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Lianhe Ratings Global

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Lianhe Global publishes the 'BB-' global scale Long-term Issuer Credit Rating of Sinic Holdings (Group) Company Limited; Outlook is Positive

HONG KONG, 22 October 2020 – Lianhe Ratings Global Limited ("Lianhe Global"), an international credit rating company, publishes the 'BB-' global scale Long-term Issuer Credit Rating of Sinic Holdings (Group) Company Limited (2103.HK) ("Sinic" or "the company"). The Outlook is Positive.

The Issuer Rating reflects our assessment of Sinic's improving operating scale, adequate profitability, and regional market franchise. The rating also considers Sinic's capability to grow from its home base in Jiangxi Province into new regions. The rating constraints include the company's high financial leverage, tight liquidity, and short track record due to its limited visible operating history.

The Positive Outlook reflects our expectation that Sinic will maintain a steady financial position and mindful growth pace, given its sizeable contracted sales proceeds which will partially fund its rapid expansion. At the same time, we expect the company to gradually pivot away from the reliance on short-term funding and trust loans in the medium term.

Rating Rationale

Sizeable Sales Proceeds Fund Regional Expansion: Sinic's management expects to further grow its scale by deepening the city coverage and expanding into new regions through the twelve regional offices/teams. Sinic uses cash received from its project development to partly fund the growth plan of its market franchise into the provincial cities in the Yangtze River Delta, Greater Bay Area, and Central and West China Region of higher potential. Sinic managed the average time required before presale for high-turnover projects down to about six months in 2019 from approximately eight months in 2018. The change sheds light on the results of its internal benchmarks and indicators that Sinic employed to monitor the status of each development phase.

However, the COVID-19 pandemic has counterbalanced such endeavors. The company booked a year-on-year contracted sales growth of 1.6% with the total contracted sales of RMB43.5 billion in the first six months ended June 2020, marking a noticeable decrease from the previous growth momentum of 62% and 30% in 2018 and 2019, respectively.

Product Design and Development Process Support High Turnover: The Shanghai-headquartered developer redesigned the product type by series and modularized its development approach to shorten the average construction duration, which lowered the operating costs and paved the way for its ambitious expansion. More than 90% of Sinic's high-turnover projects under development at end-2019 were on the new standardized model, somewhat expediting the completion of certain projects.

The company's revenue of RMB8,703 million recognized for the first six months in 2020 was up by 24.6%, comparing to RMB6,983 million of the corresponding period in 2019; net profit experienced a jump of 76.2% in the meantime.

Rising Land Costs to Further Pressure Profitability: We forecast Sinic will register a moderate decline in gross profit margin down to about 27%-28% in 2020 and 2021 (2018: 38%; 2019: 30%; June 2020: 30%), considering the continual profitability compression from rising land costs rendered by the company's appetite in new second-tier cities where land costs are usually higher than those of its home base in Nanchang City in Jiangxi Province. In addition, Sinic's use of open auctions as a primary land acquisition channel also contributed to higher land premiums driven by the heated land bidding in the Yangtze River Delta and the Greater Bay Area.

Nonetheless, Sinic's general cost control and product standardization may help partially alleviate the pinch. Leveraging on its solid access to low-cost lands in Jiangxi Province, the company has enjoyed the legacy fruits of strong Chinese economic growth in the earlier years and posted above-average margins.

Material Reliance on Joint Venture Partnerships Obscured Financial Transparency: The company cooperates with more and more industry peers through joint ventures and associates in an attempt to moderate competition risks and enlarge its market franchise. These strategic arrangements enabled Sinic to drive brisk growth with smaller input of operating capital per project. The company's minority interests as a percentage of total equity base increased to 48% at end-June 2020 (end-2018: 16%; end-2019: 45%). We believe the higher level of such partnerships and minority interests may give rise to financial transparency issues.

Liquidity Remained Tight While Funding Source Diversifying: We expect Sinic to moderately improve its tight liquidity profile with various funding sources – including bank loans, trust loans, bond offerings, and other financing tools such as ABS products, etc. – to fund its expansion blueprint. Short-term debt due in the next 12 months accounted for about 44% of its total debt, which could be covered by the company's cash position and liquid financial investments on hand at end-June 2020. Sinic is able to tap the onshore fixed-income market. Listed on the Hong Kong Stock Exchange since November 2019, the company has gained access to the offshore capital market, which further diversified its funding source.

High Leverage and Short Track Record Constrain Rating: Sinic's credit profile is constrained by its high financial leverage as measured by gross debt over capitalization ratio (end-2018: 84%; end-2019: 70%; end-June 2020: 69%) and the company's limited visible operating history of a decade when it grew rapidly from a community homebuilder to a regional market player. We expect the company's high financial leverage will continue but not substantially increase.

Rating Sensitivities

We would consider downgrading Sinic's rating if it were to (1) aggressively replenish its land bank which result in an increase in its financial leverage as measured by debt/capitalization to over 70% or a decrease in its EBITDA interest coverage to below 2.0x consistently, and/or (2) its operating performance were to deteriorate such that its contracted sales and/or revenue experience a material decline or liquidity profile is worsened.

We would consider upgrading Sinic's rating if it were to (1) considerably increase its operating scale, and (2) maintain its financial leverage as measured by debt/capitalization at below 60% or EBITDA interest coverage at above 3.0x consistently.

About Lianhe Global

Lianhe Global is an international credit rating company that provides credit ratings to corporations, banks, non-bank financial institutions, local government financing vehicles, and other asset classes around the globe. Lianhe Global also provides credit risk research and other services related to credit ratings.

Rating Methodology

The principal methodology used in this Sinic's rating is Lianhe Global's General Corporate Rating Criteria published on 16 July 2018, which can be found at the website www.lhratingsglobal.com.

Note: The above Issuer Credit Rating is solicited at the request of the rated entity or a related third party.

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