

LVGEM (China) Real Estate Investment Company Limited

Surveillance Report

Summary

Issuer Rating	BB-
Outlook	Stable
Location	China
Industry	Homebuilder and Real Estate
Date	22 January 2021

Lianhe Ratings Global Limited (“Lianhe Global”) has affirmed ‘BB-’ global scale Long-term Issuer and Issuance Credit Rating to LVGEM (China) Real Estate Investment Company Limited; Issuer Rating Outlook is Stable

Summary

The Issuer Rating reflects LVGEM (China) Real Estate Investment Company Limited (“LVGEM” or “the company”)’s established track record of handsome profit margin, specialized management expertise in the urban renewal industry, and its focus in the Greater Bay Area (GBA), including the Baishizhou project which so far marks the record-large redevelopment project in Shenzhen. Rating constraints include LVGEM’s modest business franchise in terms of contracted sales, acceptable liquidity profile with the basic source of funding, and significant concentration risks given its revenue drivers relying on a limited number of projects under development.

The Stable Outlook reflects our expectation that LVGEM would expand its operating scale in a prudent manner following its stake increase in the Baishizhou redevelopment project. It also reflects our expectation that LVGEM will maintain its competitive edge and niche strategy in the urban redevelopment market while managing an adequate financial profile without a material increase in financial leverage in the near term.

Rating Rationale

Niche Player with Regional Focus in Greater Bay Area: LVGEM is a Chinese property developer focusing on mass residential property development and commercial property operation. LVGEM concentrates on developing undervalued shantytown renewal projects in Shenzhen and the GBA in Guangdong province. Driven by this unique business model, LVGEM positions itself as a niche regional property developer and operator with a relatively narrow geographical focus of its business. LVGEM’s operating scale is relatively small with its land bank of 4.14 million square meters of total GFA at end-June 2020. LVGEM achieved contracted sales of RMB6.3 billion and RMB2.5 billion in 2019 and 1H2020, respectively.

Given its niche business strategy, LVGEM is able to gain competitive advantages over its peers in terms of profit margins and average selling prices, which partially offset its small operating scale in terms of contracted sales metrics, uncertainty or delay of redevelopment projects’ schedules, land bank size and the limited number of projects under development.

Development of Flagship Baishizhou Project Underway: Following the connected transaction with its controlling shareholder in August 2020, LVGEM completed the injection of its flagship project, namely the Baishizhou urban redevelopment project, through increasing the project stake to 80% (from 25%) at a minimal consideration of RMB4.07 million. We believe the transaction help to remove the uncertainty regarding the ownership of this project, and help to avoid a heavy burden of extra payment to its controlling shareholder at the early redevelopment stage.

The Baishizhou project consists of a total GFA of 3.58 million square meters. The redevelopment stage of phase one is underway by now, which mainly involves the approval from the majority of the inhabitants, demolition and construction, etc. We expect LVGEM to commence construction in 2H2021, and the presales to commence in 2H2022 at the earliest.

Analysts

Alex Kung
+852 3462 9577
alex.kung@lhratingsglobal.com

Ben Yau
+852 3462 9586
ben.yau@lhratingsglobal.com

Applicable Criteria

General Corporate Rating Criteria (16 July 2018)

Outstanding and Sustainable Gross Margin: As mentioned, the focus on undervalued redevelopment projects in prime locations and cities in the GBA enabled LVGEM to achieve a remarkable gross margin track record. LVGEM's gross margin reached 59.5%, 64.2%, and 65.1% in 2018, 2019 and 1H2020, respectively, which was significantly higher than the industry average. LVGEM's gross margin will experience some fluctuations going forward, given the limited number of projects for property sales revenue recognition. However, we foresee LVGEM to sustain the competitive advantage in profit margin, as the company sits on a number of low-cost projects whose sell-through rates are secured by their prime locations.

High Financial Leverages and Tight Liquidity: LVGEM reported high financial leverages over the past two years, as measured by an average debt over capitalization ratio of above 60% and an average interest coverage of about 2x in 2018-2019. LVGEM reported a cash balance of RMB10.7 billion against a short-term borrowing of RMB10.9 billion at end-June 2020. LVGEM obtained a bank line of RMB20 billion from China Everbright Bank for the Baishizhou project.

LVGEM will mainly rely on property sales proceeds from both the new and existing projects to finance the capital expenditure of the Baishizhou project in 2021 and 2022. The two new projects, namely Zhuhai Dongqiao Urban Renewal Project and LVGEM Liguang Project, are scheduled to commence presales in either 2H2021 or 1H2022. Once the Baishizhou project launches presales in either 2H2022 or 1H2023, LVGEM's cash flow position will be greatly improved, in our view, given the huge saleable resources from this project.

Rating Sensitivities

We would consider downgrading LVGEM's rating if it were to aggressively increase its financial leverage as measured by an EBITDA interest coverage to decrease to below 2x or a debt/capitalization to increase to above 70% consistently, and/or its liquidity and operational profiles were to deteriorate such as a material decline in net cash flow from operating activities, contracted sales, and/or revenue recognition, consistently.

We would consider upgrading LVGEM's rating if it were to considerably increase its operating scale, and lower its financial leverage as measured by a debt/capitalization to below 60% or an EBITDA interest coverage to above 4x consistently.

Company Profile

LVGEM is a Chinese property developer that mainly focuses on mass residential property development and commercial property operation in China. It was established by Mr. Wong Hong King in Shenzhen in 1995 and commenced its first property development project in 1998. The company issued a share offer with the intent to buy back shares issued by New Heritage Holdings Ltd. ("New Heritage"), a property developer listed in Hong Kong Stock Exchange (95.HK) since 2005, in 2014. After the acquisition at HKD940 million (HKD1.1 in cash for each offer share), the company owned 64.83% of New Heritage and became its major shareholder. The stock code of New Heritage has remained unchanged but the name has been changed to LVGEM (China) Real Estate Investment Company Limited.

LVGEM is majority owned and controlled (70.6%) by Mr. Wong Hong King, the father of LVGEM's current Chairman, Ms. Huang Jingshu and one of its Executive Directors, Mr. Huang Haoyuan. At end-June 2020, China Vanke Co., Ltd. ("Vanke") and Ping An Insurance (through Toplist Investments) are the second and third largest shareholders, respectively. Each of them held 5.9% of the company's shares.

LVGEM's Shareholding Structure (at end-June 2020)

Shareholder	Percentage
Mr. Wong Hong King (through 100%-owned Go Great and Cantrust)	70.6%
China Vanke Co., Ltd.	5.9%
Toplist Investments	5.9%
Public	17.6%
Total	100.0%

Source: LVGEM

Key Financial Assumptions

- Contracted sales amount: RMB4.5-13.5 billion for 2020-2022
- Contracted average selling price of RMB20,894-27,632 for 2020-2022
- Total revenue: RMB5.2-8.6 billion for 2020-2022

Key Financial Metrics

2018A-2022F	Debt/Land Bank	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	208.0%	2.01x	66.11%	0.44x

Source: LVGEM's 2018-2019 annual and 2020 interim reports, Lianhe Global's adjustments and forecasts

Full List of Issuance Ratings

A full list of affirmed issuance ratings is included below. Any rating action on LVGEM's rating would result in a similar rating action on the USD notes:

- USD470 million 12.0% senior unsecured notes due 2023 affirmed at 'BB-'

Disclaimer

Credit rating and research reports published by Lianhe Ratings Global Limited (“Lianhe Global” or “the Company” or “us”) are subject to certain terms and conditions. Please read these terms and conditions at the Company’s website: www.lhratingsglobal.com

A credit rating is an opinion which addresses the creditworthiness of an entity or security. Credit ratings are not a recommendation to buy, sell, or hold any security. Credit ratings do not address market price, marketability, and/or suitability of any security nor its tax implications or consequences. Credit ratings may be subject to upgrades or downgrades or withdrawal at any time for any reason at the sole discretion of Lianhe Global.

All credit ratings are the products of a collective effort by accredited analysts through rigorous rating processes. No individual is solely responsible for a credit rating. All credit ratings are derived by a credit committee vesting process. The individuals identified in the reports are solely for contact purpose only.

Lianhe Global conducts its credit rating services based on third-party information which we reasonably believe to be true. Lianhe Global relies on information including, but not limited to, audited financial statements, interviews, management discussion and analysis, relevant third-party reports, and publicly available data sources to conduct our analysis. Lianhe Global has not conducted any audit, investigation, verification or due diligence. Lianhe Global does not guarantee the accuracy, correctness, timeliness, and/or completeness of the information. Credit ratings may contain forward-looking opinions of Lianhe Global which may include forecasts about future events which by definition are subject to change and cannot be considered as facts.

Under no circumstances shall Lianhe Global, its directors, shareholders, employees, officers and/or representatives or any member of the group of which Lianhe Global forms part be held liable to any party for any damage, loss, liability, cost, expense or fees in connection with any use of the information published by the Company.

Lianhe Global receives compensation from issuers, underwriters, obligors, or investors for conducting credit rating services. None of the aforementioned entities nor its related parties participate in the credit rating process aside from providing information requested by Lianhe Global.

Credit ratings included in any rating report are solicited and disclosed to the rated entity (and its agents) prior to publishing. Credit rating and research reports published by Lianhe Global are not intended for distribution to, or use by, any person in any jurisdiction where such use would infringe local laws and regulations. Any user relying on information available through credit rating and research reports is responsible for consulting the relevant agencies or professionals accordingly to comply with the applicable local laws and regulations.

All published credit rating and research reports are the intellectual property of Lianhe Global. Any reproduction, redistribution, or modification, in whole or part, in any form by any means is prohibited unless such user has obtained prior written consent from us.

Lianhe Global is a subsidiary of Lianhe Credit Information Service Co., Ltd. The credit committee of Lianhe Global has the ultimate power of interpretation of any methodology or process used in the Company’s independent credit ratings and research.

Copyright © Lianhe Ratings Global Limited 2021.