Credit Opinion 15 June 2018

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]	2017	2016	2015
Total Assets (RMB billion)	191.9	151.3	148.2
Total Assets (USD billion) [2]	29.4	21.8	22.8
Net Assets (RMB billion)	58.7	49.3	48.2
Net Assets (USD billion) [2]	9.0	7.1	7.4
Total Revenue (RMB billion)	45.8	34.6	30.8
Total Revenue (USD billion) [2]	7.0	5.0	4.7
Net Profit (RMB billion)	6.3	4.4	2.3
Net Profit (USD billion) [2]	1.0	0.6	0.3
Gross Margin (%)	24.5	22.1	20.6
Return on Equity (%)	11.6	9.1	4.9
Total Capitalization Ratio (%)	52.6	47.0	54.4
Net Gearing Ratio (%)	67.3	43.5	67.3
Total Debt / EBITDA (x)	5.3	4.7	8.9
EBITDA / Interest (x)	3.7	3.3	1.7

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

[2] Exchange rates for 2015 (1 USD = 6.4936 CNY), 2016 (1 USD = 6.9370 CNY), and 2017 (1 USD = 6.5342 CNY) announced by PBOC

Source: Company data, CCXAP research

Rating Drivers

- Fair growth in contracted sales given tight regulation in core markets
- Rapid land acquisition exerts pressure on capital expenditure, but partially offset by acquiring projects through M&A
- Expansion in investment properties, senior living and long-term rental apartments providing recurring income
- Heightened debt burden but moderate credit metrics
- Diversified funding channels and good liquidity buffer
- Strong shareholder support from China Life

Rating Rationale

The AA_g- long-term credit rating of Sino-Ocean Group Holding Limited ("Sino-Ocean" or the "Company") is underpinned by the Company's (1) fair growth in contracted sales supported by effective operating strategy; (2) expansion in investment properties, senior living and long-term rental apartments which provided recurring income; (3) increasing revenue and profitability; and (4) strong shareholder support from China Life. However, the rating is also constrained by (1) tightening regulatory environment with uncertainties in China's property market; (2) the Company's capital expenditure pressure given expanding operating scale and diversifying business structure; and (3) heightened debt burden.

Rating Outlook

The stable outlook on Sino-Ocean's rating reflects its strong track record of contracted sales in the real estate market. We believe that Sino-Ocean will maintain a stable growth of contracted sales supported by its quality land bank and increase recurring revenue with expansion of operating scale.

What could upgrade the rating?

The rating could be upgraded if the Company (1) strong growth in contracted sales and revenue with sustains steady profitability; (2) improves its credit metrics, such as debt leverage and interest coverage; and (3) maintains disciplined financial policy and adequate liquidity profile.

What could downgrade the rating?

The rating could be downgraded if (1) the Company's credit metrics are worse than anticipated; (2) the Company becomes more aggressive in its land bank acquisition which leads to significantly increasing debt level; and (3) the Company's liquidity profile weakens.

Corporate Profile

Founded in 1993, Sino-Ocean is one of the leading property companies in China, with diversified businesses including property development, property investment and property management. Sino-Ocean was listed on the Hong Kong Stock Exchange in 2007 (Stock Code: 3377.HK). As of 31 December 2017, China Life Insurance Company Ltd. ("China Life") and Anbang Insurance Group ("Anbang") directly held approximately 29.79% and 29.78% of the Company's shares, respectively.

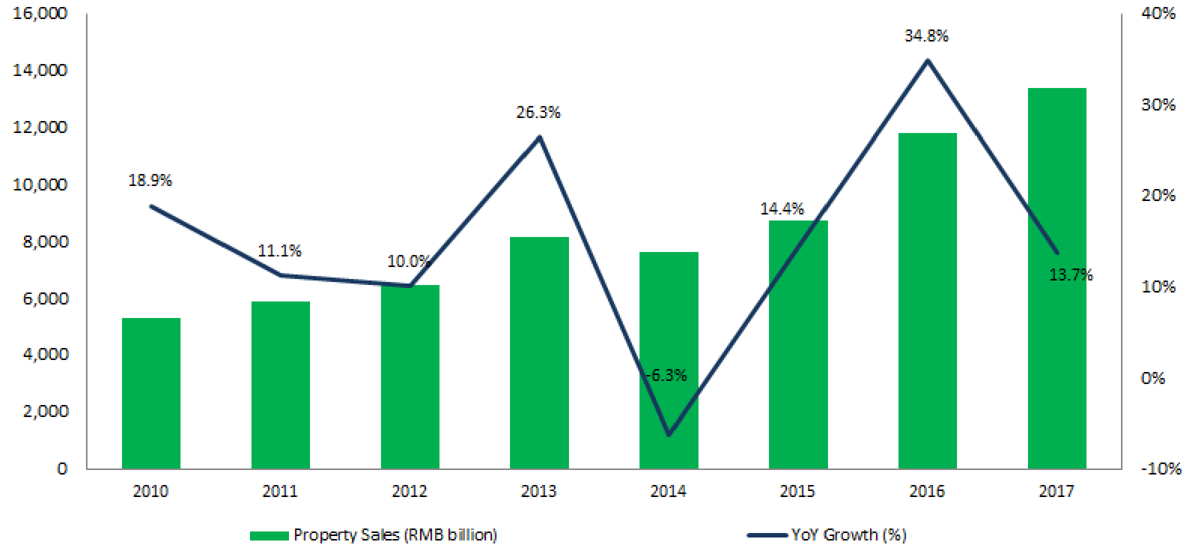
Detailed Rating Considerations

1. Market growth slowed down with tightening regulatory environment

The growth of China's property market remains steady as supported by the rigid demand from urbanization and strong purchasing power. To prevent overheating property prices and mitigate the risk of market failure, the regulatory measures have been tightening since 2016Q3. By end-2017, the regulatory measures such as purchase restrictions, sell restrictions, mortgage limitation and price limitation have been implemented in more than 150 cities, which included higher-tier cities and some of lower-tier cities.

As a result of tightening regulation, the growth of property market has slowed down and housing price has entered into mini correction. The property investment increased 7.0% YoY to RMB 11.0 trillion in 2017 from RMB 10.3 trillion in 2016. The growth in property sales has narrowed, reported a YoY increase of 13.7% to RMB 13.4 trillion in 2017, as compared to a YoY increase of 34.8% in 2016. The growth of average housing prices in first-tier and second-tier cities has been calmed down. In 2017, the average prices increased 0.5% YoY in first-tier cities, 4.3% YoY in second-tier cities and 7.1% YoY in lower-tier cities.

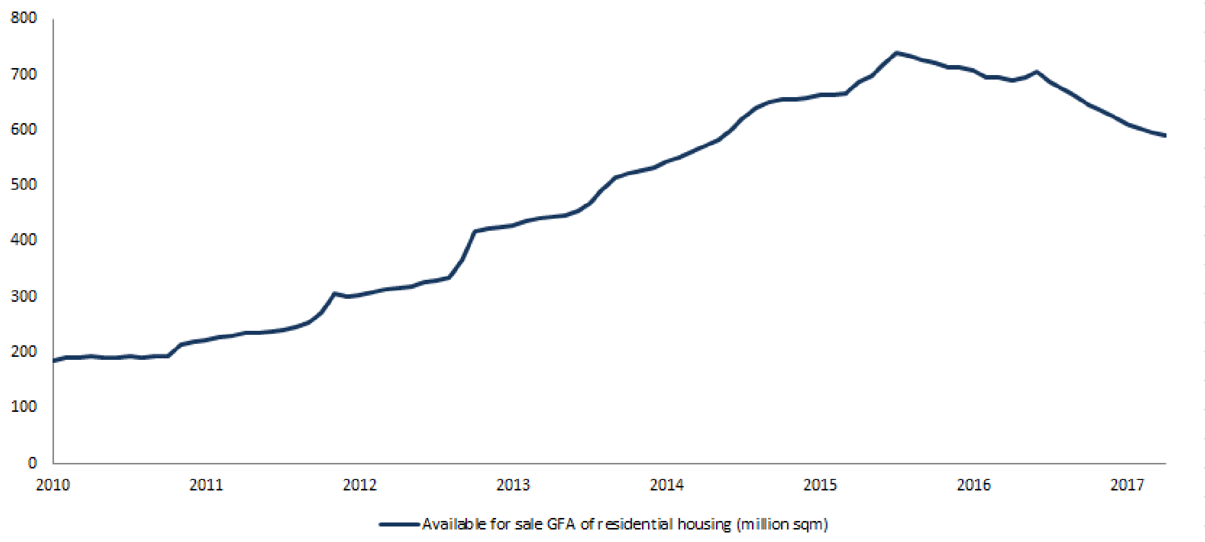
Exhibit 1. China's Property Contracted Sales in 2010-2017 (RMB billion)



Source: National Bureau of Statistics of China, CCXAP research

As a result of destocking policy in lower-tier cities, the property inventory level reduced to a healthy level. By end-2017, available for sale residential housing GFA amounted to 589.2 million sqm, decreasing by 15.3% YoY as compared with that of end-2016.

Exhibit 2. China's available for sale residential housing GFA in 2010-2017 (million sqm)



Source: National Bureau of Statistics of China, CCXAP research

Moreover, under a tightening financing environment in onshore capital market, the financing cost of Chinese property developers will increase. With intense market competition, the property sector will continue to consolidate. The developers with large operating scale and strong financing capability will be resilient in the market correction.

2. Fair growth in revenue and contracted sales given the tight regulation in core markets

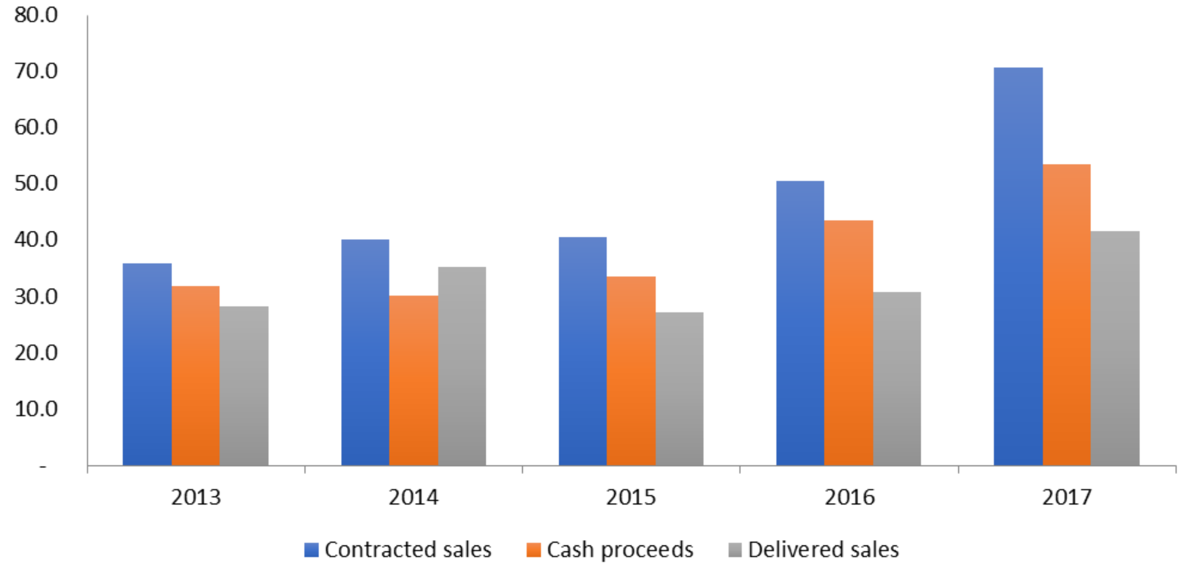
Property development was the core business of Sino-Ocean, which generated the revenue of RMB 41.6 billion in 2017 and accounted for 90.7% of the total revenue. With the increasing recognized sales from the property development business, the Company recorded total revenue of RMB 45.8 billion in 2017, increasing 32.7% YoY.

Exhibit 3. Revenue Breakdown by Segment in 2015-2017 (%)

Source: Company data, CCXAP research

The contracted sales of Sino-Ocean demonstrated a fair growth in 2017, affecting by the tightening regulation in the first and second-tier cities. As a result, Sino-Ocean ranked 27th among the property developers in Mainland China in terms of contracted sales value in 2017, lower than the ranking of 22nd in 2016. In 2017, Sino-Ocean recorded the contracted sales of RMB 70.6 billion and the contracted GFA of 3.7 million sqm, increasing by 40.1% and 27.9% YoY, respectively. The average selling price was RMB 19,000 per sqm in 2017, as compared to the price of RMB 17,400 per sqm in 2016.

Exhibit 4. Contracted Sales, Cash Proceeds and Recognized Sales in 2013-2017 (RMB billion)



Source: Company data, CCXAP research

In terms of product mix, Sino-Ocean strategically focuses on the metropolitan regions with sustainable growth and population inflow, which helps increase the contracted sales of the Company. The Company focused on the residential property development, while the contracted sales of residential properties (including villa) represented 79.1% of total contracted sales in 2017. Sino-Ocean established a product portfolio that fully covered the market from first-time buyers to high-income households. The products for first-time buyers and first upgraders contributed 74% of the contracted sales of residential properties, while the products for multiple upgraders and high-end customers accounted for 13% and 13% respectively. The high proportion of first-time buyers and first upgraders products helped maintained a fair growth in contracted sales under the tight regulation.

In terms of regional distribution, Sino-Ocean has established a development portfolio with improving geographic diversification. In 2017, the contracted sales in Beijing-Tianjin-Hebei Region, Yangtze River Delta, Pearl River Delta, Yangtze Mid-stream and Chengdu-Chongqing and other regions contributed 32%, 20.0%, 22%, 11% and 15% of the total contracted sales, while the shares represented 53%, 17%, 8%, 8% and 14% in 2016, respectively. Given the rapid development of Greater Bay Area, the Company has achieved a higher proportion of contracted sales in Pearl River Delta in 2017 versus that of 2016. Given the market penetration strategy of Sino-Ocean, the contracted sales from its core markets of Beijing, Tianjin, Hangzhou, Shenzhen and Guangzhou contributed 15%, 13%, 11%, 9% and 7% of the total contracted sales in 2017, respectively.

Exhibit 5. Contracted Sales by Regions in 2016

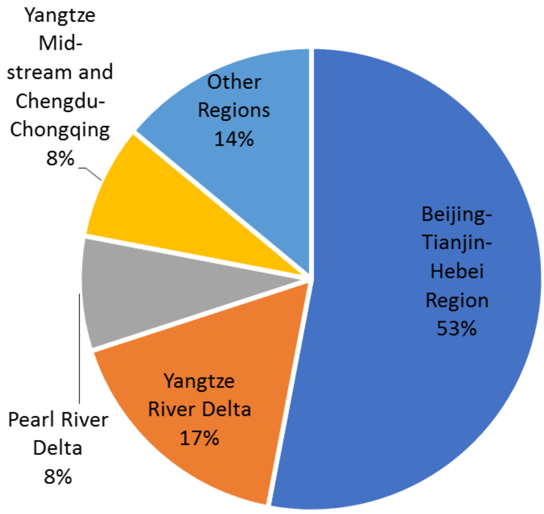
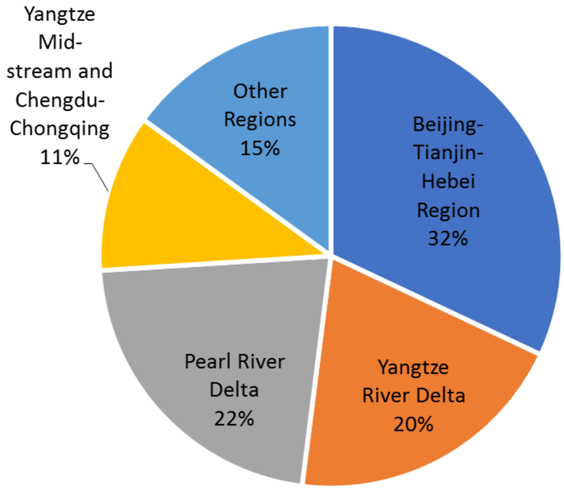


Exhibit 6. Contracted Sales by Regions in 2017



Source: Company data, CCXAP research

Sino-Ocean aimed to achieve the total contracted sales of RMB 100 billion in 2018, 42% higher than that of 2017. In first quarter of 2018, the Company recorded the total contracted sales of RMB 16 billion, increasing by about 33% YoY. Sino-Ocean has saleable resources of RMB 175 billion in 2018, of which RMB 137.4 billion saleable resources are coming from new projects. We expect that the Company has enough resources to achieve the target.

3. Rapid land acquisition exerts pressure on capital expenditure, but partially offset by acquiring projects through M&A

Sino-Ocean adhered to its strategic focus in the 5 major city clusters with sustainable growth and population inflow, namely Beijing-Tianjin-Hebei region, Yangtze River Delta, Pearl River Delta, Yangtze Mid-stream and Chengdu-Chongqing. In 2017, Sino-Ocean accelerated its land acquisitions through public market and M&A, of which 71% of the projects were acquired through M&A. The Company acquired 59 new projects with total GFA of 16.1 million sqm, of which the attributable GFA was 6.8 million sqm and attributable land cost was RMB 33.6 billion. In terms of total GFA, 90% of the newly acquired projects located in the 5 core regions, of which the new projects in Beijing-Tianjin-Hebei region accounted for 42.0% of newly acquired GFA. The Company reduced the attributable average cost of new land bank from RMB 9,472 per sqm in 2016 to RMB 7,072 per sqm in 2017.

Exhibit 7. Newly Acquired Land Bank by Regions in 2017

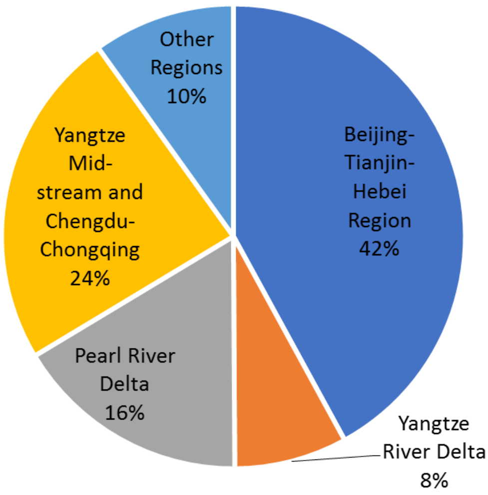
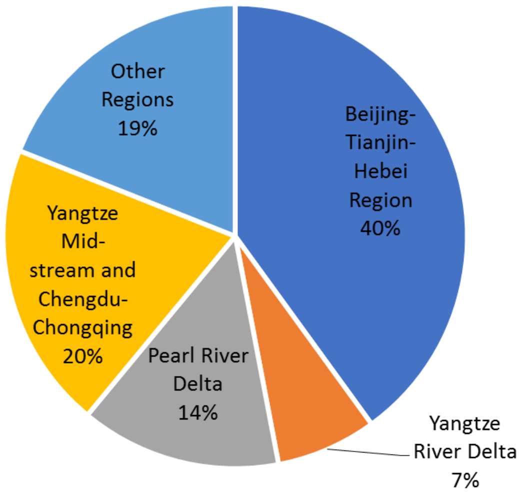


Exhibit 8. Total Land Bank by Regions as of 31 December 2017



Source: Company data, CCXAP research

The Company held sufficient reserve of land bank to support its development, but the significant scale of land bank may occupy its capital. As of 31 December 2017, the Company reported land bank for secondary land development of 34.1 million sqm, of which attributable land bank was 18.5 million sqm. Alongside the development in Greater Bay Area, Sino-Ocean participated in the urban redevelopment projects in Shenzhen, while these projects contributed total land bank of 5.0 million sqm to the Company. Sino-Ocean also engaged in primary land development, while it could provide an extra land bank of 4.9 million sqm to Sino-Ocean. As of 31 December 2017, the total land bank amounted to 43.5 million sqm. As for regional distribution, 40% of total GFA located in Beijing-Tianjin-Hebei Region, while Yangtze River Delta, Pearl River Delta and Yangtze Mid-stream and Chengdu-Chongqing and other regions accounted for 7%, 14%, 20% and 19%, respectively.

Rapid land acquisitions may challenge the business operation of Sino-Ocean and exert pressure on its capital expenditure. However, this can be partially offset by acquiring projects through M&A.

4. Investment properties provides recurring income

Sino-Ocean has accelerated the development of the business of investment properties, senior living and long-term rental apartments, aiming to create a synergy effect with its core business of property development.

Given the expansion of investment properties, Sino-Ocean adopted a new operating strategy of light asset mode transformation. With the new strategy, Sino-Ocean sells off shareholding of matured investment properties to raise its asset turnover, while it manages the projects and receives management and rental revenue. In 2017, Sino-Ocean had 7 projects operating under the new strategy in aggregate at end-2017.

In addition, since 2016, Sino-Ocean has entered into the co-working market by collaboration with WeWork, which is an experienced American office co-working space provider. As of 31 December 2017, there were 3 projects in operation and they located in the investment properties of Sino-Ocean.

In 2017, Sino-Ocean acquired 7 mature projects and newly opened 2 investment properties, which increased the total amount of operating investment properties to 18 with total GLA of 1.1 million sqm and an average occupancy rate of 91% at end-2017. The rental income generated from investment properties was RMB 2.9 billion in 2017, of which attributable rental income was RMB 1.9 billion, increasing 17.7% and 14.1% YoY, respectively.

The investment properties of Sino-Ocean mainly located first and second-tier cities, while 8 investment properties located in Beijing. Furthermore, the Company held 2 investment properties in US with over 90% occupancy rate, which improved the diversification of investment property portfolio and stabilize its recurring income. As for property type's breakdown, Grade-A offices, self-owned brand retails and commercial complexes accounted for 47.2%, 19.9% and 31.3% of total GLA, respectively.

We expect that the recurring revenue from investment properties would increase as Sino-Ocean planned to open 6 commercial complexes and grade-A offices in aggregate during 2018 to 2021, with additional GFA of 1.7 million sqm. Also, Sino-Ocean targeted to open 100 co-working projects with WeWork in aggregate by 2020.

5. Development in senior living and long-term rental apartments provides sustainable business model, with increase recurring income and stronger cash generation

The senior living business of Sino-Ocean is operated under the brand of Senior Living L'Amore by leasing small and medium-sized senior living apartments and providing nursing services. Since 2014 Sino-Ocean has cooperated with Meridian, a leading American dementia care operator, to improve its service quality with the operating and technical supports from Meridian. Apart from the 4 operating senior living projects in Beijing, Sino-Ocean newly opened 2 senior living projects in Shanghai and Wuhan in 2017, increasing the aggregate amount of operating projects to 6 with 1,500 beds at end-2017. Sino-Ocean targeted to earn revenue of RMB 1 billion in 2020, with 100 senior living projects and 25,000 beds in aggregate.

Sino-Ocean diversified its business into long-term rental apartments in 2017 under its own branding of Boonself by entering the market in first and core second-tier cities. As of 31 December 2017, Sino-Ocean had 5 projects in operation which providing 1,000 renting units. By 2020, Sino-Ocean aimed to increase the number of operating projects to 150 with 30,000 renting units in aggregate.

The business risk of senior living and long-term rental apartments was low given the supportive government policies. In addition, the diversification of business portfolio can stabilize the Company's revenue and strengthen its cash generation.

6. Moderate credit metrics with improving profitability but increased debt burden

The Company was experience in developing high-end products, which helped improve its profitability. In 2017, the gross profit margin was 24.5% and the return on equity was 11.6%, as compared to the ratio of 22.1% and 9.1% in 2016, respectively. We expect that the tightening regulation may exert pressure to the Company's revenue because the revenue from the first and second-tiers cities accounted for 92.7% of the revenue of property development business.

Sino-Ocean raised more debts to support the expansion of business. Sino-Ocean reported total debt of RMB 63.0 billion at end-2017, as compared to RMB 43.8 billion at end-2016 and RMB 54.5 billion at end-2015. As of 31 December 2017, the adjusted total capitalization ratio was 52.6% and the adjusted net gearing ratio was 67.3%.

Sino-Ocean maintained a relatively stable debt structure. As for the maturity profile, short-term debt accounted for 15.9% of total debt at end-2017. The Company increased the amount of onshore funding in 2017. The debt denominated in RMB increased to RMB 37.0 billion at end-2017, accounting for 58.8% of the total debt, while the debt denominated in USD and HKD represented 33.8% and 7.4%, respectively.

Exhibit 9. Maturity Profile of Debt in 2015-2017

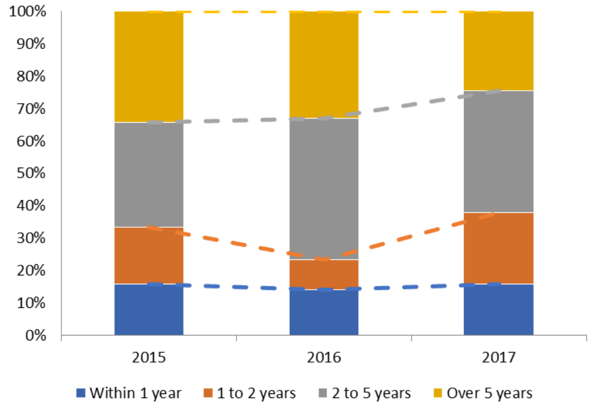
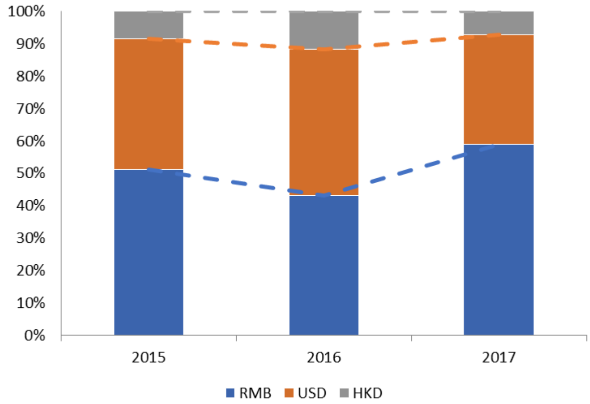


Exhibit 10. Currency Profile of Debt in 2015-2017



Source: Company data, CCXAP research

The Company's credit metrics weakened in 2017 due to the expansion in debt, but still maintained moderate. The total debt/EBITDA ratio was 5.3x in 2017, while it was 4.7x in 2016 and 8.9x in 2015. The interest coverage of Sino-Ocean improved because of the improving profitability. The EBITDA interest coverage ratio was 3.7x in 2017.

With increasing amount of joint venture projects, the Company demonstrated higher scale of due from related parties, increasing by 204.1% YoY to RMB 26.4 billion at end-2017. As of 31 December 2017, the guarantee to related parties amounted to RMB 2.5 billion, accounting for 4.3% of net assets, which was at a manageable level.

We will continue to monitor the credit metrics of Sino-Ocean because the Company would maintain high level of debt to support its business expansion while the tightening market regulation may cause uncertainties in profitability metrics.

7. Diversified funding channels and good liquidity buffer

Sino-Ocean maintained a good liquidity buffer with sufficient cash reserve and heightened credit line. As of 31 December 2017, the Company held cash reserve of RMB 24.8 billion, of which RMB 2.8 billion was pledged bank deposits. The cash to short-term debt ratio was 2.5x at end-2017, lower than 3.6x at end-2016 and 2.8x at end-2015.

As a listed company (Stock Code: 3377.HK), Sino-Ocean had good access to diversified funding channels in both onshore and offshore capital markets. The average finance cost decreased from 5.4% in 2016 to 5.2% in 2017. In 2017, Sino-Ocean issued RMB 1 billion corporate bonds and medium term notes with an aggregate amount of RMB 5 billion on the onshore market. On 22 September 2017, Sino-Ocean issued USD 600 million perpetual bonds with a coupon rate of 4.9%.

As of 31 December 2017, Sino-Ocean had unutilized credit facilities of RMB 147.1 billion. In addition, Sino-Ocean signed an agreement with Bank of Shanghai Co., Ltd. on 19 March 2018, which provided an extra credit facility of RMB 30 billion to the Company and improved its liquidity buffer.

Yet, the Company may face uncertainties on financing given the tightening financing environment and increasing interest rate and we will continue to monitor its access to capital and funding cost.

8. Strong major shareholder support

The major shareholder of Sino-Ocean is China Life, the largest commercial insurance group in Mainland China. As the only real estate investment platform, China Life had a track record of providing strong support to the Company by subscribing its shares and corporate bonds. On 15 March 2018, Sino-Ocean signed a cooperation agreement with China Life and adopted the insurance and senior living mode. The strong branding and broad customer base of China Life could provide support to the expansion of Sino-Ocean’s senior living business. 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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CCXAP has distributed and disclosed this solicited credit rating report to the rated entity prior to the publication date.

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