Credit Opinion 22 May 2017

Sino-Ocean Group Holding Limited

Hong Kong

Category:	Corporate Rating
Rating Type:	Solicited Rating
Industry:	Property Development
Long-term Credit Rating:	AA_g-
Rating Outlook:	Stable

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Key Indicators

Sino-Ocean Group Holding Limited. [1]	**2016**	**2015**	**2014**
Total assets (RMB billion)	151.3	148.2	132.2
Total assets (USD billion) [2]	21.8	22.8	21.6
Net assets (RMB billion)	49.3	48.2	44.4
Net assets (USD billion) [2]	7.1	7.4	7.3
Total revenue (RMB billion)	34.6	30.8	38.9
Total revenue (USD billion) [2]	5.0	4.7	6.4
Net Profit (RMB billion)	4.4	2.3	4.6
Net Profit (USD billion) [2]	0.6	0.3	0.8
Gross Margin (%)	22.1	20.6	21.0
Return on Equity (%)	9.1	4.9	10.5
Total debt / Total capital (%)	47.0	54.4	53.5
Net debt / Total equity (%)	43.5	67.3	76.0
Total debt / EBITDA (x)	4.7	8.9	6.5
EBITDA / Interest (x)	3.3	1.7	2.3

[1] Consolidated financial statements in accordance with Hong Kong Financial Reporting Standards audited by PricewaterhouseCoopers

[2] Exchange rates for 2014 (1 USD = 6.1190 CNY), 2015 (1 USD = 6.4936 CNY), and 2016 (1 USD = 6.937 CNY) announced by PBOC

Source: Company data, CCXAP research

Rating Drivers

- Increase in contracted sales generated
- Quality commercial properties provided recurring rental income

- Sufficient land bank in first and second-tier cities
- Lowered debt leverage and improved credit metrics
- Diversified funding channels and good liquidity buffer
- Strong shareholder support from China Life

Rating Rationale

The AA_g- rating of Sino-Ocean Group Holding Limited ("Sino-Ocean" or the "Company") is supported by the Company's (1) larger contracted sales recorded in first and second-tier cities; (2) growing rental income from property investment portfolio; (3) lowered leverage and improved credit metrics, and (4) support from its shareholders. The rating also takes into consideration (1) China's tightening regulatory policies on the real estate market in the first and second-tier cities and (2) the Company's fluctuations in revenue recognition and profitability.

Rating Outlook

The stable outlook on Sino-Ocean's rating reflects its strong track record and excellent operating performance in the real estate market. We believe that the Company will continue to generate recurring income and earnings from its quality investment properties.

What could upgrade the rating?

The rating could be upgraded if the Company (1) achieves increasing contracted sales and improving profit margins; (2) records a larger proportion of recurring rental income; and (3) further improve its credit metrics.

What could downgrade the rating?

The rating could be downgraded if (1) the operating environment in China deteriorates significantly; (2) the Company's leverage and liquidity weakens continuously; and (3) the Company's credit metrics are worse than anticipated.

Corporate Profile

Sino-Ocean was established in 1993, and listed on the Hong Kong Stock Exchange in 2007 (Stock Code: 3377.HK). China Life Insurance Company Ltd. ("China Life") began holding the Company's shares in 2009, and became the major shareholder in 2010. As of 31 December 2016, China Life and Anbang Insurance Group directly held approximately 29.99% and 29.98% of the Company's shares, and were the major shareholders of the Company. We would continue focus on the shareholder structure of the Company.

Sino-Ocean's principal businesses include property development and property investment, property management, investment holding and other services. In terms of real estate development, the Company has established its exposures in19 cities in China.

As of 31 December 2016, Sino-Ocean reported total assets of RMB 151.3 billion and total equity of RMB 49.3 billion. In 2016, Sino-Ocean generated total turnover and net profit of RMB 34.6 billion and RMB 4.4 billion, respectively.

Detailed Rating Considerations

1. Regulatory measures to remain tight

As one of the pillar sectors supporting the economic growth, China's real estate sector has undergone robust development since the sector reform in 1998. That said, the sector has also experienced several mini cycles in recent years, mainly driven by policy adjustments and monetary policies. In 2016, the real estate sector witnessed rapid growth as measured by sales and average selling prices, especially in major cities.

Property investment has improved. China’s property investment amounted to RMB 10.3 trillion in 2016, which increased by 6.9% YoY versus 1.0% in 2015. In the first quarter of 2017, the amount of property investment grew by 9.1% YoY to RMB 1.9 trillion.

Property sales experienced a huge expansion. China’s property sales recorded RMB 11.8 trillion in 2016 increasing by 34.8% YoY, as compared to the growth of 14.4% YoY in 2015. The gross floor area (GFA) sold recorded 1.6 billion sqm in 2016, increasing by 22.5% YoY, as compared to the growth of 6.5% YoY in 2015. The contracted sales continued to grow in the first quarter of 2017 by 25.1% and 19.5%, respectively.

Property prices reached a record high. As of November 2016, the average selling price in the primary markets of 100 major cities recorded RMB 12,938 per sqm, rising 0.88% MoM or 18.71% YoY. In terms of regional breakdown, the average selling prices of tier-one, tier-two and tier-three cities were RMB 40,441 per sqm, RMB 11,697 per sqm and RMB 7,359 per sqm, growing by 20.6%, 17.0% and 8.8% YoY, respectively.

Inventory level reduced as a result of destocking process. As of 31 December 2016, the properties available for sale recorded 695.4 million sqm, decreasing by 3.2% YoY. If divided by the total GFA sold in 2016, the inventory is expected to take about five months to sell out. However, the inventory destocking risks are still high in lower tier cities.

Exhibit 1. China’s Property Investment

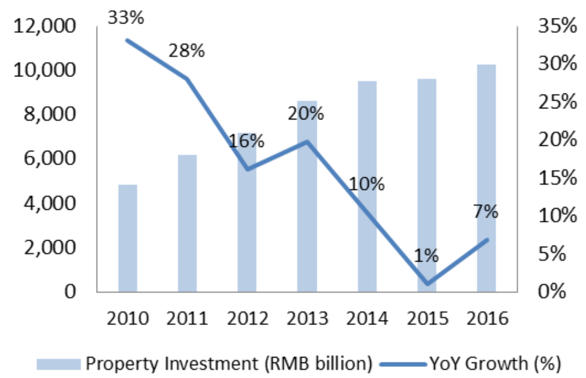
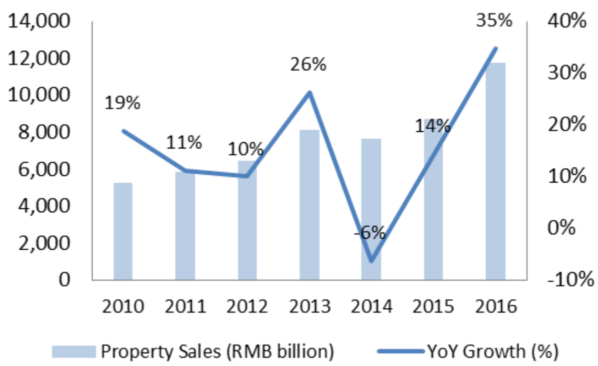


Exhibit 2. China’s Property Sales



Source: National Bureau of Statistics of China, CCXAP research

To control the property prices in higher tier cities and to prevent systematic risk, the policymakers have announced a series of tightening regulatory measures since August 2016. As of March 2017, the purchase restrictions have been implemented in 34 cities. The regulatory measures in these tier-one and tier-two cities are expected to remain tight in 2017.

Looking ahead for China's real estate sector, we believe that the overall demand will remain resilient, while tightening regulation may lead to some corrections in tier-one and tier-two cities. In addition, as market competition intensifies, the consolidation of China's real estate industry will continue. The largest companies will have advantages in land acquisitions, financing capability, marketing and pricing power.

2. Good track record with increasing contracted sales recorded

Founded in 1993, the Company initially managed commercial properties in Beijing and entered the market of Tianjin, Zhongshan and Dalian, and has retained leading positions in regional markets ever since.

Recent years have witnessed increasing contracted sales of Sino-Ocean. In 2016, the Company recorded contracted sales of RMB 50.4 billion, increasing by 24.3%. The saleable GFA sold amounted to 2.9 million sqm, decreasing by 9.2%. The average selling price (excluding car parks) increased from RMB 13,900 per sqm in 2015 to RMB 17,900 per sqm in 2016. It reflected that the Company's strategy to focus on the first and second-tier cities was effective in a heated market situation.

Exhibit 3. Contracted Sales in 2014-2016

	2016	2015	2014
Contracted sales (RMB billion)	50.4	40.5	40.1
Saleable GFA sold (million sqm)	2.9	3.2	2.9
Recognized sales (RMB billion)	30.8	27.1	35.2
Saleable GFA delivered (million sqm)	2.3	2.1	3.0

Source: Company data, CCXAP research

As for product portfolio, residential and villa, office premises, retail space and car parks contributed 74.5%, 16.1%, 8.7% and 0.6% of 2016 contracted sales, respectively. In terms of regional distribution, the Company achieved larger proportion of contracted sales in the first-tier cities than the previous years. The contracted sales from the first-tier cities represented 57.1% of total contracted sales (excluding joint venture projects and car parks) in 2016, as compared with 39.5% in 2015. Meanwhile, the Company had finished destocking of projects in some third-tier cities, such as Qinhuangdao and Fushun. The Company planned to gradually exit the non-core market of Northeast China, and focus more on the real estate development in the first and second-tier cities.

The Company's target in 2017 is to achieve contracted sales of RMB 60 billion. In the first three months of 2017, the Company recorded contracted sales of RMB 12 billion. We would continue to follow the Company's periodic achievement of its sales target.

Exhibit 4. Contracted Sales by Region in 2014-2016

Region	% of Contracted Sales		
	2016	2015	2014
Beijing-Tianjin-Hebei Region	53	40	48
Northeast Region	11	16	20
Central Region	24	29	21
Southern Region	12	15	11
Total	**100**	**100**	**100**

Source: Company data, CCXAP research

Sino-Ocean's construction pace fit its sales progress well in 2016, with total GFA completed of approximately 3.1 million sqm. The Company announced its target to complete the construction of 3.7 million sqm in 2017. The construction plan may impose larger capital expenditure pressure, and we would pay further attention to the Company's construction progress and capital expenditure.

3. Commercial properties provide recurring rental income

As of 31 December 2016, Sino-Ocean held 12 commercial properties, including five Grade-A offices, five self-owned brand retail and two commercial complexes. The quality property investment portfolio added stable rental income to the Company's operating revenue. Total rental income reached RMB 2.5 billion in 2016, while attributable income of the Company was approximately RMB 1.7 billion.

Sino-Ocean's Grade-A offices were located in core CBDs in Beijing and Shanghai, total gross leasable area ("GLA") of which amounted to 0.37 million sqm. These office buildings had all reached the mature phase of development, achieving an occupancy rate of above 90% and generating an average rental yield of 6.4% in 2016.

Sino-Ocean's self-owned brand retails were at the incubation phase, with a total GLA of 0.16 million sqm. Located in different commercial district in Beijing, Tianjin and Dalian, these brand retail properties achieved an average return yield of 5.9%.

As for commercial complexes, the Company cooperated with other real estate companies with solid track record in the industry. Sino-Ocean operated Sino-Ocean Taikoo Li Chengdu project and Beijing INDIGO project jointly with Swire properties. The two projects achieved high occupancy rates of 94% and 91%.

Exhibit 5. Commercial properties as of 31 December 2016

	Project	**GLA** (sqm)	**Occupancy**
Grade-A offices	Beijing Ocean Plaza	30,000	100%
	Beijing Ocean International Center Block A	101,000	92%
	Beijing Ocean International Center Phase II	52,000	94%
	Beijing Ocean Office Park	127,000	90%
	Shanghai East Ocean Centre	62,000	96%
Self-owned brand retail	Beijing Ocean We-Life Plaza	31,000	98%
	Beijing Ocean We-Life	25,000	99%
	Tianjin Ocean We-Life Plaza	41,000	93%
	Beijing Ocean Landscape We-Life	24,000	100%
	Dalian Ocean Worldview Retail Street	35,000	91%
Commercial complexes	Beijing INDIGO	176,000	94%
	Sino-Ocean Taikoo Chengdu	99,000	91%

Source: Company data, CCXAP research

We expect the rental income of Sino-Ocean to further increase in the future after the commitment of six commercial properties under construction. According to the Company's plan, additional GLA of 1.4 million sqm will be added to the investment properties portfolio during 2017 to 2021. We will continue to monitor the construction process, capital expenditure and tenant distribution of the Company's commercial properties portfolio.

Exhibit 6. Commercial properties under construction as of 31 December 2016

	Project	GFA (sqm)	Estimated Completion
Grade-A offices	Beijing CBD-Z13	162,000	2018
	Beijing Lize Business District	154,000	2019
	Beijing CBD-Z6	244,300	2021
Self-owned brand retail	Hangzhou Grand Canal Place	160,000	2017
	Beijing Sino-Ocean Shin Kong	214,000	2020
Commercial complexes	Beijing INDIGO phase II	436,000	2021

Source: Company data, CCXAP research

4. Optimized regional distribution and sufficient land bank

Based on its view of the real estate market, Sino-Ocean adjusted its strategic distribution of real estate development and focused more on first and second-tier cities in metropolitan regions with sustainable economic growth and population inflow. The Company further optimized its regional diversification in recent years. As of 31 December 2016, the land bank in the first-tier cities accounted for 25% in terms of land bank GFA and 41% in terms for land cost.

Exhibit 7. Land Bank in 2014-2016

	2016	2015	2014
New Land Bank (million sqm)	4.8	2.3	7.1
Total Land Bank (million sqm)	21.7	20.0	19.9

Source: Company data, CCXAP research

Exhibit 8. Land Bank by Region as of 31 December 2016

	Region	Total GFA ('000 sqm)	% of Total
Beijing-Tianjin-Hebei Region	Beijing	2,153	15.7
	Tianjin	3,126	22.7
Northeast Region	Dalian	3,508	25.5
	Shenyang	74	0.5
	Changchun	674	4.9
Central Region	Shanghai	460	3.3
	Hangzhou	644	4.7
	Nanjing	124	0.9
	Huangshan	89	0.6
	Qingdao	126	0.9
	Wuhan	538	3.9
	Shenzhen	747	5.4
Southern Region	Guangzhou	140	1.0
	Zhongshan	477	3.5
	Hong Kong	55	0.4
	Haikou	77	0.6

	Sanya	140	1.0
	Chongqing	493	3.6
	Chengdu	101	0.7
Total		**13,746**	**100.0**

Source: Company data, CCXAP research

Sino-Ocean possessed sufficient land bank to support its business strategy. As of 31 December 2016, the Company had a total land bank of 21.7 million sqm, of which attributable land bank was 13.8 million sqm. It could support the Company's development for the next 3-5 years.

5. Fluctuations in revenue generated and profitability

The Company's main stream of income was from real estate development, which accounted for 89.2% of Sino-Ocean's revenue in 2016. The Company also received stable income from investment in real estates and property management services, which represented 2.6% and 2.6% of total revenue in 2016, respectively. Sino-Ocean also actively promoted its senior living projects, customer services, real estate funds and equity investment.

Exhibit 9. Percentage of revenue in 2014-2016

	2016	2015	2014
Real estate development	89.2%	87.9%	90.6%
Real estate investment	2.6%	2.5%	1.7%
Property management	2.6%	2.7%	1.9%
Other income	5.7%	7.0%	5.8%

Source: Company data, CCXAP research

The Company recorded revenue of RMB 34.6 billion, RMB 30.8 billion and RMB 38.9 billion in 2016, 2015 and 2014, respectively. The fluctuation was mainly due to the strip-off of non-core business and the projects with slow sales and comparatively lower gross margin in the third and fourth-tier cities in late 2014. As there is a time lag between property sales and income recognition, we expect revenue will continue to rise in 2017 given the increase in contracted sales in 2016. We would focus on the Company's revenue recognition from property development projects.

The profitability of Sino-Ocean also fluctuated. The gross profit margin in 2016, 2015 and 2014 were 22.1%, 20.6% and 21.0%. The growing profit margin in 2016 mainly resulted from Sino-Ocean's strategy to gradually exit low-tier cities. However, the revenue recognition of high profit margin projects could lead to higher land appreciation tax. The land appreciation tax in 2016 was RMB 1.8 billion, much higher than RMB 0.4 billion in 2015.

6. Lowered debt burden and improved credit metrics

Sino-Ocean adhered to a prudent financial policy, with the amount of borrowings reduced in 2016. The reported total debt of the Company as of 31 December 2016 amounted to RMB 43.8 billion, which was RMB 8.1 billion lower than that of 31 December 2015. The adjusted debt to capital ratio declined from 54.4% to 47.0%. The adjusted net gearing ratio also decreased from 67.3% to 43.5%.

As for the maturity profile, short-term debt accounted for 14.1% of total debt as of 31 December 2016. The average maturity prolonged to 4.5 years in 2016 from 4.4 years in 2015, revealing a well-managed debt structure. In terms of currency profile, the borrowings denominated in RMB, USD and

HKD represented 43.0%, 45.2% and 11.8% of total borrowings, respectively. We would continue focus on the Company's hedging policies to mitigate foreign currency translation losses.

With lower leverage taken and higher income generated, the credit metrics of the Company became stronger. The adjusted debt/EBITDA ratio in 2016 was 4.7x, lower than 8.9x in 2015 and the 6.5x in 2014. The adjusted interest coverage ratio, which was measured by EBITDA over interest, was 3.3x, higher than the 2015 and 2014 figure, which was 1.7x and 2.3x, respectively.

7. Diversified funding channels and good liquidity buffer

The Company's liquidity remained strong. As of 31 December 2016, the Company held cash reserve of RMB 22.3 billion, of which RMB 3.3 billion was pledged bank deposits. The Company's cash to short-term debt ratio in 2016, 2015 and 2014 was 3.6x, 2.8x and 1.5x, respectively. As of 31 December 2016, Sino-Ocean had unutilized credit facilities of RMB 118.7 billion.

The Company had good access to diversified funding channels. Apart from maintaining a good relationship with commercial banks, Sino-Ocean has tapped into the onshore and offshore capital markets. The Company was listed on the Hong Kong stock exchange, and had issued various RMB and USD denominated bonds. The average finance cost was lowered to 5.38% in 2016, dropping 87 basis points compared to that of 2015.

8. Strong major shareholder support

The major shareholder of Sino-Ocean is China Life, the largest commercial insurance group in mainland China. As a state-owned company, China Life is one of the largest institutional investors in China's capital market. As the only real estate investment platform, Sino-Ocean's operations can benefit from the support from its China Life.

China Life subscribed 16.6% of Sino-Ocean's shares at total investment of HKD 5.8 billion in 2009, and increased its holding position to 24.1% in 2010. Since then, China Life has become the major shareholder of the Company, and China Life held 29.99% of Sino-Ocean's shares as of 31 December 2016. Furthermore, China Life also supported Sino-Ocean's financing by actively subscribing the Company's onshore and offshore corporate bond issuances. China Life also appointed three directors to join Sino-Ocean's board to monitor and assist the Company's daily operations.

We believe that the support from major shareholder helps strengthen the overall credit profile of Sino-Ocean.

Appendix. CCXAP's Credit Rating Symbols and their Meaning

China Chengxin (Asia Pacific) Credit Ratings Company Limited uses simple, consistent, and comparable rating symbols expressed in letters to represent the credit worthiness of rated entities and rated debt issues.

A. Long-Term Credit Ratings

A long-term credit rating refers to a rating for a period of more than 12 months.

Rating Symbol	Definition
AAAg	Capacity to meet commitments on short-term and long-term debts is extremely strong. Business is operated in a virtuous circle. The foreseeable uncertainty on business operations is minimal.
AAg+ **AAg** **AAg-**	Capacity to meet short-term and long-term financial commitments is very strong. Business is operated in a virtuous circle. Foreseeable uncertainty in business operations is relatively low.
Ag+ **Ag** **Ag-**	Capacity to meet short-term and long-term commitments is strong. Business is operated in a virtuous circle. Business operation and development may be affected by internal uncertain factors, which may create fluctuations in profitability and solvency of the issuer.
BBBg+ **BBBg** **BBBg-**	Capacity to meet financial commitment is considered adequate and capacity to meet short-term and long-term commitments is satisfactory. Business is operated in a virtuous circle. Business is affected by internal and external uncertainties. Profitability and solvency may experience significant fluctuation. Principal and interest may not be sufficiently protected by the terms of agreement.
BBg+ **BBg** **BBg-**	Capacity to meet short-term and long-term financial commitment is relatively weak. Financial commitment towards short-term and long-term debts is below average. Status of business operations and development is not good. Solvency is unstable and subject to sustainable risk.
Bg+ **Bg** **Bg-**	Financial commitment towards short-term and long-term debts is bad. Business is affected by internal and external uncertain factors. There are difficulties in business operations. Solvency is uncertain and subject to high credit risk.
CCCg	Financial commitment towards short-term and long-term debts is very bad. Business is affected by internal and external uncertain factors. There are difficulties in business operations. Poor solvency with very high credit risk.
CCg	Financial commitment towards short-term and long-term debts is extremely bad. Business operations are poor. There are very limited positive internal and external factors to support business operation and development. Extremely high credit risk is found.
Cg	Financial commitment towards short-term and long-term debts is insolvent. Business falls into a vicious circle. Very limited positive internal and external factors are found to support business operations and development in positive cycle. Extremely high credit risk is seen and is near default.
Dg	Unable to meet financial commitments. Default is confirmed.

B. Long-term Credit Rating Outlook

A rating outlook is the medium- and long-term trend of the credit rating of a rated entity. In formulating a rating outlook, CCXAP considers the potential change in economic and commercial factors from a medium- and long-term perspective for a period of 12 to 18 months.

Positive	Indicates a rating with an ascending trend
Negative	Indicates a rating with a descending trend
Stable	Indicates the rating is likely to be stable

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