Chinese Property Developers 2021 Annual Results Review: Survival of the Fittest

Summary

A number of Lianhe Ratings Global Limited ("Lianhe Global")'s rated Chinese property developers announced their 2021 annual results with an average growth of 6.7% and 18.2% (excluding outliers) in contracted sales and revenue, respectively. However, the gross margin squeeze continued in 2021 with a 2.3 percentage points decrease on average in 2021 compared with 2020, due to more price cuts and discounts. As a result, these property developers recorded earnings decline and dividend cut of 29.3% and 40.8% on average (excluding outliers) in 2021, respectively, mainly due to the lower gross margin. These property developers recorded an average year-on-year increase of 2.9% of their total debts in 2021, and recorded an increase of 3.7 percentage points on average in their net gearing ratios, mainly due to the lower cash on hand. These property developers' average financing cost was lowered by 0.2 percentage point on average in 2021, while all of them were able to pass either 2 or 3 out of the 3 thresholds stated in the "3 Red Lines" rules at end-2021.

We believe the decrease in contracted sales led to the lower-than-expected revenue booking in 2021. The continued gross margin deterioration started to have a significant impact on the earning performance of property developers. Also, we are concerned with the sustainability of the refinancing cost and viability for many property developers in the next 12 months.

Some property developers encountered auditor resignation or replacement, and some were even unable to announce annual results by the end of March, or only able to deliver unaudited results. We believe these issues raise the concern on the reliability of the property developers' financial statements, the transparency of their financial positions, and the soundness of their corporate governance. The suspension of property developers' stock trading caused by the result announcement delay will limit their refinancing channels. The lack of audited annual results of property developers may exacerbate the risk of rating downgrade and accelerate their debt repayment pressure, all of which may further heighten their liquidity and default risk.

Most of the property developers adopt prudent operation strategy and focus on sustainability of their businesses in 2022. These property developers set prudent contracted sales targets without significant growth for 2022, or even decline to set such targets. They stay cautious in land acquisition and concentrate on strengthening liquidity management, such as enhancing cash collection from contracted sales.

We believe the peak of policy restrictions is likely behind us, given the cooling down of the contracted sales and the ASP across the industry. We expect more local governments will implement loosening measures or relax their existing policy restrictions in the reminder of 2022. Nevertheless, the recent resurgence of Covid-19 variant cases in China may hinder or delay the contracted sale recovery.

Given the risk of credit repricing and the risk-averse sentiment of investors in the offshore USD bond market, only a few higher-quality and IG property developers may still be able to conduct their refinancing activities at higher financing costs. On the contrary, the offshore USD public bond financing channel keeps shutting out lower-quality property developers. Asset disposal is probably an alternative for lower-quality or distressed developers. However, the dilemma between potential buyers and property developers may hinge on the price and/or terms negotiation process. Also, we notice private USD debt issuance with offshore assets as collateral offers a window of opportunity for lower-quality or distressed developers with tight liquidity and limited public financing options. Also, some property developers are still able to conduct other financing alternatives, such as issuing convertible bonds, equity-linked securities, exchangeable bonds, etc. Overall, we expect property developers still face repayment pressure in the near to medium term. We remain cautious on the near-term credit outlook for the Chinese property developer industry.

Review of 2021 Annual Results

Narrowed Contracted Sales Growth, Gross Margin Squeeze and Earning Decline

Most of the Chinese property developers were still able to achieve contracted sales growth in 2021, though their growth rates were largely narrowed compared with the first half of 2021. Lianhe Global's rated Chinese property developers posted 6.7% year-on-year increase on average in their contracted sales in 2021. Together with the revenue booking of the contracted sales from the previous years, these property developers recorded 18.2% year-on-year increase on average (excluding outliers) in their revenue in 2021.

However, the gross margin squeeze continued in 2021. Lianhe Global's rated Chinese property developers' average GPM remained under pressure with a 2.3 percentage points decrease on average to 22.9% in 2021 compared with 25.2% in 2020. Besides the rising land and construction costs, we believe the price cuts and discounts offered by property developers to boost their contracted sales also contributed to the gross margin decline.

Furthermore, we noticed many property developers recorded earnings decline in 2021, mainly due to the lower gross margin. Together with the tight liquidity and financial position, some of these property developers cut their dividends significantly in 2021. Lianhe Global's rated Chinese property developers recorded a 29.3% and 40.8% year-on-year decrease on average (excluding outliers) in their core net profit and dividends in 2021, respectively.

Disciplined Debt Growth but Heightened Financial Leverage

Driven by the deleveraging process, Lianhe Global's rated Chinese property developers recorded a moderate year-on-year increase of 2.9% on average of their total debts in 2021. However, these property developers still recorded an increase of 3.7 percentage points on average in their net gearing ratios to 71.9% in 2021 compared with 68.2% in 2020. Despite the enlarged equity base, we believe the lower cash on hand was the major reason for the increase in their net gearing ratios.

Driven by the low financing cost for refinancing activities in the first half of 2021, Lianhe Global's rated Chinese property developers' average financing cost was lowered by 0.2

percentage point on average to 7.2% in 2021 compared with 7.4% in 2020. Most of the Lianhe Global's rated Chinese property developers recorded decrease in average financing cost in 2021.

Property developers were generally on the process of bringing themselves to be in compliance with all of the "3 Red Lines" tests. We notice more property developers were able to pass the last hurdle of the "3 Red Lines" tests, namely asset-to-liability ratio. Most of the Lianhe Global's rated developers were able to pass either 2 or 3 out of the 3 thresholds stated in the "3 Red Lines" rules at end-2021.

Annual Results Fell Short of Our Expectations

Property developers' 2021 annual results were generally below our expectation, mainly in terms of contracted sales, revenue booking and profit margin. We believe the decrease in contracted sales performance since the second half of 2021 led to the lower-than-expected revenue booking in 2021. At the same time, the continued gross margin deterioration started to have a significant impact on the earning performance of property developers.

On the contrary, property developers' average financing cost was above our expectation, probably due to the low refinancing cost in the first half of 2021. Nevertheless, given the narrowed financing channels and the risk repricing in the bond markets, we are concerned about the refinancing capabilities and the sustainability of the refinancing cost for property developers in the next 12 months.

Auditor Resignation and Delay in Audited Annual Results Announcement Raised Credit Warning Signal

Some property developers have encountered the following credit warning events since the first quarter of this year: i) auditor resignation, ii) auditor replacement with less reputable successor auditors, iii) qualified opinions and/or ongoing concern from auditors, iv) announcement of unaudited annual results and iv) unable to announce annual results by the end of March which led to trading suspension for their stocks since the beginning of April. We believe the frequency of the occurrence of these credit warning events is the most serious in recent years.

We believe these issues raise the concern on the reliability of the property developers' financial statements, the transparency of their financial positions and the soundness of their corporate governance. The suspension of property developers' stock trading will limit their refinancing channels. The lack of audited annual results of property developers may exacerbate the risk of rating downgrade and accelerate their debt repayment pressure, all of which may further heighten their liquidity and default risk.

We have also been experiencing and observing a large number of rating withdrawals in the property developer industry since the second half of 2021. We believe rating withdrawals are not conducive to the symmetry of information between property developer issuers and investors, especially under the current challenging capital market condition. Investors now pay more attention to property developer issuers' liquidity positions or imminent default risk on their maturing debt obligations and focus less on their fundamental credit metrics.

2022 Outlook and Strategy

Developers' Conservative Contracted Sales Outlook, Focusing on Sustainability

Most of the property developers set prudent contracted sales targets without significant growth for 2022, or even decline to set such targets, which show the contracted sales growth would not be their priorities in 2022. Instead, these property developers aim to strengthen the quality of the contracted sales in 2022, such as raising the attributable ratio and maintaining a reasonable profitability of contracted sales.

Property developers remain more optimistic on the contracted sales outlook in higher-tier cities with strong demand and property prices, compared with weaker demand in lower-tier cities. We believe the ASP on contracted sales will be under pressure in 2022, as property developers need to offer price cuts and discounts in some lower-tier cities. Having said that, if a higher proportion of contracted sales is generated from higher-tier cities, some property developers may still record an increase for their overall ASP.

Most of the property developers adopt prudent operation strategy and focus on sustainability of their businesses in 2022. These property developers stay cautious in land acquisition in 2022, with limited budget for land purchase or even temporary halt in land acquisition in the first half of 2022. They also concentrate on strengthening liquidity management, such as enhancing cash collection from contracted sales.

More Policy Loosening in 2022, but Remain Cautious on Recovery

Property developers generally remain cautious on the policy environment and the nationwide contracted sales performance in 2022. These property developers expect a flat or a slight year-on-year decline of the nationwide contracted sales in 2022 compared with the RMB18.2 trillion achieved in 2021. Nevertheless, they expect a gradual recovery on the monthly contracted sales starting from the second quarter of 2022, given the expectation of more policy relaxation from local governments and probable acceleration of mortgage loan approval from banks.

We believe the peak of policy restrictions is likely behind us, given the cooling down of the contracted sales and the ASP across the industry. The omission of the property tax during the Two Sessions was probably a harbinger. We expect more local governments will implement loosening measures or relax their existing policy restrictions in 2022, such as loosening the property purchase restrictions, downpayment requirements and eligibility of mortgage applications, etc. Having said that, homebuyers' sentiment and their expectation on property prices are crucial to the contracted sales recovery in 2022. The recent resurgence of Covid-19 variant cases in China may hinder or delay the contracted sale recovery in the second quarter of this year.

Challenging Outlook in the Offshore USD Bond Market

As there is no major policy support regarding the refinancing of property developers during the Two Sessions, we believe the refinancing channels in both the onshore and offshore markets for property developers to remain challenging in 2022. Given the risk of credit repricing and the risk-averse sentiment of investors in the offshore USD bond market, only a few higher-quality and IG property developers may still be able to conduct their refinancing activities at higher financing costs. On the contrary, the USD public bond financing channel keeps shutting out lower-quality property developers.

Property developers generally rely on internal resources, bank loan and cash inflow from contracted sales for their debt repayments. Asset disposal is probably an alternative for distressed developers. However, the dilemma that potential buyers seek to acquire high-quality assets versus developers are only interested in disposing their non-core assets may hinder the negotiation process. The distressed price and valuation would also hold back property developers' desire on selling their assets. On the other hand, we notice private USD debt issuance with offshore assets as collateral is probably a resolution for distressed developers with tight liquidity and limited financing options. Also, some property developers are still able to conduct other financing alternatives, such as issuing convertible bonds, equity-linked securities, exchangeable bonds, etc. Overall, we expect property developers still face repayment pressure in the near to medium term. We remain cautious on the near-term credit outlook for the Chinese property developer industry.

Appendix

List of Lianhe Global's Publicly Rated Chinese Property Developers

Issuer Name	Long-term Issuer Credit Rating	Outlook
CIFI Holdings (Group) Co. Ltd.	BBB-	Stable
Radiance Holdings (Group) Company Limited	BB	Stable
LVGEM (China) Real Estate Investment Company Limited	BB-	Stable
Zhongliang Holdings Group Company Limited	BB	Stable
Dexin China Holdings Company Limited	BB-	Stable
Jinke Property Group Co., Ltd.	BB+	Stable
Huijing Holdings Company Limited	B+	Positive
Jiangsu Zhongnan Construction Group Co., Ltd.	BB	Stable
Source: Lianhe Global		

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