

Redsun Properties Group Limited

Initial Issuer Report

Summary

Issuer Rating	BB-
Outlook	Stable
Location	China
Industry	Homebuilder and Real Estate
Date	14 May 2019

Operating Data:

Redsun Properties Group Limited

	2017	2018
Revenue (RMB: in million)	6,140	9,239
Contracted Sales* (RMB: in million)	13,594	24,343
Contracted Average Selling Price* (RMB/square meter)	15,602	13,235
Contracted Sales GFA* (million square meters)	0.87	1.80
Land Bank GFA (million square meters)	5.52	7.23

*Attributable
 GFA: Gross Floor Area
 Source: Redsun

Lianhe Ratings Global Limited (“Lianhe Global”) has assigned a ‘BB-’ global scale Long-term Issuer Credit Rating to Redsun Properties Group Limited. The Outlook is Stable.

Summary

The Issuer Rating reflects Redsun Properties Group Limited (“Redsun” or “the company”)’s proven operating track record and continuous expansion into tier 2 and 3 cities, especially in the Yangtze River Delta Region. However, Redsun’s rating is constrained by its small operating scale, weak competitiveness in land acquisition, moderately high financial leverage and lower-than-peer interest coverage.

The Stable Outlook reflects our expectation that Redsun would replenish its land bank portfolio and expand its operating scale in tier 2 and 3 cities while managing its debt growth cautiously commensurate with credit profiles in the ‘BB’ category.

Rating Rationale

Small Operating Scale with a Focus on Tier 2 and 3 Cities: Redsun’s operating scale was small as its total land bank by gross floor area (“GFA”) and contracted sales at end-2018 were only 13 million square meters (attributable at 7.2 million square meters) and RMB47 billion (attributable at RMB24 billion) respectively. Redsun was ranked 60th in terms of contracted sales amount and 58th in terms of contracted sales GFA in 2018, improving from 95th and 109th in 2017, respectively, according to CRIC Information Centre’s statistics. Redsun has a leading position in Nanjing and Jiangsu, as it expands continuously in the Yangtze River Delta by targeting key tier 2 and 3 cities across the region. Redsun is pursuing an above-market-average contracted sales growth of 30%.

Proven Operating Track Record in the Yangtze River Delta: Headquartered in Shanghai and Nanjing, Redsun has exhibited a proven operating track record in the Yangtze River Delta Region, especially in Nanjing. Since its establishment in 1996, Redsun has operated its property development business in 28 cities across China, of which around 16 cities are among the core cities in the Yangtze River Delta Region. However, due to its small market share, Redsun’s competitiveness in acquiring low-cost land, especially in tier 2 cities, is relatively weak. Redsun has been strengthening its competitiveness by cooperating with other property developers in acquiring new land in the past 2 years. The percentage of land acquisition GFA from Joint Venture (“JV”) projects increased to 47.4% in 2018 from 25.2% in 2017. The average acquisition cost of its land bank was lower than the peers that operated in the Yangtze River Delta Region (2017: RMB 4,170/square meter; 2018: RMB 4,614/square meter). We project that Redsun’s capacity of acquiring low-cost land in tier 2 and 3 cities would further improve its profitability. However, the company faces fierce competition in tier 2 cities, which is Redsun’s core market, for land replenishment to support its contracted sales growth in the following 12 to 24 months.

Moderately High Leverage: In 2018, Redsun continued to replenish its land bank in tier 2 and 3 cities in the Yangtze River Delta Region. The overall new land acquisition expenditure decreased to RMB16.2bn from RMB 25.4bn (in 2017) largely due to the company’s deleveraging effort to accommodate its Initial Public Offerings (“IPO”) campaign in June

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Applicable Criteria

[General Corporate Rating Criteria \(16 July 2018\)](#)

2018. The company decreased its net gearing ratio to 68.3% in 2018 from 87.7% in 2017 (Source: Redsun's FY2018 earnings announcement). Redsun has indicated that it would grow at a faster pace in terms of contracted sales than the industry average growth rate. We expect the company to grow its contracted sales at about 30% in 2019.

Rating Sensitivities

We would consider downgrading Redsun's rating if it were to aggressively replenish its land bank which results in an increase of its financial leverage as measured by an EBITDA interest coverage ratio to decrease to 1.0x or a debt over land bank ratio to increase to above 70% or a gross margin to fall below 25%.

We would consider upgrading Redsun's rating if it were to expand its operating scale while decreasing its financial leverage as measured by a debt over capitalization ratio at below 60% and improving its debt over land bank ratio at below 50% and increasing its EBITDA interest coverage ratio at above 3x consistently.

Company Profile

Redsun Properties Group Limited is a Chinese property developer, established in 1996, with its major business focus in the Yangtze River Delta Region. Headquartered in Shanghai and Nanjing, Redsun has been listed on the Hong Kong Stock Exchange (1996.HK) since 2018. Redsun is majority owned by Mr. Zeng Huansha (72.29%). (EXHIBIT 1)

Redsun's property development segment contributed over 95% of the revenue to the company in the past 4 years. In addition to property development, the company also conducts commercial property investment and hotel operations in China. These two segments' revenue contributions to Redsun were limited as they accounted for less than 5% in aggregate from 2015 to 2018. However, rental and hotel operations have provided Redsun with a stable income. The combined revenue from these two segments almost doubled in 2018 from the prior year (EXHIBIT 2). Redsun is now planning to expand its business in these two segments.

Exhibit 1: Redsun's Shareholder Structure as of 30 June 2018

Shareholder	Percentage
Mr. ZENG Huansha#	72.29%
Mr. HE Jie*	0.23%
Public	27.48%
Total	100.00%

Note:

#Mr. ZENG Huansha held 72.29% of Redsun through Hong Yang Group (Holdings) and Redsun Properties Group (Holdings). Mr. ZENG is the Chairman of Redsun.

*Mr. HE Jie is the Chief Executive Officer of Redsun.

Source: Redsun

Exhibit 2: Redsun's Revenue Breakdown by Business Segment (RMB: in million)

Revenue / % of total	FY2015		FY2016		FY2017		FY2018	
Property development	5,124	95.30%	8,549	97.42%	5,938	96.72%	8,843	95.72%
Commercial Property Investment and Operation	227	4.22%	193	2.20%	166	2.71%	359	3.89%
Hotel Operations	26	0.48%	33	0.38%	35	0.57%	37	0.40%
Total	5,377	100.00%	8,775	100.00%	6,140	100.00%	9,239	100.00%

Source: Redsun

Business Profile

Market Position

Redsun's size is small as measured by both contracted sales and land bank when compared with other Chinese property developers. It was ranked 60th in terms of contracted sales and 58th in terms of contracted sales GFA at end-2018, improving from 100th and 112nd in 2016, respectively, according to CRIC Information Centre's statistics (EXHIBIT 3 & 4). However, Redsun's attributable contracted sales at RMB 24.34bn accounted for approximately half of the reported contracted sales of RMB 44.12bn in 2018. Likewise, it was the same case for Redsun's attributable contracted sales GFA. Given the company's targeted contracted sales growth rate of 30%, we expect Redsun to deliver higher figures in the next 2 years.

Exhibit 3: Redsun's Rankings by Contracted Sales Among Chinese Property Developers

Amount / Ranking	FY2016		FY2017		FY2018		Ranking Change (2018 verse 2016)
Contracted sales amount *	15.68	100 th	17.81	95 th	44.12	60 th	+40
Contracted sales by GFA #	1.07	112 nd	1.07	109 th	3.28	58 th	+54

Note:

*The contracted sales amount is based on statistics from CRIC. Differences may exist between the company's reported amount as a different calculation method was applied. The amount is in RMB billion.

The contracted sales GFA is based on statistics from CRIC. Differences may exist between the company's reported amount as a different calculation method was applied. The amount is in million square meters.

Source: CRIC Information Centre

Exhibit 4: Redsun's Rankings by Land Bank and New Land Acquisition Among Chinese Property Developers

Amount / Ranking	FY2017		FY2018	
New acquisition land bank by value	RMB 67.32bn	38 th	RMB 33.61bn	57 th
New land acquisition by GFA	5.08mn sqm	41 st	2.69mn sqm	55 th

Note:

sqm: square meters

The amount is based on statistics from CRIC. Differences may exist between company's reported amount as a different calculation method was applied.

Source: CRIC Information Centre

Small Operating Scale with a Focus on Tier 2 and 3 Cities

Redsun has a leading position in Nanjing and Jiangsu, expanding continuously in the Yangtze River Delta by targeting key cities across the region as its strategy.

In 2018, Redsun recorded contracted sales of approximately RMB47.3 billion, representing an increase of 84.2% from the previous year. The contracted sales in GFA of the company was approximately 3,528,491 square meters, representing an increase of 107.8% from the previous year. The increase was due to the fast expansion of the company resulting in the gradual realization of sales from the previously acquired projects.

As of December 31, 2018, there were a total of 75 projects under construction with an aggregate planned GFA of 9,691,324 square meters (attributable at 5,135,844 square meters). There was a total of 29 properties for future development with an aggregate planned GFA of 2,678,659 square meters (attributable 1,436,903 square meters). (Source: Redsun 2018 Annual Results Announcement)

At end-2018, Redsun had an attributable land bank of approximately 7.23 million square meters, of which approximately 85% was in tier 2 cities or approximately 77% was in the Yangtze River Delta Region. (EXHIBIT 5 & 6 & 7)

Exhibit 5: Redsun's land bank breakdown by city tier at end-2018

Land bank (square meters)	GFA	% of total	Attri. GFA	% of total	Major cities
Tier 2	10,523,036	80%	6,116,806	85%	Nanjing, Suzhou, Changzhou, Zhenjiang, Chuzhou, Yangzhou
Tier 3 & Tier 4	2,561,340	20%	1,114,805	15%	
Total	13,084,376	100%	7,231,611	100%	

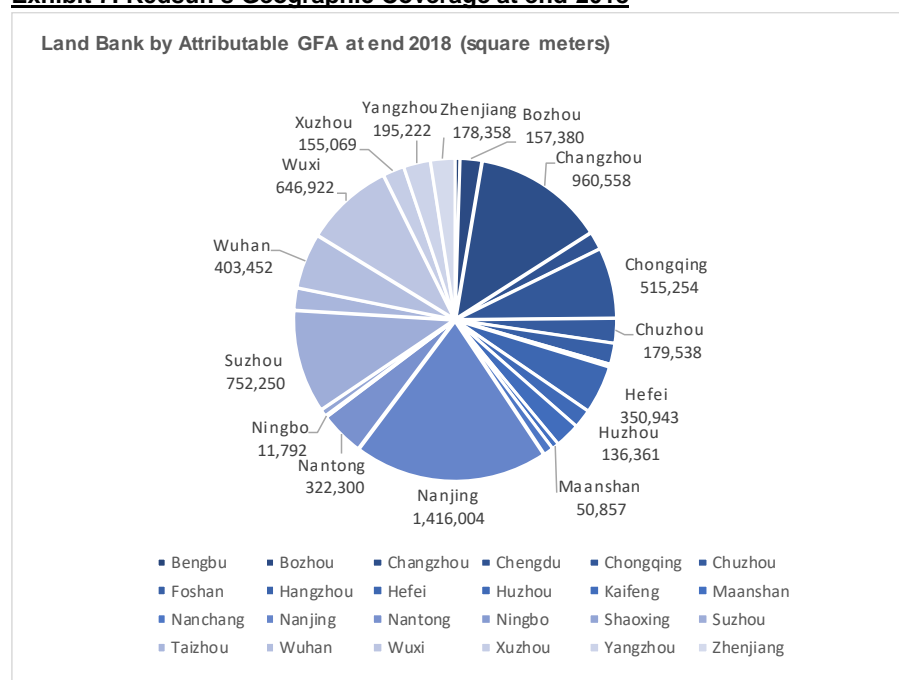
Source: Redsun

Exhibit 6: Redsun's land bank breakdown by region at end-2018

Land bank (square meters)	GFA	% of total	Attri. GFA	% of total	Major cities
Yangtze River Delta	11,100,124	85%	5,586,118	77%	Nanjing, Suzhou, Wuxi
Central regions	1,068,375	8%	1,047,310	14%	Wuhan, Chengdu, Chongqing
Other	915,877	7%	598,183	8%	Bozhou, Foshan, Kaifeng
Total	13,084,376	100%	7,231,611	100%	

Source: Redsun

Exhibit 7: Redsun's Geographic Coverage at end-2018



Source: Redsun and Lianhe Global

Operating Track Record in the Yangtze River Delta

Since its establishment in 1996, Redsun, based in Shanghai and Nanjing (dual headquarters), has a proven operating track record in the Yangtze River Delta Region, especially in Nanjing. Redsun has been operating its property development business in 28 core cities in the Yangtze River Delta Region. Redsun has been strengthening its competitiveness by cooperating with other property developers in acquiring quality new land.

Due to its small market share, Redsun employs a JV and mergers and acquisitions (“M&A”) strategy to gain access to land in tier 2 & 3 cities. The average land acquisition cost was lower than the peers that operate in the Yangtze River Delta Region (2017: RMB 4,170/square meter; 2018: RMB 4,614/square meter).

In 2017, Redsun relied primarily on (i.e. 91%) open auctions for land acquisition. Started in 2018, Redsun acquired 34% of its land via JV and M&A activities which was conducive to expand its footprint in the Yangtze River Delta Region. In general, Redsun would cooperate with large and well-established local property developers with a quick inventory turnover strategy. However, we believe that the fierce competition in the Yangtze River Delta Region, which is Redsun’s core market, is likely to impose pressure on Redsun’s land acquisition expenditure and profitability.

Strong Execution and Focus on Commercial Real Estate and Valued-added Services to Boost Revenue

Given the fierce competition in the Yangtze River Delta Region, Redsun strives to distinguish itself from its competitors by focusing on (1) a quick inventory turnover strategy, (2) offering value-added services such as hi-tech services and fully decorated units for homebuyers, as well as (3) commercial real estates to boost revenue. In 2018, decorated units accounted for approximately 50% of Redsun’s sales, which carried higher margin, and the company plans to increase the decorated units to 80% of sales.

In general, Redsun would start construction within 3 months of land purchase, presales in 6 months, target cashflow positive in 10 months and achieve a 70% sell-through rate within 30 days. In 2018, Redsun reported a cash collection rate of 88% which was evidence of its strong sales and execution capability. In addition, Redsun targets to sell 80% of the units as decorated ones from 50% in 2018. Redsun indicates that decorated units usually generate higher margins than non-decorated ones. Redsun also relies on rental income from its flagship shopping mall in Nanjing. Its flagship shopping mall (i.e. Hong Yang Plaza) had an occupancy rate of 100% in 2018. Redsun targets to keep its commercial estate exposure below 20% of total assets in the near-to-medium terms.

Financial Profile

Expanding At a Faster Pace than the Market Average

In 2018, Redsun continued to replenish its land bank in tier 2 and 3 cities in the Yangtze River Delta Region. The overall new land acquisition costs decreased to RMB16.2bn from RMB 25.4bn (in 2017) largely due to the company’s deleveraging effort to accommodate its IPO in June 2018. The company decreased its net gearing ratio to 68.3% in 2018 from 87.7% in 2017 (Source: Redsun 2018 Annual Results Announcement). Redsun has indicated that it would grow at a faster pace in terms of contracted sales than the industry average growth rate. We expect the company to grow at about 30% in 2019.

Moderately High Leverage

We project Redsun’s financial leverage would increase moderately as it plans to expand its operating scale by entering into more tier 2 and 3 cities in the following 12-24 months. Redsun indicates that it would increase its debt level in tandem with its contracted sales growth rate. Redsun’s contracted sales recorded a rapid 80% increase to RMB47.3 billion in 2018. In order to achieve its 2019 sales target of RMB60 billion, Redsun has to actively replenish its land bank, which would bring its leverage up to 67.1% in 2019 from 65.55% in 2018 as measured by debt/capitalization. However, after its IPO (in June 2018) and

shareholder's capital injection, which totalled RMB3 billion in 2018, Redsun currently has sufficient cash on hand. Therefore, we project its debt would increase moderately.

Key Assumptions

- Contracted sales: RMB60 billion for 2019 and RMB80 billion for 2020
- Sell-through Rate: 70% for 2019 and 2020
- Land acquisition expenditures: 55% of the cash collected from annual contracted sales for 2019 and 2020
- Cash collection rate: 90% for 2019 and 2020

Key Financial Metrics

2016A-2020F	Debt/Land Bank	EBITDA/Interest	Debt/Capitalisation	Quick Ratio
Weighted Average	66.68%	1.54x	71.17%	0.24x

Source: Redsun and Lianhe Global's adjustments and forecasts

Liquidity

Redsun's liquidity position is less than adequate given its unrestricted cash on hand at end-2018 was not sufficient to cover its debt due within one year (RMB6.2 billion cash against RMB8.3 billion short-term debt). But Redsun had a total of RMB18.1 billion credit line, of which RMB7 billion was available at end-2018. It also had a USD600 million approved bond issuance quota available at end-2018. But Redsun did not have any hedging mechanism in place given its relatively small USD exposure at approximately 12% of total debt. Redsun's short-term and long-term debts are evenly distributed that its short-term debt at end-2018 accounted for 37% of its total debt.

As a recently HKEX listed company in 2018, Redsun had a limited funding source in the past. The bank loans were the main source of funding, accounting for approximately 62% of total borrowing amount at end-2018. Redsun expanded the funding source with bond offerings in 2H2018, adding more liquidity source than before.

Peer Comparisons

We choose Yuzhou Properties Company Limited ("Yuzhou") and Jingrui Holdings Limited ("Jingrui") as Redsun's peers for comparison (EXHIBIT 8 & 9). Redsun had marginally better credit and operating profiles than Jingrui in terms of financial leverage and attributable land bank, respectively. Redsun had a lower debt to capitalization ratio than its peers. In addition, Redsun had 7.23 million square meters of the attributable land bank which was almost three times that of Jingrui and comparable to that of Yuzhou at 8.05 million square meters at end-2018. In addition, Redsun reported higher gross margins than Yuzhou and Jingrui in the past 2 years. We expect Redsun to report higher revenue in 2019 as it delivers more completed units to recognize its strong contracted sales reported in 2018.

Exhibit 8: Key Financial Metrics

RMB: in million	Redsun		Yuzhou		Jingrui	
Listing Code	1996.HK		1628.HK		1862.HK	
Lianhe Global's global scale Long-term Issuer Credit Rating/Outlook	BB-/Stable		BB/Stable		B+/Stable	
Period	FY2017	FY2018	FY2017	FY2018	FY2017	FY2018
Revenue	6,140	9,239	21,701	24,306	15,668	11,268
Gross Margin (%)	40.58	31.25	35.51	30.72	16.07	22.61
Operating Margin (%)	31.41	20.80	31.43	27.46	12.48	18.97
EBITDA Margin (%)	32.44	21.66	31.81	27.77	12.55	19.10
EBITDA/Interest* (x)	2.40	1.07	4.06	2.21	1.76	1.40
Debt/EBITDA (x)	5.84	9.66	3.99	6.38	7.18	8.69
Net Debt/EBITDA (x)	4.60	5.98	1.73	2.36	2.98	2.57
Total Debts to Total Capital(%)	57.90	58.25	61.25	66.78	69.71	67.97
Quick Ratio (x)	0.10	0.18	0.32	0.42	0.37	0.52

Note:

* The interest amount from Bloomberg does not include capitalized interests

Source: Bloomberg and Lianhe Global

Exhibit 9: Key Operating Metrics

RMB: in million square meters	Redsun		Yuzhou		Jingrui	
Listing Code	1996.HK		1628.HK		1862.HK	
Lianhe Global's global scale Long-term Issuer Credit Rating/Outlook	BB-/Stable		BB/Stable		B+/Stable	
Period	FY2017	FY2018	FY2017	FY2018	FY2017	FY2018
Contracted Sales (RMB: million)	25,694	47,338	40,306	56,003	18,373	25,236
Contracted Sales GFA (million square meters)	1.70	3.53	2.38	3.70	1.01	1.16
Total Land Bank GFA (million square meters)	11.25	13.08	20.52	17.38	4.41	4.80
Attributable Land Bank GFA (million square meters)	N/A	7.23	8.83	8.05	2.52	2.42

Source: Company's 2017-2018 annual reports, 2018 Results Announcement and Lianhe Global



Appendix I: Redsun's Rating Factors

Rating Factors	Weight	Initial Rating
I. Market Demand Analysis	15.0%	a-
II. Business Analysis¹	45.0%	bb
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 (SAC)		bb-
VII. External Support		
Corporate Entity Support		Not Applicable
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/land bank, EBITDA interest coverage, debt/capitalization and quick ratio.

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