Asia Credit Research

OCBC Bank

Yanlord Land Group Ltd: Credit Update

Tuesday, 07 March 2017

Balancing Act

- **FY2016 was a stellar year for profits and strong pre-sales anchors FY2017 performance.**
- **Land bank replenishment led to cash consumed and rise in gearing**
- **Expect pre-sales to drop in FY2017 with impact seen in FY2018. While average selling price may see flat-to-slight positive growth, we think transaction volume will fall.**
- **New property cooling measures have been introduced in Beijing, Hangzhou, Hefei and 2 other satellite cities of Beijing and Fuzhou respectively.**
- **While YLLG does not operate in these markets, such measures signal commitment for a steady and sustainable development of the Chinese property market**
- **Recommendation:** We are **Neutral** YLLG's issuer profile though are Underweight the YLLGSP 5.875%'22 on valuation. We think the bonds are trading at about 30-40bps tighter versus that implied by its closest comparables and see fair value at ~330bps spread. A switch into the CENCHI 8.75%'21 allows a spread pick-up of 42bps versus the YLLG 5.875%'22, which in our view provides sufficient compensation for CENCHI's smaller operating scale.

Treasury Advisory
Corporate FX & Structured Products
Tel: 6349-1888 / 1881
Interest Rate Derivatives
Tel: 6349-1899
Investments & Structured Products
Tel: 6349-1886

GT Institutional Sales
Tel: 6349-1810

OCBC Credit Research
Ezien Hoo, CFA
+65 6722 2215

- **Background:** On 6 January 2017, we lowered Yanlord Land Group Ltd's ("YLLG") issuer profile to Negative from Neutral. This was on the back of our expectations that gearing will rise over a 6 month period and that there was still uncertainty surrounding YLLG's fundraising (to take out the SGD400mn bond) amidst an overall more challenging domestic fundraising environment for Chinese property companies. Following YLLG's release of its FY2016 unaudited financials, a rise in gearing levels has occurred (albeit from a manageable base). We think a further rise in gearing is contained at ~0.9x-1.0x, for now. On 23 January 2017, YLLG also successfully issued the USD450mn YLLGSP 5.875%'22 which helps provide the liquidity to redeem the SGD bond in May 2017. We have thus revised our Negative issuer profile to **Neutral** on 1 March 2017[1].

  YLLG, incorporated in Singapore, is listed on the Singapore Stock Exchange with a market cap of SGD3.2bn (as at 6 March 2017). YLLG is a developer focused on upper scale and luxury residential property developments in China. YLLG focuses on key cities in 5 regions, namely, the Yangtze River Delta, Hainan, Pearl River Delta, Bohai Rim and Western China. In addition, YLLG also holds investment properties such as hotels, serviced apartments, offices and retail buildings. As at 31 December 2016, YLLG's investment properties were recorded at RMB13.7bn (versus RMB93.4bn in total assets).

Figure 1: YLLG Bonds Outstanding

Issue	Maturity	Outstanding Amount (USD)	Ask Price	Ask YTW (%)	I-Spread	Bond Rating
YLLGSP 5.875%'22	23 January 2022	450mn	103.75	4.997	289	BB-/Ba3/NR

Note: (1) Indicative prices as at 7 March 2017
(2) YLLGSP 5.875%'22 next callable date is on 23 January 2020
(3) We are holding the SGD bond (YLLGSP 6.2%'17s) at Neutral. We have not included it in this table as the bond will mature shortly on 8 May 2017.

- **Strong Operating performance in FY2016:** In FY2016, YLLG delivered 944,834

[1] *Asian Credit Daily as at 1 March 2017*

sqm in gross floor area ("GFA") to customers (up 60.1% against FY2015). Average selling price ("ASP") was marginally lower at RMB26,812 per sqm (FY2015: RMB27,303), resulting in a 54.8% increase in revenue of RMB25.7bn. Gross margins for FY2016 was stronger at 31.2% versus 27.5% in FY2015. This was mainly due to better gross margin performance in 4Q2016 of 42.5%. In 4Q2016, YLLG delivered a larger portion of lower-priced projects with relatively lower development costs. Based on our calculation of EBITDA (which does not include other operating income and sales), we find FY2016 EBITDA at RMB7.1bn (FY2015: RMB3.5bn) and EBITDA/Interest of 5.4x against 2.7x (including our estimates on capitalised interest).

- **Strong pre-sales in FY2016 locks-in FY2017 interest coverage:** Driven by healthy property demand in the key markets YLLG operate in, accumulated pre-sales pending income statement recognition was RMB26.5bn as at 31 December 2016. Management has guided that around 70% of these will be recognised in FY2017. This should help keep interest coverage (as measured by EBITDA/Interest) steady. Broadly, we expect ASP trend to be relatively flat-to-slight positive in FY2017 in light of demand for property in key cities vis-à-vis supply. Though we think new transaction volumes (by sales area) may decline this year, with impact to coverage ratios to be seen in FY2018. Per property brokerage Centaline, February 2017 saw Shanghai new home sales by area of 363,000 sqm (down 49.1% y/y). We think lower transaction volume may happen due to: (1) purchase restriction among buyers as a result of property cooling measures; (2) increased difficulty in securing requisite approvals for project launches; and (3) developers holding on to scarce land inventory.

Figure 2: month/month change of property prices in key cities (%)

Cities	October 2016	November 2016	December 2016	January 2017
Nanjing	2.4	0.2	-0.1	-0.2
Tianjin	1.3	0.5	Flat	-0.3
Shenzhen	-0.5	-0.3	-0.4	-0.5
Tangshan	0.6	1.1	0.3	0.2
Shanghai	0.5	-0.1	-0.2	-0.1

Note: Cities where YLLG's land bank is located

- **Cash consumed by replenishment of land bank:** Despite the healthy EBITDA generated, net cash from operations was lower at RMB10.3bn against RMB14.0bn as a result of higher working capital needs for property development and higher cash tax paid. YLLG also made more investments to replenish its land bank. In addition to holding land directly, YLLG also made investments into acquiring stakes in subsidiaries, joint ventures and associates. Cash advances were channeled downwards to fund land purchases and for property development. In FY2016, net cash used for investing activities was an RMB8.1bn outflow against an outflow of RMB583mn in FY2015. As at 31 December 2016, existing land bank (including those held via associates and joint ventures) suitable for development was 1.98mn sqm (FY2015: 1.00mn sqm). Based on current run rate, the land bank can sustain development for 5 years. As at 31 December 2016, YLLG is developing 3.223mn sqm, driven by strong pre-sales.

- **Associates and JVs increasingly important:** FY2016 saw a marked increase in investments into associates and joint ventures. We understand that this was driven by synergistic opportunities for quality landbanking at reasonable costs. Some of these transactions involved related parties, though others include subsidiaries of Ping An Insurance, Beijing Capital Land, and China Resources Land. Per company, corporate guarantees taken at the YLLG level on such associates and joint ventures are minimal. With the domestic fundraising environment challenging for property developers, we expect YLLG to take on borrowings and advancing these to associates, joint ventures, non-controlling shareholders of subsidiaries and other parties based in China. In FY2016, YLLG recorded interest income of RMB268.3mn against RMB119.2m in FY2016. While such quantum is small in totality versus income from selling properties (FY2016: RMB7.3bn), the growth in interest income was 125%.

- **Increase in gearing from historical levels:** We find gross debt-to-equity ("gearing") as at 31 December 2016 at 0.8x, rising from 0.6x as at 31 December 2015. While this came in somewhat lower than our estimated 0.9x-1.0x in our 2017

Singapore Credit Outlook[2], we understand that around RMB4.0bn of the land acquired in Nanjing in end-December 2016 remains to be paid. We expect debt to be applied for the remaining payment. In addition to higher debt levels, YLLG also saw a net reduction in book value equity of ~RMB525mn, despite the higher net profit before comprehensive income generated in FY2016. This was mainly driven by repayment of capital to minority investors following project completion, foreign currency translation loss and a gross obligation under put instrument[3] (this is a potential contractual obligation incurred in 4Q2016 for YLLG to purchase the equity interests from non-controlling shareholders of a subsidiary). YLLG's net gearing increased back to more "normalised" levels for the company at 0.17x (31 December 2015: 0.02x). We maintain that the bulk of YLLG's cash balance of RMB17.6bn needs to be conserved to fund working capital needs. Cash advances from customers (a current liability item from pre-sales generated) stood higher at RMB22.8bn.

- **Recommendation:** We are **Neutral** YLLG's issuer profile though are Underweight the YLLGSP 5.875%'22 on valuation. We think the bonds are trading at about 30-40bps tighter versus that implied by its closest comparables and see fair value at ~330bps spread. A switch into the CENCHI 8.75%'21 allows a spread pick-up of 42bps versus the YLLG 5.875%'22, which in our view provides sufficient compensation for CENCHI's smaller operating scale.

  We have considered the following:

A) YLLG has a credit rating of BB-/Ba3/BB-, though Moody's is holding its credit rating with a Positive outlook and have opined that YLLG has better credit metrics versus its peers in a similar rating band.
B) Country Garden Holdings Co Ltd's COGARD 4.75%'23 (rated at NR/Ba1/BB+) has an ask YTW of 5.20% (spread of 295bps). The COGARD bond is rated two-notches higher.
C) Guangzhou R&F Properties Company Limited's GZRFPR 5.75%'22 (rated at NR/NR/BB) has an ask YTW of 5.35% (spread of 325bps). Despite the one-notch higher credit rating, this bond is trading 36bps wider than YLLG. We think this is driven by GZRFPR's more levered credit profile.
D) Central China Real Estate Ltd's CENCHI 8.75%'21 (rated at B+/Ba3/NR) has an ask YTW of 4.92% (spread of 331bps). We think a 42bps pick-up provides sufficient compensation for CENCHI's smaller operating scale versus YLLG.
E) We do not cover Country Garden as well as Guangzhou R&F Properties Company Limited. We hold CENCHI's issuer profile at Neutral.

[2] *Singapore Credit Outlook 2017 ("Compendium") published on 6 January 2017*
[3] *Subsequent to our Asian Credit Daily (1 March 2017), we have established that the potential put obligation has been taken up as a reduction in book value equity via "other reserves"*

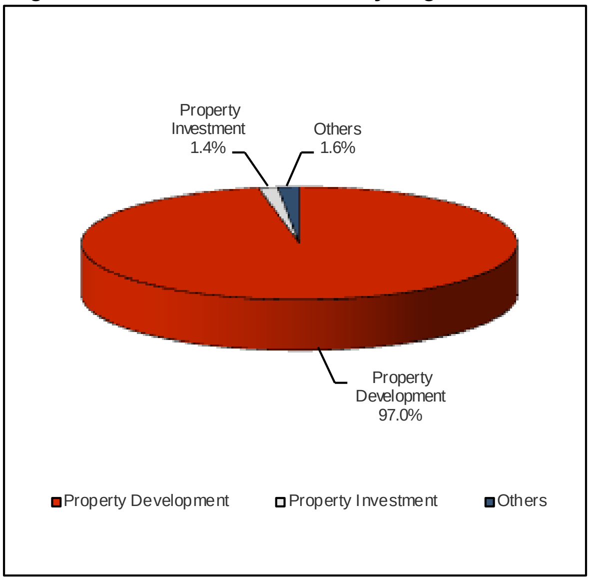
Yanlord Land Group Ltd

Table 1: Summary Financials

Year Ended 31st Dec	FY2014	FY2015	FY2016
Income Statement (RMB'mn)			
Revenue	11,733.3	16,581.4	25,664.3
EBITDA	2,675.8	3,507.4	7,059.6
EBIT	2,645.1	3,472.3	7,027.5
^ Gross interest expense	1,490.3	1,297.6	1,314.6
Profit Before Tax	3,598.2	4,317.1	7,472.1
Net profit	1,359.4	1,468.6	2,697.3
Balance Sheet (RMB'mn)			
Cash and bank deposits	6,619.9	17,517.0	17,583.4
Total assets	67,326.6	79,897.7	93,448.4
Gross debt	19,806.2	18,261.7	22,666.0
Net debt	13,186.2	744.7	5,082.6
Shareholders' equity	29,373.2	30,534.5	30,009.6
Total capitalization	49,179.4	48,796.1	52,675.5
Net capitalization	42,559.5	31,279.2	35,092.1
Cash Flow (RMB'mn)			
Funds from operations (FFO)	1,390.1	1,503.7	2,729.3
* CFO	-1,423.1	13,952.0	10,289.4
Capex	479.0	718.1	1,991.9
Acquisitions	0.0	0.0	2,046.5
Disposals	12.3	50.6	85.9
Dividends	721.1	768.8	888.8
Free Cash Flow (FCF)	-1,902.1	13,233.9	8,297.5
* FCF Adjusted	-2,610.9	12,515.7	5,448.2
Key Ratios			
EBITDA margin (%)	22.8	21.2	27.5
Net margin (%)	11.6	8.9	10.5
Gross debt to EBITDA (x)	7.4	5.2	3.2
Net debt to EBITDA (x)	4.9	0.2	0.7
Gross Debt to Equity (x)	0.67	0.60	0.76
Net Debt to Equity (x)	0.45	0.02	0.17
Gross debt/total capitalisation (%)	40.3	37.4	43.0
Net debt/net capitalisation (%)	31.0	2.4	14.5
Cash/current borrowings (x)	3.2	3.0	1.7
EBITDA/Total Interest (x)	1.8	2.7	5.4

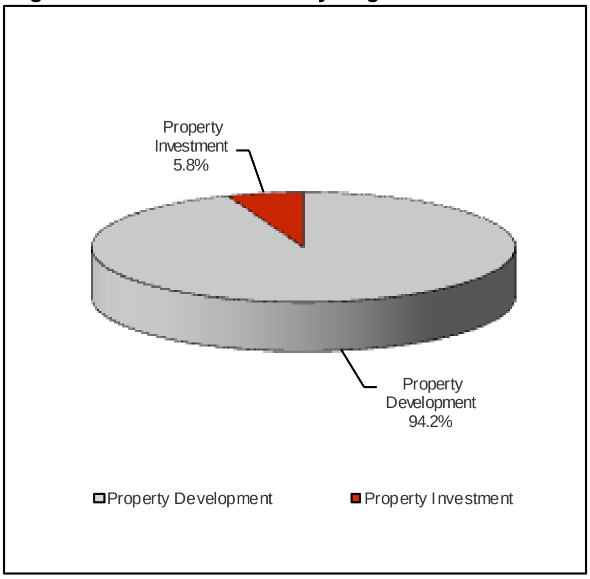
^ FY2016's numbers are OCBC's estimates *Source: Company, OCBC estimates*

Figure 1: Revenue breakdown by Segment - FY2016



Source: Company

Figure 2: PBT breakdown by Segment - FY2016



Source: Company

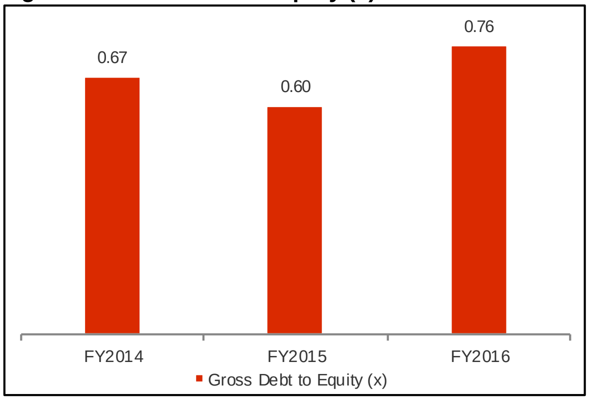
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

Figure 3: Debt Maturity Profile

Amounts in (RMB'mn)	As at 31/12/2016	% of debt
Amount repayable in one year or less, or on demand		
Secured	3,612.2	15.3%
Unsecured	7,287.2	30.8%
	10,899.4	**46.0%**
Amount repayable after a year		
Secured	7,466.4	31.5%
Unsecured	5,309.2	22.4%
	12,775.6	**54.0%**
Total	**23,675.0**	**100.0%**

Source: Company

Figure 4: Gross Debt to Equity (x)



Source: Company, OCBC estimates

Co.Reg.no.:193200032W