Credit Opinion 22 May 2017

Fantasia Holdings Group Co., Limited

Hong Kong

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

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Key Indicators

Fantasia Holdings Group Co., Limited [1]	**2016**	**2015**	**2014**
Total assets (RMB billion)	49.8	44.6	41.3
Total assets (USD billion) [2]	7.2	6.9	6.7
Net assets (RMB billion)	13.1	12.2	11.4
Net assets (USD billion) [2]	1.9	1.9	1.9
Total revenue (RMB billion)	10.9	8.2	7.3
Total revenue (USD billion) [2]	1.6	1.3	1.2
Net profits (RMB billion)	1.1	1.4	1.4
Net profits (USD billion) [2]	0.2	0.2	0.2
Gross Margin (%)	32.3	30.9	38.4
Return on Equity (%)	8.4	11.9	14.3
Total debt / Total capital (%)	62.8	55.4	59.0
Net debt / Total equity (%)	83.8	87.6	100.4
Total debt / EBITDA (x)	6.2	4.5	5.3
EBITDA / Interest (x)	2.0	2.4	2.3

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

[2] Exchange rates for 2014 (1 USD = 6.1190 CNY), 2015 (1 USD = 6.4936 CNY), and 2016 (1 USD = 6.9370 CNY) announced by PBOC

Source: Company data, CCXAP research

Rating Drivers

- Steady property sales in core markets
- Added income from property operation services

- Slow de-stocking in second and third-tier cities
- Prudent land bank policy with the focus on urban renewal projects
- Sustainable revenue growth but weakened profitability

Rating Rationale

The A_g rating of Fantasia Holdings Group Co., Limited ("Fantasia" or the "Company") is supported by the Company's (1) stable property sales in core markets; (2) added revenue generated from commercial properties and property operation services; (3) prudent land bank policy with low land costs; and (4) moderate financial policy. The rating also takes into consideration the Company's (1) execution risk for projects under framework agreements; (2) de-stocking pressure on the sellable properties in second and third-tier cities; and (3) a large percentage of USD-denominated debt.

Rating Outlook

The stable outlook reflects that Fantasia will adhere to a prudent growth strategy and retain its competitive position in the property market.

What could upgrade the rating?

The rating could be upgraded if (1) the Company records increasing sales in core markets; (2) the Company speeds up its inventory de-stocking in second and third-tier cities; or (3) the Company further expands its property operation services.

What could downgrade the rating?

The rating could be downgraded if (1) there are large fluctuations in the Chinese real estate industry; (2) the Company faces significant difficulty in its inventory de-stocking; or (3) the Company's liquidity profile deteriorates.

Corporate Profile

Fantasia was founded in 1998. It was listed on the Hong Kong Stock Exchange in November 2009 (Stock Code: 1777). Fantasy Pearl International Limited is the controlling shareholder of Fantasia, and held 57.50% of the Company's shares as of 31 December 2016. Ms. Zeng Jie Baby and Ice Apex Limited are the ultimate controlling shareholders. TCL Corporation is the second largest shareholder of Fantasia, which held 17.38% of the Company's shares through its wholly-owned subsidiary as of 31 December 2016.

Fantasia is a property developer and property-related service provider in mainland China. The Company has established two service platforms, Colour Life Services Group Co., Ltd. ("Colour Life"), which was listed on the Hong Kong Stock Exchange in June 2014 (Stock Code: 1778), and Shenzhen Home E&E Commercial Services Group Co., Ltd ("Home E&E"), which was listed on National Equities Exchange and Quotations System in December 2015.

As of 31 December 2016, Fantasia reported consolidated total assets of RMB 49.8 billion. In 2016, the Company generated total revenue and net profit of RMB 10.9 billion and RMB 1.1 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

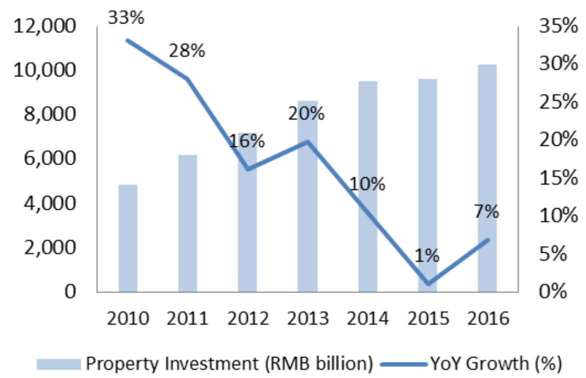
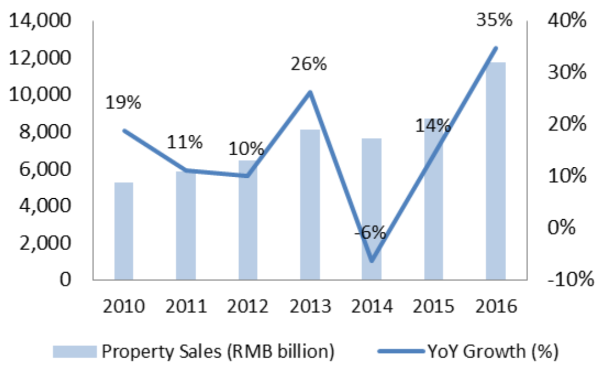


Exhibit 2. China's Property Sales



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. Steady contracted sales generated from core markets

Fantasia formulated highly-focused sales strategies and benefitted from its good brand name. The Company recorded contracted sales of RMB 12.2 billion in 2016, increasing by 8.1% YoY. The contracted sales area of the Company remained at 1.3 million sqm.

The Company exhibited differentiated products and focused regional distribution. As for product breakdown, urban complexes projects, boutique upscale residences, and mid-to-high-end residences contributed 49.4%, 30.9%, and 19.7% of the Company's total contracted sales in 2016, respectively.

In terms of regional distributions, Chengdu-Chongqing Economic Zone, Pearl River Delta, Yangtze River Delta Area, Beijing-Tianjin Metropolitan Area, Central China and Overseas contributed to 31.5%, 29.4%, 21.2%, 4.0%, 11.3% and 2.6% of the total sales, respectively. Compared with 2015, sales generated from Chengdu rose significantly to RMB 3.8 billion in 2016 from RMB 1.3 billion in 2015. Since the housing market of the low-tier cities exhibits supply surplus, we would focus on the Company's destocking process in the low-tier cities and the Company's accomplishment of its sales target.

Exhibit 3. Contracted Sales by City in 2015 and 2016

Region	% of Value			% of Area		
	2016	2015	2014	2016	2015	2014
Chengdu-Chongqing Economic Zone	31.5	11.6	21.8	41.3	20.8	24.8
Pearl River Delta	29.4	45.5	31.2	27.3	37.8	30.1
Yangtze River Delta Region	21.2	23.2	30.3	14.8	19.3	31.7
Beijing-Tianjin Metropolitan Area	4.0	8.8	5.7	2.4	9.9	4.0
Central China	11.3	9.9	10.5	14.0	12.1	9.4
Overseas	2.6	1.0	0.5	0.2	0.1	0.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company data, CCXAP research

As of 31 December 2016, Fantasia held an inventory of RMB 15.4 billion. Among them, completed properties for sale amounted to RMB 5.6 billion, representing a relatively large percentage. Most of the projects were urban complexes projects, and we will continue to monitor the Company's destocking process on these projects.

The Company's target is to achieve contracted sales amount of RMB 15 billion in 2017. In the first four months of 2017, the Company recorded contracted sales of RMB 3.6 billion, covering about 24% of its full year target. We will continue to follow Fantasia's accomplishment of its sales target.

3. Slow de-stocking of existing projects in lower-tier cities

The Company's project construction was in line with its sales progress. In 2016, the Company commenced the construction of seven new projects, with a total planned GFA of 0.51 million sqm. The Company completed 19 projects, with a total GFA of 1.8 million sqm. As of 31 December 2016, the Company had 13 projects under construction, with a total planned GFA of 1.8 million sqm. We note that Fantasia has slowed down the construction of new projects in recent years, due to the Company's forecast on the property market and slow de-stocking of existing projects.

The sales promotion of inventories has been the theme in lower-tier cities. As of 31 December 2016, Fantasia reported properties for sale of RMB 15.4 billion on its balance sheet, of which completed properties for sale accounted for 36.2%. The percentage was relatively high compared to the Company's peers. Most of the completed projects remaining unsold were located in second and third-tier cities such as Suzhou, Huizhou, Guilin, Chengdu, and Wuhan. Given the divergence of China's real estate market, we will continue to monitor the Company's inventory de-stocking process in these lower-tier cities.

4. Prudent land bank policy with the focus on urban renewal projects

Fantasia adopts a prudent investment strategy by acquiring low-cost land in selective regions. As of 31 December 2016, the Company held a land bank of 15.0 million sqm in aggregate planned GFA, of which properties under framework agreements accounted for 53.3%.

As for regional breakdown, the Company held land bank reserve in 11 cities. As of 31 December 2016, the land bank in first, second, and third-tier cities accounted for 26.1%, 50.4%, and 23.5% of the Company's total land bank, respectively. Compared with that of 2015, the land bank in first, second, and third-tier cities accounted for 16.3%, 48.1%, and 35.6% of the Company's total land bank, respectively. The Company demonstrated an improvement in the regional distribution of its land bank.

Exhibit 4. Land Bank as of 31 December 2016

Region	City	Projects under construction (sqm)	Projects to be developed (sqm)	Under framework agreements (sqm)	Aggregate planned GFA (sqm)	%
Chengdu-Chongqing Economic Zone	Chengdu	276,329	2,337,571	2,916,682	5,530,581	36.9
	Kunming	-	-	80,637	80,637	0.5
Pearl River Delta	Shenzhen	-	291,018	3,111,282	3,402,300	22.7
	Huizhou	369,447	431,398	1,099,900	1,900,745	12.7
	Guilin	465,675	1,170,272	-	1,635,947	10.9
Beijing-Tianjin Metropolitan Area	Beijing		268,174	-	536,174	3.6
	Tianjin	19,158	443,773		462,931	3.1
Yangtze River Delta	Suzhou	244,649	73,185	56,254	374,087	2.5
	Wuxi	54,428	-	-	4,428	0.0
	Nanjing	296,933	-	-	296,933	2.0
Central China	Wuhan	108,030	200,000	711,415	1,019,445	6.8
Total		**1,784,649**	**5,215,391**	**7,976,170**	**14,976,210**	**100.0**

Source: Company data, CCXAP research

However, urban renewal projects under framework agreements accounted for more than half of Fantasia's land bank. The Company has entered into preliminary framework agreements with third parties or with local governments, but the Company has not obtained the land use rights or property rights for the land parcels. Given the difficulty and uncertainty of the expropriation process, the Company may not be able to develop and sell properties on such land. The Company is subject to execution risk with respect to these potential projects.

5. Added income from property management and investment

Fantasia has adopted an asset-light business model, generating recurring income from property operation services. The Company provides community operating services mainly through its two listed subsidiaries, Colour Life and Home E&E. In 2016, Fantasia recorded revenue from property operation services of RMB 1.7 billion, as compared to RMB 1.3 billion in 2015.

Colour Life provides property management services to the projects of Fantasia and other developers. In 2015, Colour Life acquired Shenzhen Kaiyuan International Property Management Co., Ltd. ("Kaiyuan International") for a total consideration of RMB 330 million. As of 31 December 2016, GFA under management contracts and consultancy service arrangements of Colour Life reached 395.1 million sqm, and the number of residential communities managed or contracted increased to 2,339. The rapid expansion of service area was achieved by way of strategic acquisition and organic growth.

Home E&E focuses on the management of office commercial properties and high-end apartments. As of 31 December 2016, the projects under its management covered 38 cities, and the area newly put under management was 18.8 million sqm.

6. Steady revenue growth and improved profitability

Fantasia focuses on property development and property management, which accounted for 76.6% and 15.1% of the Company's total revenue in 2016, respectively. The Company recorded total revenue of RMB 10.9 billion, RMB 8.2 billion and RMB 7.3 billion in 2016, 2015 and 2014, respectively. The increase in revenue mainly resulted from the Company's steady property development revenue and improved property operation services revenue.

Fantasia's sales of high profit margin properties increased its profitability. The gross profit margin of the Company was 32.3%, 30.9%, and 38.4% in 2016, 2015, and 2014, respectively. The rise in profit margin was due to the Company's recognizing sales from high profit projects in Shenzhen. However, the de-stocking pressure in lower-tier cities may weigh on the profitability of the Company.

7. Improving credit metrics but large percentage of USD denominated debt

Fantasia retains a prudent financial policy. The Company's reported total debt (borrowings, senior notes and bonds, finance lease obligations, and asset-backed securities) amounted to RMB 22.1 billion, RMB 14.3 billion, and RMB 15.4 billion at the end of 2016, 2015 and 2014, respectively. The adjusted total capitalization ratio, as measured by total debt over total capital, was 62.8%, 55.4% and 59.0% in 2016, 2015 and 2014, respectively. The adjusted net gearing ratio, as measured by net debt over total equity, was 83.8%, 87.6%, and 100.4% in 2016, 2015 and 2014, respectively.

Fantasia's credit metrics are around industry average level. The adjusted debt to EBITDA ratio was 6.2x, 4.5x and 5.3x in 2016, 2015, and 2014, respectively. The adjusted EBITDA interest coverage ratio, as measured by EBITDA over interest expenses and capitalized interest, was 2.0x, 2.4x, and 2.3x over the same period, respectively.

The Company held a proper structure of debt maturities. As of 31 December 2016, the Company's short-term debt only accounted for 11.6% of the total debt, which is considered manageable.

We noticed that USD denominated debt represented significant portion of the Company's total debt. In 2016, the Company incurred net exchange loss of RMB 0.7 billion. Thus we would focus on how the Company hedges its foreign exposure in the future.

8. Multiple funding sources with adequate liquidity

As a listed company on the Hong Kong Stock Exchange, the Company has raised funds through both equity financing and debt financing. In 2016, the Company's wholly-owned subsidiary, Fantasia Group (China) Co., Ltd. issued public and non-public domestic corporate bonds with issue amount of RMB 1.1 billion and RMB 3 billion, respectively. The non-wholly-owned subsidiary of the Company, Shenzhen Colour Life Services Group Co., Limited issued domestic corporate bonds of RMB 0.4 billion. Fantasia also issued RMB and USD denominated senior notes in the offshore market.

Fantasia's liquidity profile is considered adequate. The Company held cash reserve of RMB 11.1 billion at 2016 year-end, which could cover its short-term debt of RMB 2.6 billion at 2016 year-end. The Company's cash to short-term debt ratio was 1.7x as of 31 December 2015, enhancing to 4.3x as of 31 December 2016. The Company's cash reserve provided sufficient liquidity buffer for its further development.

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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