

Fujian Yango Group Co., Ltd

Initial Issuer Report

Summary

Issuer Rating	BB-
Outlook	Stable
Location	China
Industry	Conglomerate
Date	23 September 2019

Operating Data:

Fujian Yango Group Co., Ltd

	31 Dec 2017	31 Dec 2018
Revenue (RMB: in million)	58,543	86,386
Contracted Sales (RMB: in million)	91,530	162,856
Contracted Average Selling Price (RMB/square meter)	13,881	12,860
Contracted Sales GFA (million square meters)	6.59	12.66
Land Bank GFA (million square meters)	38.32	44.18

GFA: Gross Floor Area
Source: Fujian Yango's and Yango's annual reports and Lianhe Global

Lianhe Ratings Global Limited ("Lianhe Global") has assigned 'BB-' global scale Long-term Issuer Credit Rating to Fujian Yango Group Co., Ltd. ("Fujian Yango"). The Outlook is Stable.

Summary

The Issuer Rating reflects Fujian Yango's leading market position and brand recognition in the Chinese property market operated by its main subsidiary Yango Group Company Limited ("Yango", 'BB-/Stable), high financial leverage and moderately weak profitability. The rating also considers Fujian Yango's standalone moderate liquidity with significant debt.

The Stable Outlook reflects our expectation that Fujian Yango would continue maintaining a controlling stake in Yango, which would acquire new land in a measured manner, and would be prudent in non-property acquisitions. This will help moderately improve its financial leverage and EBITDA interest coverage in the following 12 to 24 months.

Rating Rationale

Yango the Main Earnings Contributor: Fujian Yango was engaged in property development as the largest shareholder of Yango with 34.3% ownership at end-1Q 2019 or 44.5% including the shares held by Fujian Kangtian Industry Group Co., Ltd. acting in concert with Fujian Yango. Yango contributed over 50% revenue and 70% net profit to Fujian Yango between 2015 and 2018, and constituted over 80% of Fujian Yango's total assets at end-2018. Fujian Yango has consolidated Yango into its financial statements and appointed 5 directors (including Mr. Lin Tengjiao) out of a total of 11 seats (including 4 independent directors) on Yango's Board of Directors.

Sizable and Diversified Land Bank Supports Future Growth: Yango builds its land bank portfolio by focusing on Greater Fujian, the Yangtze River Delta, Beijing, Tianjin and Hebei Region, and the Pearl River Delta, while selectively entering into the other provincial and satellite cities in central and western China. Yango expanded its land bank by almost fourfold to 44.18 million square meters (across 59 cities in China) at end-2018 from 13.07 million square meters at end-2015. The sizable and diversified land bank helped boost its contracted sales growth from 2016 to 2018 with an annual growth rate of more than 60% and will be sufficient to support its contracted sales for the next 3.5 years. Yango's total contracted sales were RMB162.9 billion in 2018, placing it among the top 15 property developers in China.

High Leverage Key Constraint: Fujian Yango's consolidated financial leverage (gross debt to capitalisation) was still high at 74.4% at end-2018 mainly due to Yango's aggressive debt-funded land acquisition and other business expansions. Its end-2018 reported debt of RMB133.1 billion included RMB57.6 billion short-term debt and RMB75.5 billion long-term debt. The large debt burden has resulted in a low EBITDA interest coverage of 0.9x in 2018. Yango has decelerated its expansion and reined in its debt-funded land acquisition since 2018. Meanwhile, Yango has enhanced its operating efficiency to shorten the cash collection cycle of property development projects. We expect this to moderately improve Fujian Yango's overall financial leverage and interest coverage.

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Applicable Criteria

General Corporate Rating Criteria (16 July 2018)

Other Businesses Add Diversity but Small Contribution: Fujian Yango has ventured into the other businesses to expand its business scope and diversity. The commodity trading segment accounted for around 20%-30% of Fujian Yango's total revenue between 2015 and 2018, with very low gross margin of below 1%. Fujian Yango acquired shares of Fujian Longking Co., Ltd. ("Longking") to enter into the environmental protection industry in 2017, and had 25.04% shares of Longking as of end-2018. Longking has a leading position in manufacturing air pollution protection equipment and contributed about 10% of Fujian Yango's total revenue in 2018, while Fujian Yango's education segment accounted for less than 1%. Fujian Yango has also invested in some financial institutions, including a 1.08% stake in Industrial Bank Co., Ltd. and a 3.64% stake in Jiangxi Bank Co., Ltd. at end-2018.

Standalone Moderate Liquidity: Fujian Yango has significantly relied on debt financing to support its equity investment and operation and has moderate liquidity, with the cash balance of RMB3.1 billion versus the short-term debt of RMB3.9 billion (including current portion of long-term debt) as of end-1Q 2019. Fujian Yango has been able to refinance by using its credit facilities, including bank loans and onshore and offshore bonds. While Fujian Yango has pledged most of its Yango shares, its non-pledged equity portfolio can provide itself flexibility in managing its liquidity.

Rating Sensitivities

We would consider downgrading Fujian Yango's rating if it were to pursue aggressive business expansions (such as aggressive replenishment of Yango's land bank) which results in an increase in its financial leverage as measured by its EBITDA interest coverage consistently below 0.8x or a gross debt to capitalisation ratio at above 80%, or its operating performance were to deteriorate such that either its property contracted sales or cash flow from operating activities experience a material decline.

We would consider upgrading Fujian Yango's rating if it were to lower its financial leverage as measured by a debt to capitalisation ratio at below 60% and improve profitability as measured by gross margin at over 25% consistently.

In addition, we would consider reassessing Fujian Yango's credit profile should Fujian Yango significantly reduce its shareholdings in Yango or have a material expansion into the other businesses.

Company Profile

Fujian Yango has businesses across real estate development, commodity trading, environmental equipment manufacturing and educational services. Fujian Yango generates cash flow mainly from its operating subsidiaries, among which Yango is the Group's major subsidiary and property development platform, representing over 80% of Fujian Yango's total assets at end-2018. Fujian Yango started to engage in the environmental equipment manufacturing business in 2017 and held 25.04% shares of Longking, including 17.17% via the investment in Longking Industrial Group Co., Ltd and 7.87% through trust schemes at end-2018. Fujian Yang has also invested in some financial institutions, including a 1.08% stake in Industrial Bank Co., Ltd, and a 3.64% stake in Jiangxi Bank Co., Ltd. at end-2018, with a total investment amount at cost of RMB5.1 billion.

Ms. Wu Jie and Mr. Lin Tengjiao were the two largest shareholders of Fujian Yango totally holding 89.34% of Fujian Yango at end-1Q 2019. Ms. Wu has 89.34% of the voting right in Fujian Yango according to the acting in concert agreement with Mr. Lin. Ms. Wu currently is the chairman of Fujian Yango, and Mr. Lin is the chairman of Yango. Fujian Yango's Board has three seats in total, including one chairman elected by the members. Fujian Yango does not set up the Board of Supervisors, but has one supervisor, which is elected by Shareholders' Meeting.

Fujian Yango was the largest shareholder of Yango with 34.3% ownership at end-1Q 2019 or 44.5% including the shares held by Fujian Kangtian Industry Group Co., Ltd. acting in concert with Fujian Yango (Appendix II). Fujian Yango has consolidated Yango into its financial statements and appointed 5 directors (including Mr. Lin Tengjiao) out of a total of 11 seats (including 4 independent directors) on Yango's Board of Directors.

Exhibit 1: Fujian Yango's Main Subsidiaries at End-2018

RMB million	Shareholding (%)	Voting Rights (%)	Total Asset	Operating Revenue
Yango Group Company Limited	33.24	43.41	263,397	56,470
Longking Industrial Group Co., Ltd	100	100	5,477	3
Tibet Yango Environmental Technology Co., Ltd	51	51	4,422	0
Shanghai Shengsha Hotel Investment and Management Co., Ltd	100	100	781	8
Fuzhou Yango International School	100	100	109	34

Source: Fujian Yango and Fujian Yango's 3rd Bond Offering Circular on 12 June 2019

Business Profile

Yango the Core Business and Main Earnings Contributor

Yango is one of the major property developers in China which contributed over 50% revenue and 70% net profit to Fujian Yango between 2015 and 2018, and constituted over 80% of Fujian Yango's total assets at end-2018 (Exhibit 2). Yango's total contracted sales achieved RMB162.9 billion in 2018, placing it among the top 15 property developers in China.

Yango builds its land bank portfolio by focusing on Greater Fujian, the Yangtze River Delta, Beijing, Tianjin and Hebei Region, and the Pearl River Delta, while selectively entering into other provincial and satellite cities in central and western China. Yango expanded its land bank by almost fourfold to 44.18 million square meters (across 59 cities in China) at end-2018 from 13.07 million square meters at end-2015. The sizable and diversified land bank helped boost its contracted sales growth from 2016 to 2018 with an annual growth rate of more than 60% and will be sufficient to support its contracted sales for the next 3.5 years.

Please refer to Yango's Issuer Report published on 31 May 2019 for Yango's detailed credit analysis.

Exhibit 2: Yango's Contribution to Fujian Yango

RMB million	Yango			Fujian Yango			% of Fujian Yango		
	2016	2017	2018	2016	2017	2018	2016	2017	2018
Revenue	19,598	33,163	56,470	28,350	58,543	86,386	69.1	56.7	65.4
Net Profit	1,431	2,228	3,906	1,509	3,165	4,581	94.9	70.4	85.3
Total Asset	120,431	213,250	263,397	133,160	247,384	308,802	90.4	86.2	85.3
Gross Debt	68,073	120,721	128,466	75,251	128,657	135,417	90.5	93.8	94.9
Total Equity	18,924	30,570	41,030	23,833	39,499	50,716	79.4	77.4	80.9

Source: Yango's and Fujian Yango's annual reports, Lianhe Global's calculation

Venture into Other Business but Contribution Still Small

Fujian Yango has ventured into the other businesses to expand its business scope and diversity. The commodity trading segment accounted for around 20%-30% of Fujian Yango's total revenue between 2015 and 2018, but with very low gross margin of below 1% and mostly from non-ferrous metal trades. Fujian Yango has kept low inventories in the trading business although it has certain concentration of suppliers and purchasers. Fujian Yango slowed the trading business in 2016 given the downward pressure on the non-ferrous metals industry and grew in 2017 as the industry recovered. The management aims to maintain the trade revenue at around RMB20 billion a year while expanding the types of products (e.g. rubber and steel) to minimise the impact of cyclicity.

Longking has a long operating history of over 40 years in the environmental protection industry in China and owns a leading position in manufacturing air pollution protection equipment, including the design, manufacture, and installation of dust removal equipment and flue-gas desulfurisation equipment. It has manufacturing bases and R&D centres in Beijing, Shanghai, Xi'an, Wuhan, Tianjin, Suqian, Yancheng, Xinjiang with total assets of RMB18.9 billion at end-2018 and has expanded into other fields such as industrial wastewater treatment, VOC treatment, and ecological restoration. Longking became a listed company on the Shanghai Stock Exchange in 2000 (Stock Code: 600388). With its established market position and brand recognition, Longking has been expanding its business scale and scope to underpin growth and contributed about 10% of Fujian Yango's total revenue in 2018. As China is still developing the heavy chemical industry and continues to raise standards for air pollutant emissions, we expect that the demand for air pollution protection equipment would remain promising.

Fujian Yango's education sector represented less than 1% of total revenue in the past three years, although the gross margin has been high at more than 30%. The development of private education expands the supply of educational services to make up for the shortage of public education resources and provides a variety of educational services to meet market needs. Fujian Yango mainly undertakes an asset-light model by cooperating with local governments or property owners and provides private educational services from preschool to college. The management is optimistic about the prospects of the education industry and continues to develop in this sector, leading to an ongoing rise in revenue and the number of students. Fujian Yango has established Yango College, Yango International School, Peking University Peiwen School, Yango Pre-school Education, etc. with more than 30,000 students (excluding kindergartens) and about 200 kindergartens in China.

Exhibit 3: Fujian Yango's Revenue Breakdown by Business Type

RMB million	2016		2017		2018	
	Revenue	Gross Margin (%)	Revenue	Gross Margin (%)	Revenue	Gross Margin (%)
Sales of Properties	19,370	23.1	32,769	24.6	55,521	25.6
Commercial Trading	8,488	0.2	19,767	0.2	19,710	0.4
Environmental Equipment Manufacturing	-	-	5,039	24.5	9,214	23.8
Educational Service	227	47.0	300.0	32.5	436	31.2
Others	89	28.7	211	35.5	722	45.9
Total	28,174	16.4	58,086	16.4	85,602	19.8

Source: Fujian Yango and Lianhe Global's Calculation

Financial Profile

High Financial Leverage to Support Business Activities

Fujian Yango's consolidated financial leverage (gross debt to capitalisation) was still high at 74.4% at end-2018 mainly due to Yango's aggressive debt-funded land acquisition and other business expansions. Yango has decelerated its expansion and reined in its debt-funded land acquisition since 2018. Meanwhile, Yango has enhanced its operating efficiency to shorten the cash collection cycle of property development projects. We expect this to moderately improve Fujian Yango's overall financial leverage and gross debt to EBITDA.

We consider Fujian Yango's debt maturities are adequately distributed while it has the access to various financing channels, including bond issuances, bank borrowings, and equity capital markets through its public-listed subsidiaries. About 92% of its debt as of end-2018 was RMB denominated while the remaining was in USD for its business needs. 43.3% (RMB57.6 billion) of the debt will be due in 2019 and 23.8% (RMB31.6 billion) in 2020, according to the information provided by Fujian Yango. Fujian Yango had a credit line totalling RMB116.4 billion, of which RMB68.4 billion was used at end-2018. It has a RMB18.3 billion approved onshore bond issuance quota and a USD1.63 billion offshore bond issuance quota available at end-2018.

Fujian Yango reported RMB4.3 billion guarantees to unrelated third parties at end-2018, which was a RMB1 billion cut from RMB5.4 billion at end-2017. Fujian Yango's guarantees to related parties reached RMB14.7 billion at end-2018 (mainly for property development projects). We treat Fujian Yango's guarantees to unrelated third parties as debt in calculating its leverage ratios.

Exhibit 4: Fujian Yango's Debt Maturity Profile at End-2018

RMB million	Amount	Percentage (%)
2019	57,641	43.3
2020	31,637	23.8
2021	30,186	22.7
2022 and thereafter	13,703	10.3
Total	133.167	100.0

Source: Fujian Yango's 3rd Bond Offering Circular on 12 June 2019

Significant Indebtedness Constrains Liquidity

Fujian Yango's quick ratio was very low in the range of 0.25x-0.35x in 2016-2018, due to its large inventories from property business and restricted assets as well as significant indebtedness. Fujian Yango's restricted assets reached RMB77.6 billion at end-2018 (25% of its total asset at end-2018), including RMB61 billion inventories and RMB6.5 billion cash. It had RMB44.1 billion cash on hand compared with its RMB57.6 billion debt due within one year as of end-2018. Fujian Yango had improved its EBITDA interest coverage to 0.9x in 2018 from 0.5x in 2016 and 0.6x in 2017. We expect the interest coverage to continue to improve, benefitting from the increasing revenues from the property sales and education business.

At the parent level, Fujian Yango has significantly relied on debt financing to support its equity investment and operation and has standalone moderate liquidity, with the cash balance of RM3.1 billion versus the short-term debt of RMB3.9 billion (including current portion of long-term debt) as of end-1Q 2019. Fujian Yango has been able to refinance by using its credit facilities, including bank loans and onshore and offshore bonds. While Fujian Yango has pledged most of its Yango shares, its non-pledged equity portfolio can provide itself flexibility in managing its liquidity. Fujian Yango's cash income mainly comes from dividends and its education business, which would remain relatively small compared with its annual interest expense of more than RMB600 million.

Moderately Weak Profitability

Fujian Yango has maintained gross profit margins of about 17%-21% between 2016 and 2018. Fujian Yango's relatively high margin from property business was partially offset by its low-margin trading business. We expect the gross profit margin to increase only slightly as the revenue increase in low-margin trading business would reduce the positive impact of the revenue contribution from higher margin segments.

Key Assumptions

- Attributable contracted sales amount for the property business: RMB126-207 billion for 2019-2021
- Cash collection rate for the property business: 80% for 2019-2021
- Land acquisition expenditures for the property business: 55% of cash collected from annual contracted sales for 2019-2021
- Annual revenue growth rate for the trading business: 5% for 2019-2021
- Cash dividend payout ratio: 13.8% for 2019-2021

Key Financial Metrics

2017A-2021F	Debt/EBITDA	EBITDA/Interest	Debt/Capitalisation	Quick Ratio
Weighted Average	13.53x	1.11x	73.31%	0.25x

Source: Fujian Yango's 2017-2018 annual reports and Lianhe Global's adjustments and forecasts



Appendix I: Fujian Yango's Rating Factors

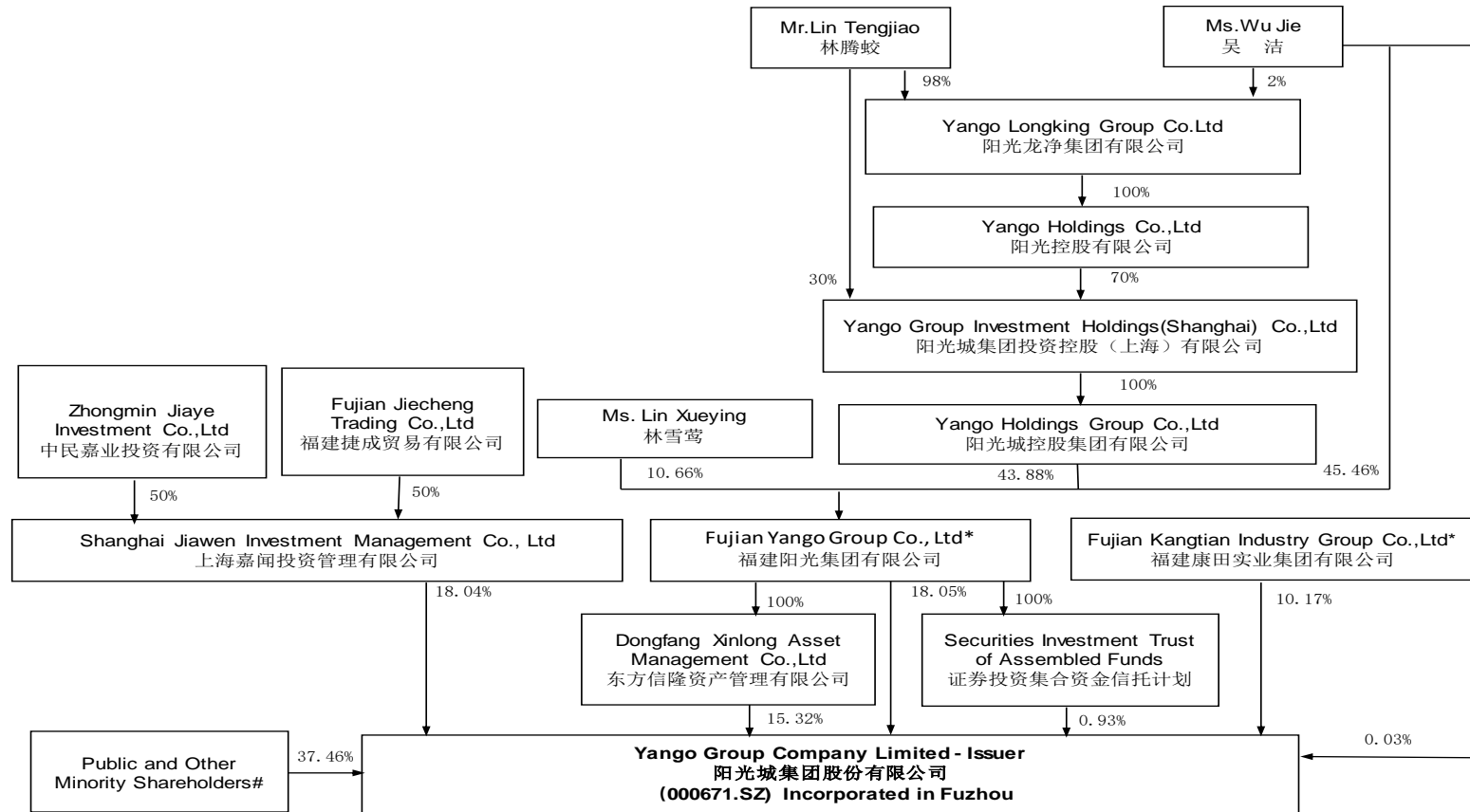
Rating Factors	Weight	Initial Rating
I. Market Demand Analysis	15.0%	a-
II. Business Analysis¹	45.0%	bbb-
III. Financial Analysis²	40.0%	ccc
IV. Base Score	100.0%	bb-
V. Industry Risk		bbb
VI. Qualifiers		
Liquidity		Neutral
Corporate Governance		Neutral
Debt Structure and Financial Policy		Neutral
Idiosyncratic Analysis		Neutral
Stand-Alone Creditworthiness		bb-
VII. External Support		N/A
Issuer Credit Rating		BB-

Source: Lianhe Global

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

² Financial Analysis contains sub-factors of debt/EBITDA, EBITDA interest coverage, debt/capitalisation and quick ratio.

Appendix II: Fujian Yango's Organisation Chart at End-March 2019



Note:

*Fujian Yango Group Co., Ltd and Fujian Kangtian Enterprise Co.,Ltd are companies acting in concert.

#Other Minority Shareholders each shares holding not exceeding 5%.

Source: Yango and Lianhe Global

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