

Analysis of Profitability of Real Estate Enterprises

Taking LONGFOR as an Example

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Abstract—For a long time, the real estate industry has been called the pillar industry of China's national economic development, which has played an important role in supporting the national economic lifeline. Even though the growing pace of economic development has become slower, the real estate industry as a whole is still on the rise. However, the state has been introducing policies to regulate the real estate industry and curb excessively high housing prices. In such a market environment, how to improve the profitability of the real estate industry to obtain higher profits has become a top priority. Taking LONGFOR Real Estate as the research object of profitability analysis, based on the financial statements of 2015-2017, through qualitative and quantitative analysis, it gives corresponding suggestions on how to improve the profitability of LONGFOR Real Estate and the whole real estate industry.

Keywords—real estate enterprises; profitability analysis; policy

I. INTRODUCTION

A. Preface

According to statistics, the national real estate investment in 2018 was 12026.4 billion yuan, an increase of 9.5% over the previous year. The sales area of commercial housing in China was 1716.54 million square meters, an increase of 1.3%, of which the sales area of residential housing increased by 2.2%. The sale of commercial housing in China has increased by 12.2% to 14997.3 billion yuan, of which residential sales increased by 14.7%. Under the background of the weak macro-economic situation, it still gained remarkable income. In 2019, the National People's Congress and Chinese People's Political Consultative Conference proposed to "improve the local tax system and steadily promote the real estate legislation". This is the third time the real estate tax was mentioned on the report of the government since it was legislated in 2013, which shows the determination of the state to strengthen the control of the real estate industry. In addition, compared with other industries, the real estate industry has the characteristics of long payback period of development investment, large amount of pre-investment, implementation of pre-sale system, and greater influence by national macro-control. Moreover, listed companies in the real estate industry generally have a relatively high asset-liability ratio, which will have an impact on cash flow and directly cause an effect on listed companies

in real estate industry. Their daily management activities become inefficient, affecting the company's profitability. Therefore, for real estate enterprises, it is very important to respond to the call of the state and improve their profitability. This paper analyses the profitability of listed real estate companies in China by selecting relevant indicators, and puts forward relevant suggestions according to the results of the analysis, so as to reduce the financial risk of enterprises and obtain higher profits.

B. Introduction to LONGFOR Real Estate

LONGFOR Group was founded in Chongqing in 1993 and developed nationwide. Its main business covers real estate development, commercial operation, long-term rental apartment and intelligent service. At the same time, it began to actively try to innovate in the field. In 2009, LONGFOR Group Holdings Co., Ltd. was listed on the main board of the Hong Kong Stock Exchange. In 2018, the Group's turnover exceeded 110 billion yuan, and it has won the 5th competitive Real Estate Enterprises" for five consecutive years. In addition to real estate development, LONGFOR is also involved in the fields of pension, production and other fields. As one of the earliest mall developers in China, LONGFOR Business has developed three format brands, Tianjie, Xingyueyi and Jiayueyi, and actively responded to the policy of "renting and purchasing simultaneously" by launching the long-Rent apartment brand "Guanyue". LONGFOR Intelligent Service was established in 1997. The service mode covers many fields such as housing, commercial activities, public construction and urban public space.

II. THE MEANING AND INFLUENCING FACTORS OF PROFITABILITY IN REAL ESTATE INDUSTRY

The so-called profitability refers to the ability of an enterprise to obtain profits, also known as the capital or capital value-added ability of an enterprise, which usually shows the amount and level of the enterprise's income in a certain period of time. For real estate enterprises, the meaning of profitability is the ability to increase the value of funds consumed by land prices and housing development through house sales and leasing.

Different scholars have different opinions on the factors affecting the profitability of enterprises. Through the empirical test of the financial data of Listed Companies in

real estate industry from 2010 to 2014, Li Qiping draws the following conclusions: the relevant policies promulgated by the government have a significant impact on the economic performance of enterprises, the appropriate scale of enterprises can improve the profitability of enterprises, and the cost of enterprises has a significant impact on the performance of enterprises. Ma Xiaohan draws a conclusion that capital structure and profitability are negatively correlated through empirical analysis of the data of real estate listed companies. Wang Meiling believes that the current assets and liabilities held by listed real estate companies in China have a reverse effect on the profitability of enterprises; inventory is the basic guarantee for the profitability of real estate enterprises, but it has no significant relationship with profitability; the negative effect of excessive money funds is not reflected because of the lag of accounting information; fixed assets of a certain scale have a negative effect on the profitability. Yang Jieli believes that the logarithm of total assets, the ratio of current assets, the proportion of the top ten shareholders and the turnover of total assets have a positive impact on the profitability of enterprises. Zhao Meng and Yao Feng, through the empirical analysis of 174 listed companies of SMEs in China, believe that with the growth of the establishment time of enterprises, the profitability of enterprises has decreased significantly. At the same time, at different stages of maturity, the influencing factors of the profitability of SMEs also have significant differences.

Summarizing the predecessors' viewpoints, this paper holds that the factors affecting the profitability of the real estate industry can be divided into internal and external factors. The external factors mainly refer to the tax policy issued by the state and the industry environment. The internal factors mainly include the size of the enterprise, the capital structure, the growth of the enterprise and its own profit model.

III. ANALYSIS OF THE PROFITABILITY OF LONGFOR REAL ESTATE

A. Operating Profitability

Operating ability directly determines the profitability of an enterprise: the stronger the operating ability is, the faster the asset turnover speed will be, and the frequency of asset profitability will increase accordingly. The main indicators of business ability are gross profit margin, net profit margin and cost expense rate.

1) *Gross margin of sales*: The gross profit margin of sales indicator indicates the gross profit brought by each yuan of sales revenue. The gross profit margin of sales should not only be positive, but also be large enough to make up for the expenses during the period. Comparing with the average gross profit rate of the industry, enterprises can know their profit level. The gross margin of sales of LONGFOR real estate from 2015 to 2017 is shown in "Table I":

TABLE I. GROSS PROFIT MARGIN OF LONGFOR REAL ESTATE SALES UNIT: RMB (THOUSAND YUAN)

	2015	2016	2017
<i>Sales revenue</i>	47,423,099	54,799,495	72,075,041
<i>Variation ratio</i>	-7.00%	15.55%	31.53%
<i>Gross profit</i>	13,014,792	15,935,481	24,435,829
<i>Variation ratio</i>	-3.71%	22.44%	53.34%
<i>Gross margin of sales</i>	27.44%	29.08%	33.90%

As can be seen from the above table, LONGFOR's sales revenue and gross profit are increasing year by year, and the growth ratio of gross profit is greater than the growth rate of income, making gross interest rate rising year by year, and far higher than the industry average level, the profitability is relatively stable.

2) *Net profit margin of sales*: Net profit margin on sales can be expressed as net profit divided by sales revenue. In finance, net profit margin on sales is often used to measure how much net profit each yuan of sales revenue brings.

While expanding sales, the growth range of sales expenses, financial expenses and management expenses may be larger; this may result in negative growth of net profit. Blindly expanding production and sales scale may not bring positive benefits to enterprises. Therefore, the analyst should focus on the increase or decrease of net profit for every 1 yuan of sales revenue, so as to improve the profitability. The net sales profit margin of LONGFOR real estate from 2015 to 2017 is shown in "Table II":

TABLE II. NET PROFIT MARGIN OF LONGFOR REAL ESTATE SALES UNIT: RMB (THOUSAND YUAN)

	2015	2016	2017
<i>Sales revenue</i>	47,423,099	54,799,495	72,075,041
<i>Variation ratio</i>	-7.00%	15.55%	31.53%
<i>Net profit</i>	9,364,117	9,934,866	16,478,488
<i>Variation ratio</i>	7.01%	6.09%	65.87%
<i>Net profit margin</i>	19.75%	18.13%	22.86%

From the "Table II", it can be seen that the net profit rate of LONGFOR Real Estate has decreased from 2016, and has rebounded in 2017, which shows that the profitability of LONGFOR Real Estate has been relatively stable. Although the state has taken a series of measures for the real estate industry in recent years, consumers are still more optimistic about the real estate industry, and in 2017, sales revenue grew by 31.53%, while net profit rose by 65.87% over the previous year, making the sales net profit margin

significantly ascended. The proportion of sales revenue and net profit of LONGFOR real estate in 2017 is shown in "Table III" (property development refers to the development and sale of office building, commercial and residential properties; Property investment refers to the investment property developed by the leasing group; Property management and related services are other means of income generated mainly through the property):

TABLE III. COMPOSITION OF SALES REVENUE OF LONGFOR REAL ESTATE IN 2017 UNIT: RMB (THOUSAND YUAN)

	Sales revenue	Variation ratio	Net profit	Variation ratio
<i>Property development</i>	67,442,452	-0.48%	15,414,464	-7.71%
<i>Property investment</i>	2,592,240	25.42%	865,516	36.84%
<i>Property management and related services</i>	2,040,349	32.78%	198,508	57.81%
<i>Total</i>	72,075,041	31.53%	16,478,488	65.87%

It can be seen that the real estate and net profit of LONGFOR Real Estate declined in 2017, but the operating income and net profit of Housing leasing and property management increased. This also reflects that under the strict control of the state, LONGFOR Real Estate adjusted its strategic direction in time and focus on investment in property and property services in future development.

B. Capital Profitability

Capital profitability refers to the ability of the owner of an enterprise to make profits through the operation of investment capital. The main indicators to measure are return

on net assets, return on capital, earnings per share and price-earnings ratio.

1) *Return on net assets*: The return on net assets (ROE) refers to the ratio of profits to the average shareholder's equity in a certain period of time. The higher the index is, the higher the return on investment and the lower the ROE is, which indicates that the profitability of the owner's equity is worse. The return on equity of LONGFOR from 2015 to 2017 is shown in "Table IV":

TABLE IV. RETURN ON NET ASSETS OF LONGFOR FROM 2015 TO 2017 UNIT: RMB (THOUSAND YUAN)

	2015	2016	2017
<i>Net profit</i>	9,364,117	9,934,866	16,478,488
<i>Variation of net profit</i>	7.01%	6.09%	65.87%
<i>ROE</i>	17.47%	15.66%	19.04%

Return on equity reflects the ability of self-owned capital to obtain net income. In 2016, the rate of return on net assets in LONGFOR decreased compared with that in 2015, and rebounded in 2017. In recent years, the average rate of return on net assets in the real estate industry is about 12%. LONGFOR's rate of return on net assets is in the forefront of the industry, and its profitability is strong.

2) *Basic earnings per share*: Earnings per share are a data frequently used by users of accounting information in evaluating enterprise profitability and predicting the development prospect of a company. It has a direct

relationship with stock investors and directly reflects the profitability of enterprises. Earnings per share are the proportion of net profit and the number of common shares. Generally speaking, the larger the earnings per share, the stronger the profitability of the enterprise, the better the operation of the enterprise, the greater the possibility of the enterprise to issue a higher dividend, and the higher the stock price will rise. The basic earnings per share for LONGFOR from 2015 to 2017 are shown in "Table V":

TABLE V. LONGFOR BASIC EARNINGS PER SHARE UNIT: YUAN/SHARE

	2015	2016	2017
<i>BPS</i>	1.54	1.57	2.17

As can be seen from the "Table V", the basic earnings per share of LONGFOR has been increasing year by year, and reached 2 yuan per share in 2017, which not only indicates

that LONGFOR's profitability is steadily improving, but also has entered the forefront of the industry.

C. Asset Profitability

The profitability of an enterprise's assets mainly depends on its asset management ability. The analysis of asset management ability is mainly to analyze the ability of an enterprise to generate profits by using its own assets. The most important measurement indicators are total assets profit margin, total assets return rate and total assets net profit margin.

1) *Total assets net profit margin*: Net profit margin on total assets refers to the proportion of the company's net

profit in the average total assets. This index can reflect the profitability level of a company using all its assets, that is, how much profit a company can get for every dollar it uses. The higher the index value is, the higher the input-output level of the company is, the more effective the assets operation and the better the cost control, which reflects the higher the management ability of the enterprise. The net profit margin of total assets of LONGFOR Real Estate in recent years is shown in "Table VI":

TABLE VI. NET PROFIT MARGIN OF LONGFOR TOTAL ASSETS

	2015	2016	2017
<i>Net profit</i>	9,364,117	9,934,866	16,478,488
<i>Variation of net profit</i>	7.01%	6.09%	65.87%
<i>Net profit margin of total assets</i>	5.10%	4.48%	4.29%

It can be seen from "Table VI" that the net profit margin of total assets of LONGFOR has shown a downward trend in recent years. It is an important index in Dupont analysis method, which can be decomposed into net profit margin of sales and turnover rate of total assets. The net profit margin of sales reflects the income level of sales revenue. The fundamental way to improve the profit margin of sales of enterprises is to expand sales revenue and reduce costs. Total asset turnover reflects the speed of total asset turnover, which reflects the operating capacity of enterprises. It was known from the previous table, the net profit margin of sales increases steadily, so the total asset turnover rate decreases rapidly, this leads to the decrease of the net interest rate of total assets.

D. Capital Structure

1) *Asset-liability ratio*: Asset-liability ratio is an important indicator to measure the capital structure of a company. As mentioned in the previous discussion, capital structure is one of the factors affecting the profitability of a company. This index mainly reflects the proportion of assets provided by creditors in the total assets of an enterprise, and reflects the ability of a company to operate with liabilities. The asset-liability ratio of LONGFOR Company is shown in "Table VII":

TABLE VII. THE ASSET-LIABILITY RATIO OF LONGFOR IN 2017

	2015	2016	2017
<i>Asset-liability ratio</i>	66.07%	66.59%	70.73%

As can be seen from the above "Table VII", the asset-liability ratio of LONGFOR real estate is gradually rising with a slow trend. Generally speaking, the asset-liability ratio of an enterprise is between 40% and 60%, but it varies from industry to industry. The asset-liability ratio of the real estate industry is relatively high. While the asset-liability ratio is too low, that indicates that the enterprise has not made full use of the financial leverage and the profit quality is poor. When the financial leverage is too high, the debt interest is too much, that will put the enterprise in the financial risk. LONGFOR should make full use of financial leverage while guarding against financial risks caused by excessive liabilities.

IV. MEASURES TO PROMOTE THE PROFITABILITY OF LONGFOR

Through the introduction of LONGFOR Real Estate and the analysis of profitability indicators, it can be known that the scale, growth and profitability of LONGFOR Real Estate

are among the TOP10 of the industry. Although the total assets scale and business income still lag behind top companies like Vanke, Biguiyuan and other industries, the potential of LONGFOR Real Estate is large, and a series of measures can be taken to further improve profitability.

A. Improving the Efficiency of Fund Utilization and the Speed of Fund Recovery

Compared with other industries, the real estate industry has the shortcomings of long payback period of development investment, large amount of pre-investment, high ratio of assets and liabilities, and long payback period of cash. Therefore, LONGFOR should speed up the cycle of real estate development projects, formulate perfect construction plans, set different sub-objectives under the general objectives, and then set up development plans and projects according to sub-objectives, so as to increase the number of projects. In order to expand market share, LONGFOR should complete housing and residential inventory sales quickly. At the same time, they should formulate more scientific and

reasonable credit policies for accounts receivable, improve the prediction level of bad debts, improve the bad debts preparation system, and reduce the loss of bad debts. They should also speed up the management of total assets and inventories and improve turnover speed, which can not only improve the ability of cash recovery, but also control the asset-liability ratio of enterprises at a reasonable level.

B. Strengthening Innovation and Staff Training in Real Estate Industry

Nowadays, many industries attach great importance to scientific and technological innovation, but the real estate industry does not invest too much in the aspect of science and technology, such as improving construction, making construction easier and simpler; focusing on the R&D department to design houses with more attracting appearances; increasing the training of sales personnel and improving the quality of employees will naturally expand the popularity and occupy a favorable position in the market.

C. Expanding Capital Scale and Increasing Financing Channels

It can be found from previous analysis that the total net asset profit margin of LONGFOR Real Estate is decreasing year by year. In DuPont analysis system, the return on net assets equals the product of the total net asset profit margin and equity multiplier. If the total net asset profit margin decreases year by year, it will affect the return on net assets, and then affect the improvement of the profitability level. Therefore, expanding the scale of capital and assets will affect LONGFOR Real Estate. It's very important. At present, LONGFOR has been listed in Hong Kong. It can take the road of A-share IPO to expand the scale of financing. On the other hand, issuing bonds can also expand the scale of capital and avoid the consequences of equity decentralization. However, excessive issuance of bonds will increase asset-liability ratio and financial risk.

D. Developing Other Businesses and Realizing Diversified Operation

At present, LONGFOR's main business covers four aspects: real estate development, commercial operation, long-term rental apartment and intelligent service. As can be seen from "Table III", the development of real estate development is not as popular as few years ago under the influence of current macroeconomic and national policies. In this case, LONGFOR can increase the importance of property investment and property management, and actively develop other fields.

E. Establishing a Good Brand Image

Good brand image will bring abundant added value to enterprises, and make enterprises gain more advantages in market competition. Establishing a good brand image is based on high-quality products and services, and can also be properly propagated by the media. In addition, the leadership of enterprises should also play an exemplary role and establish a good social image.

V. CONCLUSION

This paper summarizes the factors that may affect the profitability, and analyzes the profitability of LONGFOR group through the calculation of typical indicators, and puts forward the corresponding countermeasures for the deficiencies.

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