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Sector Strategy

Asia | **CREDIT OVERVIEW** | **China Property**

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Guangzhou R&F's blind spot

R&F's 1H14 results look weak. Revenues were stable, but EBITDA was substantially worn down by lower margins. Although 2H could see delivers (and hence revenues) catch up with strong sales over the last two reporting periods (YTD/FY13: +36%/+31% YoY), similar dynamics could recur, and could limit the extent of the likely improvements in leverage metrics, leaving FY14 with a weaker credit profile vs. FY13. In our view, balance sheet leverage (i.e. debt/cap., or gearing) remains the key problem – the same problem that has manifested itself, and indeed, worsened, over the last two years (see table). The issue is not that the numbers looked high, but that they kept getting higher, and seemingly, unnecessarily so. After all, the company now owns 12 years' worth of land – there appears to be little need to further burden the BS by buying more. Given R&F's substantial cash generating capabilities, backed by its status as a large, well-established, nationally diversified developer, it should be able to address this issue, and relatively quickly. But for some reason, the company does not appear to be addressing it. To be fair, R&F is not the only name seemingly suffering from the affliction of this blind spot in financial management. This could be due to less focus on such metrics among onshore lenders, or it could be due to the view among some developers that perpetual securities – which they intend to repay – are somehow to be seen as equity. Whatever the case, we hope to see this blind spot removed. In the meantime, this set of numbers could drive negative rating actions from one or two rating agencies, with a non-negligible chance that all three could act. This, plus the broadly negative reaction to these results across both debt and equity analysts, could add further downside and volatility to the bonds. On a relative value basis (RV), all R&F bonds look pricy to us. We suggest investors consider taking profit.

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

- **GZRFPR 16**: 108, 5.78%, -0.5/-0.5/-3.11pt, USD388m, take profit.
- **GZRFPR 19**: 99.7, 8.58%, -2.8/-2.55/-0.3pt, USD1b, take profit.
- **GZRFPR 20**: 100.25, 8.69%, -1.5/-0.75/-0.07pt, USD600m, take profit.

Further details – 1H14 results, with financial summary:

- **YTD sales**: strong, at RMB29.2b (+36% YoY), 2.1k sqm (+13% YoY), ASP RMB14k/sqm (+19% YoY). YTD own target met: 42% – slightly behind peers on a very ambitious initial target (RMB70b, +66% FY13 actual). YTD sales/FY13 sales: 69%. At L3M sales levels, the full year initial target could be met in 11.9 months (i.e. looks unlikely).
- **Topline**: 1H14 revenues were flat (RMB9.8b, -4% YoY), driven by a drop in delivered GFA (815k sqm, -16% YoY) under higher ASP (10.3k/sqm +11% YoY). Recognized sales (revenues) comprised contributions from Beijing (28%), Nanjing (18%), Tianjin 14%), Guangzhou (11%), Chongqing (8%), Hainan (6%), Taiyuan (5%), Huizhou (4%), Shanghai (4%), Chengdu (1%), Datong (1%) and Xian (<1%).
- **EBITDA**: 1H14 EBITDA was weak (RMB2.3b, -22% YoY), with materially lower gross margins (34%, 1H13: 36%) and EBITDA margins (23%, 1H13: 29%).
- **Debt & metrics**: net debt rose sharply to RMB62.3b (+53%), driven by higher gross debt (RMB86.8b, +34%) and flat cash holdings (RMB24.5b, +1%). As a result, net debt/EBITDA weakened significantly to 5.4x (FY13: 3.3x) while interest coverage fell to 2.3x (FY13: 3.2x), with balance sheet leverage (debt/cap.) rising to a high 73% (FY13: 67%).
- **Cash levels**: look adequate at 1.2x short-term debt (FY13: 1.2x), with ST debt making up a reasonable 24% of total debt (FY13: 32%). Bank access appears stable, with onshore bank loans up 2% vs. end FY13.
- **Land acquisitions**: were sizable in 1H14 (RMB4.1b, 1.5m sqm, 2.8k/sqm, 0.4 years of sales), but were less than 1H13 (RMB10.2b, 7.8m sqm, 1.3k/sqm, 2.4 years of sales).
- **Land bank**: remained stable at 43.9m sqm (FY13: 43.3m), or 12.4 years of sales (FY13: 12.8 years), comprising Chongqing (11.5%), Tianjin (9.9%), Malaysia (8%), Hainan (7.8%), Changsha (7.5%), Huizhou (7.4%), Beijing (7%), Guangzhou (6.8%), Taiyuan (5.5%), Datong (4.7%), Meizhou (4.5%), Harbin (3.5%), Baotou (3.3%), Wuxi (1.7%), Shanghai (1.5%), Nanjing (1.3%), Fuzhou (1.3%), Xian (1.1%), Chengdu (1.1%), Hangzhou (1%), Shenyang (0.6%), Foshan (0.5%), Guiyang (0.4%), Nanning (0.4%), Zhuhai (0.2%), investment properties (1.4%). Tier-1 cities 27%, T2 50%, T3 10%.

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Financial Summary - Guangzhou R&F

RMBm	12/05	12/06	12/07	12/08	12/09	12/10	12/11	12/12	12/13	6/12	6/13	6/14
Total assets	17,277	26,601	54,196	55,047	66,344	77,417	84,159	98,587	140,347	93,143	115,682	166,496
Cash (unrestricted)	2,193	1,416	1,330	1,450	6,642	5,654	6,126	7,026	17,722	9,688	13,123	16,686
Cash (restricted & equiv)	0	602	957	603	1,245	3,514	2,900	5,836	6,622	3,947	6,138	7,815
Completed property & land	5,867	12,802	22,840	18,495	18,589	21,351	22,511	26,162	32,606	23,549	26,853	36,444
Property under dev./WIP	7,419	9,673	19,231	26,769	30,556	29,328	33,732	40,126	57,258	38,367	47,460	79,650
Interest in/loans to assoc.	373	0	441	672	911	3,523	3,620	3,975	4,382	3,567	4,074	4,349
Other assets	1,425	2,107	9,397	7,058	8,400	14,048	15,270	15,462	21,758	14,024	18,035	21,553
Short-term debt	1,970	3,410	8,209	9,554	7,320	7,431	10,973	8,309	20,642	13,353	10,346	20,432
Long-term debt	1,770	4,508	12,533	10,983	17,523	20,669	18,285	28,420	44,353	20,192	36,417	66,352
Total debt	3,740	7,918	20,742	20,537	24,842	28,101	29,258	36,729	64,994	33,544	46,763	86,783
Net debt	1,547	5,900	18,455	18,484	16,955	18,932	20,232	23,867	40,650	19,909	27,503	62,282
Other liabilities	8,228	10,155	20,754	19,465	24,482	29,317	32,169	35,029	42,871	36,844	42,224	47,515
Total equity	5,309	8,528	12,700	15,045	17,019	19,999	22,732	26,830	32,482	22,754	26,695	32,198
Total debt/op. EBITDA	3.3	2.4	4.1	4.9	5.6	3.5	3.0	3.4	5.3	4.2*	4.3*	7.5*
Net debt/op. EBITDA	1.3	1.8	3.7	4.4	3.8	2.4	2.1	2.2	3.3	2.5*	2.6*	5.4*
Op. EBITDA/gs. Interest	6.0	10.1	5.5	2.6	3.2	5.0	5.1	3.9	3.2	3.4*	3.3*	2.3*
Op. EBITDA/net interest	6.8	10.1	5.5	2.7	3.3	5.2	5.5	4.1	3.3	3.7*	3.5*	2.4*
Net debt/tangible equity	29%	70%	158%	130%	105%	99%	92%	92%	129%	91%	107%	200%
Total debt/total capital	41%	48%	62%	58%	59%	58%	56%	58%	67%	60%	64%	73%
Cash/ST debt	1.1	0.6	0.3	0.2	1.1	1.2	0.8	1.5	1.2	1.0	1.9	1.2
Current debt/total debt	53%	43%	40%	47%	29%	26%	38%	23%	32%	40%	22%	24%
Offshore debt/total debt	0%	0%	0%	0%	0%	0%	12%	13%	15%	10%	18%	32%
Revenues	5,812	10,187	14,772	15,360	18,196	24,642	27,370	30,365	36,271	8,440	10,191	9,822
Operating EBITDA	1,146	3,268	5,018	4,162	4,466	7,971	9,732	10,710	12,187	2,849	2,912	2,257
Gross interest	190	323	909	1,579	1,416	1,607	1,910	2,772	3,798	1,323	1,802	2,958
Net debt inc. (dec.)		4,353	12,555	29	-1,529	1,977	1,300	3,635	16,783	-323	3,636	21,632
Gross margin	26%	36%	38%	34%	32%	38%	42%	41%	39%	42%	36%	34%
Operating margin	19%	32%	33%	25%	23%	31%	35%	34%	33%	32%	27%	20%
Op. EBITDA margin	20%	32%	34%	27%	25%	32%	36%	35%	34%	34%	29%	23%
Net margin	21%	21%	36%	20%	16%	18%	18%	19%	21%	15%	14%	16%

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

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