

Zhenro Properties

Financial stability and operational efficiency to withstand market volatility

| CORE

Zhenro's strong cash/short-term debt ratio of 2.2x stands out among its peers and could provide some comfort amid market volatility in 2H21. We prefer the high-coupon May23sC22s (OW) and recommend switching from Mar24s (MW) into Apr24s (OW) or Sep24s (OW).

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Zhenro's strong liquidity, diversified funding channels, improved capital structure in 1H21, and corporate transparency make it stand out among its high-single B peers, which should enable the issuer to benefit from increasing credit bifurcation during periods of market volatility, in our view. Unchanged FY21 revenue guidance of CNY42-45bn (versus CNY36bn in FY20) suggests stronger 2H21 bookings after 10% revenue growth in 1H21, while the FY21E gross margin should remain broadly stable at 18-20% (vs 19.1% in 1H21).

Meanwhile, Zhenro is applying for a new NDRC quota of USD1bn for refinancing. We expect a further reduction in average financing costs from 6.35% at mid-2021, along with a plan to refinance some of its high-coupon bonds, including the 10.25% perpetual (callable in January 2022), 9.15% 2023s (callable in May 2022) and 8.3% Sep23s (callable in September 2022). Zhenro is also on track to comply fully with all of the Three Red Lines ratios by end-2021.

Trade idea: Switch from Mar24s (MW) into Apr24s (OW) or Sep24s (OW)

The trade takes out 2-4pts of cash for 80-90bp higher yield to about 8.9-9.0% YTW despite slightly longer maturities of one and six months. The Mar24s have rebounded from the recent low of 98.5 and are now trading at 100.375/100.875. While the Mar24 is puttable in March 2023 at 100, the put option is currently out of the money given its asking price of 100.375. Based on our view that the put option is unlikely to be exercised at current prices should market sentiment improve, the Apr24s and Sep24s, which provide large yield pickups, are more attractive, in our view.

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1H21 results and earnings call takeaways

Zhenro reported stable 1H21 results, which were largely in line with earlier management's guidance with strong liquidity. While leverage increased slightly, partly because of its back end-loaded booking schedule and a slight decline in margin, its prudent financial management, improved financing costs, and debt structure continue to stand out among its high-single B peers, and the issuer should benefit from increasing bifurcation in the credit markets, in our view.

- EBITDA declined by 9% y/y, to CNY1.8bn, with GPM edging down slightly, by 1.3pp, to 19.1%.
- Total debt increased by 4% h/h, and net debt increased by 5% h/h.
- Debt (including perpetual)/LTM EBITDA increased slightly, to 15.6x versus 14.6x in FY20; net debt (including perpetual)/LTM EBITDA increased to 6.0x, versus 5.5x in FY20.
- Net gearing improved to 54.7% from 64.9% end-20, (or to 67.8% if treating perpetual and ABS as debt).
- Trust financing was down slightly, to 5%, from 6% of total debt at end-2020.
- Average financing cost has been reduced to 6.35% at end-1H21 from 6.5% at end-2020.
 - We expect a further reduction along with its plan to refinance some of the high-coupon offshore bonds.
- Unbooked revenue amounted to CNY200bn at mid-2021, with over CNY120bn belonging to consolidated projects.
- Zhenro remained in the 'Yellow' category under the three Red Line policy, with 1) unrestricted cash/short-term debt at 1.7x, 2) net gearing (treating ABS as debt) at 62.8%, and 3) adjusted liability/asset ratio at 72.4% (down from 76.6%).
 - Zhenro is on track to comply fully with all of the Three Red Lines ratios by the end of 2021.
- Land bank duration decreased to 3.0 years from 3.5 years at end-2020 (based on land bank value). After stripping out the CNY120bn unbooked revenue from the CNY510bn in land bank resources, we estimate land bank life based on unsold resources is 2.3 years.
- Outstanding ABS, which was classified in payables, amounted to CNY3.8bn.
- Outstanding commercial acceptance bills (CABs) amounted to CNY2.3bn at mid-2021.
- At the end of 2021, off-balance-sheet financial guarantees amounted to CNY3.1bn, while attributable off-balance-sheet cash amounted to CNY2.4bn.

Refinancing and maturity wall. Zhenro is applying for a new NDRC quota of USD1bn to refinance the Aug22s, May23sC22s, Sep23sC22s, and PerpC22s. The Nov21 is the only offshore bond due for the rest of the year, which we believe the company can either repay with cash or refinance through a new bond.

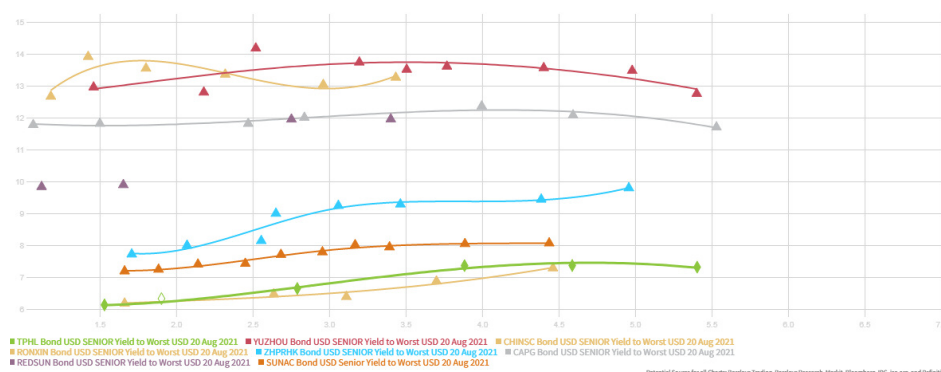
We believe the maturity wall in 2023 is manageable, even if all five 364-d bonds (including the CNH bond) due in 2022, with a combined total of USD910mn equivalent outstanding, are refinanced with new 364-d bonds that would then be due in 2023. We think that the two high-coupon 2023s, with a combined total of USD500mn outstanding, could be called and refinanced in 2022, which should help reduce refinancing pressure in 2023.

Consolidation and attributable ratio. While the attributable and consolidation ratio for new projects acquired in 1H21 fell to 45% and 48%, respectively, from 68% and 73% in 2020, mainly because of risk mitigation, we take comfort from the company's disclosure of off-balance-sheet items and its promise to control growth in minority interests in 2H21.

Relative value

Zhenro bonds offer a premium of 50-140bp over Sunac bonds and 160-210bp over China SCE bonds. Zhenro bonds are trading 220-520bp tighter than the bonds of Aoyuan, Yuzhou, and Ronshine, which have showed some company-specific credit weakness. We expect Zhenro's strong liquidity, diversified funding channels, improved capital structure, and corporate transparency to support current valuations. We also think Zhenro's bonds should benefit from increasing credit bifurcation during periods of market volatility, in our view.

FIGURE 1. Zhenro bonds offer a premium over the bonds of Sunac, China SCE, and Times China



We maintain Overweight ratings on the May23s, Sep23s and Apr24s and add coverage of the September 2024s at Overweight, based on our expectation that the front-end bonds should outperform during market volatility because of the issuer's strong liquidity and robust financial position, and their high coupons also offer good carry.

We downgrade the March 2024s to Market Weight from Overweight because the bond's yield is now close to the sector-average, which we think is insufficient versus other Zhenro bonds with shorter maturities.

We maintain Market Weight ratings on the Feb 2025s, Jan 2026s and Aug 2026s, based on yield pick-ups that we do not think are high enough to offset the bonds' longer duration. We also see supply risks in these tenors based on potential refinancing activities. We expect them to perform broadly in line with the sector.

We drop coverage of the Aug 2022s because the maturity is less than one year. Our last rating was Overweight.

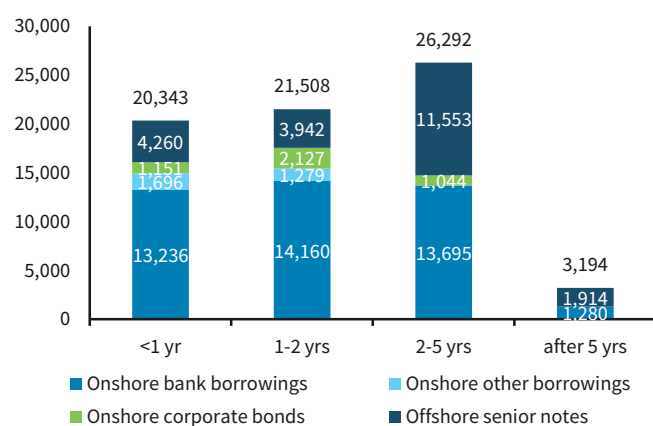
Key positive risks include better-than-expected sales, credit profile improvements, and positive rating actions. Key negative risks include policy tightening, aggressive land banking, and rising leverage.

FIGURE 2. Cash flow (CNY bn)

	19A	20A	1H21A	2H21E	21E (new)	21E (old)	Var
Cash inflow	50.3	58.6	35.5	32.0	67.5	67.5	0.0
Land purchase	25.6	30.5	18.7	12.8	31.5	31.5	0.0
Construction capex	12.0	16.0	9.8	8.9	18.7	17.5	1.2
SG&A	3.9	5.3	3.0	3.0	6.0	6.0	0.0
Interest	3.9	5.8	3.6	1.6	5.2	6.3	-1.2
Tax	2.8	4.1	2.4	2.1	4.5	4.5	0.0
Outflow	48.2	61.7	37.5	28.3	65.8	65.8	0.0
Net	2.1	-3.1	-0.1	1.8	1.7	1.7	0.0
Dividend + PCS distribution	-0.9	-1.2	-1.4	0.0	-1.4	-1.4	0.0

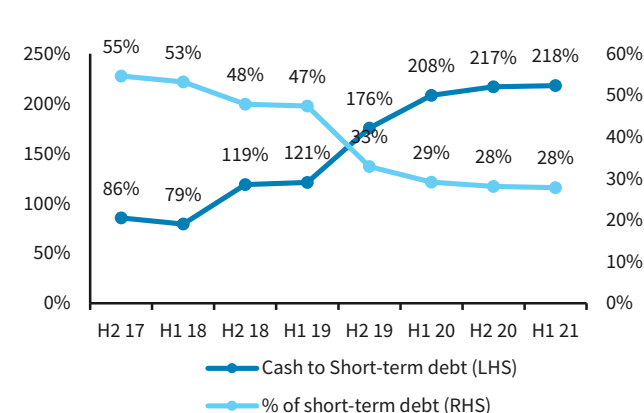
Source: Company data, Barclays Research

FIGURE 3. Debt maturity by type (CNY mn)



Source: Company data, Barclays Research

FIGURE 4. Improving debt structure



Source: Company data, Barclays Research

FIGURE 5. Summary financials

CNY mn	FY 17	FY 18	FY 19	FY 20	LTM H1 21	H1 18	H2 18	H1 19	H2 19	H1 20	H2 20	H1 21	h/h	y/y
Profit and Loss														
Operating revenue	19,995	26,453	32,558	36,126	37,595	12,315	14,138	13,648	18,909	14,542	21,584	16,011	-26%	10%
Gross profit	4,217	6,021	6,498	6,904	7,001	2,714	3,307	2,774	3,724	2,954	3,950	3,051	-23%	3%
EBITDA	2,936	4,198	4,418	4,714	4,543	1,899	2,299	1,956	2,462	2,006	2,708	1,834	-32%	-9%
EBIT	2,912	4,164	4,311	4,606	4,430	1,883	2,281	1,895	2,416	1,956	2,650	1,780	-33%	-9%
Gross interest expense	(2,948)	(4,632)	(5,066)	(5,602)	(5,696)	(2,275)	(2,356)	(2,559)	(2,507)	(3,398)	(2,204)	(3,492)	58%	3%
Revaluation on investment properties	354	145	327	324	250	98	47	123	203	80	244	5	-98%	-93%
Net income	1,409	2,121	2,506	2,651	2,941	840	1,280	933	1,573	876	1,775	1,166	-34%	33%
Cash Flow														
FFO	(758)	(477)	(1,083)	(965)	n.a.	(628)	151	(521)	(562)	(1,164)	199	n.a.	n.a.	n.a.
Changes in working capital	(3,481)	(2,187)	(12,981)	(2,053)	n.a.	(7,856)	5,669	(7,203)	(5,778)	(278)	(1,775)	n.a.	n.a.	n.a.
Net cash from operating activities	(4,239)	(2,664)	(14,064)	(3,018)	n.a.	(8,485)	5,821	(7,723)	(6,340)	(1,442)	(1,576)	n.a.	n.a.	n.a.
Capex and acquisitions	(2,287)	(2,802)	(1,787)	(1,529)	n.a.	(1,585)	(1,217)	(1,064)	(722)	(1,579)	50	n.a.	n.a.	n.a.
Dividends paid	(60)	(786)	(753)	(1,275)	n.a.	0	(786)	0	(753)	(372)	(903)	n.a.	n.a.	n.a.
Free cash flow	(6,586)	(6,252)	(16,603)	(5,821)	n.a.	(10,070)	3,818	(8,788)	(7,815)	(3,393)	(2,428)	n.a.	n.a.	n.a.
Balance sheet														
Unrestricted cash	14,539	22,539	28,369	35,478	34,982	14,798	22,539	25,072	28,369	33,581	35,478	34,982	-1%	4%
Restricted cash and deposit	5,127	5,830	6,938	7,495	9,468	6,039	5,830	5,065	6,938	6,229	7,495	9,468	26%	52%
Total assets	106,422	141,399	169,219	221,386	250,346	123,567	141,399	155,273	169,219	192,397	221,386	250,346	13%	30%
Short-term debt	22,984	23,839	21,133	19,814	20,388	26,264	23,839	24,903	21,133	19,116	19,814	20,388	3%	7%
Long-term debt	19,079	25,938	41,010	50,676	52,955	23,060	25,938	27,626	41,010	46,420	50,676	52,955	4%	14%
Total debt	42,064	49,777	62,143	70,489	73,343	49,324	49,777	52,529	62,143	65,536	70,489	73,343	4%	12%
Total debt (including perp)	45,038	52,785	63,583	71,908	74,760	52,444	52,785	57,016	63,583	66,963	71,908	74,760	4%	12%
Net debt	27,524	21,409	26,837	27,517	28,893	28,487	21,409	22,392	26,837	25,726	27,517	28,893	5%	12%
Total equity	12,224	24,479	31,060	37,603	47,041	16,581	24,479	29,055	31,060	33,236	37,603	47,041	25%	42%
Credit ratios (non lease-adjusted)														
Gross profit margin	21.1%	22.8%	20.0%	19.1%	18.6%	22.0%	23.4%	20.3%	19.7%	20.3%	18.3%	19.1%	0.76pp	-1.26pp
EBITDA margin	14.7%	15.9%	13.6%	13.0%	12.1%	15.4%	16.3%	14.3%	13.0%	13.8%	12.5%	11.5%	-1.09pp	-2.34pp
EBITDA/gross interest	1.0x	0.9x	0.8x	0.8x	0.8x	0.8x	1.0x	0.8x	1.0x	0.6x	1.2x	0.5x	-57%	-11%
Total debt/EBITDA (LTM)	14.3x	11.9x	14.1x	15.0x	16.1x	13.4x	11.9x	12.3x	14.1x	14.7x	15.0x	16.1x	8%	10%
Total debt/total capital	77%	67%	67%	65%	61%	74.8%	67.0%	64.4%	66.7%	66.4%	65.2%	60.9%	-4.29pp	-5.43pp
Cash to ST debt	86%	119%	167%	217%	218%	79%	119%	121%	167%	208%	217%	218%	1.14pp	9.76pp
Net gearing ratio	183%	87%	86%	73%	61%	172%	87%	77%	86%	77%	73%	61%	-11.76pp	-15.98pp
Net gearing ratio (co. definition)	183.2%	74.0%	75.2%	64.7%	57%	158%	74%	77%	75%	71%	65%	57%	-7.50pp	-14.28pp
Net gearing ratio (Treating perps as debt)	274%	114%	95%	80%	64%	235%	114%	109%	95%	85%	80%	66%	-13.53pp	-18.93pp
Revenue (LTM) / total debt	48%	53%	52%	51%	51%	49%	53%	53%	52%	51%	51%	51%	0.01pp	0.22pp

Source: Company data, Barclays Research

Summary of Ratings**Bloomberg Barclays EM Asia USD High Yield Credit Index**

	Old	New
Asia HY China Property	Overweight	Overweight
ZHPRHK 6.63 01/07/26	Market Weight	Market Weight
ZHPRHK 6.7 08/04/26	Market Weight	Market Weight
ZHPRHK 7 7/8 04/14/24	Overweight	Overweight
ZHPRHK 7.1 09/10/24		Overweight
ZHPRHK 7.35 02/05/25	Market Weight	Market Weight
ZHPRHK 8.3 09/15/23	Overweight	Overweight
ZHPRHK 8.35 03/10/24	Overweight	Market Weight
ZHPRHK 8.7 08/03/22	Overweight	Coverage Dropped
ZHPRHK 9.15 05/06/23	Overweight	Overweight

Source: Barclays Research

Analyst(s) Certification(s):

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Primary Issuers/Bonds

ZHENRO PROPERTIES GROUP LTD, CD/FA/J

ZHPRHK 8.7 08/03/22, Coverage Dropped (USD 101.00, 23-Aug-2021)

Valuation Methodology: Coverage Dropped

Risks that May Impede Achievement of the Rating: Coverage Dropped

ZHPRHK 6.63 01/07/26, Market Weight (USD 89.75, 23-Aug-2021)

ZHPRHK 6.7 08/04/26, Market Weight (USD 87.75, 23-Aug-2021)

ZHPRHK 7.35 02/05/25, Market Weight (USD 94.00, 23-Aug-2021)

Valuation Methodology: MW rating reflects our view that the yield pickup is not sufficient for the longer duration.

Risks that May Impede Achievement of the Rating: Key positive risks include better-than-expected sales, credit profile improvements and positive rating actions. Key negative risks include policy tightening, aggressive landbanking and rising leverage.

ZHPRHK 8.35 03/10/24, Market Weight (USD 100.00, 23-Aug-2021)

Valuation Methodology: MW ratings because the bond's yield is now close to as the sector-average, which we think is insufficient versus other Zhenro bonds with shorter maturities.

Risks that May Impede Achievement of the Rating: Key negative risks include policy tightening, aggressive landbanking and rising leverage.

ZHPRHK 7 7/8 04/14/24, Overweight (USD 97.25, 23-Aug-2021)

ZHPRHK 7.1 09/10/24, Overweight (USD 94.75, 23-Aug-2021)

ZHPRHK 8.3 09/15/23, Overweight (USD 100.50, 23-Aug-2021)

ZHPRHK 9.15 05/06/23, Overweight (USD 102.13, 23-Aug-2021)

Valuation Methodology: Our OW rating reflects our view that front-end bonds should outperform during market volatility on back of the issuer's strong liquidity and the robust financial position and the high coupons offer good carry.

Risks that May Impede Achievement of the Rating: Key negative risks include policy tightening, aggressive landbanking and rising leverage.

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For sectors rated against the Bloomberg U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Pan-European High Yield Finance Index or the Bloomberg EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to exceed the six-month total return of the relevant index.

Market Weight (MW):

For sectors rated against the Bloomberg U.S. Credit Index, the Bloomberg Pan-European Credit Index, the Bloomberg EM Asia USD High Grade Credit Index or the Bloomberg EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to be in line with the six-month excess return of the relevant index.

For sectors rated against the Bloomberg U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Pan-European High Yield Finance Index or the Bloomberg EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to be in line with the six-month total return of the relevant index.

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For sectors rated against the Bloomberg U.S. High Yield 2% Issuer Capped Credit Index, the Bloomberg Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials, the Bloomberg Pan-European High Yield Finance Index or the Bloomberg EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to be less than the six-month total return of the relevant index.

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Market Weight (MW): The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be in line with the six-month expected excess return of the relevant sector.

Underweight (UW): The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be less than the six-month expected excess return of the relevant sector.

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Market Weight (MW): The analyst expects the six-month total return of the debt security subject to this rating to be in line with the six-month expected total return of the relevant sector.

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