

# Vanke Co., Ltd. Financial Risk Analysis and Countermeasures

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## ABSTRACT

In recent years, the government has continuously strengthened its control policies on the real estate market, which has brought great pressure on housing transactions. Under this background, it is very important to conduct financial risk analysis. This paper takes Vanke Co., Ltd. as the research object, selects its financial data from 2016 to 2019, analyzes its debt repayment risk, operating risk and profit risk, and on this basis interprets the reasons. Finally, it puts forward the conclusion of preventing risks: optimizing debt, improving debt solvency, diversifying operations, expanding financing structure, etc.

**Keywords:** financial risk, Vanke Co., Ltd., countermeasures

## 1. INTRODUCTION

With the continuous improvement of my country's economic development level, the real estate industry has grown rapidly, making a significant contribution to the prosperity and progress of China's economy. Based on the National Bureau of Statistics, the real estate industry contributed to more than 5 trillion yuan to my country's GDP in 2018 [1-2]. However, with the adjustment of the economic structure, the government introduced strict control policies, such as purchase restrictions, loan restrictions and pre-sale price restrictions, etc. In the first half of 2018, Premier Li Keqiang emphasized that the house is for living, not for speculation. According to data from the National Bureau of Statistics, the sales area of commercial housing nationwide in 2019 was 1.716 billion square meters, a year-on-year decrease of 0.1%. The growth rate was 1.5 percentage points lower than in 2018. In terms of prices, according to the full-sample survey data of 100 cities by the China Real Estate Index System, the cumulative price of 100 cities in the first half of 2018 increased by 2.62%, which was 1.57 percentage points lower than the same period last year. Facing the declining

sales performance and the tight macro environment, the real estate industry needs to strengthen financial analysis, strengthen prevention and control and guard against risks. Vanke Co., Ltd. (hereinafter referred to as Vanke) is one of the most representative companies in the real estate industry in terms of asset scale, development speed, development strategy and development path. Analyze the financial risks that arise in the course of its business operations, and propose corresponding solutions to these risks. So as to improve the company's ability to control financial risks, and also provide reference for other companies facing similar problems.

## 2. EXISTING FINANCIAL RISKS

### 2.1. The Debt Ratio is High, and the Debt Repayment Pressure is Great

Solvency, including long-term and short-term solvency, measures the ability of an enterprise to repay debt, which is directly related to the survival of the enterprise.

**Table 1** Analysis of Assets and Liabilities of Vanke Co., Ltd

| Year              | 2017                 | 2018                 | 2019                 |
|-------------------|----------------------|----------------------|----------------------|
| Total assets      | 1,165,346,917,804.55 | 1,528,579,356,474.81 | 1,729,929,450,401.23 |
| Total liabilities | 978,672,978,646.26   | 1,292,958,626,477.23 | 1,459,350,334,988.27 |
| Gearing ratio     | 0.84                 | 0.85                 | 0.84                 |

According to the above table, we can see that the asset-liability ratio of Vanke has remained high in the past three years [3-4]. And it has remained above 80%, showing an upward trend. Compared with the industry's 60%-70% asset-liability ratio standard, it is more than 10% higher. It can be seen that most of the assets of Vanke are

maintained by debt, and its debt solvency is weak, which is not conducive to its further debt financing. If there are mistakes in project development or economic depression, it is easy to have a debt crisis. Create obstacles to the development of Vanke.

**Table 2** Comparative Analysis Table of Real Estate Enterprise Current Ratio

| Company name                           | 2017 | 2018 | 2019 |
|--|------|------|------|
| Vanke                                  | 1.20 | 1.15 | 1.13 |
| Evergrande Real Estate                 | 1.40 | 1.36 | 1.37 |
| Central-south construction Constructio | 1.40 | 1.21 | 1.17 |

In an environment of high corporate debt, it is very important to keep appropriate funds. Sufficient funds can help companies repay their debts in a short time. At this time, a current ratio analysis is needed. The current ratio in theory is 2:1. In financial management, an excessively high current ratio means a waste of resources, and an excessively low current ratio means insufficient free funds for enterprises, which may easily lead to a debt crisis.

In 2019, Vanke's current ratio dropped by 2.36% year-on-year, and its quick ratio dropped by 5.56%. And the current ratio in the industry has shown a downward trend in the past three years. By analyzing the financial statements of real estate companies, we find that the current ratio of real estate companies is approximately stable between 1 and 1.4. However, Vanke's current ratio is at a relatively low level in the industry. An excessively

high debt-to-asset ratio increases the company's debt burden, and an excessively low current ratio is not conducive to debt repayment. The imbalance between the two is a significant financial risk of the company. It can be seen that not only Vanke has certain risks in its solvency, but the entire real estate industry has certain risks in repaying debts, and it may happen that funds cannot normally repay debts.

### **2.2. Profitability Needs to be Strengthened**

Generally speaking, there are many indexes to measure a company's profitability. We analyze Vanke's profitability through the net profit margin and return on total assets.

**Table 3** Analysis of Vanke Co., Ltd 2017-2019 Net Profit Margin

| Year | Operating revenue  | Net Profit        | Net Profit Margin |
|------|--------------------|-------------------|-------------------|
| 2017 | 242,897,110,250.52 | 37,208,387,330.07 | 15%               |
| 2018 | 297,679,331,103.19 | 49,272,294,534.61 | 17%               |
| 2019 | 367,893,877,538.94 | 55,131,614,572.09 | 15%               |

The higher the net sales margin, the stronger the profitability of the company and the greater the potential for development. According to the financial data of real estate companies in the past three years, Vanke's net sales margin in the past three years has been around 15%-17%, which has been relatively stable in the past three years. However, from the perspective of the industry's average level of about 20%, Vanke's profitability needs to be strengthened [5-6]. Moreover, affected by factors such as national policies and declining demand, the operating costs

of enterprises are increasing, and in fact the profitability of enterprises has declined. From the financial statements of listed companies, the cost of the entire real estate industry is increasing, the net interest rate of real estate companies is showing a downward trend, and the profit margin is narrowing. Moreover, in the entire industry, the gap in profitability is relatively large, especially between listed companies and non-listed companies, large companies and small companies.

**Table 4** Analysis of Vanke Co., Ltd return on total assets from 2017 to 2019

| Year | Operating profit  | Average total assets | Total return on |
|------|-------------------|----------------------|-----------------|
| 2017 | 51,141,952,665.41 | 998,010,565,864.35   | 5.12%           |
| 2018 | 67,460,201,390.98 | 1,346,963,458,902.27 | 5.01%           |
| 2019 | 76,539,289,517.59 | 1,629,254,403,438.02 | 4.70%           |

In addition to the decline in net sales interest rates, Vanke's total return on assets also showed a downward

trend. That the efficiency use of funds if decline, the company's overall profitability will decline. In 2020, due

to the impact of the epidemic in COVID-19, corporate profitability will also be subject to certain fluctuations. Asset turnover slows down and operational risks increase

Operational risk usually refers to the risks caused by changes in production, supply, sales and external environment in the course of business operation.

**Table 5** Analysis of Vanke Co., Ltd. Asset Management Operation Capability

| Project                                      | 2017 | 2018 | 2019 |
|--|------|------|------|
| <b>Inventory turnover rate (times)</b>       | 0.3  | 0.28 | 0.28 |
| <b>Turnover rate of fixed assets (times)</b> | 34.9 | 32   | 30.7 |
| <b>Accounts receivable turnover rate</b>     | 21.2 | 19.1 | 15.4 |

From the above table, the enterprise’s inventory turnover, fixed assets turnover and accounts receivable turnover are on a downward trend. Corporate inventory turnover fell from 0.3 in 2017 to 0.28 in 2019. In particular, the receivable rate decreased from 21.2 in 2017 to 15.4 in 2019.

From the above table, the company’s inventory turnover rate, fixed asset turnover rate and accounts receivable turnover rate are all showing a downward trend. The turnover rate of corporate inventory dropped from 0.3 in 2017 to 0.28 in 2019. In particular, the accounts receivable ratio dropped from 21.2 in 2017 to 15.4 in 2019. Generally speaking, the higher the turnover rate of a company’s accounts receivable, the better, and the decline in the turnover rate means that the company’s credit sales are increasing, which can easily cause bad debts. In addition, Vanke’s current asset ratio has remained at around 0.28 for the past three years, but it has also shown a downward trend. In addition, in the past five years, the current asset turnover rate of Poly Development Control Group Co., Ltd. has dropped from 0.33 to 0.28 times, and the total asset turnover rate has dropped from 0.32 to 0.25 times. It can be seen that from the perspective of the entire real estate industry, the speed of corporate liquidity has slowed down, and the inventory turnover rate in the past five years was not ideal. The industry has the characteristics of large investment and long turnover period.

Through the above-mentioned comprehensive analysis of solvency analysis, operating capacity analysis, and profitability, we can see that Vanke has certain deficiencies. Next, we will analyze the causes of these risks.

**3. ANALYSIS OF CAUSES**

(1) There are three reasons for the high debt pressure of Vanke Co., Ltd. The first is the long development cycle of the real estate industry, large capital investment, multiple construction links and other factors that have resulted in high debt in the real estate industry. The higher the debt-to-asset ratio, the more assets the company has to raise through debt and the greater the risk. Second, Vanke’s debt structure is not reasonable enough. As of December 2019, current liabilities accounted for 87% of total liabilities. It can be seen that the amount of debt that Vanke needs to repay in a short time is relatively large, and the short-term debt repayment pressure is relatively

high. Third, the financing channels are relatively simple. In 2019, more than 50% of Vanke’s financing came from banks. The increase in bank financing has led to an increase in interest-bearing borrowings.

(2) There are two main reasons for the decline in the profitability of Vanke Co., Ltd. First, the country’s increased supervision of the real estate industry has led to a decline in house sales. The adjustment of tax policy has resulted in an increase in corporate tax expenditures. In addition, due to the rapid expansion of Vanke Co., Ltd., management and financial expenses have increased.

(3) Declining inventory turnover rate leads to accumulation of inventory. As of December 2019, the inventory of Vanke Co., Ltd. was 897.02 billion yuan, an increase of 19.6% from the end of 2018. Among them, products to be developed are 207.61 billion yuan, accounting for 23.1%. Products under development are 622.22 billion yuan, accounting for 69.4%. The backlog of inventories causes a waste of resources, reduces the company’s capital turnover capacity, and is not conducive to corporate reinvestment.

In addition, for real estate companies, it has its own uncertainty characteristics. When a developer invests in the construction of a project, the investment in the project is too large, but it is not possible to conduct a specific assessment of the various risk factors faced. For example, in the early stage of the project, it is determined whether the market requirements are met, the market price changes during the sale of commercial housing, and market development trends. But these factors may cause a crisis for real estate companies.

**4. SUGGESTIONS AND COUNTERMEASURES**

**4.1. Improve Debt Solvency**

Diversified financing methods. The real estate industry is a huge investment project, and the diversification of financing makes the companies have enough funds to invest in new projects. The survey results show that the key factors affecting the economic development of real estate are the structure of financing channels and the level of their efficiency. Therefore, real estate companies need to pay attention to building professional financing

platforms, and raise funds through bank loans, issuing bonds, stocks and other forms. Furthermore, according to the company's own influence, overseas financing can be considered to attract foreign investment. In the real estate economic development, capital and land are two very important factors. In short, the use of land and capital must be controlled scientifically and rationally to better promote the sustainable development of the real estate economy.

Optimize the debt structure and reduce the current debt ratio. Excessive current liabilities lead to high debt pressure. Companies can first make a loan plan, reasonably calculate the amount needed according to the size of the development project, the length of the loan, and the overall financial pressure to choose a reasonable method of borrowing, so as to live within their means, choose medium and long-term financing, and reduce the current debt ratio. Companies can also sort out the advantages and disadvantages of various borrowing methods, and choose the settlement method suitable for their long-term development in combination with their own development characteristics.

#### **4.2. Improve Profitability**

Increase revenue by diversifying business methods. Since Economic Reform and open up, the real estate industry has developed rapidly. However, in recent years, due to the imbalance of resources in the real estate industry, the ceiling effect gradually appeared in the real estate industry, and the growth rate slowed down obviously. Relying solely on the sales of commercial housing can no longer allow enterprises to develop steadily and sustainable development. China's country's domestic real estate companies focus on development and sales, and their main business income accounts for more than 90%. The development and sales of listed real estate companies in Hong Kong, China are no longer the main source of profit. The income from leasing and investment has become an important part of the current profit income of listed real estate companies. Real estate companies can learn from foreign business methods and expand their business to decoration, real estate and even different industries. After the outbreak of COVID-19, the demand for property, medical care and security has increased obviously.

Adopt a more flexible sales method. Companies can distinguish between peak and off-season sales based on their previous sales performance and experience. During the off-season, a variety of promotional activities can be adopted. For example, if old customers recommend new customers, they will be given appropriate preferential policies, and the property management fee will be waived for a certain period of time. Sell at a high price to make more profits. When there are no eligible investment projects, the sales speed of the completed projects can be appropriately slowed down, which can appropriately increase the sales price, and also allow companies to set aside time for better construction projects.

Understand the needs of young consumer groups and carry out precision marketing. Under the influence of economic

development, the increase of young people's income, buying houses and getting married and other factors, the number of people buying houses in China is decreasing year by year. They are more inclined to buy hardcover houses in first-tier and second-tier cities, focusing on the quality of property management. Companies can provide more personalized housing with more complete supporting facilities and improve after-sales service to increase sales according to the needs of post-90s. In addition, the rate of women buying houses is also increasing. The increase in women's income makes them financially capable of buying houses. Companies can develop female-specific housing based on the needs of women.

Real estate companies can make improvements by improving management efficiency, improving organizational structure, and clarifying development plans. The execution and efficiency of an enterprise directly affects the production of the enterprise. The organization is complicated and the structure is huge, which is not conducive to the financial management of the enterprise. Enterprises need to strengthen the control of funds, and must pay attention to the constant changes of enterprise organizations and the disclosure of financial data.

#### **4.3. Improve Operational Capabilities**

Improve inventory turnover rate. Companies need to strengthen the daily inventory management ability and maintenance of houses. While maintaining the normal production of the house, increase sales and reduce inventory backlog. Companies can reduce inventory by reducing the amount of reserved land. As a scarce resource, the price of land continues to rise. Excessive storage of land resources on the one hand increases the cost, resulting in slower capital flow and lower capital utilization efficiency. On the other hand, heavy financial pressure has also reduced the speed of business expansion. Enterprises can use the method of signing a contract to stipulate the useful life of the land and develop and use it within a certain period of time. This will not only obtain land resources, but also reduce inventory.

Increase the management of accounts receivable. The main measure to increase the accounts receivable of enterprises is to improve the construction of the credit system. The credit standards cannot be continuously lowered because of the pursuit of expansion and the increase in sales. In addition, companies can also consider whether to sell on credit according to the credit status of users. In the face of uncollectible accounts, companies can recover them after calculating the cost to reduce bad debts.

Pay attention to the feasibility analysis of the project. Before investing in the project, the company has clear goals and precise user positioning for the development project while accurately assessing its own financial, operating and cash flow conditions. It is also necessary to have a detailed understanding of the market conditions and expected returns of investment projects and select the best construction plan, so as to maximize the utilization rate of corporate funds, thereby enhancing the competitiveness of

the company and reducing the investment link to the company. Therefore, how to use funds rationally is a necessary way for enterprise development. Whether it is a survey project or a development project that is being put into construction, the sale of commercial housing requires comprehensive consideration of many factors. The real estate industry should develop resources and land resources rationally.

## 5. SUMMARY

Due to the change of macro environment, it is a great challenge for real estate companies to limit the amount of housing purchased by the government. Improving debt paying ability, profitability and operating ability will help Vanke improve its operating efficiency and achieve high-quality long-term development.

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