

CCXAP affirms Zhuhai Huafa Industrial Co., Ltd.'s long-term credit rating at BB_g+, with stable outlook

Hong Kong, 18 June 2021 -- China Chengxin (Asia Pacific) Credit Ratings Company Limited ("CCXAP") affirms the BB_g+ long-term credit rating of Zhuhai Huafa Industrial Co., Ltd. ("Huafa Industrial" or the "Company"), with stable outlook.

The BB_g+ rating of Huafa Industrial reflects the Company's (1) rapid contracted sales growth with optimized sales layout; (2) good access to capital markets; and (3) strong support from its parent company.

However, the rating is constrained by the Company's (1) high capital expenditure pressure; (2) weakened profitability due to margin compression; and (3) high debt leverage and weak liquidity profile.

Corporate Profile

Founded in 1992, Huafa Industrial (Stock Code: 600325.SH) has been listed on Shanghai Stock Exchange since 2004. The Company develops residential properties in Zhuhai and gradually expands to other first-tier and second-tier cities including and surrounding Shenzhen, Shanghai, and Wuhan. As of 31 March 2021, the Company's business layout covered Zhuhai, Southern China, Eastern China, Northern China, and Beijing.

As of 31 March 2021, Zhuhai Huafa Group Co., Ltd. ("Huafa Group" or the "Group") was the largest shareholder of the Company, holding 24.2% of the shares, and its controlled subsidiary, Zhuhai Huafa Industrial Multi-Business Development Co., Ltd, held 4.29% of the shares. The Zhuhai State-Owned Assets Supervision and Administration Commission ("Zhuhai SASAC") is the Company's ultimate controlling shareholder.

Rating Rationale

Credit Strengths

Rapid contracted sales growth with optimized sales layout. Driven by national layout strategy and good sales execution, Huafa Industrial's contracted sales demonstrated rapid growth amid the pandemic. The Company realized contracted sales of RMB120.5 billion and contracted sales area of 5.0 million square meters ("sqm") in 2020, increasing by 30.6% and 27.3% year-on-year ("YoY"), respectively. For the first quarter of 2021, the Company's contracted sales rose by 84.1% YoY to RMB28.1 billion. With a rapid sales growth, the Company's market position also improved. According to the statistics of CRIC, the Company ranked 34th by total contracted sales among Chinese property developers in 2020, as compared to 39th in 2019. In addition, the Company's sales layout was further diversified to regions with strong economy and housing demands. In 2020, the contracted sales in Zhuhai, Eastern China, and Southern China accounted for 24%, 49% and 17% of total contracted sales respectively, while that of Northern China and Beijing accounted for the remaining 10%.



High-quality land bank with improving geographic diversification. In 2020, Huafa Industrial accelerated its land bank expansion in core cities, such as Shanghai, Zhuhai, Wuhan and Shenzhen, through diversified channels including public auction markets, joint ventures, M&As and urban renewal projects. In 2020, the Company newly acquired land parcels with total gross floor area (“GFA”) of 5.8 million sqm and a total cost of RMB67.7 billion. As of 31 December 2020, Huafa Industrial’s total land bank amounted to 8.1 million sqm in terms of GFA, increasing by 15.5% YoY. In terms of regional distribution, the land bank in the Yangtze River Delta Area and the Yangtze River Economic Belt accounted for 57% of its total land bank, while the Greater Bay Area accounted for 42%. We expect that the Company’s high-quality land bank in the Yangtze River Delta Area and the Greater Bay Area is supportive for its future contracted sales growth.

Good access to capital markets. As a listed subsidiary of Huafa Group, the Company has a good access to debt and equity capital markets. In 2020, Huafa Industrial raised funds through diversified financing channels, which help lower its financing cost. During the year, the Company has issued various types of financing vehicles, including REITS, MTN, PPN, ABS, CMBN, commercial paper, corporate bond and offshore USD bond, and its overall financing cost decreased from 6.35% in 2019 to 6.17% in 2020.

Strong support from its parent company. As the sole property arm of Huafa Group, Huafa Industrial’s total asset and operating revenue accounted for 66.0% and 46.7% of Huafa Group at end-2020, respectively. Due to its strategic and economic importance, the Company has received ongoing support from Huafa Group in terms of project resources and financial support. Huafa Group is authorized to carry out primary land development in Zhuhai, which is conducive to the Company’s project acquisitions. Huafa Group also provides loans to Huafa Industrial and its subsidiaries, joint ventures and associates through its subsidiary Zhuhai Huafa Group Finance Co., Ltd (“Huafa Finance”). As of 31 December 2020, the Company’s loan balance from Huafa Finance was RMB19.5 billion, increasing from RMB15.5 billion at end-2019. We believe that Huafa Group will continue to provide support to the Company when needed.

Credit Challenges

High capital expenditure pressure from large amount of construction projects. Huafa Industrial’s scale of construction projects continued to increase. As of 31 December 2020, the Company has 98 projects under construction, covering an area of 17.8 million sqm, as compared to 13.7 million sqm at end-2019. The total investment of the development projects was RMB234.5 billion with the uninvested portion of RMB175.8 billion. The increase in the scale of construction projects can support the Company’s future business development, but this also elevates its capital expenditure pressure.

Weakened profitability, albeit fast growing revenue. Supported by its growing contracted sales, Huafa Industrial demonstrated fast revenue growth. In 2020, the Company recorded operating revenue of RMB51.0 billion, significantly increasing by 53.9% YoY. For the first quarter of 2021, the Company’s revenue fell by 29.5% YoY to RMB6.4 billion. In light of its contracted liability of RMB62.4 billion at end-2021Q1, we expect that the Company’s revenue will continue to rise in the next 12 to 18 months. However, the Company’s adjusted gross profit



margin declined to 23.4% in 2020 from 28.6% in 2019 due to the margin compression in China's property market. Consequently, the Company's net profit margin declined to 8.9% in 2020 from 10.0% in 2019.

High debt leverage. With the expansion of its business, Huafa Industrial's debt scale continued to increase. As of 31 December 2020, the Company's adjusted total debt (including perpetual bonds) increased by 38.2% YoY to RMB155.2 billion. However, due to substantial increase in its non-controlling interest, the Company's net gearing ratio declined to 195.2% at end-2020, but still at a high level. Furthermore, owing to increasing interest expenses and relatively weak profitability, the Company's adjusted EBIT/interest ratio remained at a modest level of 1.1x in 2020.

Weak albeit improved liquidity profile. The Company's liquidity position and debt profile has improved in 2020. As of 31 December 2020, Huafa Industrial's cash/short-term debt ratio was 0.9x, increasing from 0.6x at end-2019. The Company's short-term debt amounted to RMB46.6 billion, accounting for 30.0% of its total debt, as compared to 39.3% at end-2019. Moreover, the Company's the non-standardized financing accounted for about 17% of its total debt at end-2020. Its liquidity profile, albeit improved, is relatively weak given its sizable short-term debt as well as large capital expenditure over the next 12-18 months.

Nevertheless, this can be partially mitigated by its sufficient stand-by liquidity buffer. The Company has bank facilities of RMB182.5 billion at end-2020, with unused amount of RMB108.2 billion. Given strong support from Huafa Group, good access to capital markets and sufficient liquidity buffer, we believe that the Company's liquidity risk is manageable.

Rating Outlook

The stable outlook on Huafa Industrial's rating reflects our expectation that the Company will maintain a steady contracted sales growth over the next 12 to 18 months. We also expect that the Company will receive ongoing support from its parent company.

What could upgrade the rating?

The rating could be upgraded if (1) Huafa Group demonstrates enhanced credit profile and provides stronger support to the Company; (2) the Company demonstrates a sustainable and strong contracted sales growth; and (3) the Company improves its stand-alone credit metrics, such as debt leverage below 150% or interest coverage above 1.5x.

What could downgrade the rating?

The rating could be downgraded if the Company (1) receives weaker support from its parent company; (2) generates weak contracted sales; or (3) adopts aggressive land acquisition strategy, leading to significant increase in its debt leverage.



Rating Methodology

The methodology used in this rating is the [Rating Methodology for Real Estate Development Industry \(December 2019\)](#).

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The first name below is the lead rating analyst for this rating and the last name below is the person primarily responsible for approving this rating.

Peter Chong

Credit Analyst

+852-2860 7126

peter_chong@ccxap.com

Elle Hu

Director of Credit Ratings

+852-2860 7120

elle_hu@ccxap.com

Client Services: +852-2860 7111



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China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 1904-1909, 19/F, Jardine House,
1 Connaught Place, Central, Hong Kong

Website: www.ccxap.com

Email: info@ccxap.com

Tel: +852-2860 7111

Fax: +852-2868 0656