Property
Debt View

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Anne Stevenson-Yang
+86 139 1082 0535
anne@jcapitalresearch.com

Qin Shengxian
+86 186 0026 1068
qin@jcapitalresearch.com

Companies Discussed

1. Guangzhou R&F (2777 HK)
2. Evergrande (3333 HK)
3. Agile (3383 HK)
4. COLI (688 HK)
5. Country Garden (2007 HK)
6. Longfor (960 HK)

USD/RMB Exchange Rate

Source: Wind

Property faces currency risk

+ Net profit declines

Based on 2013 H1 numbers, another 2.5% depreciation will bring down net income from between 2% and 9% for the five listed developers we examined.

+ Investors fleeing bonds

Given a default on a Shanghai-traded bond by Chaori Solar and international concern about debt, yields in Chinese bonds have risen, and investors have been selling. We believe this is just the start: long-only bond funds will lose their mandates and Chinese bonds will see tighter conditions, meaning yet-higher yields and losses for institutions that bought the earlier tranches.

KEY POINT

Unhedged USD exposure means eroding income for Chinese developers.

Chinese developers have negligible income in hard currency, and they not hedged their exposure. As the RMB begins to depreciate, this represents a significant risk.

Exposed

What RMB depreciation is doing to developers

By Qin Shengxian

Chinese companies have benefited from the appetite in overseas markets for high-yield bonds, and, by 2013 H1, USD debt had risen to about 28% of the total for 42 listed developers. Since that time, USD bond issues have accelerated; the five developers we examined have raised USD 5.25 bln since mid-year 2013 in new bonds.

In 2012 and 2013, an appreciating RMB made this an attractive proposition. But, in January 2014, that began to change. Since the Renminbi touched a record high of 6.0412 in mid January, the currency has dropped 2.6% against dollar, ending the one-way appreciation that started with QE3 in the second half of 2012. By March 24 this year, the RMB was hovering at 6.22, back to its level in April 2013.

Currency shifts affect net income, as property developers must revalue their liabilities at least twice per year and report the net gains or losses from the change in offshore liabilities. Of the developers we examined, Agile Property (3383 HK) will see the sharpest mark-down from a depreciation, with a 9% drop in net income should the RMB drop 5% from its height, and a 27% hit at a 15% depreciation, based on the company's 2013 H1 level of USD debt. Agile had reported a gain of RMB 347.8 mln in 2013 H1, contributing about 7.13% of its pre-tax profits.

Our sensitivity analysis of the potential impact of RMB depreciation against the USD looks at both the property companies' P&L and balance sheets. We selected six Hong Kong-listed Chinese property developers that have offshore liabilities, using full-year 2013 figures for Guangzhou R&F, Country Garden and COLI and 2013 H1 numbers for the other three, with Bloomberg estimates for profit impact. In this report, we run the test by assuming RMB appreciates by 5%, 10% and 15%.

Table 1. Impact on 2013E net income

Company	Decrease of 2013E net income if RMB depreciates by		
	5%	10%	15%
Evergrande (3333 HK)	2.4%	4.8%	7.2%
Guangzhou R&F (2777 HK)	1.9%	3.8%	5.8%
COLI (688 HK)	4.2%	8.4%	12.6%
Agile (3383 HK)	8.9%	17.7%	26.6%
Country Garden (2007 HK)	4.5%	9.0%	13.5%
Longfor (960 HK)	3.8%	7.6%	11.4%

Source: Company data, J Capital estimates, Bloomberg estimates

Given that the companies have different policies around capitalizing financial costs, they see differing impact from depreciation. Guangzhou R&F has capitalized only 48% of financial costs, while other five companies capitalized 87.8% to 100%, so depreciation hits Guangzhou R&F harder.

➲ Developers kept issuing in H2 2013 and through January.

Table 2. Corporate bonds issued since 2013 H2

Company	Issuer Name	Principal due (USD mln)	Announce Date	Maturity Date
GUANGZHOU R&F	Big Will Investments Ltd	1000	14-1-6	19-1-10
COLI	China Overseas Finance Cayman III Ltd	500	13-10-23	18-10-29
COLI	China Overseas Finance Cayman III Ltd	500	13-10-23	23-10-29
COLI	China Overseas Finance Cayman III Ltd	500	13-10-23	43-10-29
Evergrande	Evergrande Real Estate Group Ltd	500	13-11-6	18-10-30
Evergrande	Evergrande Real Estate Group Ltd	1000	13-10-24	18-10-30
Agile	Agile Property Holdings Ltd	500	14-2-11	19-2-18
Country Garden	Country Garden Holdings Co Ltd	750	13-9-25	21-4-4

Source: Company reports

Table 3. Interim reported exchange gains and losses in 2013

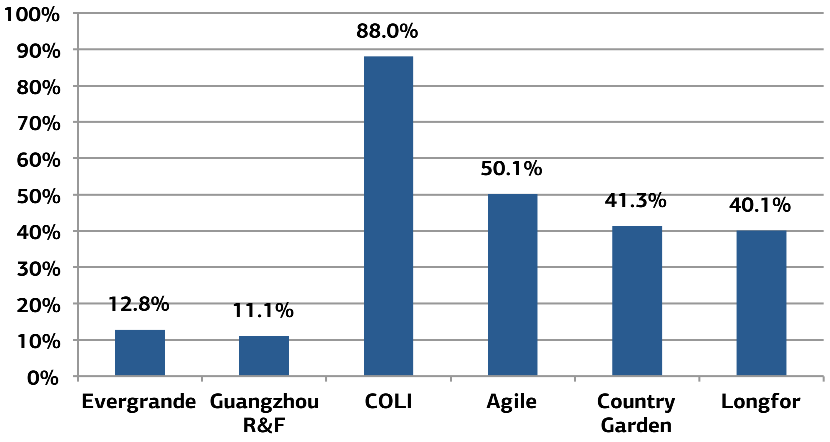
Company	Currency	Exchange gains/(losses)	As % of Pre-tax Income
Evergrande (3333 HK)*	RMB 000s	137439	0.0122
Guangzhou R&F (2777 HK)	RMB 000s	102522	0.0408
COLI (688 HK)	HKD 000s	12835	0.0004
Agile (3383 HK)*	RMB 000s	347776	0.0713
Country Garden (2007 HK)	RMB 000s	248562	0.0348
Longfor (960 HK)*	RMB 000s	154607	0.0248

Source: Company reports

* Financial figures are as of 2013 H1, while others are as of FY 2013.

COLI has the highest ratio of foreign currency-denominated debt, at 88.0%, of the companies we picked. We believe the foreign-currency debt of Guangzhou R&F and Agile should have risen, as both issued offshore bonds at the beginning of 2014.

Chart 1. Offshore debt in foreign currency as % of total debt



Source: Company reports, J Capital estimates

On the balance sheet, debt positions increase from less than 1% to 13.2% under the range scenario. COLI would see the heaviest impact, while Evergrande and Guangzhou R&F would see the least.

Table 4. Increase in total debt

Company	Increase of total debt if RMB depreciates by		
	5%	10%	15%
Evergrande (3333 HK)	0.6%	1.3%	1.9%
Guangzhou R&F (2777 HK)	0.6%	1.1%	1.7%
COLI (688 HK)	4.4%	8.8%	13.2%
Agile (3383 HK)	2.5%	5.5%	7.5%
Country Garden (2007 HK)	2.1%	4.1%	6.2%
Longfor (960 HK)	2.0%	4.0%	6.0%

Source: Company reports, J Capital estimates

Table 5. Net gearing

Company	Net gearing	Net gearing if RMB depreciates by 5%	10%	15%
Evergrande (3333 HK)	73.9%	74.7%	75.5%	76.7%
Guangzhou R&F (2777 HK)	130.6%	132.0%	133.3%	134.6%
COLI (688 HK)	28.2%	30.8%	34.3%	37.0%
Agile (3383 HK)	75.7%	78.5%	81.4%	85.1%
Country Garden (2007 HK)	57.9%	60.4%	63.0%	65.8%
Longfor (960 HK)	60.1%	62.3%	64.5%	66.5%

Source: Company reports, J Capital estimates

Markets less welcoming

Beyond the immediate impact on these companies' P&L and balance sheets, we expect them to see reduced ability to sell USD bonds. Defaults and RMB depreciation reduce the attractiveness of the bonds. In addition, given the high volume of issuance in the last two years, investors have little appetite for additional exposure. Therefore, in the future it will be harder for property developers to raise money in the offshore USD bond market unless the yield is sufficiently attractive and/or bond covenants are very restrictive.

As we've previously highlighted in Debt View, offshore yields are mispriced when compared to onshore yields and don't adequately compensate for the risk. Investors are just discovering this now, and yields may well go higher.

Meanwhile, the U.S. Fed has signaled its intention to continue tapering. As more liquidity is withdrawn from Asian bond markets, there will be even less appetite to hold these bonds. The developers will end up being squeezed, because onshore rates are high, and offshore rates will go higher.

The sell-off in USD-bonds has been sharp because of a lack of liquidity. As the wider investment community understands this, they may pull their mandates from the long-only bond funds. This is pro-cyclical and means even less demand and higher yields.

Will the current RMB depreciation trend stop offshore bond issuance by Chinese developers? Offshore markets will remain important to the developers, but only the most creative, we think, will get the bonds away.

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