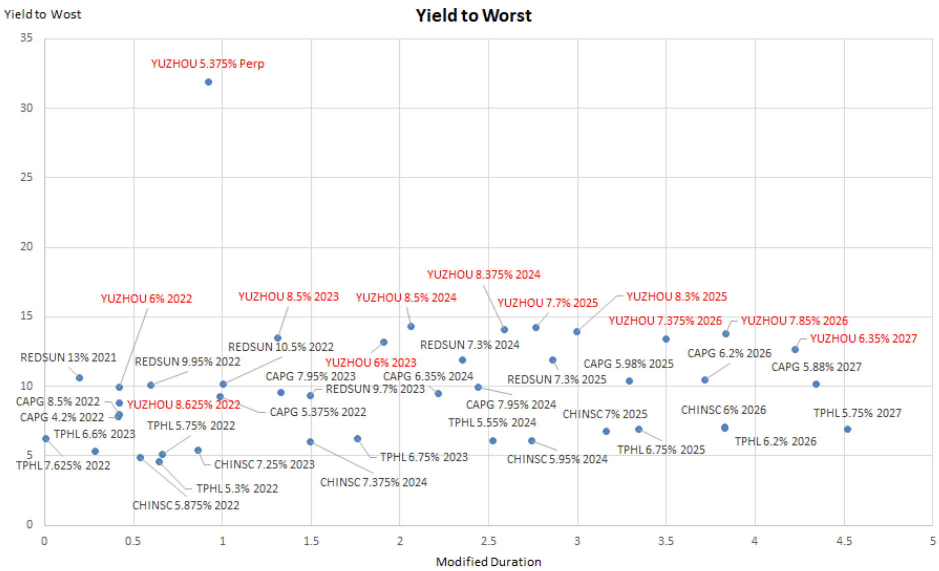
CMBI Credit Commentary - YUZHOU

YUZHOU: Back on track as expected

Yuzhou reported in-line interim results, featuring recovered revenue and gross margin, stable net gearing ratio and good liquidity. The results are very much in line with our *Corporate Day First-take on 7 Jul'21*. Management expects to be in full compliance with "3 red lines" guidance by 2021. Company reported negative free cash flow in 1H21 but expects to turn positive in 2021. Company mentioned that it does not issue commercial paper for financing/payment. We are comfortable with its refinancing prospects. **Compared to its peers, YUZHOUs are offering 150-300bps on a relative value basis. We reiterate our OW call on YUZHOU 23s given attractive premium over YUZHOU 22s, CAPG 23s and REDSUN 23s. We also think the bond trading technical will be supported by company's bond buy back, after the interim result back-out period.**



Interim result recovered; in line with previous guidance.

Yuzhou reported 1H21 revenue of RMB12bn (guided RMB12bn in 1H21; +495% yoy vs. 1H20 restate; +3% yoy vs. 1H19). 1H21 gross margin recovered to 20.1%, which also met previous guidance, but lower than the 2019 level (26.2%), following the industry trend.

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Yuzhou expects its recognized gross margin to be 17-18% in FY21, reflecting the lower gross margin for projects to be recognized in 2H21, affected by higher fair value re-measurements and higher capitalized interests. Yuzhou's net gearing ratio improved to 80% in 1H21 from 86% in 2020, supported by the increase of minority interests (+RMB4.5bn vs. 2020). Note that the external guarantee of Yuzhou has also declined RMB5.7bn in Jun'21 from RMB6.6bn in Dec'20. We take comfort that Yuzhou has increasingly moved to pro-rata guarantees from joint and several guarantees. This will reduce contain Yuzhou's off-balance sheet exposure. Liquidity ratio (cash / ST debts) remained stable at 1.85x (2020:1.83x). Company remained in yellow camp under "3 red lines" guidance with adj. liab/asset ratio improved to 74% in 1H21 from 78% in 2020. Management guided that it will be in full compliance with "3 red lines" by 2021.

On track to achieve full-year sales target

In 7M21, Yuzhou's contract sales increased 16% yoy to RMB62.3mn (attributable ratio of c60%) and cash collection rate (same-year sales) was c70%. It achieved c56.7% of its sales target (RMB110bn). Management is comfortable with the full year sales target with RMB130bn sale-able resources in 2H21. Yuzhou spent RMB2.2bn attributable costs for 4 land parcels and saleable resources of RMB11.1bn.

Revised cash flow guidance to reflect more vigilant land investment and higher construction costs

Yuzhou revised its cash flow guidance in 2021 with key changes in land investment budget (from RMB23.6bn to RMB18.6bn) and construction costs (from RMB18.9bn to RMB23.4bn). This is due to the company to ensure the projects delivery and revenue recognition in 2021.

Yuzhou's refinancing is manageable for its good liquidity position

Yuzhou has RMB6.5bn onshore maturities and USD590mn offshore maturities. While we think the onshore/offshore funding environment could remain challenging, we draw comfort from Yuzhou's good liquidity (cash/ST debts >1.8x). We think the company could use internal resources (1H21 cash of RMB20.9bn with 2.5bn restricted) and expected free cash flow of RMB800mn for the bond repayment.

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