Lianhe Ratings Global

Non-rating Commentary
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Coronavirus Fuels the Pace of Change in the Industry Dynamics for Chinese Property Developers

Coronavirus outbreak, which began in China in December 2019 and has since spread across multiple regions, is affecting various economic activities in China. We believe Chinese property developers will experience decrease in contracted sales in the short-term and those with weaker financial profiles will be under liquidity pressure due to a slow-down in sales recognition and cash collection resulting from the delays in both the construction and presales fronts. Credit polarization in the Chinese property industry is expected to exacerbate as a result of the outbreak.

Weaker operation performance due to decreased sales

Due to the outbreak and spreading of the coronavirus, the Chinese government has taken measures to limit passenger travelling to and moving in many cities since the Lunar New Year. Many public places are shut down and closed. The China Real Estate Association also called for temporary closure of presale centers of its members on Jan 26th, and the date of resumption would depend on the development of the outbreak. We believe property sales will likely decrease in the short-term. According to public statistics, TOP100 property developers recorded sales of RMB510 billion in January 2020, representing an approximately 12% decrease compared with the same period last year. Even though the first quarter is usually the lowest season for property sales, we believe the drop has factored in the impact of the outbreak.

Meanwhile, construction schedules and presale activities will also likely be delayed, which will further weigh on Chinese property developers' sales and cash flow in 2020. Delayed projects in constructions will lead to a decrease in saleable resources, which will lead to a drop in contracted sales hence cash inflow. In addition, Chinese property developers have already been increasingly relying on cash collections from contracted sales to finance land purchases and repay indebtedness, and therefore we expect them to be more cautious on future investments. More importantly, Chinese property developers are faced with an operating environment that is more challenging than before. A slowing economy, regulatory constraints both on the financing and demand ends, as well as intensified competitions within the industry are what property developers will need to confront with in 2020 and onward.

Pressure for developers with weaker liquidity profiles and higher refinancing needs

Chinese property developers with weaker liquidity profiles and higher refinancing needs would be under liquidity pressure, thus weakening their debt servicing capabilities. In particular, property developers which have more exposure in lower tier cities, deploy a high turnover strategy and rely on non-bank/non-traditional financing channels will be most affected. Property sales in lower tier cities will likely be negatively impacted as demands from those migrant workers may be hampered during the outbreak. As a continuously high turnover strategy is unlikely to be deployed successfully, small-scale property developers which focus on this strategy will be under pressure to manage their cash flow. On the other hand, property developers who have high refinancing needs may not raise fund to meet their capital needs in a timely manner, which will further put pressure on their liquidity. In addition, property developers with a higher retail rental income contribution will face further weakening cash inflow if they further reduce tenants' rents and management fees in response to consumption disruptions from the outbreak.

Industry credit polarization to intensify

While we do not expect any material change of policy stance in 2020, we will not rule out any policy loosening under the "one city, one policy" stance especially with the outbreak. It is expected that stimulus measures could be taken in countering the possible negative impact on the Chinese property industry. The People's Bank of China has already taken measures to inject liquidity into the onshore financial markets since the first trading day after the Lunar New Year holidays to prevent unexpected market fluctuations and ensure liquidity.

We believe industry credit polarization will intensify in the next 12-24 months. Since late 2018, we noticed an increasingly pronounced polarization among Chinese property developers in terms of their delivery of revenue, execution of contracted sales, and management of financial leveraging, land purchase pace and liquidity. The coronavirus outbreak further exacerbates this polarization trend. We believe large property developers with leading market position, strong and diversified financing channels will have sufficient buffer to counter the negative impact and continue outperforming. Medium-sized property developers with a disciplined investments and decent operating efficiency will likely sustain. The same cannot be said for smaller property developers with low operating efficiency and high refinancing needs. We believe some smaller property developers may be forced out sooner given the current situation, as they tend to have fewer financial means to absorb the shocks.

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