

## **Lianhe Global has assigned ‘BB-’ global scale Long-term Issuer and Issuance Credit Ratings to LVGEM (China) Real Estate Investment Company Limited and its proposed USD notes; Issuer Rating Outlook is Stable**

HONG KONG, 20 February 2020 – Lianhe Ratings Global Limited (“Lianhe Global”), an international credit rating company, has assigned ‘BB-’ global scale Long-term Issuer Credit Rating to LVGEM (China) Real Estate Investment Company Limited (95.HK) (“LVGEM” or “the company”). The Outlook is Stable.

At the same time, Lianhe Global has assigned ‘BB-’ global scale Long-term Issuance Credit Rating to the proposed senior unsecured USD notes (“the USD notes”) to be issued by Gemstones International Limited and unconditionally and irrevocably guaranteed by LVGEM. Gemstones International Limited is a wholly-owned subsidiary of LVGEM.

LVGEM intends to use the net proceeds from the USD notes for refinancing its existing indebtedness.

### **Key Rating Rationales**

The USD notes are rated at the same level as LVGEM’s global scale Long-term Issuer Credit Rating of ‘BB-’ as they constitute LVGEM’s senior and unsecured obligations. LVGEM’s obligations for the USD notes shall rank pari passu with all its other present and future unsubordinated and unsecured obligations.

The Issuer Rating reflects LVGEM’s niche strategy and tactical arrangement with low-cost land acquisition of urban renewal projects, which results in higher than average-industry gross margins at approximately 60%. LVGEM acquires redevelopment projects mainly from its controlling shareholder’s ‘project incubator’ business units specializing in early-stage negotiations and relocation contract signings. By doing so, the company could contain the associated risks of redevelopment. LVGEM’s unique approach to shantytown redevelopment both largely shortens the timeline and reduces uncertainties.

The Stable Outlook reflects our expectation that LVGEM would expand its operating scale in a prudent manner with the anticipated inclusion of the marque Bai Shi Zhou redevelopment project in Nanshan District of Shenzhen which will likely strengthen its land bank quality and size while boosting its business scope regarding project portfolio and contracted sales. It also reflects our expectation that the company will maintain its operating metrics as well as financial leverages in the near-term.

**Small Operating Scale with Quality Land Bank:** Positioned as a regional niche property developer and operator with a relatively narrow geographical focus on its business in the Greater Bay Area (GBA), LVGEM’s residential and commercial property development businesses are primarily concentrated in Shenzhen, Zhuhai, Hong Kong, and other cities in

the GBA. LVGEM's operating scale is relatively small, as its total land bank by GFA at end-June 2019 was only 4.4 million square meters and its contracted sales amount for the first six months of 2019 was about RMB 4 billion.

Nonetheless, LVGEM's core focus on the GBA gains competitive advantages over the other property developers and competitors with higher sellable asset values as the average price in the area is higher. This partially offset its small operating scale in terms of contracted sales metrics, land bank, and limited number of projects under development.

**Unique Business Model with Niche Strategy and Industry Know-How:** LVGEM focuses on developing undervalued shantytown renewal projects in the GBA with its value-add expertise, industry-specific knowledge, and 25-year experience in the urbanization business. The company differentiates its niche strategy in various aspects from its business strategy to the nitty gritty details in different phases of the redevelopment timeline which involves frequent discussion with local governments, collective negotiation with the associations of incumbent residents, meticulous execution of project plans, and adequate funding management.

**Exceptionally High Gross Margin:** LVGEM reported above-average gross margins of 65.3%, 59.5% and 70.0% in 2017, 2018 and 1H2019, respectively, primarily because of the company's low-cost land acquisition strategy and its redevelopment projects being in prime locations of the GBA. The company currently holds 25% ownership of the Bai Shi Zhou redevelopment project in Nanshan District of Shenzhen and plans on acquiring the rest within the rating monitoring period. We expect the company to maintain its high margin in the next 12 to 24 months given its successful project execution track records.

**Development Timeline Susceptible to Multiple Contributing Factors and Policy Risks:** As the urban renewal business often involves various correlative elements and rather complex redevelopment process, the company from time to time faces different risks throughout the trajectory of work-in-progress. Some challenges could take lengthy time to resolve. Each step within the redevelopment process also varies materially among different projects and some of them would require extension/reschedule as any lagging in certain stages could delay the whole series of processes and ultimately project delivery. LVGEM's core competency, project management, and strategic focus in such arena will help alleviate the associated risks to a certain extent.

**High Financial Leverages and Tight Liquidity:** The company reported high financial leverages as measured by a debt over capitalization ratio at above 65% and a weak interest coverage at about 2x at end-2018. The company reported an unrestricted cash balance of RMB 5.84 billion and an unutilized bank credit line of RMB 2.55 billion against a short-term borrowing of RMB 4.37 billion and commitments of RMB 1.67 billion at end-June 2019. Notwithstanding, we believe these constraints would be partially mitigated through its future cash collections from contracted sales in 2020 and 2021 estimated at approximately RMB 15 billion in aggregate.

## Rating Sensitivities

We would consider downgrading LVGEM's rating if it were to aggressively replenish its land bank which result in an increase in its financial leverage as measured by debt/capitalization to over 80% or a decrease in its EBITDA interest coverage to below 2.0x consistently, and/or 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 LVGEM's rating if it were to (1) considerably increase its operating scale, and (2) maintain its financial leverage as measured by debt/capitalization at below 60% or EBITDA interest coverage at above 3x consistently.

Any rating action on LVGEM's rating would result in a similar rating action on the USD notes.

### **About Lianhe Global**

Lianhe Global is an international credit rating company that provides credit ratings to corporations, banks, non-bank financial institutions, local government financing vehicles, and other asset classes around the globe. Lianhe Global also provides credit risk research and other services related to credit ratings.

### **Rating Methodology**

The principal methodology used in this LVGEM's rating is Lianhe Global's General Corporate Rating Criteria published on 16 July 2018 which can be found at the website [www.lhratingsglobal.com](http://www.lhratingsglobal.com).

**Note:** The above Issuer/Issuance Credit Ratings are solicited at the request of the rated entity or a related third party.

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