

**Press Release: Fitch Revises Evergrande's Outlook to Positive; Affirms at 'B+'**

3,105 words

2 May 2018

19:38

Dow Jones Institutional News

DJDN

English

Copyright © 2018, Dow Jones & Company, Inc.

The following is a press release from
Fitch Ratings:

Fitch Ratings-Hong Kong-02 May 2018: Fitch Ratings has revised the Outlook on China Evergrande Group to Positive from Stable, and affirmed the Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'B+'. Evergrande's senior unsecured rating and the rating on all its outstanding senior notes are affirmed at 'B-', with a Recovery Rating of 'RR6'. A full list of rating actions is at the end of this rating action commentary.

The Outlook revision reflects our expectation that Evergrande's leverage, measured by net debt/adjusted inventory, can be sustained below 50%, after falling to 49.6% at end-2017 from 63.3% in 2016, if management follows through with its commitment to lower the company's gearing. Its leverage headroom is very small and we think it is premature to upgrade Evergrande's ratings until we see more sustained deleveraging. The sharp decline in Evergrande's leverage was mainly due to the one-off CNY130 billion in new equity raised by its homebuilding subsidiary, Hengda Real Estate Group Co., Ltd. (Hengda), in 2017, of which CNY117 billion was received in 2017.

We believe Evergrande's improving credit profile is also reflected in the continued reduction of the payable-to-gross inventory ratio to 0.38x in 2017 from 0.46x in 2016. Evergrande's ratings had been constrained to the 'B' rating category by its aggressive financial policy as its business profile is more commensurate with that of 'BB' rating category peers.

KEY RATING DRIVERS

Financial Profile Improvement: Fitch estimates that Evergrande's 2017 leverage would have been closer to 62% without the CNY130 billion raised by Hengda. Of more significance is Hengda's sharp increase in EBITDA margin to 30.4%, helped by higher selling prices from 2016. Evergrande's improved profitability can be supported until 2020 just based on its large land bank of almost 156 million sq m at end-2015, which would fully enjoy the higher selling prices. The company's sustained significant reduction of its payable ratio since it plateaued at 0.5x and above between 2012 and 2015 is another credit improvement.

We think the payable-to-inventory ratio can be sustained at 2017's level of 0.38x while the company is still deleveraging, assuming Evergrande only replenishes land it sold.

Deleveraging Objective: Evergrande had in its 2017 results announcement said it will "further reduce its net gearing ratio in 2018" and "will systematically plan its business development for the year through prudent land acquisitions, emphasis on promoting sales and controlling costs and expenses". Its stated 2018 contracted sales target of CNY550 billion can potentially allow it to cut this year's land acquisition by more than half of the 126 million sq m in gross floor area (GFA) of new land reserves it acquired in 2017. Fitch will assess Evergrande's deleveraging plan in conjunction with its trade payable changes to ensure that the company is not placing more reliance on its contractors and suppliers to extend more credit to help it deleverage.

Sizeable Low-Cost Land Bank: Evergrande's land bank is well diversified and distributed in accordance with economic development potential. We estimate that its 312 million sq m land bank can generate a conservative CNY2,925 billion in contracted sales. Its widespread diversification is shown by 15 of China's

faster developing provinces plus Chongqing municipality (out of 31) accounting for 80% of its total contracted sales, which we expect to continue.

Evergrande's large proportion of active projects also demonstrates its land bank robustness. Evergrande had 656 projects for sale, 628 under construction and 498 projects going through delivery in 2017, out of its 766 projects at end-2017. Evergrande's average land cost of CNY1,711 per sq m is low compared with the average selling price (ASP) of CNY9,960 per sq m it achieved in 2017 and CNY10,233 in 1Q18.

Minorities Leakage Impact Contained: The dilution of Evergrande's stake in Hengda to 63.5% in 2017 from 100% has resulted in increased subordination of the parent's creditors. Fitch believes this impact is not yet significant as Evergrande's leverage, based on proportionately consolidating Hengda, is only 3% higher than that of the consolidated leverage. The presence of minorities also means that Evergrande's attributable scale is reduced. The risk of material subordination at Evergrande may surface when Hengda has a significantly lower leverage than that of the consolidated profile. The high level of debt concentrated at Evergrande ex-Hengda may reflect Evergrande's inability to strengthen its financial profile through improved performance at Hengda and this will indicate weak control over Hengda and therefore show weak parent-subsidiary linkage between the two.

Shareholder Friendly Measures: Evergrande bought back its shares totalling HKD6.3 billion (CNY5.6 billion) in 2017. It also plans to declare a high dividend of 50% of distributable profit since 2016 following the completion of the restructuring of Hengda. These measures will exhaust liquidity at the holding company level and weaken its debt-servicing capacity.

DERIVATION SUMMARY

Evergrande's business profile is more comparable with 'BB' category peers as Evergrande has a diversified footprint across the country and products. This offsets its very aggressive financial profile, which is in the weak 'B' category.

Its peers like Country Garden Holdings Co. Ltd. (BBB-/Stable), Greenland Holding Group Company Limited (BB-/Negative) and Sunac China Holdings Limited (BB-/Negative) are operating with similar aggressiveness in their scale expansion and are of similar size except for Sunac, which is growing very rapidly to match these peers.

Country Garden's leverage of around 30% and churn rate of over 1.5x are commensurate with an investment-grade profile and explains the multiple-notch rating difference with Evergrande. Greenland's leverage is higher than Evergrande's but Greenland has a large level of uncollected sales and a lower payable to offset its high leverage. Greenland as a state-owned enterprise has a strong position in acquiring land at low costs especially for new city districts that local governments are keen to develop. We expect Sunac's leverage to fall below 50% in 2018 and it does not have high payables risks, unlike Evergrande.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- low single-digit total growth in land bank over the next three years
- ASP to increase in 2018 but moderate to 2017 level by 2020; GFA growth to range between 5% and 10% to get single-digit contracted sales growth from 2019.
- land cost to increase by 5% per annum resulting in falling EBITDA margin towards 25%
- dividend payout ratio of 30% following the 50% special dividend to be declared after completion of Hengda restructuring

Recovery Rating Assumptions:

- Evergrande will be liquidated in a bankruptcy because it is an asset-trading company
- 10% administrative claims
- The liquidation estimate reflects Fitch's view of the value of inventory and other assets that can be realised and distributed to creditors
- Evergrande's current tax payables net of tax assets will be the most senior claim over its lenders
- We applied a haircut of 30% on its receivables, and 50% on its investment properties

- - We applied a higher haircut of 40% on adjusted inventory despite Evergrande's high margin, which would otherwise support a lower 25% to 30% discount rate, because we believe there will be a leakage of its recoverable value to its very high level of trade creditors

We estimate the recovery rate of the offshore senior unsecured debt at 0%, which corresponds to a Recovery Rating of 'RR6'. This is based on our calculation of the adjusted liquidation value (after administrative claims) of 10%, and based on the order of repayment waterfall.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- - Net debt/adjusted inventory sustained below 50% (49.6% in 2017)
- - Contracted sales/gross debt sustained above 0.8x (0.7x in 2017)
- Developments That May, Individually or Collectively, Lead to the Outlook Reverting to Stable
- - Failure to achieve the above over the next 12 months
- - Change in management strategy to refocus on aggressive expansion from stated objective to reduce gearing ratio
- - Failure to reduce short-term debt to below 35% of total debt (48% at end-2017)

LIQUIDITY

Liquidity Remains Adequate: Evergrande has maintained a large cash balance totalling CNY288 billion, including CNY136 billion of restricted cash. It has CNY356 billion of debt maturing in 2018 that can be funded by ongoing contracted sales and its existing cash. We expect Evergrande's working capital investment to fall sufficiently to generate positive cash flow from operations (CFO) in 2018 to support debt repayment. The company also issued HKD18 billion in convertible bonds in 1Q18 to improve its liquidity.

FULL LIST OF RATING ACTIONS

China Evergrande Group

- - Long-Term IDR affirmed at 'B+', Outlook revised to Positive from Stable
- - Senior unsecured debt rating affirmed at 'B-', with Recovery Rating of 'RR6'
- - USD598.18 million 6.25% senior notes due 2021 affirmed at 'B-', with Recovery Rating of 'RR6'
- - USD1 billion 8.25% senior notes due 2022 affirmed at 'B-', with Recovery Rating of 'RR6'
- - USD4.68 billion 8.75% senior notes due 2025 affirmed at 'B-', with Recovery Rating of 'RR6'
- - USD1 billion 9.5% senior notes due 2024 affirmed at 'B-', with Recovery Rating of 'RR6'
- - USD500 million 7% senior notes due 2020 affirmed at 'B-', with Recovery Rating of 'RR6'
- - USD1.34 billion 7.5% senior notes due 2023 affirmed at 'B-', with Recovery Rating of 'RR6'

-

- Contact:

Primary Analyst

- Su Aik Lim
- Senior Director
- +852 2263 9914
- Fitch (Hong Kong) Limited
- 19/F Man Yee Building
- 68 Des Voeux Road Central, Hong Kong

Secondary Analyst

- Vicki Shen
- Director
- +852 2263 9918

Committee Chairperson

- Kalai Pillay
- Senior Director
- +65 6796 7221

Summary of Financial Statement Adjustments -

- - CNY3,333 million long-term payables added to debt
- - CNY1,961 million fair-value adjustment added to gross debt
- - CNY12.8 billion guarantees to third parties and joint ventures at end-2017 added to adjusted debt
- - Inventories adjusted to include development-related assets and liabilities
- - Capitalised interest in cost of sales treated as non-operating expenses

Media Relations: Wai-Lun Wan, Hong Kong, Tel: +852 2263 9935, Email: wailun.wan@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria

- Corporate Rating Criteria (pub. 23 Mar 2018)
- <https://www.fitchratings.com/site/re/10023785>
- Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)
- <https://www.fitchratings.com/site/re/10024585>
- Country-Specific Treatment of Recovery Ratings Criteria (pub. 16 Apr 2018)
- <https://www.fitchratings.com/site/re/10026835>
- Sector Navigators (pub. 23 Mar 2018)
- <https://www.fitchratings.com/site/re/10023790>

Additional Disclosures

- Dodd-Frank Rating Information Disclosure Form
- <https://www.fitchratings.com/site/dodd-frank-disclosure/10028964>
- Solicitation Status
- <https://www.fitchratings.com/site/pr/10028964#solicitation>
- Endorsement Policy
- <https://www.fitchratings.com/regulatory>

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND

METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

- The information in this report is provided as is without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

- For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

- Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSROs credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

2 May 2018 05:38 ET *Fitch Revises Evergrande's Outlook to Positive; Affirms at 'B+'

2 May 2018 06:02 ET *Fitch: Positive Outlook Reflects Expectation That Evergrande's Leverage Can Be Sustained Below 50%

(END) Dow Jones Newswires (212-416-2800)

May 02, 2018 06:02 ET (10:02 GMT)

Document DJDN000020180502ee520011g