

E-House (China) Enterprise Holdings Limited

Surveillance Report

Lianhe Global has downgraded E-House (China) Enterprise Holdings Limited's global scale Long-term Issuer and Issuance Credit Rating to 'BB-' from 'BB+'; Issuer Rating Outlook Negative

Summary

The Issuer Rating downgrade to 'BB-' reflects E-House (China) Enterprise Holdings Limited's ("E-House" or "the company") weakening credit profile and fluctuating financial metrics with the negative impact from the unexpected loss allowance on its account receivables. Additionally, the company encountered narrowed financing channels following the termination of the proposed equity financings, slower-than-expected revenue growth due to the compressed commission rates, and margin pressure in view of the expansion into low-margin business segments.

The Negative Outlook on E-House's rating reflects our expectation of E-House's increasing exposure to the counterparty risk for its account receivables, which would adversely affect its operating cash flow in the next 12-18 months. We would revise the Rating Outlook to Stable when there is a clearer sign on the resolution of the recovery of E-House's account receivables, and demonstrated effort to sustainably manage its leverage level and liquidity position.

Rating Rationale

Deteriorating Counterparty Credit Profiles Put Pressure on Operating Cash Flow:

The tightened financing environment and deteriorated financial positions of leading property developers increased E-House's counterparty risk in its real estate agency service business. E-House recorded a net loss allowance on financial assets subjected to expected credit loss ("ECL") of RMB1.94 billion for 1H2021, compared with RMB52.6 million for 1H2020. As E-House still has existing business relationships with leading property developers, we expect E-House to continue encountering the counterparty risk with its substantial exposure to these major property developers for its account receivables in the next 12-18 months. If there is any delay or default in payments by the major property developers, it will possibly dampen E-House's operating cash flow. Also, if the credit profiles of the leading property developers worsen, E-House will likely record additional loss allowance for the ECL on its account receivables in the next 12-18 months.

Termination of Proposed Equity Financing Narrows Financing Channels: On 1 September 2021, E-House announced that the share subscription agreements with Taobao China, the Zhou Subsidiary (Mr. Zhou Xin, the chairman of E-House, is the ultimate beneficial owner), and Yunfeng were terminated. E-House originally proposed to raise total proceeds of HKD2.49 billion through the issue of new shares. As the proposed equity financings were terminated, we expect E-House's financing channels to narrow. We expect E-House's debt financing will be primarily for refinancing needs, thus the company has to rely on its operating cash flow from its businesses to maintain its liquidity in the next 12-18 months.

Profit Margin Under Pressure Given Higher Contributions from Lower-Margin

Summary

Issuer Rating	BB-
Outlook	Negative
Location	China
Industry	Real Estate Service
Date	9 September 2021

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Applicable Criteria

General Corporate Rating Criteria (16 July 2018)

Segments: We expect both the brokerage network services and digital marketing services to remain the major growth drivers of E-House's revenue in the next 12-18 months. However, both segments command lower profit margins compared to E-House's other businesses. Therefore, we expect both segments will act as a drag to E-House's margin profile, and E-House's profit margin will be under pressure in the next 12-18 months.

Agency Services' Revenue Growth Affected by Declining Commission Rate and Policy Headwinds: E-House's total gross transaction value ("GTV") in its primary market real estate agency services has recovered since 2H2020. However, the commission rates for both the agency services and brokerage network services segments dropped in 2020 and 1H2021. We expect steady revenue growth for E-House's real estate agency services in the next 12-18 months. Nevertheless, given the declining commission rates and policy headwinds, the segmental revenue growth rate is likely to be less than that of the GTV.

Proposed JV Acquisitions Help to Establish a Comprehensive Online and Offline Platform: On 1 September 2021, E-House and Alibaba China entered into a strategic cooperation agreement. Upon the completion of all acquisition and subscription agreements, E-House will have the exclusive right to build and operate the online real estate marketing and transaction service platform under the Tmall brand through the JV. The proposed acquisition will complement E-House's existing business, create synergies and eventually increase the real estate transaction volume. Having said that, E-House may incur capital expenditure to develop the platform and it may take time for E-House to realize these benefits.

Adequate Liquidity Despite Pressure on Financial Leverage: E-House had a cash balance of RMB7.34 billion (or RMB6.09 billion of unrestricted cash) at end-June 2021, sufficient to cover its short-term debt of RMB4.02 billion. Despite recording a negative EBITDA in 1H2021, we expect E-House to have sufficient liquidity to cover its interest expenses and support its repayment capacity for the next 12 months. E-House managed to record a positive operating cash flow in 1H2021, though the counterparty risk as aforementioned will put pressure on its operating cash flow in the next 12-18 months. Overall, in the absence of any further deterioration of credit profiles of the major property developers, we do not expect any major liquidity crisis for E-House for the next 12 months.

Rating Sensitivities

We would consider downgrading E-House's rating if (1) its operating performance were to deteriorate as measured by an EBITDA margin to decrease to below 10% consistently, or (2) its financial leverage as measured by a debt/EBITDA ratio to increase to over 5.0x consistently, or (3) its operating performance and working capital management were to deteriorate such that its revenue experiences a material decline or operating cash flow shows sign of worsening.

An upgrade is unlikely given the negative outlook on E-House. However, if E-House's operating efficiency were to exhibit a remarkable improvement such that it could maintain a sustainable positive operating cash flow and visible loss allowance, strengthen its profitability as measured by an EBITDA margin to increase to above 20% consistently, and its financial leverage as measured by a debt/EBITDA ratio to decrease to below 3.0x consistently, we may consider upgrading E-House's rating.

Company Profile

E-House is a leading real estate brokerage service provider that operates its business in mainland China. E-House has been cooperating with the leading property developers in China to provide property brokerage services to home buyers. In addition to brokerage services, E-House is also engaged in providing real estate data and consulting services through its own database and providing real estate brokerage network services to small- and medium-sized brokerage firms. E-House also provides digital marketing services after acquiring a 56% stake in Leju in November 2020.

Exhibit 1: E-House's Shareholding Structure at end-2020

Shareholder	Percentage
Mr. Zhou Xin	23.62%
China Evergrande Group	9.82%
China Vanke Co., Ltd.	9.82%
Alibaba Group Holding Limited	8.32%
Public	48.42%
Total	100.0%

Source: E-house

Business Profile

Revenue from real estate agency services in the primary market is E-House's major revenue source. This segment contributed over 80% of total revenue to E-House in both 2017 and 2018. Although the percentage decreased to 26.2% in 1H2021, it remained one of the main revenue sources of E-House. Real estate brokerage network services experienced strong growth in 2018-2019. The segment recorded a decrease in revenue in 2020, but it rebounded by 96.2% year-on-year in 1H2021. The segment's contribution to total revenue increased to 34.6% in 1H2021 from 7% in 2018. It has become another key division since then. Revenue generated by real estate data and consulting services grew steadily in 2018-1H2021. This segment contributed 7.9% of E-House's total revenue in 1H2021. The new segment, namely digital marketing services upon the acquisition of Leju in November 2020, contributed revenue of RMB1,129 million and RMB1,952 million in 2020 and 1H2021, respectively, and accounted for 31.3% of the total revenue in 1H2021.

Exhibit 2: E-House's Revenue Breakdown by Business Segment (RMB: in million)

Revenue / % of total	FY2018		FY2019		FY2020		1H2021	
Real estate agency services in the primary market	4,753	80.0%	4,566	50.2%	3,204	39.8%	1,637	26.2%
Real estate data and consulting services	773	13.0%	978	10.8%	987	12.3%	496	7.9%
Real estate brokerage network services	421	7.0%	3,551	39.0%	2,732	33.9%	2,162	34.6%
Digital marketing services	-	-	-	-	1,129	14.0%	1,952	31.3%
Total	5,948	100.0%	9,095	100.0%	8,052	100.0%	6,247	100.0%

Source: E-house

Key Financial Assumptions

- Average commission rate for real estate agency services in the primary market: c. 0.70-0.75% for 2021-2023
- Average commission rate for real estate brokerage network services: c. 2.0-2.5% for 2021-2023

Key Financial Metrics

2019A-2023F	Debt/EBITDA	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	17.9x	2.0x	43.4%	1.4x

Note: Negative figures/ratios were excluded as they are not applicable for the purpose of weighted average calculations.

Source: E-House'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 E-House's rating would result in a similar rating action on its USD notes:

- USD300 million 7.625% senior unsecured notes due 2022 downgraded from 'BB+' to 'BB-'
- USD300 million 7.600% senior unsecured notes due 2023 downgraded from 'BB+' to 'BB-'

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