

# Kasen International Holdings Limited

## Initial Issuer Report

### Summary

Issuer Rating	BB+
Outlook	Stable
Location	China
Industry	Corporate
Date	11 March 2024

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned ‘BB+’ global scale Long-term Issuer Credit Rating to Kasen International Holdings Limited (“Kasen”). The Outlook is Stable.

### Summary

The Issuer Rating reflects Kasen’s established market presence in the upholstered furniture sector, low financial leverage and limited debt scale, sufficient liquidity, as well as ongoing capital expenditure to support its overseas business expansion. However, Kasen’s rating is constrained by its weakened profitability and downward trajectory in operating income.

The Stable Outlook reflects our expectation that Kasen will continue to maintain its low leverage and manage its debt level prudently, and gradually stabilize its profitability in the following 12 to 24 months.

### Key Rating Rationales

**A Prominent Upholstered Furniture Company Pioneering the Global Market:** Kasen is a prominent domestic manufacturer of leather products and upholstered furniture, boasts a vertically integrated supply chain from raw materials to finished furniture. This approach provides a unique competitive advantage within the domestic industry, with upholstered furniture contributing over 70% to the company’s total revenue in the past three years. Key clientele from the United States, China, and Europe constituted 82.9%, 9.7%, and 4.3% of sector revenue in 2022. However, concerns about China’s economic situation led to a 23.5% year-on-year decrease of the sector revenue in 2022, totaling RMB599.8 million. To counter the challenges, Kasen is relocating production to Cambodia, aiming to reduce costs and stabilize the sector performance. Although this relocation presents some challenges, the relocation and expansion in Cambodia is likely to increase orders from European and American customers.

**Fading Contribution from Property Development Business:** The property development sector recorded a 71.2% year-on-year decrease in revenue in 2022, which reached RMB173.4 million. The company manages seven projects located in China and Cambodia. In view of the weak Chinese real estate market, the company halts acquisition of new domestic projects, and shifts its focus on selling existing projects. Asset disposal helps to accelerate capital recovery, while overseas projects in Cambodia present growth prospects. With limited projects for sale and no new land reserve, the declining revenue contribution from property development is likely to continue.

**Higher Planned Capital Expenditure to Support Business Expansion:** Kasen is adjusting its business strategy to penetrate into industries and regions aligned with the Belt and Road Initiative, which include energy, resources and industrial park development. Currently, Kasen is focusing on industrial park project in Cambodia and overseas power generation project. Therefore, we expect Kasen to incur a higher capital expenditure in the next 2-3 years compared with the past few years, which is mainly for the purchase of new land and fixed assets to support its business expansion. Also, the new projects may take a long time for generating positive cash flow and have long cash collection cycles.

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### Applicable Criteria

[General Corporate Rating Criteria \(31 December 2021\)](#)  
[General Corporate Rating Criteria: Addendum \(30 August 2022\)](#)

**Weakened Profitability amid Deteriorating Market Environment:** Kasen faced declining profit margin compared to the peak in 2021. The declining foreign orders and challenges on industrial transition undermined the revenue and profitability of Kasen's upholstered furniture business. Also, the weak Chinese property market weakened Kasen's property development sector's revenue and profitability. The travel and tourism-related services sector also suffers from revenue decreases due to pandemic-induced restrictions. Kasen is paying efforts to mitigate these challenges by shifting its manufacturing operations to Cambodia, but the new industrial park development and higher operational costs still pose hurdles. It may take time for the contribution from new businesses and recovery of its upholstered furniture business to support Kasen's turnaround for its declining gross margin, EBITDA margin and EBIT margin.

**Financial Leverage Remains Low with Moderately Sufficient Liquidity:** Kasen maintained a low financial leverage, with a debt/capitalization ratio of 18-19% from 2020 to 2022. The strategic decision to halt leveraging for real estate acquisitions resulted in a decrease in total adjusted debt from RMB939.9 million in 2021 to RMB821.5 million in 2022. The projected annual capital expenditures of RMB1.2-1.4 billion in 2023-2025 may increase Kasen's financial leverage to around 22%-26%. The company's debt-servicing capacity is weak given its declining profitability, which is reflected in its high debt/EBITDA ratio. The EBITDA/Interest ratio may fall further to below 2x in the next three years. Despite the financial challenges, Kasen maintains solid liquidity, with a cash balance of RMB460.3 million and adequate bank facilities at end-2022, compared with its short-term debt of RMB217.8 million, providing flexibility in managing working capital. Its quick ratio, as measured by cash and cash equivalents and short-term investments and receivables divided by current liabilities, remained between 0.7x-1x in the past three years.

### Rating Sensitivities

We would consider downgrading Kasen's rating if (1) it increases its financial leverage as measured by debt/capitalization consistently to above 40%, or a decrease in its EBITDA interest coverage to below 2.0x, or (2) it suffers a significant deterioration in operating performance in terms of revenue, margin or cash flow generation, or (3) its liquidity is materially worsened.

We would consider upgrading Kasen's rating if (1) it maintains its financial leverage consistently to below 20%, and improves its EBITDA interest coverage consistently to above 4.0x, and/or (2) it improves operating performance and profitability significantly.

## Company Profile

Established in the Cayman Islands in 2022, Kasen is a privately-owned enterprise and a prominent player in the Chinese furniture manufacturing industry. The company, operating through its subsidiaries, specializes in the manufacturing and trading of upholstered furniture, properties development, travel and tourism-related operations, with a focus on business activities in China, Europe, and the United States.

In 2005, Kasen was successfully listed on the Stock Exchange of Hong Kong under the trading code "0496.HK". As of end-June 2023, Mr. Zhu Zhangjin, the company's chairman, as settlor, and persons in concert, collectively hold 39.36% of issued shares directly and through a family trust, excluding options. Joyview Enterprises Limited owns 38.50% through the trust.

## Business Profile

### A Prominent Upholstered Furniture Company Pioneering the Global Market

#### Kasen's Revenue Breakdown by Business Type

RMB million	2019 Revenue	2020 Revenue	2021 Revenue	2022 Revenue
Manufacturing and Trading of Upholstered Furniture	701.0	692.9	784.2	599.8
Property Development	2,552.1	440.2	602.8	173.4
Others	160.1	127.2	126.6	90.2
<b>Total</b>	<b>3,413.2</b>	<b>1,260.3</b>	<b>1,513.5</b>	<b>863.4</b>

Source: Kasen and Lianhe Global's Calculation

Kasen is a Prominent domestic manufacturer of leather products and upholstered furniture. The company boasts a vertically integrated complete supply chain, spanning from raw material processing to the production of leather goods and finished furniture. This integrated approach provides a unique competitive advantage within the domestic industry. Throughout the last three years, the manufacturing and trading of upholstered furniture has been the primary source of operational revenue for Kasen, constituting over 70% of the total revenue. The major clientele hails from the United States, China, and Europe, constituting 82.9%, 9.7%, and 4.3% of this sector's revenue in 2022, respectively. However, in 2022, due to foreign clients' concerns about the economic situation in China, there was a 28.6% decrease in revenue for this sector, amounting to RMB 599.8 million.

Anticipating a slight future decline in export sales for this sector, however, the company is currently undergoing capacity relocation, having shifted approximately 40% of its furniture production lines to Cambodia. This move aims to reduce production costs by taking advantage of lower rental and labor expenses, thereby slowing down the declining trend in net profit for this sector. Additionally, although the capacity relocation has posed obstacles to some business and order quantities, the expansion of the production base in Cambodia is expected to contribute to a certain extent by increasing the number of orders from European and American customers.

### Fading Contribution from Property Development Business

The property development sector serves as another significant revenue stream for the company but has exhibited a fluctuating trend in the past, realizing a revenue of RMB173.4 million in 2022, marking a 71.2% YoY decrease. As of June 2023, the company has seven property projects, with six located in various Chinese provinces (such as Hainan, Jiangsu, Zhejiang) and one in Phnom



Penh, Cambodia. Four projects have been completed and delivered, while the ongoing projects are currently situated in Hainan, encompassing residential, hotel, and tourism resort areas.

In response to the downturn in the Chinese real estate market, the company has decided to refrain from developing new domestic projects and instead focuses on selling and delivering existing projects. Asset disposal is also accelerated to recover funds. Simultaneously, overseas real estate projects in Cambodia proceed as planned, offering new sales growth opportunities. Considering limited available projects for sale and no new development plans, it is anticipated that the declining trend in revenue for the property development sector will persist.

### **Higher Planned Capital Expenditure to Support Business Expansion**

The company is currently undergoing a transformation, shifting its focus from traditional manufacturing and property development towards the development of industries related to the 'Belt and Road Initiative'. This includes business such as energy, resources, and industrial park construction in corresponding countries. The company's current development and business focus are concentrated on countries along the Belt and Road, particularly the industrial park project in Cambodia and overseas power generation projects.

The company is involved in the development and construction of industrial parks by acquiring industrial land in Cambodia (in 2023, it acquired a 49% stake in 1,134 hectares of land for RMB338 million from the controlling shareholder's daughter) and aims to recover investment costs through subsequent land sales. Future plans rely on the operation of industrial parks, enhancing project profitability through services like logistics, value-added services, financial and tax services, and utility supply within the industrial parks. However, these plans may face significant capital expenditures of approximate RMB1.3 billion per year since 2024, leading to considerable capital spending pressure. These projects currently lack the ability to generate operating cash flow, given their relatively long construction cycles. We anticipate that some projects will start generating operating cash flow, supplementing the company's gross profit, at the earliest by 2025.

## **Financial Profile**

### **Weakened Profitability amid Deteriorating Market Environment**

Kasen has confronted significant financial challenges, experiencing a substantial decline in revenue and gross profit across its key sectors. The manufacturing and trading of upholstered furniture, a traditional stronghold, saw a sharp downturn primarily due to COVID-19 disruptions and a decrease in foreign orders. The ongoing industrial transition further constrained operational capacity, impacting overall revenue and profitability. Additionally, the property development sector faced a substantial downturn, prompting swift asset disposal to address real estate market declines. The travel and tourism-related services sector also suffered revenue decreases due to pandemic-induced restrictions. These multifaceted challenges, combined with early-stage overseas ventures, highlight the complexity of Kasen's profitability landscape, necessitating strategic resilience.

Examining financial indicators, Kasen's gross margin declined from 43.5% in 2021 to 38.8% in 2022. While the shift of manufacturing operations to Cambodia may alleviate some of the declining gross profit trends, the nascent nature of the new sector (industrial park development in Cambodia) and higher operational costs still pose significant challenges to the company's profitability. Thus, the EBITDA margin is expected to further decrease from 23.7% in 2022 to 20.0% in 2023, reflecting increased challenges in generating operational profits.

## Financial Leverage Remains Low with Moderately Sufficient Liquidity

In recent years, Kasen maintained relatively low financial leverage, with a debt/capitalization ratio ranging between 18% and 19% from 2020 to 2022. The total adjusted debt, primarily consisting of bank borrowings and lease liabilities, decreased from RMB939.9 at the end of 2021 to RMB824.5 at the end of 2022, attributed to a strategic decision to cease leveraging for real estate land acquisitions.

Considering the projected capital expenditure of RMB1.2 billion to RMB1.4 billion annually for various overseas projects related to the Belt and Road Initiative to be constructed between 2023 and 2025, we anticipate a slight increase in Kasen's financial leverage to approximately 22%-26% over the next three years. The company's debt-servicing capacity, reflected in the total debt/EBITDA ratio, is expected to remain weak due to declining profitability and increasing financing needs. Furthermore, the EBITDA/Interest ratio may continue to deteriorate, falling below 2x in the next two years, following a significant decline to 3.2x in 2022 (2021: 9.1x).

Kasen had a cash balance and unused credit line of RMB460.3 million and RMB480 million at end-2022, compared to the company's short-term debt of RMB242.3 million at the same time. The quick ratio stayed between 0.7x-1x in the past three years. In addition, a significant portion of its fleets are unpledged, which can add flexibility in its debt and liquidity management. Most of the Kasen's credit facilities were renewed on an on-going basis, which provided sufficient cash to finance its working capital requirement in the past three years.

### Kasen's Debt Maturity Profile at End-2022

RMB million	Amount	Percentage (%)
2023	242.3	29.4%
2024	135.5	16.4%
2025-2027	176.7	21.4%
After 2027	270.0	32.7%
<b>Total</b>	<b>824.5</b>	<b>100.0%</b>

Source: Kasen and Lianhe Global's Calculation

## Key Assumptions

- Total revenue continues to decline in 2023 given the limited saleable GFA, the persistently downturn real estate market, and the reduction in overseas manufacturing orders, but start to stabilize and increase in 2024 and 2025 with the operation of the industrial parks in Cambodia.
- EBITDA margin to decrease to 17%-20% in 2023-2025
- Annual capital expenditure of RMB1.2-1.4 billion for 2023-2025
- Mainly relying on external financing to support capex thus a moderate increase in total debt in 2023-2025

## Key Financial Metrics

2021A-2025F	Debt/EBITDA	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	6.1x	2.5x	20.3%	1.0x

Note: the weight distribution of the financial metrics: 15% for the two preceding fiscal years, 35% for the current fiscal year, and 50% for the two succeeding fiscal years

Source: Kasen and Lianhe Global's adjustments and forecasts



## Appendix I: Kasen'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>1</sup></b>	<b>45.0%</b>	<b>bb+</b>
<b>III. Financial Analysis<sup>2</sup></b>	<b>40.0%</b>	<b>bb</b>
<b>IV. Base Score</b>	<b>100.0%</b>	<b>bb+</b>
<b>V. Industry Risk</b>		<b>bbb</b>
<b>VI. Qualifiers</b>		
Liquidity		Neutral
Corporate Governance		Neutral
Debt Structure and Financial Policy		Neutral
Idiosyncratic Analysis		Neutral
<b>Stand-Alone Creditworthiness</b>		<b>bb+</b>
<b>VII. External Support</b>		<b>N/A</b>
<b>Issuer Credit Rating</b>		<b>BB+</b>

*Source: Lianhe Global*

<sup>1</sup> Business Analysis contains sub-factors of market position, diversification, competitive position, operating efficiency and profitability.

<sup>2</sup> Financial Analysis contains sub-factors of debt/EBITDA, EBITDA interest coverage, debt/capitalization and quick ratio.

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