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Implications of Greentown's 1H14 deterioration

Greentown's (GT) 1H14 results look weak. Sales are down YTD (-13% YoY), with meaningful chance of undershooting the company's FY13 sales and its FY14 sales target. Revenues were up 23%, but EBITDA (E) was eroded to a 9% decline by weaker gross and EBITDA margins, reflecting price, as well as cost, pressures. This, plus losses at its associates, drove a 60% drop in net income. Meanwhile, gross debt was up by a fifth, cash fell 16% to rather low-looking levels (0.5x short-term debt), causing net debt (ND) to escalate by a third. As a result, coverage metrics weakened substantially (ND/E to 6.3x from 4.6x, interest cov. to 2.2x from 2.7x), while balance sheet debt rose to relatively high levels (debt/cap: 62% vs. B median 52%). Given the weakness in YTD sales, these metrics seem unlikely to be reversed any time soon. More troubling is that the core of the company's stated future strategy (associate-driven, "asset-light" growth) appears to be dysfunctional, as it has delivered losses rather than growth. GT's sale to Sunac is reportedly in question at the HKSE, and this latest set of GT numbers could raise further doubts among investors and analysts on the wisdom of such a purchase by Sunac at the agreed price (HKD12/share, 55% premium vs. last price). Wharf has been largely silent on the situation so far, giving no new hooks on which to hang hopes of outside financial assistance if current conditions deteriorate. If GT projects (owned + associates) could not be sold profitably (hence the 1H14 loss), it seems questionable if buying the company would make financial sense – presumably the main logic of Wharf's involvement with GT in the first place, when it lifted the company from apparent financial distress a year and a half ago. At the start of this year, we did not like the GT bonds (looked pricy vs. operational/corp. gov. risks), we liked them less when the Sunac acquisition was announced (on Sunac's corp. gov. risks), and we like them even less now, given the addition of deteriorating fundamentals and an observably non-functioning core strategy. We suggest investors consider taking profit on the Greentown bonds. Please see below price performance of the GT bonds and further details on GT's 1H14 results.

Bond (USD unless noted): bid price, YTM, L5d/L20d/YTD price change, amount outstanding, our call on the bond based on relative value:

- **GRNCH 16 CNH:** 98.375, 6.64%, +0.13/-0.34/-1.48pt, CNH2.5b, take profit.
- **GRNCH 19:** 97.5, 8.67%, -0/-1.75/-4.46pt, USD300m, take profit.
- **GRNCH 18:** 99.5, 8.67%, -0/-1.75/-5.28pt, USD700m, take profit.

Further details – 1H14 results, with financial summary:

- **Jul sales:** RMB2b (-23% MoM, -9% YoY); 105k sqm (-24% MoM, -27% YoY); RMB19k/sqm (+1% MoM, +25% YoY).
- **YTD sales:** weak, at RMB15.2b (-13% YoY), 752k sqm (-15% YoY), ASP RMB20.2k (+3% YoY). YTD own target met: in line with peers at 45%, but on a flat target. YTD sales/FY13 sales: 47% – on track to undershoot last year. At L3M sales levels, the full year target (RMB33b, +5% FY13 actual) could be met in 8.1 months.
- **Topline & EBITDA:** 1H14 revenues were strong (RMB12.6b, +23% YoY), driven by flat delivered GFA (658k sqm, +2% YoY) under higher ASP (17.9k/sqm +21% YoY). However, 1H14 EBITDA was weak (RMB2b, -9% YoY), due to weaker gross margins (26%, 1H13: 31%) as well as EBITDA margins (16%, 1H13: 22%).
- **Debt, metrics & cash:** net debt expanded by a third (+34%) to RMB40.4b, driven by higher gross debt (RMB49.9b, +20%) and a meaningful drop in cash holdings (-16%, to RMB9.5b). As a result, net debt/EBITDA weakened substantially to 6.3x (FY13: 4.6x) while interest coverage fell to 2.2x (FY13: 2.7x), with balance sheet leverage (debt/cap.) rising to a high 62% (FY13: 56%). Cash levels look quite low at 0.5x short-term debt (FY13: 0.7x), with ST debt making up a somewhat high 38% of total debt (FY13: 41%).
- **Land & acquisitions:** Land bank remained stable at 14.1m sqm (FY13: 13.6m), or 9.1 years of sales (FY13: 8.2 years). Land acquisitions were sizable in 1H14 (RMB3.1b, 1.8m sqm, 1.7k/sqm, 1.2 years of sales), and were significantly more than 1H13 (RMB2.4b, 29k sqm, 8.3k/sqm, 0.2 years), hence exerted greater pressures on the company's credit profile.

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Financial Summary - Greentown

RMBm	12/06	12/07	12/08	12/09	12/10	12/11	12/12	12/13	6/12	6/13	6/14
Total assets	17,839	32,866	42,815	75,476	125,359	127,977	107,707	122,336	126,615	117,580	130,974
Cash (unrestricted)	3,249	2,877	1,498	9,405	12,408	3,615	6,164	10,686	4,747	9,409	8,703
Cash (restricted & equiv)	630	506	220	2,377	2,565	2,269	1,734	595	2,535	982	800
Completed property & land	1,189	2,161	3,056	3,097	5,891	6,865	11,952	18,139	8,099	13,048	22,784
Property under dev./MIP	10,462	21,428	29,640	44,681	76,795	82,331	49,959	47,285	62,388	51,793	51,200
Interest in/loans to assoc.	1,019	2,922	5,976	9,100	18,912	22,059	29,196	36,845	21,229	32,652	36,456
Other assets	1,289	2,971	2,424	6,815	8,789	10,838	8,702	8,786	27,616	9,696	11,030
Short-term debt	3,468	7,364	11,871	16,124	28,589	29,836	22,381	16,933	28,332	17,094	18,770
Long-term debt	5,433	9,318	9,549	14,437	22,305	16,048	6,118	24,494	8,616	16,984	31,106
Total debt	8,900	16,681	21,420	30,561	50,894	45,884	28,499	41,426	36,948	34,078	49,877
Net debt	5,021	13,298	19,702	18,779	35,921	40,000	20,601	30,145	29,666	23,686	40,374
Other liabilities	4,200	6,698	11,114	32,466	60,013	64,449	51,721	48,898	68,489	54,673	50,335
Total equity	4,739	9,487	10,281	12,449	14,453	17,643	27,488	32,011	21,178	28,829	30,763
Total debt/op. EBITDA	3.6	10.4	17.7	26.7	27.1	8.1	3.2	6.3	6.8*	4.1*	7.8*
Net debt/op. EBITDA	2.0	8.3	16.3	16.4	19.1	7.1	2.3	4.6	5.5*	2.8*	6.3*
Op. EBITDA/gs. Interest	6.7	2.2	0.9	0.6	0.7	1.6	2.5	2.7	1.3*	3.6*	2.2*
Op. EBITDA/net interest	9.4	2.6	0.9	0.6	0.7	1.6	2.6	2.9	1.4*	3.7*	2.5*
Net debt/tangible equity	106%	140%	192%	151%	249%	227%	75%	94%	140%	82%	131%
Total debt/total capital	65%	64%	68%	71%	78%	72%	51%	56%	64%	54%	62%
Cash/ST debt	1.1	0.5	0.1	0.7	0.5	0.2	0.4	0.7	0.3	0.6	0.5
Current debt/total debt	39%	44%	55%	53%	56%	65%	79%	41%	77%	50%	38%
Offshore debt/total debt	39%	30%	23%	8%	1%	1%	1%	21%	1%	21%	23%
Revenues	6,400	5,739	6,635	8,727	11,161	21,964	35,393	28,991	12,601	10,214	12,560
Operating EBITDA	2,456	1,598	1,207	1,146	1,877	5,636	8,814	6,593	2,709	2,230	2,029
Gross interest	365	732	1,386	1,853	2,662	3,553	3,481	2,431	2,143	994	1,470
Net debt inc. (dec.)		8,277	6,403	-922	17,142	4,079	-19,399	9,545	-10,334	3,086	10,229
Gross margin	44%	36%	28%	26%	30%	34%	30%	30%	28%	31%	26%
Operating margin	38%	27%	17%	12%	16%	25%	24%	22%	21%	21%	16%
Op. EBITDA margin	38%	28%	18%	13%	17%	26%	25%	23%	22%	22%	16%
Net margin	20%	18%	9%	13%	17%	19%	17%	16%	17%	24%	8%

Source: Company reports, Credit Suisse. * Last 12 months.

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