Press Release
18 June 2021

Correction: Lianhe Global publishes the 'BB' global scale Long-term Issuer Credit Rating of Jiangsu Zhongnan Construction Group Co., Ltd.; Outlook is Stable

HONG KONG, 18 June 2021 – This replaces the press release published on 17 June 2021 to correct the amount of non-traditional banking products as a percentage of total debt at end-2020.

Lianhe Ratings Global Limited ("Lianhe Global"), an international credit rating company, publishes 'BB' global scale Long-term Issuer Credit Rating of Jiangsu Zhongnan Construction Group Co., Ltd. ("Zhongnan" or "the company"). The Outlook is Stable.

The Issuer Rating reflects Zhongnan's improved market position and financial leverage. It also considers Zhongnan's established track record of property development in the Yangtze River Delta (YRD) region, especially Jiangsu province, growing and sizable scale of contracted sales and revenue, and more controlled land acquisitions. However, Zhongnan's rating is constrained by its land bank exposure to low-tier cities, moderate interest coverage and the lower margin of its construction segment.

The Stable Outlook reflects our expectation that Zhongnan will maintain its market position in Jiangsu province and continue to grow in terms of sales and revenue in a moderate manner, while employing a prudent expansion and land acquisition approach to manage its financial leverage and liquidity position.

Key Rating Rationales

Sizable and Diversified Land Bank Supports Contracted Sales Growth: Zhongnan has a sizable and diversified land bank portfolio with a total GFA of 44.7 million square meters (sq.m) across 86 cities in China at end-2020. Zhongnan aims to expand its presence to high-tier cities in its land bank portfolio in the long term, but maintains a balanced approach at the same time supported by strong tier 3 cities with quick asset turnover. Zhongnan has deep penetration and brand awareness in the YRD region, particularly Jiangsu province, and gradually expands to central and western China, the Bohai Rim region and the Pearl River Delta region.

Zhongnan's land bank is primarily located in tier 2 and 3 cities, which accounted for over 95% of its land bank at end-2020. The contribution to land bank from tier 3 cities decreased gradually to c. 59% at end-2020, compared with c. 76% at end-2017. We believe the company is moving towards the direction of enhancing its presence in high-tier cities, although this strategy comes with rising land costs and execution risks.

Zhongnan's sizable land bank supported its contracted sales growth. The company recorded contracted sales growth of 52.2%, 33.7% and 14.2% in 2018-2020, respectively. Zhongnan's total contracted sales reached RMB223.8 billion in 2020, which placed it at 17th among

Chinese property developers, according to CRIC Information Centre. The company expects to maintain c. 10% growth per annum of total contracted sales in 2021-2023. At end-2020, Zhongnan's unrecognized sales reached RMB120.3 billion, with most of them can be booked in the next 12 to 24 months.

Zhongnan's focus on low-tier cities with quick asset turnover to expand and gain market share resulted in low segment gross margins at 17-20% in 2018-2020, which was below industry average level. As Zhongnan gradually moves towards high-tier cities for its contracted sales, we expect Zhongnan's property development segment gross margins to maintain at c. 20% in the next 12 to 18 months.

Construction Segment of Lower Margin though Creates Synergies: Zhongnan has an established construction segment which has been granted the highest qualification for general contractor of house building and construction (the only privately-owned enterprise receiving such qualification). Zhongnan's construction business possesses strong technical know-hows and track record across a number of provinces in China. Zhongnan's construction segment is expected to aid its property development segment's expansion, especially outside of Jiangsu province. Given the contracting nature of the construction business, there is considerable working capital requirement. In addition, the construction business commanded lower gross margins of c. 8-12% in 2018-2020. This segment contributed c. 24% of Zhongnan's revenue in 2020. We expect a moderate segment revenue growth in the next 12 to 18 months.

Moderate and Improving Leverage with More Managed Land Acquisition Strategy: Zhongnan's total land bank on hand at end-2020 was sufficient to support its contracted sales for the next two to three years. In order to maintain steady contracted sales growth, we expect Zhongnan to continue replenishing its land bank in a measured manner. Zhongnan spent c. 35% of contracted sales proceeds for land acquisitions in 2020, scaled back from 45-65% in 2017-2018. We expect the company to keep spending 30-35% of contracted sales proceeds for land acquisitions in the next 12 to 18 months.

Zhongnan's reported total debt increased from RMB70.6 billion at end-2019 to RMB79.9 billion at end-2020, while adjusted debt increased from RMB81.4 billion to RMB90.7 billion during the same period. Given the larger equity base, Zhongnan's financial leverage as measured by debt/capitalization ratio improved from 74.8% at end-2019 to 64.9% at end-2020. Also, Zhongnan's net gearing ratio dropped to 97.3% at end-2020, compared with 168.4% at end-2019. We expect Zhongnan to maintain a moderate debt growth rate. Overall, we forecast Zhongnan's financial leverage to further improve to c. 59-63% in the next 12 to 18 months.

***Access to Various Financing Channels Despite Exposure to Alternative Financing*:** Zhongnan has wide access to various financing channels especially in the onshore markets. Exposure to non-traditional banking products, such as trust loans which typically carry higher funding costs, amounted to c. 22% of Zhongnan's total debt at end-2020. The ratio decreased from c. 30% and 27% at end-2018 and end-2019, respectively. We expect Zhongnan to continue lowering this exposure in order to manage its funding cost and debt maturity profile.

Zhongnan’s had cash on hand of RMB32.9 billion (including RMB24.4 billion unrestricted) at end-2020 to cover its RMB23.4 billion of debt due within one year. The company also had c. RMB131 billion of approved but unutilized bank line at end-2020. We expect Zhongnan to be able to maintain its liquidity profile in the next 12 to 18 months. Zhongnan is also planning to seek other financing channels such as ABN and ABS to diversify its funding sources.

Rating Sensitivities

We would consider downgrading Zhongnan’s rating if it were to (1) aggressively expand and replenish its land bank which results in an increase in its financial leverage as measured by debt/capitalization to over 70% or a decrease in its EBITDA interest coverage to below 1.5x 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 Zhongnan’s rating if it were to (1) considerably increase its operating scale while maintaining competitive position in its core markets, and (2) maintain its financial leverage as measured by debt/capitalization at below 60% and EBITDA interest coverage at above 3.0x 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 Zhongnan’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.

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