

Redco Properties Group Limited

Surveillance Report

Summary

Issuer Rating	BB-
Outlook	Stable
Location	China
Industry	Homebuilder and Real Estate
Date	11 January 2022

Operating Data:

Redco Properties Group Limited

	31 Dec 2020	30 Jun 2021
Revenue (RMB: in million)	12,452	9,131
Contracted Sales (RMB: in million)	40,975	23,510
Contracted Sales ASP (RMB/square meter)	8,615	8,772
Contracted Sales GFA (million square meters)	4.76	2.68
Land Bank GFA (million square meters)	23.40	23.67

ASP: Average Selling Price

GFA: Gross Floor Area

Source: Redco's 2020 annual report and 2021 interim report

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Applicable Criteria

[Chinese Property Developer Rating Criteria \(31 December 2021\)](#)

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

Summary

The Issuer Rating reflects Redco's established track record of contracted sales growth and geographical diversification, as well as sufficient low-cost land bank. However, Redco's rating is constrained by its moderate operating scale, relatively high financial leverage and tapering margins.

The Stable Outlook reflects our expectation that Redco would maintain a moderate growth of contracted sales and prudently continue its geographical diversification. The company also has a low-cost land bank that can support its sales growth for the next three to four years.

Rating Rationale

Small Scale Developer with Demonstrated Track Record of Growth: Redco expanded its footprint from Fujian Province to other major regions and provinces in China under its "1+3+N" development strategy. Redco selectively and strategically entered into Tier 2 cities in three core regions, namely Greater Bay Area ("GBA"), Yangtze River Delta ("YRD") and Bohai Rim regions, with radiation towards cities in the Mid-West region. Redco's total land bank by GFA reached c. 23.7 million square meters (sq.m.) at end-June 2021, with 131 property development and investment projects located in 46 cities. The YRD and GBA regions accounted for 33% of Redco's land bank GFA at end-June 2021. The continuous land bank expansion provided Redco with the land resources to sustain the growth of its operating scale.

Redco recorded strong year-on-year growth of contracted sales by 49.5% and 80.6% in 2020 and 1H2021, respectively. Given the slowdown of China's property sales in 2H2021, Redco's contracted sales growth moderated to c. 15% in 2021. We expect Redco to continue its contracted sales growth momentum in the next 12-18 months, supported by its ample saleable resources. Also, we expect Redco's revenue will grow in tandem with its contracted sales in the next 12-18 months, given its relatively high consolidation level. 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 contracted sales growth, Redco's relatively moderate operating scale will be a constraint on its credit profile in the next 12-18 months.

Diversification of Land Bank with Low-cost Land: Redco's land bank was sufficient to support its sales growth for the next three to four years. The company acquired 16 pieces of land parcels with the GFA of c. 3.0 million sq.m. in 1H2021. We expect Redco's land acquisition cost to increase as Redco continues its geographical expansion into the YRD and GBA regions. Having said that, we expect Redco to continue enjoying a low-cost land

bank at an average cost of c. RMB2,000-2,500/sq.m. The majority of Redco's coverage is located in Tier 2 cities, which provides the company with opportunities to acquire land parcels at a relatively lower cost. We expect Redco's strategy of continuous geographical diversification and expansion of coverage to continue benefiting Redco in containing its execution risk.

To sustain its growth in scale, we expect Redco to maintain its prudent and selective land acquisition appetite and spend c. 30-40% of contracted sales proceeds for land acquisitions while keeping average land cost/average selling price ratio to c. 30-35%.

Margins Tapering Off from Previous High; Expect to Stabilize at a Moderate Level:

Redco registered high gross margin of 35.4% and 34.3% in 2018 and 2019, respectively, primarily due to its low average land acquisition cost and the revenue recognition of certain high-margin projects. However, Redco's gross margin fluctuated to 22.6% and 24.8% in 2020 and 1H2021, respectively, primarily due to rising average recognized land acquisition cost.

Redco's main coverage is in Tier 2 cities and its customer base is not under the key radar of price restriction policies, hence we expect its ASP to remain relatively stable in the near term. Nevertheless, Redco implemented price cut and other promotion strategies for accelerating contracted sales in certain regions. Furthermore, Redco's fast-churn strategy to grow its scale would inevitably subject the company to less flexibility to achieve a higher margin. As a result, we expect Redco's gross margin to maintain at c. 20% level in the next 12-18 months.

Moderately High Leverage with Improving Maturity Profile; Adequate Liquidity:

Redco's financial leverage as measured by gross debt over capitalization ratio (end-2019: 62.0%; end-2020: 58.6%; end-June 2021: 57.8%) is considered to be moderately high. Redco's reported total debt increased by 19.8% in 2020, followed by an 14.2% increase in 1H2021. The company aimed to contain its total debt and financial leverage. We expect Redco's financial leverage to stay at c. 60% in the next 12-18 months.

On the other hand, Redco managed to improve its debt maturity profile by mitigating short-term re-financing burden. Redco's short-term debt accounted for c. 33% and 37% of its total debt at end-2020 and end-June 2021, respectively, down from 72% at end-2019. The company has also been able to demonstrate a track record of refinancing short-term debt and lengthening its maturity profile with debt issuances of longer tenor and entering term loan facility with banks. Also, Redco's proportion of trust loans and other debts to total debt remained low at c. 12% at end-June 2021. In addition, Redco's liquidity is adequate as it had RMB15.4 billion (RMB11.3 billion unrestricted) cash on hand and RMB1.9 billion undrawn committed credit facility at end-June 2021 to cover its RMB8.6 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 a 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 which mainly focuses on mass residential property development and diversifies its business to property management services and project management services.

The company was set up in 1992 and engaged in trading construction materials at the beginning. Redco entered into the property development market in 1996 and commenced its first project in Quanzhou. Redco has been listed on the Hong Kong Stock Exchange (1622.HK) since 2014.

Redco's main business operation consists of three business lines: (i) sales of properties, (ii) property management services, (iii) project management services and others. The sales of properties was the primary source of revenue for the company. Its contribution to the total revenue increased to 98.3% in 1H2021 from 93.9% in 2017.

Redco also entered property management services in 2019 and contributed 1.2% to the total revenue in 1H2021. Redco plans to spin-off the operating entity of the property management segment, Redco Healthy, and list it on HKEX separately.

Exhibit 1: Redco's Revenue Breakdown by Business Segment (RMB: in million)

Revenue / % of total	FY2019		FY2020		1H2021	
Sales of properties	8,219	95.5%	12,203	98.0%	8,973	98.3%
Property Management services	81	0.9%	145	1.2%	109	1.2%
Project Management services	34	0.4%	59	0.5%	40	0.4%
Construction services	256	3.0%	28	0.2%	0	0
Others	13	0.1%	17	0.1%	8	0.1%
Total	8,602	100.0%	12,452	100.0%	9,131	100.0%

Source: Redco's 2020 annual report and 2021 interim report

Exhibit 2: Redco's Shareholder Structure at end-June 2021

Shareholder	Percentage
Mr. Wong Yeuk Hung ⁽¹⁾	39.1%
Mr. Huang Ruoqing ⁽²⁾	29.5%
Public	31.4%
Total	100.00%

Note:

(1) Mr. Wong Yeuk Hung is Redco's chairman of the board and founder.

(2) Mr. Huang Ruoqing is Redco's executive director, president and founder.

Source: Redco

Key Financial Assumptions

- Contracted sales growth: c. 5% to 15% per annum for 2021-2023
- Gross margin: c. 20% to 22% for 2021-2023
- Total revenue: RMB17 to 25 billion for 2021-2023

Key Financial Metrics

2019A-2023F	Debt/Land Bank	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	34.9%	1.37x	59.3%	0.15x

Source: Redco's annual reports, Lianhe Global's adjustments and forecasts

Full List of Issuance Rating

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

- USD285 million 8.0% senior unsecured notes due 2022 affirmed at 'BB-'
- CNH600 million 10.5% senior unsecured sustainable notes due 2023 affirmed at 'BB-'

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