

Research Update:

# Yanlord Land Group Outlook Revised To Stable On More Disciplined Expansion; Ratings Affirmed

March 18, 2021

## Rating Action Overview

- We believe Yanlord Land Group Ltd.'s moderate investment and expansion appetite will help it to maintain its debt level. This would temper the credit impact of the China-based residential property developer's compressed profitability.
- Yanlord's good market standing with a focus on the higher-end residential segment in higher-tier cities will support its operating cash flow.
- On March 18, 2021, S&P Global Ratings revised its outlook on Yanlord to stable from negative. 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 senior unsecured notes.
- The stable outlook reflects our view that Yanlord will moderately grow its contracted sales and accelerate project delivery, while better managing its debt-funded land replenishments over the next 12-24 months.

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## Rating Action Rationale

We revised our outlook on Yanlord because we believe the company's moderate investment appetite and solid execution in higher-tier cities will help it reduce its leverage over the next one to two years. These positive developments should temper the impact of Yanlord's compressed profitability, which remains a key risk in our view. Swelling land costs and restrictive selling prices in cities the company operates in have limited its profits.

**Yanlord is likely to slow down its pace of expansion over the next one to two years.** The management intends to maintain moderate growth in contracted sales in the period. The company has caught up on scale with peers with similar ratings. This follows two years of strong growth in 2018-2020. Yanlord rose to be among the top-50 property developers in China in 2020, from the 80th position two years ago. Its contracted sales grew at a compounded annual rate of 75% in the period.

We forecast Yanlord's contracted sales will be Chinese renminbi (RMB) 75 billion-RMB80 billion in 2021, compared with RMB78 billion in 2020. This is based on our assumption of a lower

sell-through rate due to the company's increasing saleable resources in lower-tier cities. Yanlord faces greater uncertainty in these cities over the cycle because the company may not be very accustomed to development there. Yanlord has maintained an above-average sell-through rate of more than 85% in the past three years, mainly due to the prime location of the company's properties in higher-tier cities in Yangtze River Delta and Greater Bay Area.

**Yanlord will likely continue to control land replenishment to stabilize its leverage.** The company reduced its adjusted debt to RMB42.3 billion at the end of 2020, from RMB57.9 billion a year ago. This was aided by satisfactory cash collection from contracted sales and a reduction in guarantees to joint ventures (JVs) and associates. The debt-to-EBITDA ratio also improved to 5.1x in 2020, from 7.5x in 2019.

We estimate Yanlord's land spending will only moderately pick up to 35%-40% of contracted sales in 2021-2022, compared with 30% in 2020. The company's unsold land reserve of approximately 6.8 million square meters should be enough for nearly three years of development.

**Yanlord's profitability will be under pressure because the company has been dependent to a certain extent on land replenishment through public auctions.** We project the company's gross profit margin from the property development segment will be 25%-27% over the next two to three years, significantly lower than the 36% in 2020. This is because of some low-margin projects acquired in 2017-2018 in top-tier cities (such as Suzhou, Nanjing, and Shenzhen) had higher land costs and lower selling prices than Yanlord expected because of government-imposed price caps. The company is likely to gradually digest the impact of such projects in the next two to three years. Management has increased land purchases through urban renewal projects and project acquisitions. This should also enhance Yanlord's profitability.

One key risk to the improvement in profitability is that competition to acquire land through less costly means may intensify, while price caps imposed in higher-tier cities do not loosen.

**We expect Yanlord's revenue recognition to remain strong in 2021.** This is on the back of strong growth in contracted sales in previous years. The company's total sold but unrecognized revenue increased by 40.5% to RMB106 billion as of end-2020. We estimate about RMB80 billion of this was from JVs. Yanlord set up most of these JVs in 2017 and 2018, and they will start revenue contribution in the next two years. However, sales growth will gradually decrease to single-digit levels owing to a high base.

We expect Yanlord's improved revenue to reduce its leverage on a look-through basis as long as execution risks at JVs are well managed. The company's ratio of consolidated debt to EBITDA will likely fall to 4.5x-4.7x by 2022, from 5.1x in 2020, while its look-through (after proportionally consolidating JVs) debt-to-EBITDA ratio will decline to 4.3x-4.5x from 5.7x-5.9x.

**In our view, the acquisition of United Engineers Ltd. (UEL) in February 2020 will slightly enhance Yanlord's cash flow diversity.** We don't expect Yanlord to incur high capital expenditure on UEL assets in the next two years. Yanlord's revenue from its non-property segment has increased to 12% in 2020, from 5% before the acquisition in 2018. We expect this ratio to be stable over the next two to three years.

## Outlook

The stable outlook reflects our expectation that Yanlord will better control land spending and debt owing to its reduced aspirations for growth in contracted sales. This should help the company

sustain the improvement in both consolidated and look-through leverage over the next 12-24 months. Yanlord's compressed profitability due to regulatory restrictions on sale prices in higher-tier cities will temper the improvement.

## **Downside scenario**

We could downgrade Yanlord if its consolidated or look-through debt-to-EBITDA ratio weakens to above 5x. This could happen if:

- the company's debt-funded land replenishment needs are greater or more aggressive than we anticipate;
- its revenue recognition is weaker than our expectation due to delay in project completion; or
- its profitability weakens significantly more than our forecast.

## **Upside scenario**

We could upgrade Yanlord if the company's consolidated and look-through debt-to-EBITDA ratios are sustainably below 4x. This could happen if Yanlord can significantly improve its profitability via less expensive means of land bank replenishment, expedite project delivery for stronger revenue growth, and strike a good balance between debt growth and land acquisitions.

## **Company Description**

Yanlord engages in the investment, development, and management of real estate properties in China and Singapore. The company develops mid- to high-end residential properties, commercial properties, and integrated complexes for sale and lease.

Yanlord is listed on the Singapore stock exchange since 2006. The company has operations in 18 cities in China and Singapore. As of Dec. 31, 2020, Yanlord's total land bank is about 10.9 million square meters (including Singapore), the majority in cities such as Shanghai, Nanjing, Suzhou, Shenzhen, and Zhuhai. Yanlord also has two residential projects under development in Singapore.

## **Our Base-Case Scenario**

### **Assumptions**

- China's sales of residential property will be flat in 2021 due to tightening funding conditions. Average selling prices will drop by up to 5%, but the impact will be offset by growth in gross floor area (GFA) sold.
- Yanlord's contracted sales will be RMB75 billion-RMB80 billion in 2021, in line with our expectation for the industry. We anticipate only a modest 5%-7% annual growth over 2022-2023. Of the total contracted sales, 60%-65% will be from JV projects.
- Yanlord's revenue will increase to RMB32 billion-RMB33 billion in 2021 and RMB34 billion-RMB35 billion in 2022. This growth will be supported by RMB27 billion of consolidated unrecognized revenue as at end-2020.
- Gross margin will weaken considerably to 27%-29% in 2021-2022, from 36.4% in 2020, due to

recognition of low-margin projects. Sizable contributions from high-margin non-property development segments, including investment properties, hotels, and agent construction, should temper the decline.

- EBITDA margin will fall to 27%-29% in 2021-2022, from 34.4% in 2020, in line with the declining trend in gross margin.
- Overall cash collection will be about 95% of attributable sales for 2021, similar with that for 2020.
- Yanlord's land premium will be RMB10 billion-RMB11 billion in 2021 and RMB12 billion-RMB13 billion in 2022, accounting for 35%-40% of consolidated contracted sales.
- Construction expenditure will increase along with GFA delivery. Construction costs will reach RMB9 billion-RMB10 billion in 2021 and RMB10 billion-RMB11 billion in 2022.
- Adjusted debt will increase to RMB44.7 billion in 2021 and RMB45.7 billion in 2022, from RMB42.3 billion in 2020.

We arrive at the following credit metrics based on the above assumptions:

- Consolidated debt-to-EBITDA ratio will decline to about 5x in 2021 and 4.5x-4.7x in 2022, from 7.5x in 2020.
- Look-through debt-to-EBITDA ratio will be 4.3x-4.8x in 2021 and 2022, from 5.7x-5.9x in 2020.
- EBITDA interest coverage will rise to 3.3x-3.8x in 2021 and 2022, from 2.9x in 2020.

## Liquidity

We assess Yanlord's liquidity as adequate to reflect our expectation that the company will continue to have satisfactory sales growth, maintain an adequate cash balance, and manage its debt maturity profile.

We estimate Yanlord's ratio of liquidity sources to uses for 2021 at about 3.3x. We do not assign a higher liquidity score despite the high liquidity coverage because we have included only committed land premiums in our liquidity uses. The overall investments will likely exceed this amount (if we include uncommitted land premiums, the ratio will be below 1.5x). Nevertheless, we believe Yanlord has the 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 the company's long operating and listing record, it has strong banking relationships with large onshore and, particularly, overseas banks. Yanlord's newly acquired assets in Singapore through UEL have increased its access to offshore bank facilities.

Principal liquidity sources include:

- Unrestricted cash of about RMB17.2 billion as of Dec. 31, 2020.
- Funds from operations of RMB15.5 billion-RMB16.5 billion in 2021, assuming: (1) cash flows from contracted sales and other income of RMB40 billion-RMB41 billion; (2) construction expenditure of RMB9 billion-RMB10 billion; (3) land premium of RMB10.5 billion-RMB11.5 billion; (4) selling, general, and administrative expenses, taxes, interest expenses, and other miscellaneous expenses that we estimate at RMB15 billion-RMB16 billion.
- Undrawn offshore committed bank facilities of RMB3.5 billion.

Principal liquidity uses include:

- Short-term borrowings of RMB8.4 billion as of Dec. 31, 2020.
- Committed but unpaid land premium payments of about RMB773 million for 2021.
- Capital expenditure, acquisitions, and dividends of RMB2 billion-RMB2.2 billion in 2021.

## **Covenants**

Yanlord has some financial covenants on its borrowings, mainly on net borrowings, tangible net worth, interest coverage, and current assets. As of Dec. 31, 2020, the company was in compliance with its financial covenants. We believe Yanlord has ample headroom to meet its covenants over the next 12 months.

## **Issue Ratings - Subordination Risk Analysis**

### **Capital structure**

As of Dec. 31, 2020, Yanlord's capital structure consisted of RMB23.0 billion in secured debt and RMB23.5 billion in unsecured debt (including external guarantees), of which RMB14.9 billion is at the subsidiary level. All guarantees, except for one jointly provided by holding company, Yanlord Land Group Ltd., and two subsidiaries, are at its subsidiary level and are included as priority debt. The company's priority debt is therefore about 81.5% of the total debt, significantly above our notching-down threshold of 50%.

### **Analytical conclusions**

We rate the senior unsecured notes issued by Yanlord's financing vehicle, Yanlord Land (HK) Co. Ltd., and guaranteed by Yanlord, one notch below the issuer credit rating because the notes 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)
- 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
- 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: 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
<b>Yanlord Land Group Ltd.</b>		
Issuer Credit Rating	BB-/Stable/--	BB-/Negative/--

### Ratings Affirmed

<b>Yanlord Land (HK) Co. Ltd.</b>		
Senior Unsecured	B+	

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

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criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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