

# Redco Properties Group Ltd.

## Initial Issuer Report

**Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BB-’ global scale Long-term Issuer Credit Rating to Redco Properties Group Ltd.; Outlook is Stable**

### Summary

Issuer Rating	BB-
Outlook	Stable
Location	China
Industry	Homebuilder and Real Estate
Date	4 February 2021

### Summary

The Issuer Rating reflects Redco Properties Group Ltd.’s (1622.HK) (“Redco” or “the company”) 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 will continue its scale expansion and geographical diversification in a prudent manner, while maintaining its healthy margins and containing its growth in financial leverage.

### Operating Data:

Redco Properties Group Ltd.

	31 Dec 2019	30 Jun 2020
Revenue (RMB: in million)	8,602	6,703
Contracted Sales (RMB: in million)	27,412	13,018
Contracted Average Selling Price (RMB/square meter)	10,594	7,699
Contracted Sales GFA (million square meters)	2.58	1.69
Land Bank GFA (million square meters)	14.56	17.90

GFA: Gross Floor Area  
Source: Redco

### Rating Rationale

**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.), increased 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 provides 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 the Greater Bay Area, the Yangtze River Delta Region and the Bohai Rim with progression towards cities in the Mid-West Region enables 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, represented a c. 49.5% increase year-over-year. This was preceded 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 contracted 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 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 1H2020 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.

The majority of Redco’s land bank coverage is located in Tier 2 cities, which provides the company with opportunities to acquire land parcels at relatively low 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

### Analysts

Ben Yau  
+852 3462 9586  
[ben.yau@lhratingsglobal.com](mailto:ben.yau@lhratingsglobal.com)

Alex Kung  
+852 3462 9577  
[alex.kung@lhratingsglobal.com](mailto:alex.kung@lhratingsglobal.com)

### Applicable Criteria

General Corporate Rating Criteria (16 July 2018)

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; Expects 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 1H2020. 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 experiencing by 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 to maintain at c. 25 % level in the next 12-18 months.

**Moderately High and Increasing Financial Leverage with Improving Debt 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 will likely increase moderately 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 the 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 issuance of longer tenor. In addition, Redco's liquidity was adequate as it had RMB14.3 billion (including 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 the next 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<sup>1</sup>/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.

## Company Profile

Redco is a Chinese property developer that mainly focuses on mass residential property development and diversifies its business to construction services and property management services in China. The company was set up in 1992 and engaged in trading construction materials

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<sup>1</sup> Total debt includes Redco's reported interest-bearing debt, lease liabilities and guarantees made in favour of related parties

at the beginning. It entered into the property development market in 1996 and it commenced its first project in Quanzhou. Redco has been listed on the Hong Kong Stock Exchange (1622.HK) since 2014.

**Exhibit 1: Redco's Shareholder Structure at end-June 2020**

Shareholder	Percentage
Mr. Wong Yeuk Hung <sup>(1)</sup>	39.06%
Mr. Huang Ruoqing <sup>(2)</sup>	26.66%
Mr. Ng Leung Ho	8.77%
Others	25.51%
<b>Total</b>	<b>100.00%</b>

Note:

(1) Mr. Wong Yeuk Hung is Redco's Executive Director and the Chairman of the Board

(2) Mr. Huang Ruoqing is the Executive Director and the President of Redco

Source: Redco

## Business Profile

### Moderate Market Position

Redco's main business operation consists of three business lines: (1) sales of properties, (ii) construction, and (iii) property management services and others. Revenue from the sales of properties is Redco's major source. Its contribution to total revenue remained at c. 93-95% over the past few years. In 1H2020, revenue derived from the sales of properties amounted to RMB6.6 billion, representing a fourfold year-on-year increase, mainly due to an increase in the delivery of GFA.

The property management service segment only accounted for less than c. 2% of Redco's total revenue, yet it achieved rapid growth in 2019. Revenue from this segment was RMB114 million with exponential year-on-year growth in 2019. This significant growth is mainly attributable to its property management services operated by its subsidiary, UG Property Management Co., Ltd, and revenue reached RMB94 million with year-on-year growth of more than 10 times in 1H2020. Revenue from the other segments accounted for less than 5% of the total revenue and contribution to the company was limited.

**Exhibit 2: Redco's Revenue Breakdown by Business Segment (RMB: in million)**

Revenue/% of total	FY2017	%	FY2018	%	FY2019	%	1H2020	%
<b>Sales of properties</b>	<b>6,325</b>	<b>93.9</b>	<b>6,419</b>	<b>95.3</b>	<b>8,219</b>	<b>95.5</b>	<b>6,602</b>	<b>98.5</b>
Construction and reclamation	378	5.6	34	0.5	256	3.0	0	0.0
Property management services	31	0.5	4	0.1	114	1.3	94	1.4
Others	0	0.0	279	4.1	13	0.1	8	0.1
<b>Total</b>	<b>6,734</b>	<b>100.0</b>	<b>6,736</b>	<b>100.0</b>	<b>8,602</b>	<b>100.0</b>	<b>6,703</b>	<b>100.0</b>

Source: Redco's financial reports

Redco is a relatively moderate-size property developer as measured by contracted sales and land bank. After three years of expansion, Redco achieved rapid growth and its contracted sales was RMB27.4 billion in 2019 and RMB41.0 billion in 2020, representing a year-on-year increase of 24.7% and 49.6%, respectively. The company became one of the top 100 Chinese property developers in terms of contracted sales amount in 2018 and its ranking increased to 80<sup>th</sup> in 2020

from 124<sup>th</sup> in 2017. Redco's contracted sales GFA ranking was much higher than its contracted sales amount ranking due to its focus on sales in Tier 2 and Tier 3 cities with relatively low ASP.

Redco's land bank GFA increased to c. 17.9 million sq.m at end-June 2020. Redco has begun to actively replenish its land bank and expand its operation into more populous regions (such as the Bohai Rim Region, the Greater Bay Area and the Yangtze River Delta) and cities with high economic growth since 2018. Redco's land bank is sufficient to support its future development for approximately four years. Meanwhile, Redco has also diversified its land bank overseas. Its project in Sydney was successfully delivered in 2019 and its cooperation with Makati City Government of Philippines in 2019 further strengthened its geographic diversification.

**Exhibit 3: Redco's Rankings by Contracted Sales Among Chinese Property Developers**

Amount / Ranking	FY2017		FY2018		FY2019		FY2020		Ranking Changes (2020 vs 2017)
Contracted sales amount (RMB bn)	13.2	124 <sup>th</sup>	22.0	95 <sup>th</sup>	27.4	89 <sup>th</sup>	13.0	80 <sup>th</sup>	+44
Contracted sales by GFA (m sq.m.)	1.3	101 <sup>st</sup>	2.5	80 <sup>th</sup>	2.6	68 <sup>th</sup>	3.5	57 <sup>th</sup>	+44

Note: CRIC might use adjusted numbers of contracted sales and GFA in the ranking

**Exhibit 4: Redco's Rankings by Land Bank Among Chinese Property Developers**

Amount / Ranking	FY2017		FY2018		FY2019		1H2020	
Attributed land bank by value (RMB bn)	N/A	>100 <sup>th</sup>	67.2	98 <sup>th</sup>	102.6	79 <sup>th</sup>	N/A	N/A
Land bank by GFA (m sq.m.)	N/A	>100 <sup>th</sup>	9.94	71 <sup>st</sup>	14.53	57 <sup>th</sup>	17.90	41 <sup>st</sup>

Note: The amount is based on statistics from CRIC. Differences may exist between company's reported amount as a different calculation method was applied

**Geographic Diversification**

Redco has adopted a 3+N+1 global layout strategy, focusing on land investment in the three core economic circles of the Bohai Rim, the Yangtze River Delta, and the Guangdong-Hong Kong-Macao Greater Bay Area, as well as high-value and high-growth cities, and actively expanding overseas markets. In terms of the city tier classification, most of the company's land bank was in Tier 2 and Tier 3 cities.

**Exhibit 5: Redco's Land Bank Breakdown by Region and Tiers**

GFA (in m sq.m.)	2019		1H2020		Major Cities
	2019	%	1H2020	%	
Bohai Rim Region	4.31	29.6%	5.10	28.6%	Jinan, Tianjin, Yantai, Shijiazhuang
Mid-west Region	1.38	9.5%	2.46	13.8%	Wuhan, Changsha, Enshi, Xi'an, Xianyang, Chongqing, Huaihua, Yongzhou
Yangtze River Delta Region	7.14	49.0%	7.32	41.0%	Hefei, Nanchang, Fengcheng, Jiangsu region, Shanghai, Huanggang, Macheng
Greater Bay Area	1.70	11.7%	2.94	16.5%	Ganzhou, Quanzhou, Huizhou, Putian, Foshan, Qingyuan, Shenzhen, Zhanjiang, Jiangmen, Zhongshan
Overseas	0.03	0.2%	0.02	0.1%	Sydney
<b>Total</b>	<b>14.56</b>	<b>100.0%</b>	<b>17.85</b>	<b>100.0%</b>	

GFA	2019		1H2020	
	2019	%	1H2020	%
Tier 1 Cities	0.42	2.9%	0.42	2.4%
Tier 2 Cities	8.69	59.7%	8.85	49.6%
Tier 3 Cities	3.96	27.2%	7.11	39.9%
Others	1.49	10.2%	1.47	8.2%
<b>Total</b>	<b>14.56</b>	<b>100.0%</b>	<b>17.85</b>	<b>100.0%</b>

Source: Redco and Lianhe Global's adjustments

## Financial Profile

### Moderately High and Increasing Financial Leverage with Improving Debt Maturity Profile; Adequate Liquidity

Redco's proactive land acquisition activities in 2018 and 2019 led to a notable increase in its financial leverage. We expect the company's financial leverage to continue increasing as it needs to continue purchasing land, though selectively, to sustain its sales growth and scale expansion. We assume Redco will continue focusing on residential property projects and diversifying its project portfolio to other regions. Redco's focus on less prime locations and first-time buyers could largely insulate it from the direct impact of price-cap policies, and together with a stabilizing land cost, we expect Redco to record a gross margin at c. 25% level in the next 12-18 months.

Redco's contracted sales are expected to grow at c. 20-25% in the next 12-18 months, with its revenue growth to follow in the subsequent one to two years. Redco usually begins pre-sale in 6 months and delivers projects within approximately 1-1.5 years after acquiring land certificates. This fast-churn strategy enables Redco to grow its scale quickly, while subjecting itself to less flexibility in "timing" the market.

Redco's financial leverage in terms of debt over land bank is projected to improve gradually given the higher rate of growth in its land bank. The debt over capitalization ratio is expected to increase moderately in the next 12-18 months. We expect Redco to continue monetizing its projects and carefully managing its financial leverage. However, the company's credit profile will continue to be constrained by its relatively small operating scale.

### Key Assumptions

- Contracted sales growth: c. 20-25% growth for 2021-2022
- Contracted average selling price: c. 3% growth for 2021-2022
- Land acquisition expenditures: RMB13-15 billion for 2021-2022

### Key Financial Metrics

2018A-2022F	Debt/Land Bank	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	46.5%	2.04x	66.1%	0.26x

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

## Liquidity

Redco's liquidity was 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 the next 12 months. The company has a wide access to various financing channels in both the onshore and offshore markets, as demonstrated by the number of offshore USD issuances in the past 18 months. Moreover, as a Hong Kong-listed company, Redco can also utilize other financial channels such as via the equity market to ease its liquidity if needed. Therefore, we expect Redco's liquidity will be sufficient.

## Appendix I: Redco's Rating Factors

Rating Factors	Weight	Initial Rating
<b>I. Market Demand Analysis</b>	<b>15.0%</b>	<b>bbb+</b>
<b>II. Business Analysis<sup>2</sup></b>	<b>45.0%</b>	<b>bb</b>
<b>III. Financial Analysis<sup>3</sup></b>	<b>40.0%</b>	<b>b</b>
<b>IV. Base Score</b>	<b>100.0%</b>	<b>bb-</b>
<b>V. Industry Risk</b>		<b>bbb</b>
<b>Base Rating</b>		<b>bb-</b>
<b>VI. Qualifiers</b>		
Liquidity		Neutral
Corporate Governance		Neutral
Debt Structure and Financial Policy		Neutral
Idiosyncratic Analysis		Neutral
<b>Stand-Alone Creditworthiness (SAC)</b>		<b>BB-</b>
<b>VII. External Support</b>		
Corporate Entity Support		Not Applicable
<b>Issuer Credit Rating</b>		<b>BB-/ Stable</b>

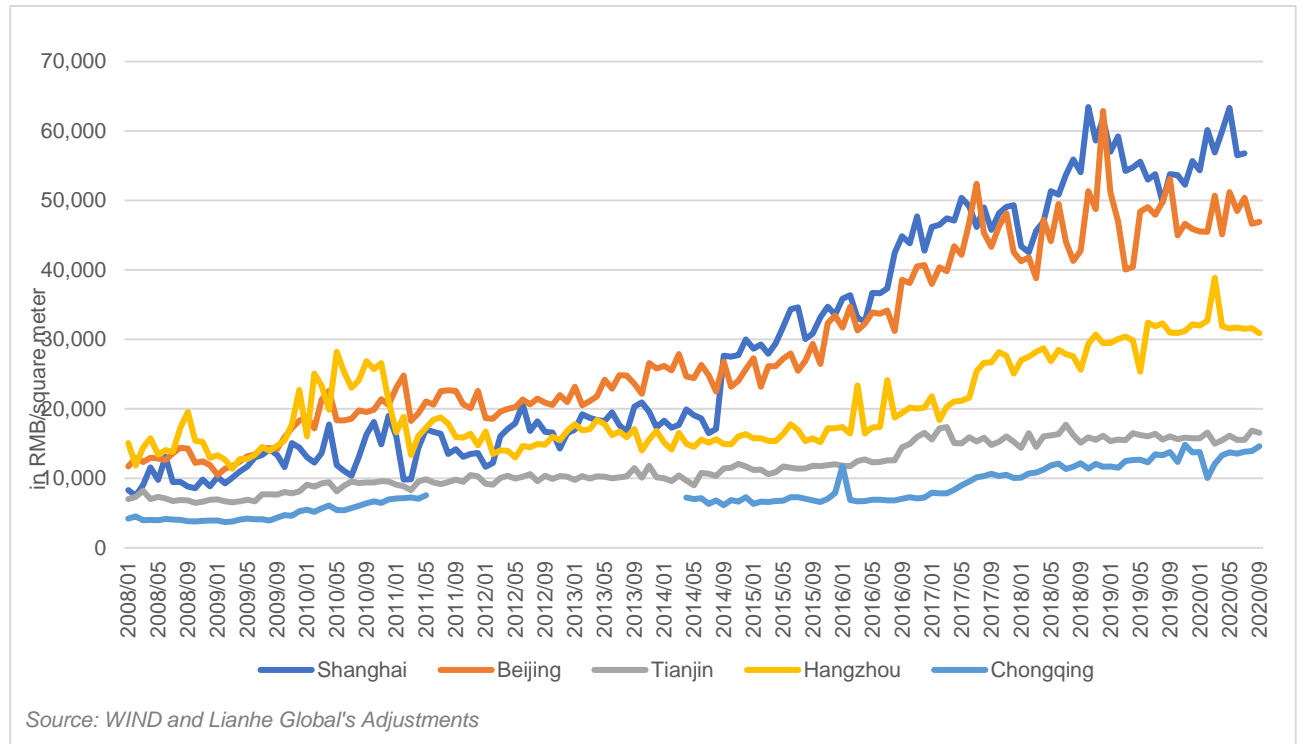
Source: Lianhe Global

<sup>2</sup> Business Analysis contains sub-factors of market position, diversification, competitive position, operating efficiency and profitability.

<sup>3</sup> Financial Analysis contains sub-factors of debt/land bank, EBITDA interest coverage, debt/capitalization and quick ratio.



Appendix II: Major Chinese Cities' Monthly Contracted Sales Average Selling Price



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