Fujian Yango Group Co., Ltd.

Surveillance Report

Summary	
Issuer Rating	BB-
Outlook	Stable
Location	China
Industry	Conglomerate
Date	24 June 2021

Lianhe Ratings Global Limited ("Lianhe Global") has affirmed 'BB-' global scale Long-term Issuer and Issuance Credit Rating of Fujian Yango Group Company Limited; Issuer Rating Outlook Stable

Summary

The Issuer Rating affirmation reflects Fujian Yango Group Company Limited's ("Fujian Yango" or "the company") leading market position and brand recognition in the Chinese property market operated by its main subsidiary Yango Group Company Limited ("Yango", 'BB'/Stable), high financial leverage and moderately weak profitability. The rating also considers Fujian Yango's standalone soft liquidity profile and significant indebtedness.

The Issuer Rating's Stable Outlook reflects our expectation that Fujian Yango would remain prudent in non-property acquisitions and continue maintaining a controlling stake in Yango, which would acquire new land in a disciplined manner. This will help moderately improve its financial leverage and EBITDA interest coverage in the following 12 to 18 months.

Rating Rationale

Yango Remains the Major Contributor: Fujian Yango is engaged in property development as the largest shareholder of Yango with 34% ownership, or 44% including the shares held by Fujian Kangtian Industry Group Co., Ltd. acting in concert with Fujian Yango at end-2020. Yango contributed about 75% and 80% of Fujian Yango's total revenue and net profit, respectively, in 2020. Yango also constituted about 85% of Fujian Yango's total assets at end-2020. We expect the revenue contribution from Yango to be significant, considering its healthy growth, steady gross margin, and performance track record.

At the same time, Yango also constituted about 83% of Fujian Yango's total debt on a consolidated basis at end-2020. Yango has been on a debt diet by a regulatory decree of the 3-Redline Rule, which keeps its debt growth in check. On a consolidated basis, Fujian Yango's debt growth rate remained flat at end-2020.

Sizable and Diversified Land Bank Supports Consistent Contracted Sales Growth: Yango had a sizable and diversified land bank portfolio with a total GFA at 42.5 million square meters at end-2020 across dozens of cities in China, sufficient to support Yango's contracted sales growth for the next three years. Yango achieved total contracted sales of RMB218 billion (RMB139.6 billion in attributable amount) in 2020, which placed it among the top 20 property developers in China.

Yango adjusted its strategic focus, concentrating on its financial profile improvement, value-added services, and developing process modularization as attempts to sustain its business margin against market headwinds. We expect Yango would selectively and cautiously expand its current land bank portfolio by targeting metropolitan area around the identified strategic cities in the next 12 to 18 months.

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Applicable Criteria
General Corporate Rating Criteria (16 July 2018)

Reliance on Debt Financing to Support Fuijian Yango's Equity Investment and Business Operation Constrains Credit Profile: Fujian Yango has relied mainly on debt financing to support its equity investment and operation. Fujian Yango's equity investments continued increasing in 2020. In addition to direct equity investments, it has provided funding to related parties. The shares acquisition of Fujian Longking Co., Ltd. ("Longking") in 2017 as well as the other equity investments led to an increase in the parent company's long-term equity investment to 143% of its total equity at end-2020.

Fujian Yango's consolidated financial leverage as measured by its adjusted gross debt to capitalisation was high at 66.0% at end-2020 (end-2019: 68.9%). Yango's total debt growth rate slowed in 2020. Yango has decelerated its expansion and reined in its debt-funded land acquisition since 2018 while enhancing its operating efficiency to shorten the cash collection cycle of property development projects, all of which provided a solid basis of the overall financial improvement for Fujian Yango. But at the same time, Fujian Yango's reported debt on a standalone basis increased by c. 10% year-on-year to RMB11.6 billion at end-2020 from RMB10.6 billion. At end-2020, Fujian Yango's reported total debt of RMB135.6 billion included RMB46.6 billion short-term debt and RMB89 billion long-term debt.

Fujian Yango's EBITDA interest coverage was at about 1x in 2019 and 2020. We expect Yango's strategic change to moderately improve Fujian Yango's overall financial leverage and interest coverage if the company manages its growth aspirations in a more prudent manner.

Perceivable Business Diversification Efforts Albeit Small Contribution: Fujian Yango has been on a journey of enhancing its operation scope and diversity through investments in subsidiaries and joint ventures. Apart from property development, the company ventured into environmental protection and education businesses.

Fujian Yango has other segments for business diversification. The commodity trading segment accounted for around 23%-15% of Fujian Yango's total revenue between 2018 and 2020, with very low gross margins of about 0.5% or below. Fujian Yango acquired shares of Longking to enter into the environmental protection industry in 2017, and controlled 25.04% shares of Longking indirectly through subsidiaries. This segment contributed about 9% of Fujian Yango's total revenue in 2020. The company expects to increase its holding in Longking with the subscription of its convertible bonds of up to RMB500 million issued in 2020.

Longking operates three core business segments, namely air treatment, solid waste treatment (including waste-to-energy incineration), and water treatment (including soil restoration). Longking has a leading position in manufacturing air pollution protection equipment. It was ranked first by sales and production volume in the industry for 13 consecutive years and captured more than 60% market share in the electric bag composite dust collector market. Longking has also entered into waste-to-energy incineration business through the acquisition of Dechang Environment Protection Co., Ltd in 2019 and has since been proactively expanding into solid and hazardous waste treatment business via acquisition and investments.

Education Segment Enjoys Fast and Steady Growth Rate with Decent Margin: While the education segment comprises a small portion, it has been experiencing fast and steady growth rates of above 30% with decent margins of above 20% in the recent years. The company cooperates with local governments and property developers to develop education platforms to facilitate K12 and higher education. At end-2020, Fujian Yango's operated 26 private primary-to-secondary schools in 14 provinces and municipalities including Fujian, Guangdong, Guizhou, Shanxi, Shaanxi, Jiangsu and Zhejiang. It has also agreed to cooperate with more than 40 K12 schools in 19 provinces and municipalities throughout China. Yango College was founded in 2001 as one of the first privately funded second-tier colleges in affiliation with public universities in Fujian Province. It was ranked 10th on the 2021 Private Universities Ranking by Chinese University Alumni Association in China. This segment is relatively asset light in comparison with property development and it offers a decent margin of above 20%. Based on K12 Education, the company is developing a full chain of education services and gradually establishing an education service ecosystem comprising education consulting management, logistics, study and research tours, training, cultural creativity and informatization.

Soft Standalone Liquidity Profile: We consider Fujian Yango's standalone liquidity profile as weak with a total cash balance of RMB1.07 billion versus the short-term debt of RMB 6.97 billion (including current portion of long-term debt) at end-2020. Cash plus short-term investments to short-term debt ratio on a standalone basis was 40.6% at end-2020 compared with 111.3% at end-2019. Nonetheless, Fujian Yango held financial assets for trading purposes of RMB1.758 billion on a standalone basis at end-2020, which primarily included structured deposits, wealth management products, and investment funds that could be tapped as standby liquidity sources on top of its marketable securities investments.

While Fujian Yango has pledged most (i.e. 77%) of its invested shares of Yango and Longking as credit enhancement for bank facilities, its non-pledged securities portfolio can provide itself flexibility in managing its liquidity.

Rating Sensitivities

We would consider downgrading Fujian Yango's rating if it were to pursue overly ambitious business expansions (such as aggressive debt-funded investments and/or excessive replenishment of Yango's land bank) which results in an increase in its financial leverage as measured by its EBITDA interest coverage below 0.8x or a gross debt to capitalisation ratio at above 70% consistently, or 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 Fujian Yango's rating if it were to lower its financial leverage as measured by its EBITDA interest coverage above 2.0x, and a gross debt to capitalisation ratio at below 60% consistently.

In addition, we would consider reassessing Fujian Yango's credit profile should Fujian Yango significantly reduce its shareholdings in Yango or have material expansion into the other businesses.

Company Profile

Fujian Yango has businesses across real estate development, commodity trading, comprehensive environmental protection services and educational services. Fujian Yango generates cash flow mainly from its operating subsidiaries, among which Yango is the major subsidiary and property development platform, representing over 85% of Fujian Yango's total assets at end-2020. Fujian Yango has started to be engaged in the environmental equipment manufacturing business since 2017 and held 25.04% shares of Longking, including 18.09% via the investment in Longking Industrial Group Company Limited and 6.95% through investment subsidiaries at end-2020. Fujian Yango has also invested in some financial institutions, including a 2.39% stake in Industrial Bank Co., Ltd, 3.66% stake in Jiangxi Bank Co., Ltd., and 8.17% stake in Huatai Insurance at end-2020, with a total investment amount at cost of RMB10 billion.

Ms. Wu Jie and Mr. Lin Tengjiao were the two largest shareholders of Fujian Yango holding together 89.34% of Fujian Yango at end-2020. Ms. Wu has 89.34% of the voting right in Fujian Yango according to the acting-in-concert agreement with Mr. Lin. Ms. Wu currently is the chairperson of Fujian Yango, and Mr. Lin is the chairperson of Yango. Fujian Yango's Board has three seats in total, including one chairman elected by the members.

Fujian Yango is the largest shareholder of Yango with 33.92% ownership at end-2020 or 43.98% including the shares held by Fujian Kangtian Industry Group Co., Ltd. acting in concert with Fujian Yango. Fujian Yango has consolidated Yango into its financial statements and appointed 5 directors (including Mr. Lin Tengjiao, Mr. Zhu Rongbin, Ms. He Mei, Mr. Lin Yihui, and Mr. Liao Jianfeng) out of a total of 12 seats (including 4 independent directors) on Yango's Board of Directors ("BOD").

Fujian Yango held 25.04% of Longking at end-2020. Fujian Yango has consolidated Longking into its financial statements and appointed 5 directors (including Ms. He Mei, Mr. Lv Jianbo, Mr. Lin Yihui, Mr. Lin Bing, and and Mr. Liao Jianfeng) out of a total of 12 seats (including 6 independent directors) on Longking's BOD.

Exhibit 1: Fujian Yango's Main Subsidiaries at end-2020

RMB million	Shareholding	Total Asset	Operating Revenue
Yango Group Company Limited	43.98%	352,302	82,171
Fujian Longking Company Limited	25.04%	25,130	10,181

Source: Fujian Yango 2020 annual report

On 9 September 2020, Yango entered into a 10-year agreement with two of its shareholders (altogether holding 13.53%), 泰康人寿保险有限责任公司 and 泰康养老保险股份有限公司 (or collectively "the purchasers"), in which Fujian Yango agrees to cause a dividend pay-out ratio of not less than 30% by Yango and compensate the purchasers shall Yango's financial performance fall under certain thresholds. Specifically, the agreement benchmarks Yango's 2019 net profit attributable to its parent company at RMB 4.02 billion as a base ("the base year") and requires Yango to deliver a CAGR of not less than 15% (or growth rate of 18.13% per annum) from the base year for the next 5 succeeding years starting in 2020. The agreement further stipulates specific dollar amount targets for 2025 through 2029. Fujian Yango agrees to compensate the purchasers for the difference or shortfall between the specific thresholds and the reported net profit attributable to the parent company if any for the next 10 succeeding years. The company believes it is able to meet the thresholds for the next 5 years (i.e. 2020-2024). In 2020, Yango's net profit attributable to the parent company stood at RMB 5.22 billion which represented a year-on-year increase of nearly 30% that met and exceeded the threshold.

Key Financial Assumptions

- Total revenue: RMB127-156 billion for 2021-2023
- Gross profit margin: 18.5-19.4% for 2021-2023

Key Financial Metrics

2019A-2023F	Debt/EBITDA	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	13.3x	1.0x	69.7%	0.2x

Source: Fujian Yango's annual 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 Fujian Yango's rating would result in a similar rating action on its USD notes:

- USD310 million 12.5% senior unsecured notes due 2021 affirmed at 'BB-'
- USD200 million 11.75% senior unsecured notes due 2022 affirmed at 'BB-'
- USD300 million 11.875% senior unsecured notes due 2023 affirmed at 'BB-'

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