Credit Opinion

25 May 2018

Future Land Holdings Co., Ltd.

Hong Kong

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

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Key Indicators

Future Land Holdings Co., Ltd. [1]	2017	2016	2015
Total Assets (RMB billion)	183.5	103.2	67.8
Total Assets (USD billion) [2]	28.1	14.9	10.4
Net Assets (RMB billion)	26.0	16.4	13.9
Net Assets (USD billion) [2]	4.0	2.4	2.1
Total Revenue (RMB billion)	40.5	28.0	23.6
Total Revenue (USD billion) [2]	6.2	4.0	3.6
Net Profit (RMB billion)	6.3	3.2	2.4
Net Profit (USD billion) [2]	1.0	0.5	0.4
Gross Margin (%)	33.6	23.4	21.2
Return on Equity (%)	29.6	20.9	18.4
Total Capitalization Ratio (%)	63.2	61.6	53.7
Net Gearing Ratio (%)	87.5	78.3	69.4
Total Debt / EBITDA (x)	4.0	5.1	3.9
EBITDA / Interest (x)	5.2	3.7	3.4

[1] Consolidated financial statements in accordance with PRC GAAP audited by PwC China

[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

- Strong revenue and sales growth as supported by expanding operating scale, improving geographical diversification, and rapid asset turnover strategy
- Active land bank acquisitions exert pressure on capital expenditures, but partially offset by strong contracted sales collections
- Strengthened recurring cash generation as supported by expansion in investment properties
- Expansion of debt, but moderate credit metrics
- Adequate liquidity profile and good access to capital

Rating Rationale

The A_g+ long-term credit rating and senior unsecured debt rating of Future Land Holdings Co., Ltd. ("FLH" or the "Company") is underpinned by the Company's (1) strong revenue and sales growth supported by rapid asset turnover strategy; (2) improving geographic diversification with a focus on Yangtze River Delta; (3) strengthened cash generation capability from investment properties; and (4) improving profitability metrics. However, the rating is also constrained by (1) tightening regulatory environment with uncertainties in property market; (2) active land acquisitions and expanding investment properties which exert pressure on capital expenditures; and (3) increasing debt burden.

Rating Outlook

The stable outlook on FLH's rating reflects its strong sales growth in property development and recurring revenue from commercial complexes. We expect that the Company's operating scale will continue to increase with high degree of geographical diversification and more sustainable revenue generation.

What could upgrade the rating?

The ratings could be upgraded if the Company (1) maintains stable growth in contracted sales and 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 ratings 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

Found in 1993, FLH was established as a limited liability company in Changzhou. In December 2015, FLH completed a restructuring by merging its subsidiary, Jiangsu Future Land Co., Ltd., and listed as A shares on the Shanghai Stock Exchange (Stock Code: 601155.SH). As of 31 December 2017, Mr. Wang Zhenhua was the controlling shareholder of FLH by indirectly holding 67.1% of the Company's shares. FLH is one of the leading property developers in Yangtze River Delta, which also diversified its property portfolio into Pearl River Delta, Bohai Rim and Central and Western China.

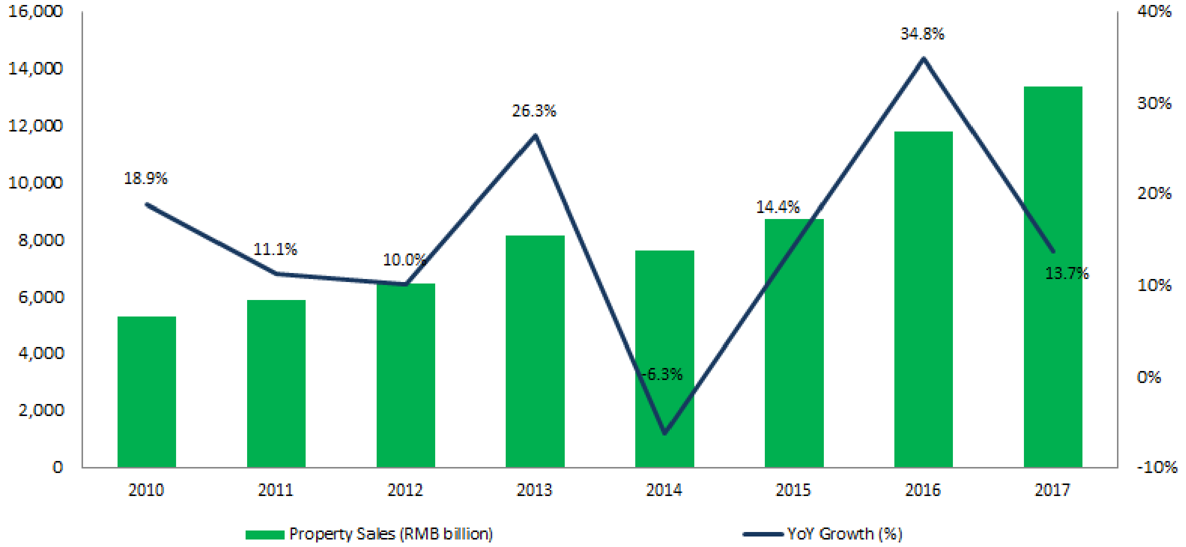
Detailed Rating Considerations

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.

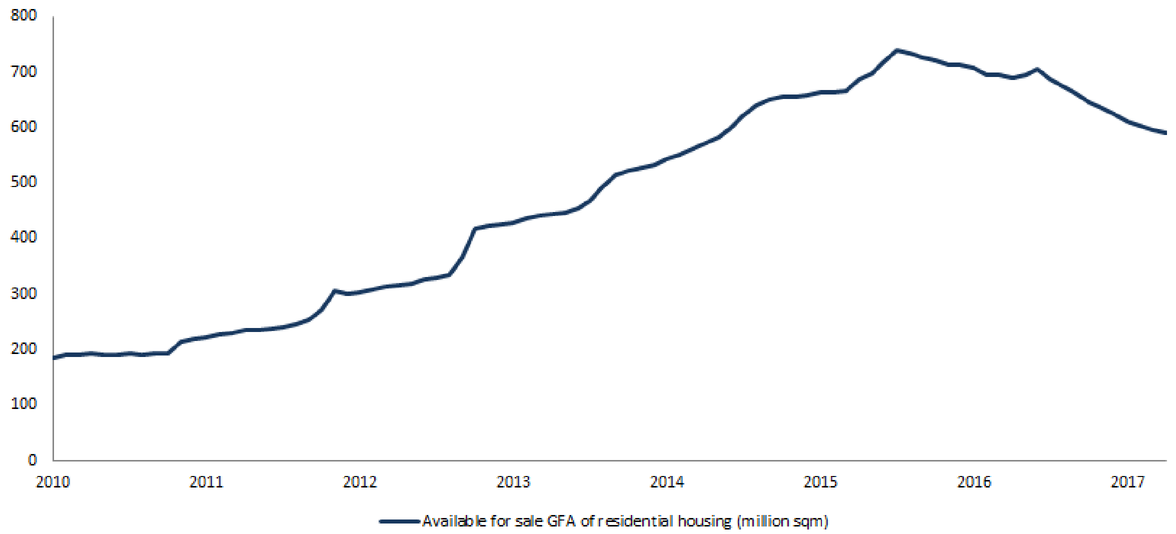
Exhibit 1. China's Property Contracted Sales in 2010-2017 (RMB billion)



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)



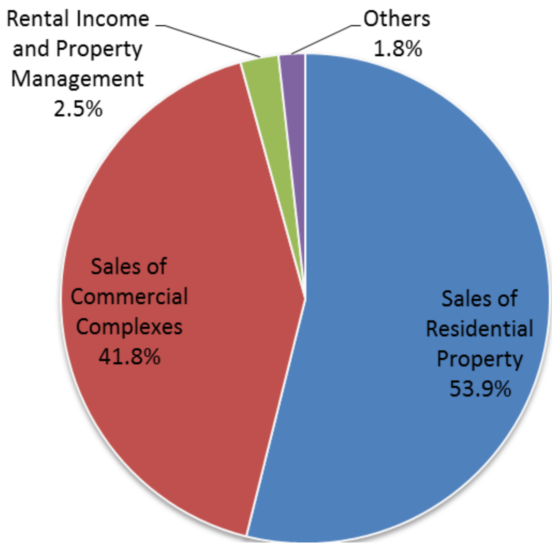
Source: National Bureau of Statistics of China, CCXAP research

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. Strong revenue and sales growth as supported by expanding operating scale, improving geographic diversification, and rapid asset turnover strategy

The sales of residential properties and commercial complexes were the key drivers of FLH's revenue, accounting for 53.9% and 41.8% of total revenue in 2017. With the increasing amount of completed projects, FLH reported total revenue of RMB 40.5 billion in 2017, increasing by 44.9% YoY.

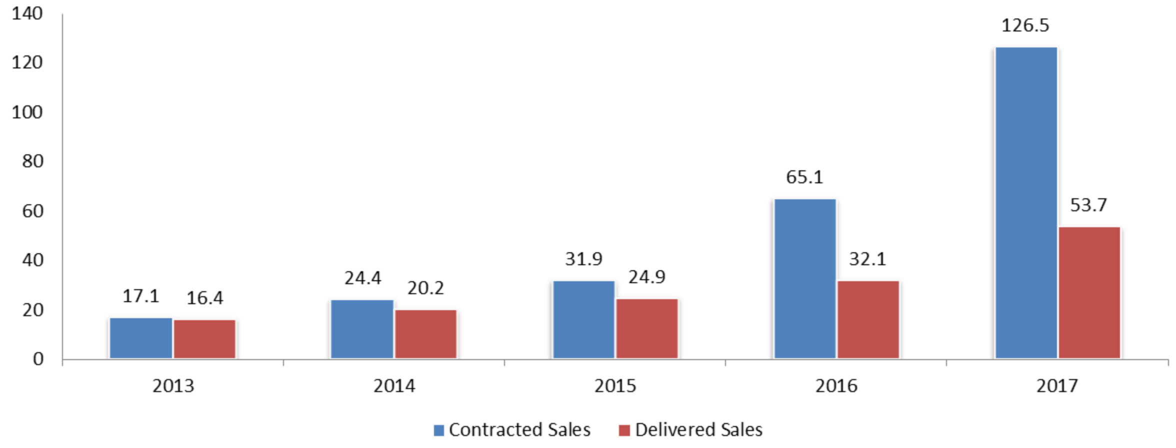
Exhibit 3. Revenue Breakdown of the Company in 2017



Source: Company data, CCXAP research

The Company's development strategy of "regional focus, rapid turnover and diverse products" helped provide a solid foundation for its rapid growth. FLH maintained a strong market position by consolidating its market share in the tier-one and tier-two cities in Yangtze River Delta and expanding into Pearl River Delta, Bohai Rim and Central and Western China. FLH's residential property portfolio included five product series of "FirstHomes", "SweetHomes", "DreamHomes", "PrestigeHomes" and "Puyue" targeting first time buyers, young families, mid-to-high income households, high net worth households and premium buyers, respectively. The adoption of rapid asset turnover strategy helped reduce the time period of land acquisition, pre-sale and project completion. The time period between land acquisition and pre-sale could be less than one year, which supported the rapid expansion of the Company with a high cash collection ratio of over 85%.

Exhibit 4. FLH's Contracted Sales and Delivered Sales in 2014-2017 (RMB billion)



Source: Company data, CCXAP research

In 2017, the Company's contracted sales increased by 94.4% YoY to RMB 126.5 billion while the contracted GFA increased by 61.4% to 9.3 million sqm, of which the attributable contracted sales and GFA were 89.9 billion and 7.1 million sqm, respectively. The contracted average selling price (excluding carparks) increased from RMB 12,090 per sqm in 2016 to RMB 14,520 per sqm in 2017. Given the expanding operating scale, FLH ranked 13th among the property developers in Mainland China in terms of contracted sales value in 2017, as compared with the ranking of 15th in 2016.

Exhibit 5. Contracted Sales by City in 2017

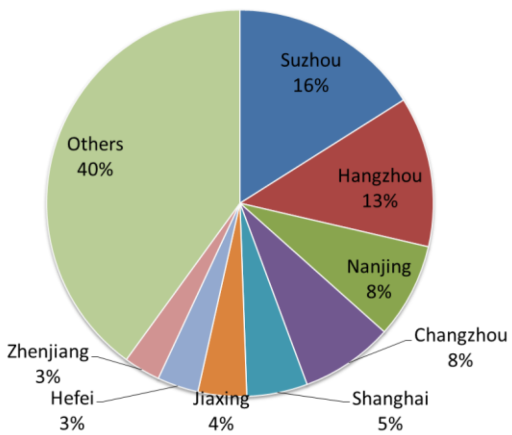
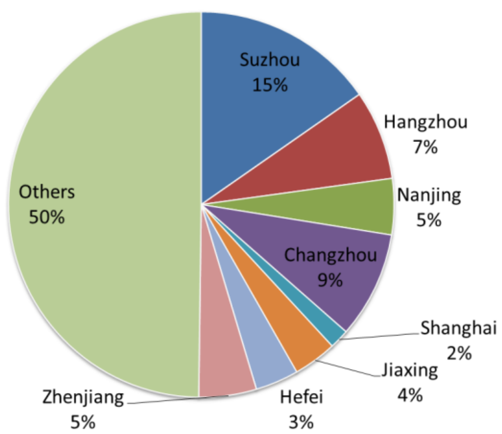


Exhibit 6. Contracted GFA by City in 2017



Source: Company data, CCXAP research

In 2017, the contracted sales in Yangtze River Delta were the main growth driver which accounted for 78.7% of the Company's total contracted sales, while Bohai Rim, Central and Western China represented 8.6% and 10.8% of the total sales respectively. FLH's contracted sales were more diversified in terms of breakdown by cities. The contracted sales in Suzhou, Hangzhou, Nanjing, Changzhou and Shanghai contributed 16.0%, 12.6%, 8.0%, 7.8% and 5.1% of the total contracted sales in 2017 respectively, representing about 49.4% in aggregate, as compared to 56.0% in 2016. As for product mix, residential properties and commercial complexes contributed 66.8% and 30.5% of the Company's total contracted sales in 2017.

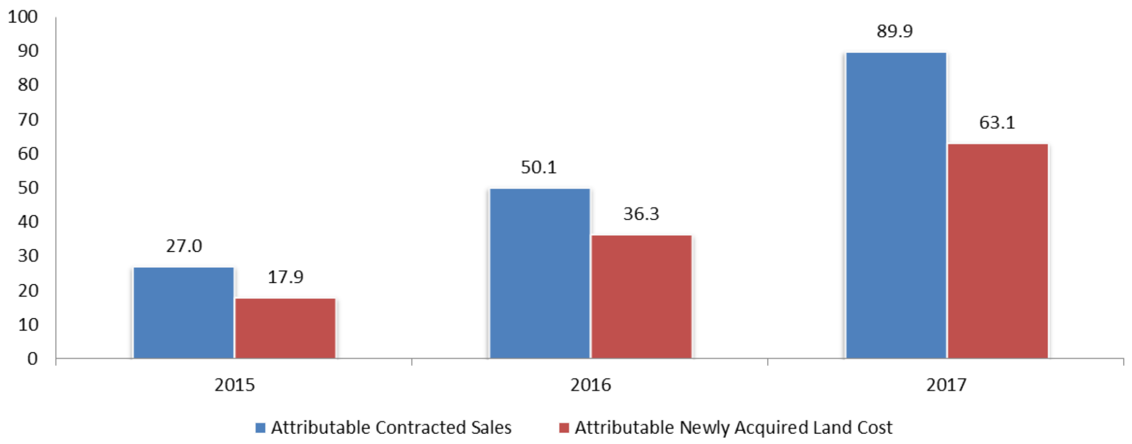
In the first quarter of 2018, FLH's contracted sales were RMB 37.9 billion, increasing by 63.7% YoY. With the expected saleable resources of RMB 400 billion in 2018, we expected that FLH would have enough resources to achieve its contracted sales target of RMB 180 billion in 2018.

3. Active land acquisitions exert pressure on capital expenditures, but partially offset by increase in contracted sales

FLH maintained a sizeable capital expenditure on land acquisition so as to support its rapid expansion of operating scale. In 2017, FLH acquired 122 new projects with total GFA of 33.9 million sqm at a cost of RMB 89.4 billion. Given more newly acquired projects in lower-tier cities such as Huizhou and Xuzhou, the Company's average land cost reduced from RMB 3,762.1 per sqm in 2016 to RMB 2,633.7 per sqm in 2017.

With the "1+3" business strategy, the Company kept focusing on Shanghai and Yangtze River Delta as well as expanding into Pearl River Delta, Bohai Rim and Central and Western China. As for regional breakdown, the GFA of newly acquired projects in Yangtze River Delta represented 50.2% of the total GFA while Pearl River Delta, Bohai Rim and Central and Western China accounted for 5.7%, 8.9% and 35.2% of the total. In addition, FLH accelerated the development in the Central and Western China in 2017 while it newly acquired 11 projects in Chengdu and 4 projects in Chongqing with total GFA of 2.1 million sqm and 0.9 million sqm respectively. The active land acquisitions of FLH were supported by the growing contracted sales. In 2017, the attributable contracted sales and attributable newly acquired land cost to the Company were RMB 89.9 billion and RMB 63.1 billion, respectively.

Exhibit 7. Attributable Contracted Sales and Attributable Newly Acquired Land Cost in 2015-2017 (RMB billion)



Source: Company data, CCXAP research

As of 31 December 2017, FLH had a total land bank of 68.5 million sqm, of which the land bank in Yangtze River Delta, Pearl River Delta, Bohai Rim and Central and Western China accounted for 54.3%, 4.9%, 14.3% and 24.9%, respectively. FLH continued to improve the diversification of its property portfolio in 61 cities.

Exhibit 8. Newly Acquired Land bank by Cities in 2017

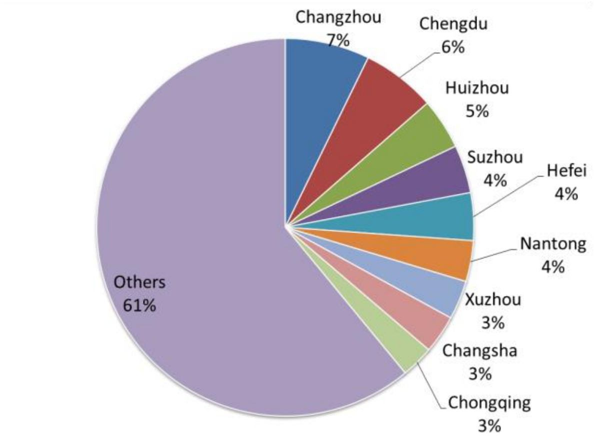
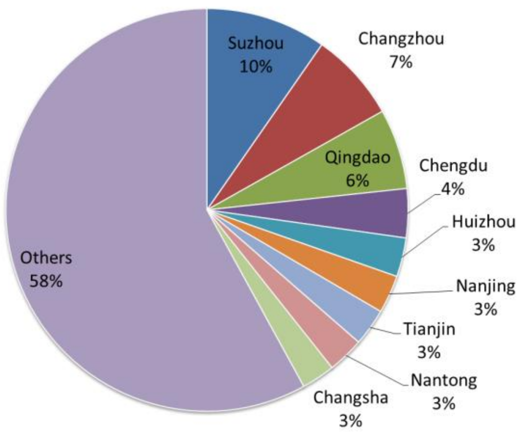


Exhibit 9. Land Bank by Cities as of 31 December 2017



Source: Company data, CCXAP research

The Company could reduce the investment risk through developing projects by using joint venture partnership with large property developers, such as Vanke Co., Ltd. and Country Garden Holdings Company Limited. In addition, developed through joint venture partnership could assist the Company to expand into new markets, which included Hefei and Xuzhou.

The sufficient reserve of land bank supports the Company’s development in the next 3-4 years. However, given the rapid business expansion, we believe that FLH will continue the execution of active land acquisition strategy and its business operation may be challenged by the fast growing scale of its total land bank.

4. Expansion in the investment properties which strengthened the Company’s cash generation capability, but the rapid growth may exert pressure on capital expenditure

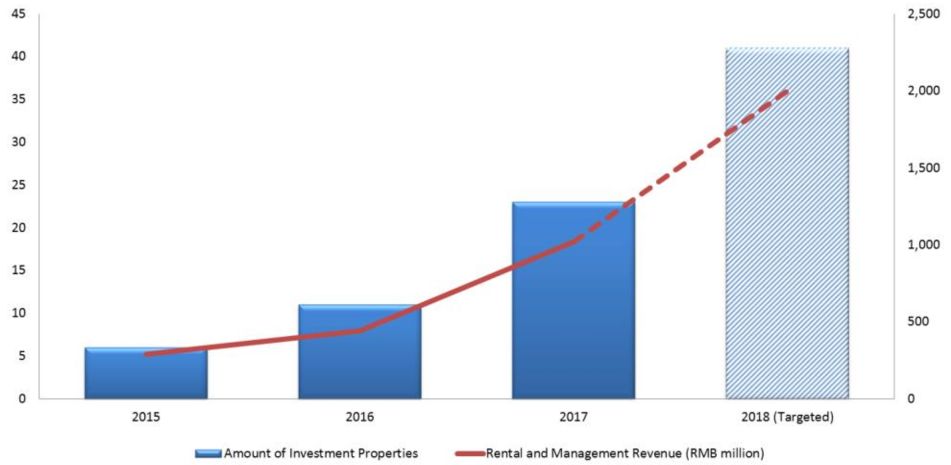
With the residential and commercial two-wheel driven model, investment properties were one of the core businesses of the Company, so it accelerated the development of investment properties in 2017 with 12 newly opened commercial complexes. In order to support rapid growth and improve customer experience, FLH elevated the development model of “Wuyue” series by integrating local culture into commercial complexes.

The expansion of investment properties helped provide recurring rental revenue and cash flow to the Company. As of 31 December 2017, the Company had 24 investment properties, of which 4 of the investment properties were operated under the asset-light operation model. With the increasing amount of investment properties, the Company generated rental income and property management revenue of RMB 1.0 billion in 2017, increasing by 131.0% YoY. The average occupancy rate was 97.9% at end -2017, which reflected a mature operating model and strong branding of the Company’s investment properties.

As for regional breakdown, FLH focuses on Yangtze River Delta. The investment properties in Yangtze River Delta contributed 77.2% of the rental income and property management revenue in 2017. To increase the coverage of commercial complexes and served population, FLH expanded into lower-tier cities. In 2017, the investment properties in lower-tier cities contributed 59.7% of the revenue. In 2018, FLH planned to open 18 commercial complexes with total GFA of 4.0 sqm, of which the commercial complexes in Yangtze River Delta and in lower-tier cities represented 73.9% and 73.3% of the GFA, respectively.

The targeted rental income and property management revenue in 2018 was RMB 2.0 billion. Half of the newly opened commercial complexes in 2017 started operation in 2017Q4. Also, 18 commercial complexes will be opened in 2018, which further increase the leasable GFA of FLH. We expect that the investment properties will generate higher revenue in 2018 and the Company may achieve its targeted revenue.

Exhibit 10. Number of and Revenue from Investment Properties in 2015-2018



Source: Company data, CCXAP research

FLH planned to start constructing 24 commercial complexes with total GFA of 8.7 million sqm in 2018 to expanding the operating scale of investment properties. We expect that the rental income and property management revenue will continue to increase in the next 2 to 3 years. However, the Company's development strategy of commercial properties could result in additional pressure on capital expenditure.

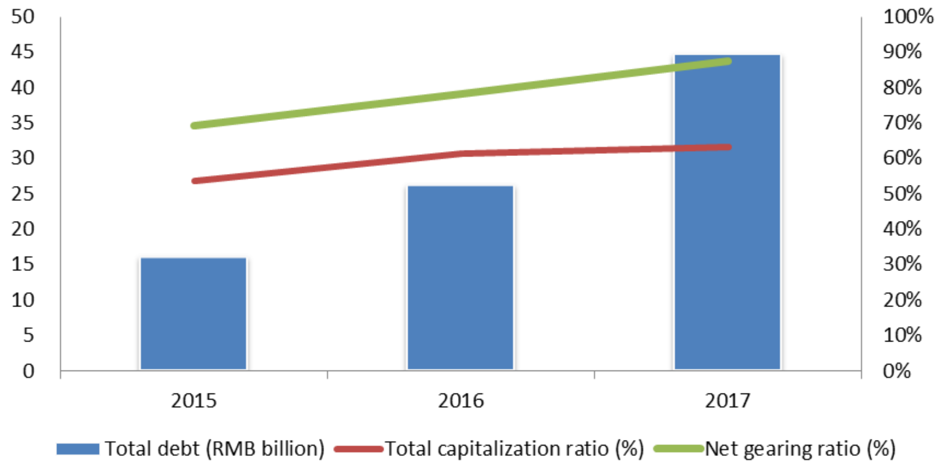
5. Moderate credit metrics with improvement in profitability but expansion of debt

FLH's profitability has improved since 2014 due to the increasing property price. As the property sales were mainly came from Yangtze River Delta and the property price in this region has increased significantly since 2015, the average selling price of delivered property products of FLH was RMB 10,582.7 per sqm in 2017, RMB 9,849.1 per sqm in 2016 and RMB 8,413.7 per sqm in 2015. The Company's gross profit margin was 33.6% and the return of equity was 29.6% in 2017, while they were 23.4% and 20.9% in 2016 respectively. Given the property sales of FLH mainly come from Yangtze River Delta, we expect that the tightening market regulation may exert pressure to its profitability.

The Company's debt level significantly increased because of the sizeable capital expenditure on land acquisitions. As of 31 December 2017, the Company reported total debt of RMB 44.7 billion, as compared to that of RMB 26.2 billion at end-2016 and RMB 16.1 billion at end-2015. We expected the Company will remain a relatively high debt level in order to support expanding operating scale.

FLH maintained a moderate credit metrics. As of 31 December 2017, the total capitalization ratio and net gearing ratio was 63.2% and 87.5%. With higher profitability, the total debt to EBITDA ratio was 4.0x while the EBITDA interest coverage ratio was 5.2x in 2017, as compared to the ratio of 5.1x and 3.7x in 2016 respectively.

Exhibit 11. Debt Level and Debt Leverage in 2015-2017



Source: Company data, CCXAP research

6. Adequate liquidity profile and good access to capital

FLH maintained an adequate liquidity profile. As of 31 December 2017, the cash to short-term debt ratio was 1.1x, which showed that the Company's adequate cash reserves to meet its short-term debt obligations. With the development of investment properties, we expect the Company's cash generation capability can be improved but we will continue to monitor its cash flow and liquidity position given its rapid expansion.

As an A-share listed company (Stock Code: 601155.SH), FLH has demonstrated good access to both onshore and offshore capital market. The Company's funding cost reduced from 5.5% in 2016 to 5.3% in 2017 with a more diversified funding channel. In 2017, the Company issued domestic mid-term notes through private placement with an aggregate amount of RMB 4.5 billion. On 8 August 2017 and 12 February 2018, FLH issued USD 200 million guaranteed senior notes with a coupon rate of 5% due 2022 and USD 300 million short-term bonds with a coupon rate of 4.75% through its offshore subsidiary, New Metro Global Limited. As of 31 December 2017, FLH's total credit facilities amount was RMB 65.3 billion, of which unutilized amount was RMB 54.5 billion. The deleverage process and increasing interest rate may exert pressure to the Company's funding and we will continue to monitor the Company's access to capital as well as its funding cost.

Subordination considerations

We did not notch FLH's senior unsecured debt rating from its long-term credit rating. As of 31 December 2017, the Company's secured debt amounted to RMB 17.9 billion, representing 9.7% of the total assets, as compared to secured debt of RMB 6.7 billion or 6.5% of total assets in 2016. Although banks loans will remain as one of the major funding sources for the Company, we expect that the structural subordination risk is manageable.

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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