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Ratings

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Research Update:

Yanlord Land Group Ltd. Downgraded To 'BB-' On Debt Expansion After UEL Acquisition; Outlook Stable

January 21, 2020

Rating Action Overview

- Yanlord's acquisition of Singapore-based United Engineers Ltd. (UEL) will result in considerable debt growth from the deal and the consolidation of UEL's debt.
- At the same time, margin compression and exposure to higher market volatility will add pressure to its rating.
- As a result, on Jan. 21, 2020, S&P Global Ratings lowered its long-term issuer credit rating on Yanlord and the issue rating on the company's senior unsecured notes to 'BB-' and 'B+', respectively. We also removed the ratings from CreditWatch, where they were placed with negative implications on Oct. 25, 2019.
- The stable outlook on Yanlord reflects our expectation that Yanlord will modestly improve its credit metrics via debt reduction through lower spending and expediting cash collection over the next 12 months, after substantially raising leverage following the transaction.

PRIMARY CREDIT ANALYST

Aeon Liang
Hong Kong
(852) 2533-3563
aeon.liang
@spglobal.com

SECONDARY CONTACT

Edward Chan, CFA
Hong Kong
+ 852 2533 3539
edward.chan
@spglobal.com

Rating Action Rationale

The downgrade reflects Yanlord Land Group Ltd.'s elevated leverage following the UEL acquisition. Notwithstanding the company's expected debt reduction following the deal, it will be difficult for the entity to achieve a prompt recovery in its financial profile commensurate with its original rating. It also reflects an expected deterioration in profitability, because of the company's exposure to higher market volatility give its niche business focus. The firm is exposed to the premium residential segment in higher-tier cities with a smaller operating scale and geographic diversity than peers in the same rating category.

We don't expect the company's leverage to swiftly return to its prior levels of below 4.0x debt to EBITDA in the next one to two years. This is despite anticipated proactive debt reduction of Chinese renminbi (RMB) 8 billion-RMB10 billion in 2020 and the sale of noncore assets acquired through the UEL deal. The debt-financed UEL acquisition will cause the combined group's pro

forma debt-to-EBITDA leverage to weaken to 4.3x-4.6x in 2019 from 3.8x in 2018, against our previous expectation of 3.8x-3.9x. The Singapore dollar (S$) 1 billion debt on UEL's balance sheet, with only a modest add-on to Yanlord's revenue and EBITDA after consolidation, will add to the leverage pressures. We forecast net proceeds of about S$85 million from asset disposals during 2020. However, the size is not material and the timing of such disposals uncertain.

We believe Yanlord will face increasing margin compression over the next one to two years. Its niche premium positioning across only about 15 higher-tier cities such as Shanghai and Hangzhou will continue to constrain its business standing. Unhelpfully for the firm, governments in those markets typically have stricter regulations, for example tighter price caps or presale restrictions, than in lower-tier cities. Competition is also rising.

This niche-premium business model--despite helping Yanlord to achieve strong brand recognition and sales execution--exposes it to higher volatility than peers with greater geographic and product diversity. We forecast its EBITDA margin will trend downward to 30%-33% by 2021 from about 44% in 2018, primarily reflecting swelling land costs, restrictive government policies, and the rising contribution of lower-margin projects to company results. We believe Yanlord will focus on sales execution and cash collection in the coming year to aid deleveraging, leading to faster inventory turnover even at the expense of pricing.

In our view, the benefits of an improved business scale and diversity from the acquisition won't be able to fully offset the debt increase and subsequent integration and restructuring efforts. On a pro forma consolidated basis, each of UEL's six business segments will only contribute modest cash flows and earnings. For instance, UEL's rental and hotel business is primarily located in Singapore but the scale is small, only representing about 2.5% of Yanlord's total revenue. In addition, we anticipate there will be greater uncertainty relating to capital expenditure (capex) covering enhancement works, as well as costs covering restructuring such as the sale of noncore assets. The integration of non-property businesses may also create execution risk.

Yanlord intends to maintain its scale (measured by total contracted sales), control land costs, and sustain market access by partnering with larger industry peers and local state-owned enterprises. This results in joint venture and associate projects generating a significant portion of its sales. In 2019, while about 60% of total contracted sales were attributable to Yanlord, the firm was only able to consolidate a much smaller amount to its results.

We expect the portion of consolidated total to increase in the next one to two years to 50%-55% given some partners are looking to exit and many partnership agreements allow Yanlord to take out minority shares. However, this model reduces financial transparency because such joint ventures disclose limited data. Despite a "see-through" assessment that proportionately consolidates off-balance sheet figures, operations and capital structures at the project level are difficult to monitor and authenticate, in our view. We estimate Yanlord has 20-30 active joint venture projects in 2020, contributing about 10% of group EBITDA, with overall leverage moderately higher than the consolidated group.

Outlook

The stable outlook reflects our expectation that Yanlord will focus on controlling leverage over the next 12 months through cash collection from sales and debt reduction. We forecast the company will achieve faster revenue growth in the next year, compared with 2019, while maintaining satisfactory profitability. In our base case, Yanlord's consolidated debt-to-EBITDA ratio will stabilize within 4.1x-4.4x in the next 12 months from our expected 4.6x at the end of 2019 (pro forma UEL).

Downside scenario

We may lower the rating if Yanlord's leverage does not improve from 2020 as we expect. This is likely to happen if: (1) the company's revenue recognition is well below our expectation; or (2) its land acquisition or other investment activities significantly exceeds our forecast, such that its adjusted debt-to-EBITDA ratio, either consolidated or after proportionally consolidating joint ventures, is above 5.0x from end of 2020 for an extended period.

Upside scenario

We may raise the rating if Yanlord reduces leverage, such that its adjusted debt-to-EBITDA ratio, both consolidated and after proportionally consolidating joint ventures, remains below 4.0x on a sustained basis, while it significantly improves its diversity and scale.

Company Description

Yanlord engages in the investment, development, and management of real estate properties in China. The company develops mid- to high-end residential properties, commercial properties, and integrated complexes for sale and lease. Founded in 1993, the company is listed on the Singapore stock exchange and has operations in about 15 cities in China. As of end-September 2019, Yanlord's total land bank was about 8.6 million square meters with most in cities such as Nanjing, Shenzhen, and Tianjin.

Our Base-Case Scenario

- China's national contracted sales will increase by 0%-5% in 2020, largely driven by higher growth in gross floor area.
- Yanlord's sales growth will outperform the overall market due to the company's product positioning in the high-end residential segment and its strategic focus on tier-one and key tier-two cities, where demand is comparatively resilient.
- We estimate Yanlord's total contracted sales will reach RMB82 billion in 2020 from about RMB56 billion in 2019, growing 5%-10% per year over 2021-2022.
- Total revenue will increase to about RMB29 billion in 2020 from an estimated RMB26 billion (pro forma UEL) in 2019, and 10%-15% annually in 2021-2022, from RMB24.8 billion in 2018. The recognition of contracted sales, stable contribution from other segments, and the addition of UEL will contribute most of this growth.
- EBITDA margins will trend downward to 30%-33% in 2021 from about 43% in 2019 and 44% in 2018.
- Land premium payments will be 10%-15% of proceeds from contracted sales in 2020, before increasing to about 30% in 2021. This compares to 50% in 2018 and our estimate of 33%-38% in 2019. Management's rate of deleveraging will determine the final number.
- Construction costs will remain at 25%-28% of average selling price.
- Adjusted debt before accessible cash will grow to about RMB55 billion in 2019 (pro forma the UEL transaction) and gradually decline to about RMB45 billion in 2021, similar to the 2018 level, due to debt repayment by the company.

Based on these assumptions, we arrive at the following credit measures:

- Ratio of consolidated debt to EBITDA of 4.3x-4.6x in 2019, and 4.2x-4.5x in 2020-2021.
- Ratio of see-through debt to EBITDA of 5.0x-5.5x in 2019, and 4.3x-4.8x in 2020-2021
- EBITDA interest coverage of 3.5x-4.0x in 2019, and 3.1x-3.6x in 2020-2021.

Liquidity

We continue to assess Yanlord's liquidity as adequate. In our base case, the ratio of liquidity sources to uses was about 2.1x as of Sept. 30, 2019. We believe the company will focus on cash collection and debt repayment following the UEL acquisition.

We do not include uncommitted land acquisition spending in our liquidity uses calculation as the company has the flexibility to adjust land acquisitions according to its sales performance. The assessment was also done prior to the UEL acquisition, which used around S$790 million of its cash balance. We calculate the company has insufficient headroom to absorb high-impact, low-probability events without refinancing.

The company has developed and maintained diverse funding channels including bank borrowings and capital markets. Given its long operating and listing record, it has strong banking relationships with large onshore and, particularly, overseas banks. The fact its newly acquired assets are in Singapore will strengthen its ties to offshore banks.

Principal Liquidity Sources:

- Unrestricted cash of about RMB15.6 billion as of Sept. 30, 2019.
- Funds from operations over the 12 months to Sept. 2020 of RMB14 billion–RMB16 billion, assuming (1) cash flows from contracted sales and other income of about RMB38 billion; (2) construction expenditure of RMB9 billion-RMB10 billion; (3) selling, general, and administrative expenses, taxes, interest expenses, and other miscellaneous expenses that we estimate at about RMB13 billion.
- New drawdown of loans and undrawn committed bank facilities, including about S$960 million acquisition financing for the UEL transaction, of about RMB12 billion.

Principal Liquidity Uses:

Short-term debt maturities of RMB11.7 billion as of Sept. 30, 2019.

- Committed but unpaid land premium payments of about RMB5 million for the next 12 months.
- Capex, acquisitions and dividends of RMB8 billion–RMB9 billion.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Sept. 30, 2019, Yanlord's capital structure consisted of RMB20.4 billion in secured debt and

RMB32 billion in unsecured debt issued at the company level, of which RMB11.3 billion was at the subsidiary level. This included the external guarantees provided by the subsidiaries of Yanlord for its joint venture projects. Priority debt is therefore about 60.5% of total debt, above our notching-down threshold of 50%.

Analytical conclusions

We rate the existing senior unsecured notes issued by its financing vehicle, Yanlord Land (HK) Co. Ltd., guaranteed by Yanlord, one notch below its issuer credit rating because they rank behind a significant amount of priority debt in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Stable/--

Business risk: Fair

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Aggressive

- Cash flow/leverage: Aggressive

Anchor: bb-

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile : bb-

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- Criteria | Corporates | Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 3, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Yanlord Land Group Ltd.		
Issuer Credit Rating	BB-/Stable/--	BB/Watch Neg/--
Yanlord Land (HK) Co. Ltd.		
Senior Unsecured	B+	BB-/Watch Neg

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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