts a quick asset turnover business model and standardized real estate development process for developing the projects in the second-, third- and fourth-tier cities. As a result, the company has well established the "Zhongliang" brand name nationwide. It was ranked first among the top ten real estate developers in China in terms of the growth rate in 2018 and development potential in 2019, respectively, recognized by China Real Estate Association and E-house China R&D Institute China Real Estate Appraisal Center.

Zhongliang's main business operation consists of three business lines: (i) sales of properties, (ii) management consulting services, and (iii) property lease. Revenue from sales of properties is Zhongliang's major source. For the year ended December 31, 2016, 2017, and 2018, revenue derived from sales of properties amounted to RMB2.90 billion, RMB13.91 billion, and RMB29.99 billion, respectively, accounting for 99.3%, 99.2%, and 99.3%, respectively, of the company's total revenue.

[1] Total debt includes Zhongliang's reported interest-bearing debt, lease liabilities and guarantees given to banks in connection with facilities granted to related companies

Exhibit 1: Zhongliang's Revenue Breakdown by Business Segment (RMB Mn)

Revenue / % of total	FY2016		FY2017		FY2018		1H2019*	
Sales of Properties	2,904	99.3	13,913	99.2	29,992	99.3	20,414	99.3
Management Consulting	0	0.0	7	0.1	6	0.0	0	0.0
Property Management	22	0.7	106	0.8	212	0.7	139	0.7
Property Lease	0	0.0	0	0.0	4	0.0	4	0.0
Total	**2,925**	**100**	**14,026**	**100.0**	**30,215**	**100.0**	**20,557**	**100.0**

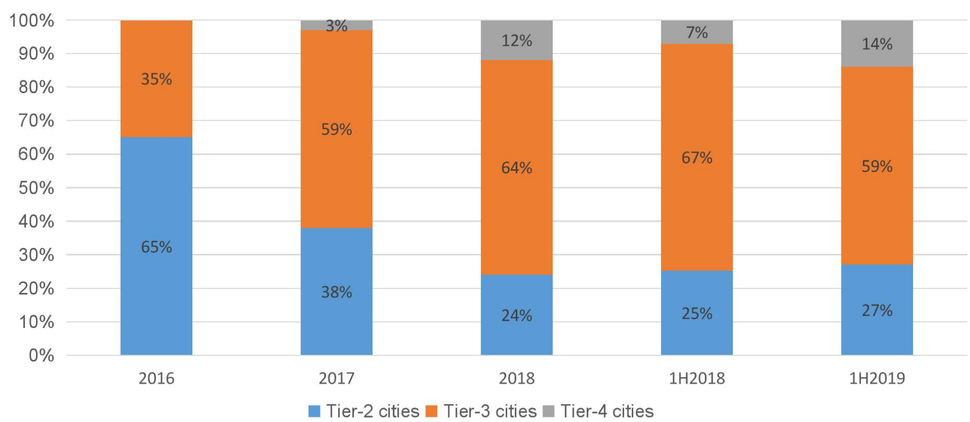
*Note:*1H2019 numbers unaudited*
Source: Zhongliang's audited financial reports

Business Profile

Market Position

From 2016 to 2018, Zhongliang jumped on the bandwagon by focusing on lower tier cities to capitalize on the monetization of shantytown redevelopment in China. Contracted sales from lower tier 3 and 4 cities comprised of 62% of total sales in 2017 and more than 70% in 2018 and 1H2019. As a result, the company reported a lower average selling price ("ASP") of RMB10,600 per sqm in 1H2019, compared with RMB14,383 per sqm in 2016. Zhongliang's ranking was improved to 23rd in 2018 from 40th in 2016 in terms of gross contracted sales according to CRIC, and further improved to 19th in 2019 with gross contracted sales of RMB152.5 billion. Zhongliang's focus on the Yangtze River Delta Region enables it establish a market recognition in a competitive landscape. At end-June 2019, Zhongliang had 49% of its land bank GFA in the Yangtze River Delta Region.

Exhibit 2: Zhongliang's Contracted Sales Breakdown by City-Tiers



Source: Zhongliang and Lianhe Global

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

Amount / Ranking*	FY2016		FY2017		FY2018		FY2019		Ranking Changes (2019 vs 2016)
Contracted sales amount (RMB bn)	19.0	40th	64.9	25th	101.5	23th	152.5	19th	21
Contracted sales by GFA (m sqm)	1.3	56th	5.6	23th	10.1	11th	14.9	N/A	N/A

*Note: *CRIC Information Centre might use adjusted numbers of contracted sales and GFA in the ranking*
Source: Contracted sales (and GFA) and ranking are from CRIC Information Centre

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

Amount / Ranking	FY2017		FY2018	
Attributable land bank by value (RMB bn)	198.1	45th	411.1	16th
Land bank by GFA (m sqm)	17.4	41th	47.0	12th
New acquisition land bank by value (RMB bn)	83.0	35th	220.1	12th
New land acquisition by GFA (m sqm)	9.2	25th	25.2	8th

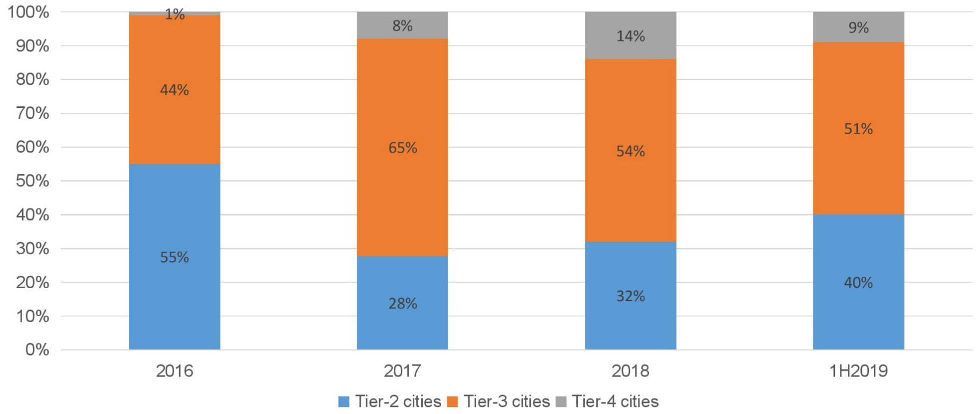
Note: The amount is based on statistics from CRIC. Differences may exist between company's reported amount as a different calculation method was applied.
Source: CRIC Information Centre

A Strong Market Presence in Lower-tier Cities

At end-June 2019, Zhongliang achieved a nationwide operating coverage and a strong presence in 139 cities in 23 provinces and municipalities across five strategic economic areas, namely, the Yangtze River Delta, the Midwest China, the Pan-Bohai Rim, the Western Taiwan Straits Zone and the Pearl River Delta Zone. At end-June 2019, Zhongliang had a portfolio of 385 projects, including 281 projects developed by its subsidiaries and 104 projects developed by its joint ventures and associates. The company had approximately 42.0 million sqm of attributable land bank, of which approximately 36.9 million sqm was from projects developed by its subsidiaries and 5.1 million sqm was from projects developed by its joint ventures and associates, respectively. The diversified geographic coverage helps mitigate potential regional economic and policy shocks as well as externalities.

Zhongliang experienced robust revenue and contracted sales growth, underpinning by strong housing demand in lower-tier cities over the past three years. As the momentum of shantytown redevelopment recedes, Zhongliang turns its focus back to tier-2 cities, with the land purchase in tier-2 cities representing 53% of 2019's full-year land purchase. Zhongliang's revenue increased at a CAGR of 221.4% to RMB 30.22 billion in 2018 from RMB 2.93 billion in 2016. Meanwhile, its contracted sales also reported a high CAGR of 131.1% from 2016 to 2018. For the first half of 2019, Zhongliang reported a revenue of RMB 20.56 billion and contracted sales of RMB 63.67 billion, representing year-on-year growth of 111.2% and 26.8%, respectively. We consider that Zhongliang's strategy may reach its plateau especially with a vast majority (i.e. 49%) of its land exposure in the Yangtze River Delta Region where there is intense competition. We expect its contracted sales growth to slow to 21%-28% year-on-year after 2019 and onwards.

Exhibit 5: Breakdown of Zhongliang's Land Premium of New Land Purchase by City-Tiers



Source: Zhongliang and Lianhe Global

High Operating Efficiency on Strong Project Execution

Zhongliang has adopted a quick asset turnover strategy which has supported its high cash collection rates at 90%, 99%, 99% and 87% in 1H2019, 2018, 2017, and 2016 respectively. It keeps individual projects small and targets first-time home buyers and first-time upgraders in less sought-after cities with latent demands while avoiding competitions on land purchase and property price. In addition, Zhongliang adopts a decentralized operation approach but a centralized procurement process. All land and projection selection decisions are made at the regional divisions (as long as they fall within the general parameters) for effective execution, while all finance related functions including cash management and financing are centralized at the headquarter. Furthermore, Zhongliang sets up a profit-sharing program to align the interests of both the company and its employees to counterbalance a decentralized operation.

We expect Zhongliang's strong execution would continue to support its high cash collection rate although the collection rate may moderately decline to between 80% and 85% as its entry to tier 2 cities which may be subject to policy risks.

Financial Profile

Quick Asset Turnover Constrains Profit Margin

Zhongliang's large exposure to lower-tier cities and quick asset turnover strategy focusing on preserving cash flow while adopting property prices to market conditions has resulted in gross margins of low 20% in the past three years. Its gross margins were 21.1%, 20.4% and 22.9% in 2016, 2017 and 2018, respectively and still stayed at mid 20% in 1H2019. As the company will continue to follow its strategy of low land cost, small project size, high sell-through rates as well as high cash collection rates, we expect the upside of its gross margin to be limited, although it has entered higher-tier cities.

Zhongliang keeps individual projects relatively small to de-stock quickly and achieve positive cash flow generation within a short period, which has resulted in higher SG&A cost due to higher overheads on a larger number of small projects. We expect its SG&A cost will account for about 8% of its total revenue in the next 12 to 24 months.

Ongoing High Financial Leverage

Zhongliang will continue to incur a high level of financial leverage for land purchase to sustain its contacted sales growth. Its land bank is only sufficient to support contracted sales for the next 2-3 years (our estimates) given its quick asset turnover strategy, while the acquisitions of more land parcels in tier 2 cities could drive up its land costs, although the company continues to avoid highly sought locations/cities with intense competition.

Zhongliang has funded its property projects primarily through proceeds from the pre-sales and sales of its properties and borrowings from financial institutions, including banks and trust financing and asset management companies. In general, Zhongliang directs approximately 50% to 60% of cash collected from contracted sales toward land acquisition. As a result, we expect Zhongliang to continue to increase debt borrowing with its leverage as measured by debt/capitalization ratio to remain high at above 70% in the next 12 to 24 months. Zhongliang's reported debt increased to RMB 28.8 billion at end-June 2019 from RMB 27 billion at end-2018 and RMB 24.48 billion at end-2017. Strong revenue recognition in 1H2019 resulted in a decline in the debt/EBITDA ratio to 4.5x in 1H2019 from 6.2x in 2018.

More Diversified Financing Channels to Improve Funding Structure

Zhongliang's utilization of various financing sources were distributed among bank loans (49% of total debt) and other financing channels (51%) of which trust loans made up a majority at end-1H2019. Meanwhile, short-term debt due in the next 12 months accounted for 50.2% of its total debt at end-1H2019. We anticipate better banking relationships and access to more diverse funding following Zhongliang's listing on the Hong Kong Stock Exchange, which should help improve its funding structure by reducing debts from non-bank financing channels. Non-bank financing usually has a short duration but high interest cost. 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 repay its trust loans.

We also note that 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.

Key Assumptions

- Contracted sales growth rate: 21% to 28% for 2019-2021
- Cash collection rate: 80% to 85% for 2019-2021
- Land acquisition expenditures: 50% to 60% of annual contracted sales for 2019-2021
- SG&A cost: about 8% of its total revenue for 2019 to 2021

Key Financial Metrics

2017A-2021F	Debt/Land Bank[2]	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	30.76%	2.14x	76.56	0.26

Source: Zhongliang's 2018-2019 annual and interim reports and Lianhe Global's adjustments and forecasts

[2] Total debt includes Zhongliang's reported interest-bearing debt

Liquidity

Zhongliang had unrestricted cash on hand and liquid short-term investments totaled RMB10.3 billion and approved but unutilized bank credit line of RMB26.1 billion, compared with the RMB14.5 billion debt due within one year, committed but unpaid land fee of RMB4.8 billion, expected land acquisition of RMB3.7 billion and dividend payment of RMB1 billion at end-1H2019. Moreover, the company can utilize other financing channels, such as secondary offering, as well as proceeds from contracted sales, to ease its liquidity.

Appendix I: Zhongliang's Rating Factors

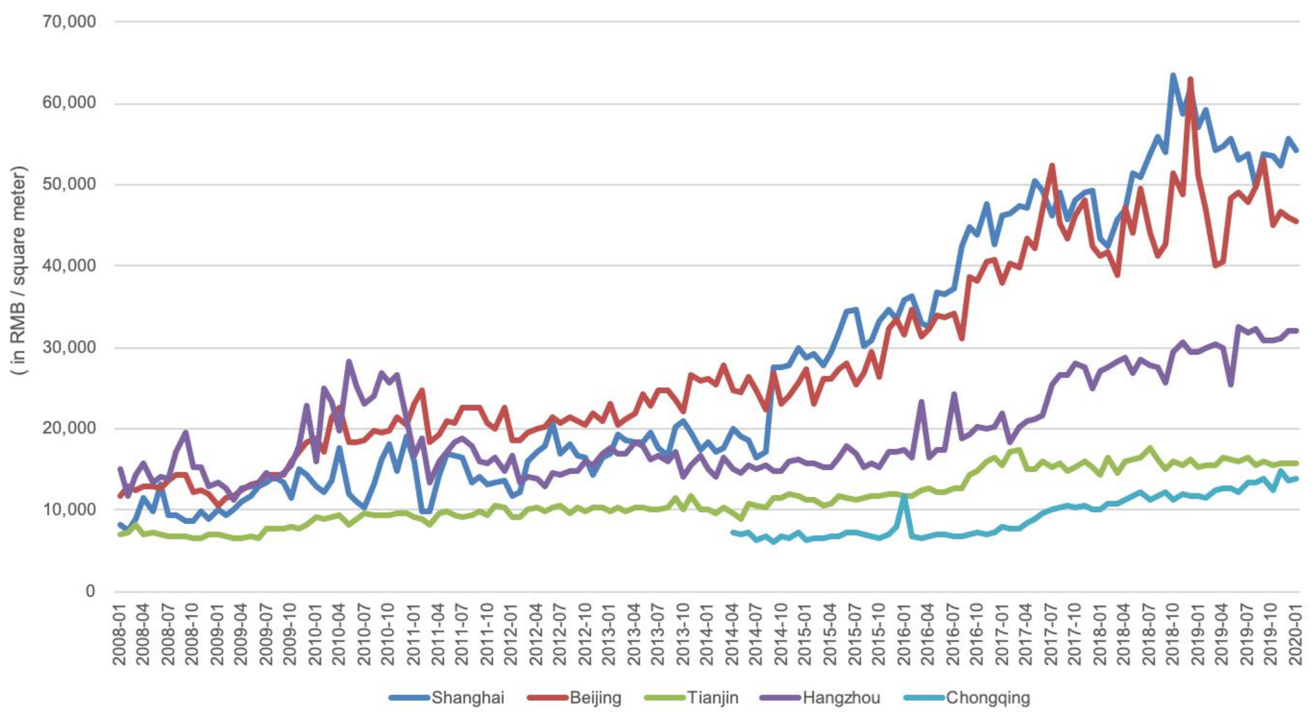
Rating Factors	Weight	Initial Rating
I. Market Demand Analysis	**15.0%**	**a-**
II. Business Analysis[3]	**45.0%**	**bbb-**
III. Financial Analysis[4]	**40.0%**	**b+**
IV. Base Score	**100.0%**	**bb**
V. Industry Risk		**bbb**
VI. Qualifiers		
Liquidity		Neutral
Corporate Governance		Neutral
Debt Structure 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

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

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

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



Source: WIND and Lianhe Global's Adjustments

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