Lianhe Global has assigned 'BB-' global scale Long-term Issuer Credit Rating with Stable Outlook to Redco Properties Group Ltd.

HONG KONG, 11 January 2021 – Lianhe Ratings Global Limited ("Lianhe Global"), an international credit rating company, has assigned 'BB-' global scale Long-term Issuer Credit Rating to Redco Properties Group Ltd. (1622.HK) ("Redco" or "the company"). The Outlook is Stable.

The Issuer Rating reflects Redco's established track record of scale expansion and healthy margins. However, Redco's rating is constrained by its relatively small operating scale.

The Stable Outlook reflects our expectation that Redco would continue its scale expansion and geographical diversification in a prudent manner, while maintaining its healthy margins and containing its growth in financial leverage.

Key Rating Rationales

Small Scale Developer with Demonstrated Track Record of Growth: Redco commenced its operations in 1992 and has expanded its footprint from Fujian Province to other provinces in China in the past three decades. Its total land bank by GFA at end-June 2020 was c. 17.9 million square meters (sq.m.), increasing from c. 14.6 million sq.m. at end-2019 and c. 10.0 million sq.m. at end-2018, representing year-over-year growth range of 25-45%. The continuous expansion in land bank provided Redco with the land resources to sustain the growth in its operating scale. The company's selective and strategic entrance into Tier 2 cities in three core regions, namely Greater Bay Area, Yangtze River Delta Region and the Bohai Rim with progression towards cities in Mid-West Region enabled it to sail through various policy restrictions with less severe impact on its financial performance.

Redco recorded gross contracted sales of RMB41.0 billion in 2020, representing a c. 49.5% increase year-over-year. This was precedented by a year-over-year growth in contracted sales of c. 24.7% in 2019 and c. 66.6% in 2018. We expect Redco to continue its growth momentum with a c. 20-25% growth in sales per annum in the next 12-18 months, with revenue growth in tandem in the following one to two years given its relatively high consolidation level of 70-75%. Having a decent growth trajectory is important in light of the intensifying polarization in the Chinese property development industry. Despite the consistent track record of growth, Redco's still relatively small scale will continue to be a constraint to its credit profile in the next 12 to 18 months.

Diversification of Land Bank with Low Land Cost: At end-June 2020, Redco had 101 projects in 29 cities in China and in Sydney, Australia, continuing its geographical diversification from 89 project and 25 cities at end-2019. Redco's land bank was sufficient to support its sales growth for approximately four years. The company acquired c. 4.0 million sq.m. of land parcels in 1H 2020 with an average land cost of c. RMB2,000/sq.m., which was a bit lower than the average land acquisition cost of c. RMB2,500 in 2019, which enables Redco to continue enjoying a low-cost land bank at an average cost below RMB2,000/sq.m. at end-June 2020.

Majority of Redco's coverage is located in Tier 2 cities, which provided the company with opportunities to acquire land parcels with relatively lower cost. This strategy of continuous geographical diversification and expansion of coverage is expected to continue benefiting Redco in containing its execution risk. To sustain its growth in scale, we expect Redco to maintain its land acquisition appetite, though with more cautions, and spend c. 40-50% of contracted sales proceeds for land acquisitions while keeping land cost/average selling price ratio to c. 30%. Land acquisition cost is expected to increase as Redco continues its expansion.

Margins Tapering Off from Previous High; Expected to Stabilize at a Healthy Level: Redco registered higher than industry average gross margin of 35.4% in 2018 and 34.3% in 2019, primarily because the company was able to keep average land acquisition cost low. However, its gross margin decreased to 20.9% in 1H 2020, primarily due to rising average recognized land acquisition cost from RMB2,263/sq.m. in 2019 to RMB4,531/sq.m. in 1H 2020. We expect average land acquisition cost to stay at the RMB2,500-3,000/sq.m. level in the next 12-18 months.

Redco's coverage in Tier 2 cities and its customer base are not under the key radar of price restriction policies, hence we expect its ASP to remain relatively stable in the near term. Together with the alleviation of heightened average land acquisition cost, we expect Redco to be less impacted by the continuous margin squeeze of the industry. However, Redco's fast-churn strategy to grow its scale would inevitably subject the company to less flexibility to achieve higher margin. As a result, we expect Redco's gross margin in the next 12-18 months to maintain at c. 25 % level.

***Moderately High and Increasing Leverage Yet with Improving Maturity Profile; Adequate Liquidity*:** Redco's financial leverage as measured by gross debt over capitalization ratio (end-2018: 61.4%; end-2019: 62.0%; end-June 2020: 60.5%) is considered moderately high. We expect the company to continue its land acquisition to sustain its expansion, hence its financial leverage to moderately increase in the next 12-18 months.

On the other hand, Redco has managed to improve its debt maturity profile, to mitigate short-term re-financing burden. Redco's short-term debt accounted for c. 72% of total debt at end-2019, and the ratio dropped to c. 53% at end-June 2020. The company has also been able to demonstrate a track record of re-financing short-term debt and lengthening its maturity profile with debt issuances of longer tenor. In addition, Redco's liquidity is adequate as it had RMB14.3 billion (RMB10.1 billion unrestricted) cash on hand and RMB2.3 billion undrawn committed credit facility at end-June 2020 to cover its RMB9.8 billion of debt maturing within 12 months.

Rating Sensitivities

We would consider downgrading Redco's rating if it were to (1) aggressively expand and replenish its land bank which results 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 1.0x 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 Redco's rating if it were to (1) considerably increase its operating scale while maintaining competitive position in its core markets, 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 Redco'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/Issuance Credit Ratings are solicited at the request of the rated entity or a related third party.

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