

Research Update:

Yanlord Land Outlook Revised To Negative As Declining Profitability Could Hinder Deleveraging; Ratings Affirmed

September 30, 2020

Rating Action Overview

- We expect Yanlord Land Group Ltd.'s margins to decline and investment needs to remain high over the next 12 months. As a result, its leverage will likely stay elevated.
- We believe the China-based residential property developer's high quality land bank and strong operation capabilities will support its deleveraging and growth in the longer term.
- On Sept. 30, 2020, S&P Global Ratings revised its outlook on Yanlord to negative from stable. At the same time, we affirmed our 'BB-' long-term issuer credit rating on Yanlord and our 'B+' long-term issue rating on the company's guaranteed outstanding senior unsecured notes.
- The negative outlook reflects our view that Yanlord may not be able to deleverage substantially in the next six to 12 months due to its growth appetite and deteriorating profitability.

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Rating Action Rationale

We revised the outlook to negative to reflect our view that Yanlord's weakening profitability and aspirations to further expand its scale may not allow it to substantially deleverage in the next 12 months. The company's strong sales execution will temper this risk.

In our view, Yanlord will achieve strong contracted sales growth of more than 20% per year during 2020-2021. Executing on this strategy requires the company to increase investments and operating cash outflow, which could dent the company's aggressive debt reduction plan. Since 2019, Yanlord has shifted its business strategy from prioritizing margins over scale to balancing profitability with scale growth. This transition is partly due to caps on property prices imposed by local governments, limiting the company's ability to charge premium prices in the high-end market it has been focusing on.

We expect Yanlord to reduce its debt by Chinese renminbi (RMB) 3.6 billion by repaying some maturities in the second half of 2020 and paying off some construction loans early. We believe the company will reduce an external guarantee of RMB8.5 billion in the fourth quarter after pledging

the land certificate for one of its Shanghai joint venture (JV) projects for construction loans. Hence, we expect Yanlord to reduce its total adjusted debt to RMB46.4 billion by the year-end, despite a moderate 1.7% increase as of end-June 2020 from end-2019 levels.

Yanlord's profitability will likely be under pressure in 2020-2021. This expectation mainly reflects the company's control over selling prices and swelling land costs, especially in higher-tier cities. Some of Yanlord's projects in Suzhou and Shenzhen, for example, sold at much lower prices than the company expected because of government-imposed price caps. Moreover, Yanlord has shifted its strategy from focusing merely on high-end upgraders to more mass-market properties that typically have lower profit margins. As a result, we expect the company's gross profit margin to dip to 30%-35% in 2020-2021 from 41% in 2019.

Yanlord will improve its leverage, in our view, but slower than we originally expected. We expected consolidated leverage, as measured by the ratio of debt to EBITDA, to decline to 5.5x-6.0x in 2020, and to 4.5x-5.0x in 2021, from 7.5x in 2019. This is on the basis of an estimated revenue growth of 35%-40% in 2020, mainly supported by a robust 116% growth in contracted sales in 2019.

In our base case, Yanlord's sufficient and high-quality land bank will support its deleveraging and growth. As of June 30, 2020, the company had 9.9 million square meters of land in China (about 70% in Yangtze River Delta Area and Greater Bay Area, and 90% in tier-one and tier-two cities). This should be enough for three to four years of sales and development.

Yanlord has demonstrated strong execution capabilities amid the pandemic, in our opinion. In the first eight months of 2020, its contracted sales grew 74% year-on-year, with a cash collection ratio of over 90%, due to solid demand in higher-tier cities.

We anticipate contracted sales from joint controlled entities will account for 60%-65% of Yanlord's contracted sales in 2020-2021, down from 67% in 2019. This is because we expect the company to continue acquiring land through tenders (by partnering with local governments) or public auctions (by collaborating with other property developers). However, some of Yanlord's partners could exit from partnership agreements and allow Yanlord to consolidate some of its off-balance sheet projects.

We forecast Yanlord's debt-to-EBITDA ratio on a see-through basis will improve to 6.5x-7.0x in 2020, and further to 4.3x-4.8x in 2021, from 8.0x in 2019, due to concentrated project delivery from JV projects in which the company has invested since 2018.

We expect Yanlord to gradually diversify its geographic coverage, with more exposure to lower-tier cities. In the first half of 2020, about 53% of the new land acquired by gross floor area was in lower-tier cities. These cities are exposed to less restrictive housing policies. However, such projects may involve greater execution uncertainties and could undermine Yanlord's profitability, in our view.

Outlook

The negative outlook reflects our expectation that Yanlord's debt will stay elevated to support its operations and expansion needs. The outlook also reflects our view that the company's profitability will weaken on the back of a change in its business strategy to cope with restrictive pricing policies. As such, Yanlord's leverage may not improve substantially over the next six months.

Downside scenario

We could downgrade Yanlord if:

- The company's debt-funded acquisitions are more aggressive or its profitability deteriorates more than we expect, such that its consolidated debt-to-EBITDA ratio does not improve to about 5.5x or see-through debt-to-EBITDA ratio does not improve to about 6x in 2020.
- Over a longer horizon, the company's leverage improvement is below our expectation due to more aggressive debt-funded growth, such that its consolidated debt-to-EBITDA ratio or see-through debt-to-EBITDA ratio is above 5.0x in 2021 and beyond.

Upside scenario

We may revise the outlook to stable if Yanlord controls its debt while achieving solid revenue growth and stable margin. An upside trigger could be the company's consolidated debt-to-EBITDA ratio and its see-through debt-to-EBITDA ratio improving to below 5.0x on a sustained basis.

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 17 cities in China. As of June 2020, Yanlord's land bank in China is about 9.9 million square meters in China, with the majority in cities such as Nanjing, Shenzhen, and Tianjin. The company also has two residential projects under development in Singapore, after its acquisition of a 100% stake in United Engineers Ltd. (UEL) in February 2020.

Our Base-Case Scenario

- China's property sales will increase by 0%-5% in 2020, with higher-tier cities leading the recovery after COVID-19 disruptions.
- Yanlord's contracted sales will rise faster than the industry, supported by its abundant saleable resources of RMB120 billion in 2020. We expect the company's total contracted sales to reach RMB70 billion–RMB75 billion in 2020 from about RMB56 billion in 2019. Of the total contracted sales, 60%-65% will be from JV projects.
- The company's revenue will increase to RMB25 billion–RMB27 billion in 2020 and RMB31 billion–RMB33 billion in 2021. This growth will be supported by RMB24.2 billion of unrecognized revenue as at end-June 2020. About 55% of this will be recognized in 2020.
- EBITDA margins will decline to 30%-35% in 2020-2021, from about 37% in 2019 and 44% in 2018, mainly reflecting swelling land costs and price caps in higher-tier cities.
- Yanlord's land premium will increase to RMB9 billion–RMB10 billion in 2020 and to RMB14 billion–RMB15 billion in 2021, accounting for 30%-35% of consolidated contracted sales.
- Construction costs will remain at about 30% of consolidated contracted sales.
- Net cash upstream from JV projects to be 13%-18% of JV contracted sales.

We arrive at the following key metrics for Yanlord based on the above assumptions:

- Consolidated ratio of debt to EBITDA of 5.5x-6.0x in 2020, from 7.5x in 2019, improving further to 4.5x-5.0x in 2021.
- See-through debt to EBITDA ratio of 6.5x-7.0x in 2020 and 4.3x-4.8x in 2021, from 8.0x in 2019.

Liquidity

We assess Yanlord's liquidity as adequate. In our base case, the company's ratio of liquidity sources to uses is about 1.9x as of June 30, 2020. We do not assign a higher liquidity score because we have included only committed land premiums, and overall investments may exceed this amount. If we include uncommitted land premium in liquidity uses, the ratio will drop to below 1.5x. Nevertheless, we believe Yanlord has flexibility to cut its budgeted costs for construction and land acquisitions in exchange for extra liquidity.

Yanlord 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 such as Oversea-Chinese Banking Corp and Hang Seng Bank Limited. The company's newly acquired assets in Singapore through UEL have increased its access to offshore bank facilities.

Principal liquidity sources include:

- Unrestricted cash of about RMB14.7 billion as of June 30, 2020.
- Undrawn offshore committed bank facilities of RMB1.1 billion.
- Funds from operations over 2020 of RMB15 billion–RMB16 billion, assuming: (1) cash flows from contracted sales and other income of RMB45 billion–RMB 46 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 RMB20 billion–RMB21 billion.
- New committed facility of US\$1.1 billion of syndicated loan in August 2020.

Principal liquidity uses include:

- Short-term borrowings of RMB16.4 billion as of June 30, 2020.
- Committed but unpaid land premium payments of about RMB59 million for the 12 months ending June 30, 2021.
- Capital expenditure, acquisitions, and dividends of RMB3.8 billion–RMB4.0 billion in the period.

Covenants

Yanlord has some financial covenants on its borrowings, mainly relating to net borrowings, tangible net worth, interest coverage, and current assets ratio. As of June 30, 2020, the company is in compliance with its financial covenants. We believe Yanlord has ample headroom to meet its covenants over the next 12 months.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Negative/--

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)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (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
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Yanlord Land Group Ltd.		
Issuer Credit Rating	BB-/Negative/--	BB-/Stable/--

Ratings Affirmed

Yanlord Land (HK) Co. Ltd.		
Senior Unsecured	B+	

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