

**Credit Opinion**

5 July 2017

**Colour Life Services Group Co., Limited**

Hong Kong

Category:	Corporate Rating
Rating Type:	Solicited Rating
Industry:	Property Management
Long-term Credit Rating:	BB <sub>g</sub> +
Rating Outlook:	Stable

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**Key Indicators**

Colour Life Services Group Co., Limited <sup>[1]</sup>	2016	2015	2014
Total assets (RMB billion)	4.0	2.7	1.6
Total assets (USD billion) <sup>[2]</sup>	0.6	0.4	0.3
Net assets (RMB billion)	1.5	1.3	1.1
Net assets (USD billion) <sup>[2]</sup>	0.2	0.2	0.2
Total revenue (RMB billion)	1.3	0.8	0.4
Total revenue (USD billion) <sup>[2]</sup>	0.2	0.1	0.1
Net Profit (RMB million)	216.0	182.7	150.5
Net Profit (USD million) <sup>[2]</sup>	31.1	28.1	24.6
Gross Margin (%)	43.6	54.9	79.6
EBITDA Margin (%)	28.8	35.1	57.3
Return on Equity (%)	15.2	15.3	23.7
Total debt / Total capital (%)	46.6	31.3	10.5
Total debt / EBITDA (x)	3.5	2.0	0.6
EBITDA / Interest (x)	10.2	26.2	116.3

[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

- Leading market position in the property management industry
- Diversified model drives business growth
- Increase in revenue but decline in profitability
- Moderate debt leverage and improving debt structure
- Good liquidity buffer and diversified financing channels

## Rating Rationale

The BB<sub>g</sub>+ rating of Colour Life Services Group Co., Limited (“Colour Life” or the “Company”) is supported by the Company’s (1) leading market share in China’s property management industry; (2) fast business expansion through multiple channels; and (3) increasing property management fees generated. The rating is also constrained by the Company’s (1) falling gross profit margin due to the change in portfolio composition; and (2) higher leverage compared with previous years.

## Rating Outlook

The stable outlook on Colour Life’s rating reflects its leading market position in the property management industry. We believe that the Company will maintain its competitiveness in the future.

### What could upgrade the rating?

The rating could be upgraded if the Company (1) generates increasing property management fees through further business expansion; (2) improves its profitability by developing its value-added services; and (3) lowers its debt leverage and improves its credit metrics.

### What could downgrade the rating?

The rating could be downgraded if the Company (1) adopts aggressive expansion that leads to operating inefficiencies; (2) heightens its leverage; and (3) demonstrates deteriorated credit metrics.

## Corporate Profile

Colour Life was incorporated in 2002, and was listed on the HKEX in 2014 (Stock Code: 1778.HK). As of 31 December 2016, Fantasia Holdings Group Co. Limited (“Fantasia”), who was also a listed company on the HKEX (Stock Code: 1777.HK), directly held approximately 50.4% of the Company’s shares. The ultimate controlling shareholder of Colour Life was the same with that of Fantasia, Ms. Zeng Jie Baby.

The principal business of Colour Life and its subsidiaries include property management, provision of engineering services, community leasing, sales and other services. In terms of property management services, as of 31 December 2016, the Company provided services to residential communities in 208 cities in mainland China, Hong Kong and Singapore.

As of 31 December 2016, Colour Life reported total assets of RMB 4.0 billion, and net assets of RMB 1.5 billion. In 2016, Colour Life generated total turnover and net profit of RMB 1.3 billion and RMB 0.2 billion, respectively.

## Detailed Rating Considerations

### 1. Labor-intensive property management industry exhibits low profitability

The history of property management industry in mainland China started in 1981, when the first property management company was established in Shenzhen. Since then the development of Shenzhen's property management was replicated in other regions of China, and the industry has experienced a steady growth. The main driver of the demand of property management industry was China's increasing urban population and the rapid growth of real estate market. From 2012 to 2016, total GFA under management of the industry recorded a CAGR of 6.24%, while total GFA under management reached 18.5 billion sqm at end-2016. In the future, we expect the rapid urbanization and growing disposable income per capita will continue to drive the demand of property management industry.

The traditional property management industry is labor-intensive. Property management companies need to employ a large amount of labor to operate the traditional scope of services, such as security, cleaning, gardening, repair and maintenance. Due to the growing wage and the stable average property management fees in major cities, property management companies exhibit low profitability with increasing cost pressure. According to China Index Academy's statistics of the top 100 companies, labor cost represented 53.4% of total cost, and the net profit margin was 7.29% in 2016. Property management companies have outsourced some labor-intensive part of their operations and incorporated information technology methods to enhance service quality and reduce labor cost.

Amid rising labor cost, property management companies seek for the development of value-added services, profit margin of which is relatively higher than the traditional property management services. The innovative scope of services includes housekeeping, engineering, rental and leasing, real estate agencies, and e-commerce. The percentage of revenue generated from other services of the top 100 companies in the industry accounted for 17.3% in 2016, with a YoY growth of 20.0%. We expect property management companies will continue to develop the fast growing and more profitable value-added services in the future.

In general, the property management industry in China is highly fragmented. Though the industry concentration improved in 2016, the GFA under development of top 100 market players represented 29.4% of the whole industry. The average GFA under management of top 100 companies reached 27.3 million sqm in 2016, increasing by 15.7% YoY. While the large property management companies will continue to grow their operational size, we expect industry consolidation will improve the efficiency of the property management industry.

### 2. Leading company in the property management industry

The history of the Company's property management segment can be traced back to the establishment of Shenzhen Colour Life Property Management in May 2002. Since then, the Company has first operated the property management services such as security, cleaning, gardening, repair and maintenance of the residential communities in Shenzhen, and gradually expanded to Southern and Eastern China. After its IPO in June 2014, the Company has further improved its market position. As of 31 December 2016, Colour Life operated in 208 cities in mainland China, and also provided property management services in Hong Kong and Singapore. The GFA under management of Colour Life reached 395.1 million sqm, becoming the largest property management company in terms of the

scale of managed residential area in the industry. Meanwhile, only 1.2% of the properties managed by Colour Life were constructed by Fantasia, indicating the Company's low reliance on its parent company.

Colour Life has achieved strong brand name in the property management industry. The Company was honored as the "TOP 100 Property Management Companies of China" by China Property Management Institute and China Index Academy from 2009 to 2016. In June 2016, the Company was awarded "2016 TOP 10 Property Management Companies in terms of Growth Potential" and "2016 China Specialized Property Service Company – Intelligent Community". As for business scale, the Company was also awarded "2016 China TOP 10 Property Management Companies in terms of Business Size" and "2015 World Largest Property Management Company in terms of Scale of Residential Properties Managed".

### **3. Multiple development channels of business expansion**

Colour Life adopted multiple development channels of business expansion, and enlarged its GFA under management through organic growth, acquisition, and cooperation.

The Company implemented organic growth by establishing strong reputation and high service quality. This helped attract real estate developers and owners to enter into service contracts with Colour Life. The Company added total contracted GFA of 131.2 million sqm in 516 residential communities to its property management portfolio through new engagements during the period from 2014 to 2016.

The Company also achieved fast business growth by actively exploring acquisition opportunities. The Company added total contracted GFA of 147.5 million sqm in 1,089 residential communities to its property management portfolio through acquisitions during the period from 2014 to 2016. In February 2015, the Company acquired 100% shares of Shenzhen Kaiyuan International Property Management ("Kaiyuan International"), which consisted of high-end properties with contracted GFA of 29.3 million sqm. In August 2016, the Company's parent company, Fantasia acquired Wanda Property Management Co., Ltd ("Wanda Property"), and Colour Life would provide property management consultancy services to the residential portion of Wanda Property.

Starting from 2016, the Company approached to and cooperated with partners which facilitated the further expansion of its online platform service area. In November 2016, the Company entered into a strategic cooperation with Shanghai Yinwan Life Network Co., Ltd. ("Yinwan Network"), which allowed Colour Life to provide value-added services to the projects of Yinwan Network. The cooperation method of expansion required less capital expenditure compared with the acquisition method, and we will monitor the Company's process of implementing lighter and quicker expansion strategy.

### **4. Operating both traditional property management services and value-added services**

Colour Life's coverage of services continued to grow. As of 31 December 2016, Colour Life provided online platform services to 3,175 communities with a total contracted GFA of 519.6 million sqm. Among them, 2,172 communities with a GFA of 357.5 million sqm were directly managed by the Company. The property management service agreements usually have a maturity of three to five years. Since switching to another property management company required votes from more than half of the homeowners, most of the contracts would retain after the previous contracts expired.

**Exhibit 1. Property management services as of 31 December 2014, 2015 and 2016**

	Contracted GFA (thousand sqm)			Number of Communities		
	2016	2015	2014	2016	2015	2014
Managed by the Company	357,521	303,473	137,164	2,172	1,879	796
Under the Company's consultancy service arrangements	37,599	18,651	68,086	167	122	469
Cooperated with the Company	124,445	—	—	836	—	—
<b>Total</b>	<b>519,565</b>	<b>322,124</b>	<b>205,250</b>	<b>3,175</b>	<b>2,001</b>	<b>1,265</b>

Source: Company data, CCXAP research

Meanwhile, as of 31 December 2016, 167 communities with a GFA of 37.6 million sqm were managed through consultancy service agreements of the Company. By providing consultancy services to these communities, the Company recognized executable and profitable projects, and acquired some of these property management companies, thus transferring to the residential community portfolio under the Company's management.

As of 31 December 2016, there were 836 communities with a GFA of 124.4 million sqm that the Company has entered into cooperation with other partners. Through cooperation in platform service, the Company output its online platform and vertical application services to targeted partners, sharing the profit newly added from online services.

In terms of regional distributions, the Company mainly operated in the regions with high disposable income population and property management service demand. The GFA under management in Southern China and Eastern China together contributed to 53.2% in 2016. The Company also expanded its business in Southwestern China, GFA of which represented 14.9% of total GFA in 2016.

**Exhibit 2. Regional distribution of property management services as of 31 December 2014, 2015 and 2016**

Region	% of Contracted GFA			% of Residential Communities		
	2016	2015	2014	2016	2015	2014
Shenzhen	2.7	2.6	2.7	6.4	7.3	9.5
Southern China (excluding Shenzhen)	19.5	19.3	23.5	21.5	21.5	24.3
Eastern China	31.0	34.7	38.4	32.6	34.7	36.2
Southwestern China	14.9	12.9	10.3	14.8	11.9	7.4
Northeastern China	3.8	4.2	4.4	3.2	3.9	4.7
Northwestern China	4.9	4.8	5.3	4.0	3.4	4.3
Northern China	5.4	4.9	5.5	4.6	4.4	2.9
Central China	17.7	16.3	9.5	10.6	9.9	8.5
Hong Kong	0.0	0.0	0.0	0.7	0.8	0.0
Singapore	0.2	0.3	0.3	1.6	1.9	2.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Company data, CCXAP research

Apart from property management services, the Company also provided engineering services to property developers and communities under its management. Along with the Company's increasing GFA under management, the Company's engineering services also expanded. However, engineering services fees decreased by 6.9% to RMB 126.1 million in 2016, resulting from the Company's decision to outsource some of the repair and maintenance services to contracted providers.

The Company achieved diversified development through community leasing, sales and other services. Colour Life constructed an open online platform, Caizhiyun APP, which enabled residents to purchase services or goods. As of 31 December 2016, registered users of Caizhiyun APP increased to 3,026,000 and the active users amounted to 1,737,000, increasing by 51.1% and 102.4% YoY, respectively. Community leasing, sales and other services added RMB 156.9 million to the Company's operating revenue in 2016, increasing by 48.1% YoY.

## 5. Increasing revenue generated but weakened profitability

The Company's enlarged service area led to larger revenue. The Company recorded revenue of RMB 1.3 billion in 2016, RMB 0.8 billion in 2015 and RMB 0.4 billion in 2014. The main source of revenue of Colour Life was its property management services. In 2016, revenue from property management services accounted for 78.9% of total revenue, while engineering services and community leasing, sales and other services contributed 9.9% and 12.9% to the total revenue, respectively. As for the property management services, since most of the existing service agreements would continue after expiration, the revenue of Colour Life is expected to be relatively stable in the future.

### Exhibit 3. Breakdown of total revenue in 2014-2016

	2016	2015	2014
Property management services	78.9%	70.8%	60.7%
Engineering services	9.9%	16.4%	22.5%
Community leasing, sales and other services	12.9%	12.8%	16.8%

Source: Company data, CCXAP research

Despite the increasing revenue generated, Colour Life's profit margin weakened. The overall gross profit margin of the Company was 43.6% in 2016, 54.9% in 2015 and 79.6% in 2014. In terms of different segments, the gross profit margin of property management services fell to 35.6% in 2016 from 46.8% in 2015 and 80.4% in 2014. That of engineering services and community leasing, sales and other services also slightly declined to 51.0% and 91.9% in 2016, respectively.

The decline in gross profit margin was mainly due to the increasing GFA under lump sum basis. The Company's acquisition and expansion increased the revenue proportion generated from property management services under lump sum basis. The property management fees are mainly charged on commission basis or lump sum basis, which have different accounting treatments. The property owners bear the cost of property management under commission basis, while the property management companies bear the cost under lump sum basis. Thus the gross profit margin of commission basis was nearly 100%, while that of lump sum basis was relatively lower. In 2016, the GFA under lump sum basis grew to 50.2 million sqm, and the property management fees generated from these properties also increased to RMB 0.8 billion, representing 71.6% of total property management revenue.

**Exhibit 4. Breakdown of revenue from property management services in 2014-2016**

	2016	2015	2014
Commission basis	15.5%	24.5%	51.4%
Lump sum basis	71.6%	49.2%	12.8%
Pre-sale services	8.7%	17.9%	13.1%
Consulting fees	4.3%	8.4%	22.6%

Source: Company data, CCXAP research

The business expansion of communities under management required more effective cost control of the Company. Administrative expenses accounted for over 20% of the Company's revenue. The EBITDA margin, which was measured using EBITDA divided by revenue, fell from 57.3% in 2014 to 35.1% in 2015 and 28.8% in 2016, which was mainly due to the falling gross profit margin as well as the increasing share based compensation.

In general, Colour Life's enlarged business scale helped generate larger revenue and relatively strong profitability. However, the change in revenue structure lowered the Company's overall profitability recently.

## 6. Moderate leverage and improving debt structure

Colour Life had moderate but heightened debt leverage. As of 31 December 2016, the Company reported total debt of RMB 1.3 billion, increasing by RMB 0.7 billion YoY. The debt to capital ratio was 46.6% in 2016, as compared to 31.3% in 2015 and 10.5% in 2014, which was still at a controllable range.

As for the maturity profile, short-term debt represented 16.0% of total debt as of 31 December 2016, lower than that of 51.1% as of 31 December 2015. This reflected an improvement in the Company's debt structure. As for the currency, as the Company's borrowings were denominated in RMB, there existed limited foreign exchange loss for the Company's operations.

The Company's debt servicing capability remained at a moderate level. The total debt to EBITDA ratio was 3.5x in 2016, which was higher than that of 2.0x in 2015 and 0.6x in 2014. The EBITDA interest coverage was 10.2x in 2016, which was lower than that of 26.2x in 2015 and 116.3x in 2014.

## 7. Good liquidity buffer and multiple funding channels

Colour Life had good liquidity buffer. As of 31 December 2016, the Company held cash reserves of RMB 1.2 billion, while net cash flow from operating activities was RMB 321.8 million. The Company's liquidity was sufficient to cover its short-term debt of RMB 213.6 million. In addition, the funds from operations to total debt ratio was 0.3x, while the retained cash flow to net debt ratio was 3.6x in 2016.

The Company financed through diversified channels. Colour Life is a Hong Kong listed Company, and has tapped into the onshore bond market. In January 2016, Shenzhen Colour Life Services Group Co., Ltd. ("Shenzhen Colour Life"), a wholly-owned subsidiary of the Company, issued domestic corporate bonds in aggregate principal amount of RMB 0.1 billion at a rate of 6.7%. In September 2016, Shenzhen Colour Life issued domestic corporate bonds in aggregate principle amount of RMB 0.3 billion at a rate of 7.0%. Shenzhen Colour Life also issued ABS under securitisation arrangements collateralised by the future cash inflows relating to property management fee with aggregate nominal value of RMB 0.3 billion.

## 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
<b>AAAg</b>	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.
<b>AAg+</b> <b>AAg</b> <b>AAg-</b>	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.
<b>Ag+</b> <b>Ag</b> <b>Ag-</b>	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.
<b>BBBg+</b> <b>BBBg</b> <b>BBBg-</b>	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.
<b>BBg+</b> <b>BBg</b> <b>BBg-</b>	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.
<b>Bg+</b> <b>Bg</b> <b>Bg-</b>	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.
<b>CCCg</b>	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.
<b>CCg</b>	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.
<b>Cg</b>	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.
<b>Dg</b>	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.

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

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