Moody's

Rating Action: Moody's assigns Ba1 CFR to Country Garden Services and withdraws Baa3 issuer rating; outlook negative

14 Aug 2023

Hong Kong, August 14, 2023 – Moody's Investors Service has assigned a Ba1 corporate family rating (CFR) to Country Garden Services Holdings Company Ltd (CGS) and withdrawn its Baa3 issuer rating.

At the same time, Moody's has changed the rating outlook on CGS to negative from stable.

"The rating action reflects our concerns over CGS' increased contagion risks to Country Garden Holdings Company Limited (CGH, Caa1 negative), given the latter's deteriorated credit profile and the two entities' common controlling shareholder and brand name," says Kelly Chen, a Moody's Vice President and Senior Analyst.

"The negative outlook reflects uncertainties over CGS' operations and the financial impacts should CGH's credit conditions worsen," adds Chen.

RATINGS RATIONALE

Moody's believes CGS faces increasing contagion risks from CGH as the two entities share the same brand name an controlling shareholder, Ms. Yang Huiyan. Ms. Yang also serves as the Chairman of the board in both companies. Moody's is concerned CGH's heightened liquidity and refinancing risks could weigh on CGS' business growth trajectory and access to funding.

CGS is also exposed to governance risk stemming from its concentrated ownership as Ms. Yang Huiyan effectively controls 36.12% of the voting rights of the company, which indicates that influence from the largest shareholder could materially change its financial policy and strategy. The increased governance risks at CGH raise uncertainties regarding CGS' financial management strategy.

CGH's financial struggles create uncertainties over the prospects of CGS' revenue growth and operating cash flow, as 42% of the latter's property management services revenue is from projects developed by CGH in 2022. As a result, Moody's has lowered its revenue growth forecast for 2023-24 to around 6% from 10%-11% previously to reflect such uncertainties. CGH's credit stress could also lengthen CGS' working capital cycle, with around 11% of CGS' receivables related to CGH as of December 2022.

In addition, Moody's expects the company's adjusted gross profit margin to continue to decline over the next 12-18 months to around 27% from 29% in 2022. Such a decline is mainly attributed to the provision of value-added services to non-property owners and community value-added services. Accordingly, Moody's estimates the company's adjusted EBITA margin will drop to around 15% from 17% over the same period.

However, the agency expects CGS to grow organically over the next one to two years with limited acquisitions. As a result, Moody's projects CGS' adjusted debt/EBITDA and EBITA/interest coverage will stay at 0.6x-0.7x and 37x-38x, respectively, over the next one to two years, which support its Ba1 CFR.

CGS' Ba1 CFR also reflects the company's position as a leading property management and community services provider in China with well-diversified operations across China and a significant proportion of recurring earnings. Moody's expects CGS to maintain its net cash position over the next 6-12 months.

At the same time, CGS' CFR also reflects its prolonged working capital cycle and modest profitability, execution risk stemming from its large acquisitions in recent years and the contagion risk from CGH on the company.

In terms of environmental, social and governance (ESG) factors, CGS' Credit Impact Scores of CIS-4 reflects the impac of ESG attributes, especially governance risk, on its ratings. In addition to the concentrated ownership, the agency has also considered the presence of only 3 independent nonexecutive directors on the company's 7-member board when assessing the governance risk.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of CGS' ratings is unlikely over the next 12 months, given the negative outlook.

However, the outlook could return to stable if contagion risks from CGH decline, as reflected by the company maintaining steady business and financial profiles, stable financial and dividend policies, a net cash position, and ongoing access to funding, all on a sustained basis.

Moody's could downgrade CGS' ratings if CGH's credit conditions deteriorate further, such that contagion risks from CGH to CGS increase and materially weigh on CGS' operations and financial profiles, or the company adopts more aggressive financial or dividend policies that turn its net cash position into net debt.

The principal methodology used in these ratings was Business and Consumer Services published in November 2021 and available at https://ratings.moodys.com/rmc-documents/356424. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

Country Garden Services Holdings Company Ltd is one of China's largest property management service providers with a market capitalization of around HKD26.9 billion as of 9 August 2023. It listed on the Hong Kong Stock Exchange in 2018. As of July 2023, its key shareholder, Ms. Yang Huiyan, directly and indirectly controls about 36.12% of the voting rights of the company. Country Garden Holdings Company Limited (Caa1 negative) is CGS' sister company, and the former is 52.6% owned by the same shareholder.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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