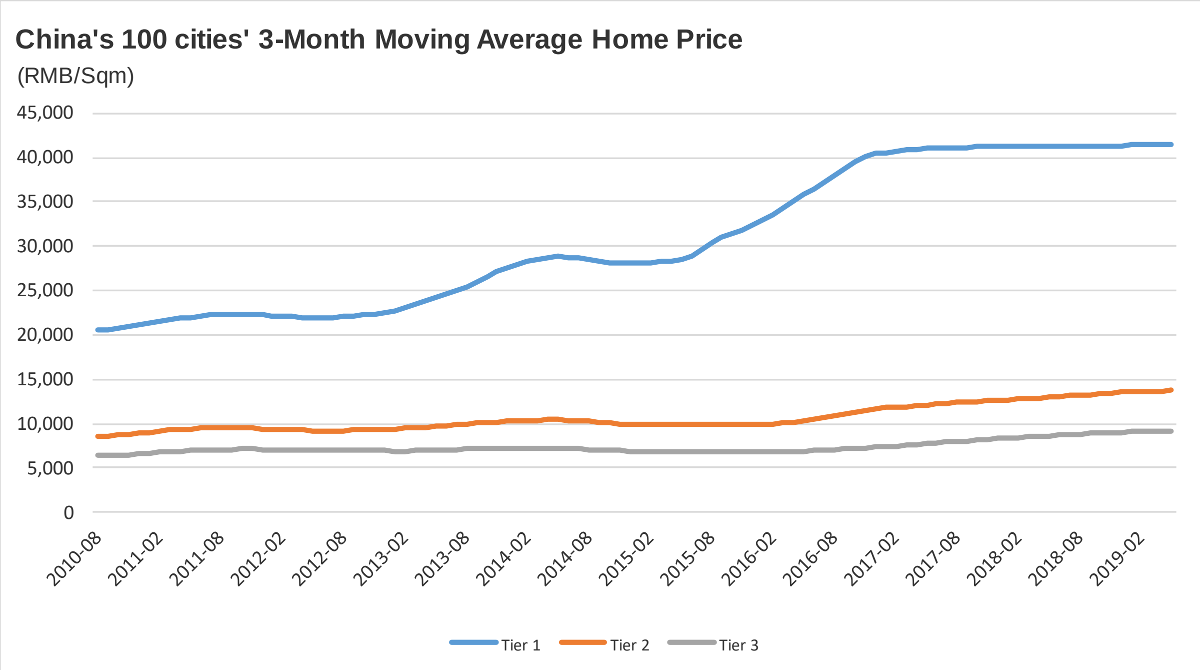
Mid-Year Review on Chinese Property Market Trend

Lianhe Global believes that contracted sales of Chinese property developers will experience a decelerated growth in 2019 as the Chinese government has placed restrictive measures on home purchases, selling prices, and mortgage financings to control the runaway home prices. As a result, the pace of home price growth has been levelling across all city tiers on aggregate since 1Q 2019 (Exhibit 1).

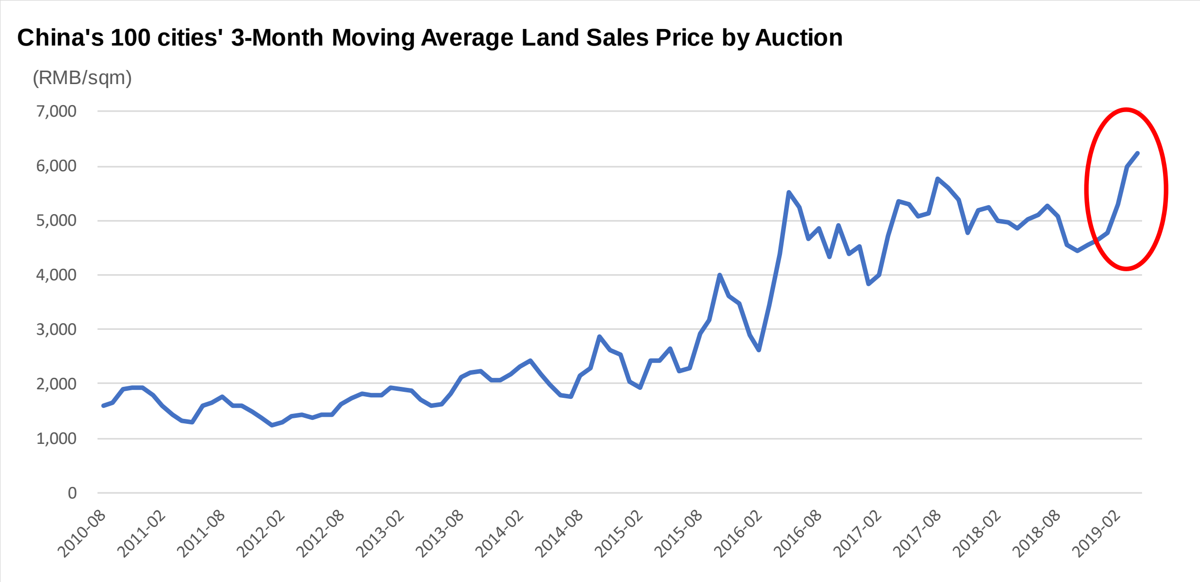
Exhibit 1: Levelling home prices as of recent



Source: WIND and Lianhe Global

Meanwhile, the Chinese land sales market has been thawing and land auction price has enjoyed a renewed growth in some higher-tier cities since 1Q 2019 (Exhibit 2). As such, we expect that margins of Chinese property developers will be under pressure as a result of rising land prices and levelling home prices in 2019. The Chinese government is expected to maintain a prudent control on external non-traditional financing channels, which will increase the funding costs for some property developers, especially the smaller and financially weaker property developers, for the remaining of 2019.

Exhibit 2: Rising Land Price



Source: WIND and Lianhe Global

For larger property developers, we believe that their financial metrics will improve in the coming 12 months. Most of them have been deleveraging since 2017. In addition, the larger players have competitive advantages on acquiring low-cost land and funding, as well as strong sales execution and cash collection ability which allow them to maintain a high operating efficiency to support their business operations and growth. We believe operating efficiency and funding ability will play an increasing role to differentiate the credit profiles of the larger players in the future.

For smaller regional players with more concentrated land portfolios than their peers, we believe they will increase leverages to expand operating scales beyond their home bases. After bottoming-out in 2018, investments in land has rebounded since 1Q2019 and has pushed up the land acquisition price in the market, especially in the second-tier cities with intense competition among property developers. Moreover, financing costs for smaller players are likely to remain elevated as the Chinese government is still regulating the overall financing channels, such as cutting shadow banking financing which was utilized heavily by some financially weaker players in the previous years. Investors have taken notice and become risk averse, and they have either moved up the credit spectrum or opted for shorter tenors. We believe that funding costs of smaller and financially weaker players will remain elevated in 2019, the maturity of their debts will be shorter and they are more likely to face margin compressions from rising land prices and levelling home prices.

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