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A Study on the Capital Structure of China Fortune Land Development Co., Ltd. under the Background of "De-Leveraging"

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Abstract: *The real estate industry is one of the key industries of the country and plays an important role in promoting the healthy and stable development of China's economy. At the same time, it is also a key industry for the government to implement the "deleveraging" policy. While rapidly advancing the national strategic layout of the real estate industry, the scale of debt continues to increase, highlighting the problems in capital structure. The characteristics of the real estate industry, coupled with China's ever-changing and complex economic environment, make choosing a reasonable capital structure crucial for the operation and development of enterprises. In the context of deleveraging policies, this article uses a case study method to analyze the problems and reasons in the capital structure of CFLD. It proposes strategies to optimize the capital structure, such as reasonably reducing the asset liability ratio, accelerating the pace of deleveraging, increasing the proportion of non-current liabilities, and balancing the debt structure of enterprises. This not only helps the company improve its capital structure under the premise of deleveraging. Moreover, it has important reference significance for enterprises to achieve high-quality development, and also provides a certain reference for optimizing the capital structure of other real estate enterprises.*

Keywords: *real estate industry; de-leveraging; capital structure*

1. Introduction

With the continuous development of the Chinese economy, the real estate industry has become an important industry driving the development of the Chinese economy. However, most real estate companies have continuously increased their asset liability ratio in order to develop and expand their businesses. This highly leveraged capital structure has caused unprecedented operational pressure. At the same time, the State owned Assets Supervision and Administration Commission (SASAC) has forced central enterprises to reduce their average leverage ratio by 2 percentage points from 2017 before 2020, but this policy is often not conducive to debt Financing. If a company faces difficulties in financing, it will not be conducive to maintaining a reasonable capital structure and sustainable and healthy development. Therefore, if a company wants to achieve the goal of maximizing enterprise value, a scientific and reasonable capital structure and good financing channels have a huge impact on the operation of real estate companies.

2. Overview of CFLD and Analysis of the Current Capital Structure

2.1. Introduction for CFLD

China Fortune Land Development Co.,Ltd. abbreviated as CFLD, was founded in 1998 and is a leading development zone investment and operation enterprise group in China. CFLD's main business is divided into six parts: residential development, asset management, industrial development and services, investment services, park services, and real estate services. The company has been committed to the development, construction and operation of new industrial city, and has become a leading operator of new industrial city in China.[1]

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2.2. CFLD Financial Situation

Based on the financial statement information disclosed by CFLD, select some important indicators from the financial data of CFLD for the past five years from 2017 to 2021 and conduct horizontal and vertical analysis to identify financial problems, continuously improve and prevent them.

Table 1: Financial Indicators of CFLD from 2017 to 2021

Unit: Ten thousand yuan

Index	2021	2020	2019	2018	2017
Total assets	44,096,415	48,876,236	45,781,195	40,971,183	37,586,471
Accounts receivable	5,649,255	6,314,203	4,687,104	3,443,766	1,891,032
Inventory	14,528,012	17,922,464	29,028,139	25,452,268	22,979,439
Net profit	-3,902,967	366,549	1,461,178	1,174,579	878,081
Operating margin	-97.23	7.92	21.43	21.33	21.59
Current ratio	1.08	1.54	1.58	1.52	1.53
Asset liability ratio	94.6	81.29	83.9	86.65	81.1
Shareholders' equity ratio	5.4	18.71	16.1	13.35	18.9
Accounts receivable turnover rate	0.72	1.84	2.59	3.14	4.2
Growth rate of net assets	-73.94	24.08	34.67	-22.97	86.77

(Data source: money.163.com)

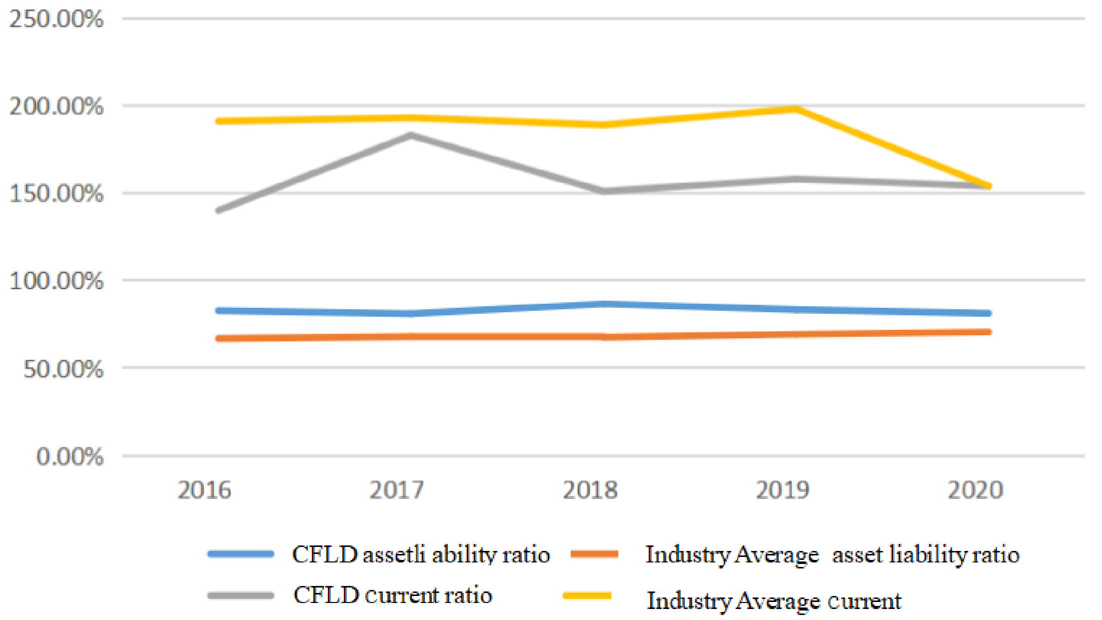

Figure 1: Asset liability ratio, current ratio, and industry level of CFLD from 2016 to 2020

According to Table 1, as of the end of the reporting period, the total assets of CFLD Company reached 440.996 billion yuan in 2021, showing a decreasing trend compared to the total assets of 4888.762 billion yuan in 2020. Secondly, the operating profit margin of CFLD in 2021 reached -97.23%, and the overall trend has been decreasing year by year, indicating that the company is not doing well and its profitability is continuously declining. The turnover rate of accounts receivable of CFLD has continued to decline, from 4.2 in 2017 to 0.72 in 2021, which has affected the company's liquidity and led to a decrease in debt repayment ability. This is due to a significant increase in the net amount of accounts receivable and an extension of account age of CFLD.[2]

According to Table 1 and Figure 1, it can be seen that the asset liability ratio of CFLD is increasing year by year, reaching 94.6% in 2021, and has been consistently higher than the industry average level from 2016 to 2020. According to the provisions of the Basel Accord, in theory, the asset liability ratio of financial institutions is 92%, which is the upper limit, and the average level of China's real estate industry in the past two years is around 89%. This indicates that CFLD has hit the red line and the deleveraging effect is not good. It still needs to reduce the asset liability ratio and deleverage. Although the current ratio of CFLD from 2018 to 2020 showed an overall upward trend, its ratio is still relatively

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low compared to the industry. The current ratio of CFLD increased in 2019 because the growth rate of current assets was higher than that of current liabilities. [3]Judging a company's ability to repay short-term debts solely based on its current ratio is relatively one-sided, and it should also be judged based on the shareholder equity ratio. It can be clearly seen that the shareholder equity ratio of CFLD has shown an overall downward trend from 2017 to 2021, dropping to 5.4% in 2021. This means that the debt ratio of CFLD is constantly increasing, indicating that the debt repayment pressure of CFLD is also gradually increasing.

Overall, the financial situation of CFLD in the past five years from 2017 to 2021 is not optimistic, with poor operating conditions and a need to improve profitability. In the past five years, the debt scale of CFLD has been continuously increasing, which means that its debt repayment pressure is also increasing, and the financial risks faced by the company are also increasing, which needs to be prevented.

2.3. Analysis of the Current Situation of CFLD Capital Structure

(1) Debt structure analysis

Table 2: Debt Structure of CFLD from 2017 to 2021

Unit: Billion

Index	2021	2020	2019	2018	2017
Total liabilities	4,171	3,973	3,841	3,550	3,048
current liabilities	3,640	2,856	2,653	2,426	2,281
Non-current liability	531.5	1,117	1,188	1,124	767.8
Current liability ratio	87.26	71.88	69.07	68.34	74.82
Industry Average	77	70.12	68.64	65.42	61.88
Non-current debt ratio	12.71	28.12	30.93	31.66	25.81
Industry Average	23	29.88	31.36	34.58	38.12

(Data source: eastmoney.com)

According to Table 2, the current liabilities of CFLD have been increasing in the past five years, from 228.1 billion yuan in 2017 to 364 billion yuan in 2021, and the proportion of its current liabilities is also increasing. The higher the short-term leverage ratio ratio of the company, the greater the pressure on debt repayment, and the greater the demand for fast working capital.[4]

Non-current liabilities showed an increasing trend from 2017 to 2020, but decreased to 531.5 billion yuan in 2021, indicating a continuous decline in the proportion of non-current liabilities. The ratio of total liabilities to total liabilities reflects the borrowing costs and the cost of increasing long-term liabilities. The more long-term external financing a company receives in its business process, the greater the corresponding debt repayment pressure on the company [5].

The ratio of current liabilities in the past three years is also far greater than the industry level, indicating that CFLD's current liabilities to total liabilities ratio is greater than the industry average, and it is facing capital turnover problems. The ratio of non-current liabilities in the past three years has been lower than the industry average, indicating that the proportion of non-current liabilities to total liabilities of CFLD is lower than the industry average. This indirectly reflects that the proportion of current liabilities in CFLD's liabilities is relatively high, and the debt repayment burden is relatively high.

(2)Analysis of equity structure

In 2019, Wang Wenwen, the chairman of Huaxia Xingfu, held the actual control of Huaxia Xingfu. The equity of Huaxia Xingfu accounted for 35.99%, indicating that its equity concentration ratio was high. At the same time, in order to maintain the sustainable and healthy development of the enterprise, Wang Wenwen diluted the equity ratio from 69% in 2011 to 35.99% in 2019, indicating that equity financing was carried out. According to research, there were three major changes in equity structure during this period: firstly, CFLD became the largest shareholder with 69% equity in 2011; The second is to raise 7 billion RMB through targeted issuance in 2015; [6]Thirdly, CFLD transferred nearly 20% of its shares to Ping An Asset Management in 2018 for 13.8 billion yuan, alleviating cash flow pressure.

In summary, it can be seen that CFLD may experience a situation of "one shareholder dominating", which is not conducive to the interests of other small shareholders.

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(3) Analysis of comprehensive capital cost rate

Table 3: Financing Methods of CFLD and Two Other Enterprises in the Same Industry from 2019 to 2021

Unit: Ten thousand yuan

Reporting period	Total capital	Equity capital	Debt Capital
CFLD:			
2019	28,014,583.98	8,648,130.56	19,366,453.42
2020	28,015,296.54	5,060,440.40	22,954,856.14
2021	24,174,150.08	1,408,939.32	22,765,210.76
VANKE:			
2019	69,147,029.05	35,992,328.29	33,154,700.76
2020	66,372,196.23	32,171,525.64	34,200,670.59
2021	57,302,994.61	22,034,712.75	35,268,281.86
CG:			
2019	61,409,078.13	24,420,878.13	36,988,200
2020	52,529,684.86	19,881,184.86	32,648,500
2021	44,889,078.11	13,096,878.11	31,792,200

(Data source: eastmoney.com)

Table 4: Comprehensive Capital Cost Ratio of CFLD and Two Other Enterprises in the Same Industry from 2019 to 2021

Unit: %

Reporting period	Equity ratio	Individual capital cost ratio of equity	Debt ratio	Individual capital cost ratio of debt	Comprehensive capital cost rate
CFLD:					
2019	30.87	9.54	61.13	5.24	6.57
2020	18.06	0.72	81.94	4.62	3.92
2021	5.83	5.89	94.17	3.39	3.53
VANKE:					
2019	52.05	8.75	47.95	5	6.95
2020	48.47	0.93	51.53	5.13	3.09
2021	38.45	3.95	61.55	5.49	4.9
CG:					
2019	39.77	10.67	60.23	7.45	8.73
2020	37.85	3.27	62.15	7.58	5.95
2021	29.18	2.7	70.82	7.88	6.37

(Data source: Wind database)

According to Tables 3 and 4, it can be seen that based on the above formula and the financial data disclosed by two well-known enterprises in the real estate industry, the individual cost of capital ratios calculated based on their respective equity capital and debt capital are used to calculate the comprehensive cost of capital ratios of the five enterprises for the three years 2019 to 2021. It can be seen that the comprehensive cost of capital ratio of these three enterprises in 2021 has decreased compared to 2019, indicating that the effect of "deleveraging" proposed by the government in macroeconomic regulation of the real estate industry is initial. At the same time, it can be seen from the proportion of their respective financing methods that CFLD heavily relied on debt financing from 2019 to 2021. In 2021, the proportion of debt capital was as high as 94.17%, while equity capital only accounted for 5.83%. According to the data, the current liabilities account for 72.19%, 70.82% of the debt capital of Country Garden in 2021, and 61.55% of the debt capital of Vanke in 2021. [7]It can also be seen that CFLD is constantly expanding its debt scale at this stage, and the debt repayment pressure is gradually rising. At the same time, under the influence of factors such as the COVID-19, the overall real estate market adjustment, and the company's debt crisis, the financial risk of enterprises will also increase.

3. Problems in the Capital Structure of CFLD

By analyzing the overview, financial situation, and other aspects of CFLD Company, and

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comparing its capital structure vertically and in the same industry, we can identify the problems in the capital structure of CFLD.

(1) The leverage ratio is still high, and the debt scale is relatively radical

The debt scale of CFLD in recent five years is large, and the leverage ratio ratio is high. Even with the implementation of the "deleveraging" policy, the particularly ideal results have not been achieved. Since 2020, the real estate industry has been very sluggish due to the overall unfavorable situation of the global economy. At the same time, the country has implemented significant macroeconomic regulation on the real estate industry, which has dealt a huge blow to the capital intensive real estate industry and faced a deadlock in the shortage of a large amount of working capital. In this situation, CFLD also had to incur significant debts to maintain production and operation. In the past two years, although CFLD has made efforts to promote "deleveraging", the results have not been ideal. The scale of debt financing has continued to increase, and the asset liability ratio has continued to rise. Although it can increase the working capital of CFLD, it also makes CFLD bear a high leverage risk. In the long run, the leverage ratio of CFLD needs to be moderately reduced to achieve the balance between risk and return.

(2) Imbalance of debt maturity structure

The proportion between current and non-current liabilities of CFLD is imbalanced, with the total current liabilities significantly exceeding the total non-current liabilities, and facing significant debt repayment pressure. The large scale of a company's current liabilities can lead to high financial risk, as their maturity time is fast and their debt repayment cycle is short. Especially in the context of "deleveraging", the bank raised the loan threshold, which will prevent CFLD from replenishing working capital through borrowing, thus increasing risks. Furthermore, once the profitability of CFLD decreases that year, the funds available for repaying short-term loans will be very tight. On the one hand, CFLD may expand its borrowing and use new bonds to repay old debts, leading to high debt levels and exacerbating risks; On the other hand, it may affect the reputation of CFLD, hinder its establishment of a good corporate image in the real estate industry, and lead to more difficulties in financing, which will be detrimental to the long-term and healthy development of CFLD.[8]

(3) There are certain defects in the equity structure

According to the analysis of the equity structure of CFLD, Chairman Wang Wenwen holds the actual control of CFLD, and there are certain defects in the company's equity structure. Compared to the advantages brought by the company, the disadvantage of being a dominant shareholder cannot be ignored: excessive concentration of equity in the hands of individuals may lead to major shareholders arbitrarily encroaching on the interests of small and medium-sized shareholders, completely controlling and determining the company's operations; The senior management is also subject to the orders of major shareholders or ultimate controllers, therefore, the company may experience insider trading and abnormal related party transactions, leading to defects in the company's internal control; It is possible to form dictatorship, leading to unreasonable decision-making, causing conflicts among shareholders of the company, and not conducive to improving the company's governance level [9].

(4) Insufficient balance in financing structure

Funds determine the source of funds and directly determine the company's capital structure. The financing structure mainly refers to the proportion between internal and external funding sources. Generally speaking, internal financing is the most ideal financing method for a company, as it comes from the company's own resources and is the initial accumulation of capital, which should be used reasonably. In contrast, external financing not only has high costs, but the amount of funds involved also depends on the financing channels and has greater uncertainty. It can be seen from the previous article that the proportion of internal financing of CFLD in 2017-2021 is low, compared with the previous two years, and it mainly depends on debt Financing. On the other hand, in terms of external funding sources, in the past two years, the funds used for investment mainly came from loans, indicating that CFLD has a relatively single external funding channel, with a higher proportion of external funds than internal sources. The proportion of internal and external funds of the company is very unbalanced. At the same time, external financing relies too much on borrowing, which is an extremely dangerous model in the context of the country's vigorous promotion of "deleveraging" reform, causing CFLD to face enormous financing pressure and exacerbating financial risks. It can be seen that the financing structure of CFLD is not reasonable, and there is room for further optimization.

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4. Strategies for Optimizing the Capital Structure of CFLD

4.1. Reasonably reduce the asset liability ratio and accelerate the pace of deleveraging

According to the asset liability ratio level of CFLD over the past five years, it has been consistently higher than the level of the same industry and is in a highly leveraged debt state. If the company operates poorly or has poor capital turnover ability, it may lead to the company not being able to repay on time or even going bankrupt. Therefore, CFLD should first strengthen its own real estate project management and enhance the company's profitability. Secondly, CFLD should accelerate the capital turnover of the enterprise, increase the turnover rate of accounts receivable, thereby increasing operating surplus, increasing company profits, enhancing the company's operational and debt paying capabilities, thereby reducing the asset liability ratio and accelerating the pace of deleveraging. CFLD should also consider using the "three red lines" as the benchmark for financial decision-making, and clarify its responsibilities in cost, expense, and income distribution to avoid excessive waste of resources and costs leading to diminishing returns. At the same time, it is necessary to increase the share of retained earnings and invest more profits to cope with current financial difficulties, in order to achieve the stability and long-term development of the company.[10]

4.2. Increase the proportion of non-current liabilities and balance the debt structure of the enterprise

According to the debt structure of CFLD, short-term debt has been far greater than long-term debt in the past five years. When the company is operating well and its current liabilities involve a shortage of short-term funds, current liabilities exhibit the advantages of low interest rates and short-term repayment terms. However, when enterprises operate poorly and the industry is under national policy regulation, a large amount of short-term liabilities inevitably increase the company's liquidity risk. Based on the above analysis results, the current internal and external environment of CFLD is not conducive to the company's development in a "deleveraging" environment. Therefore, the debt structure composed of current and non-current liabilities of CFLD should be relatively stable, while further increasing the proportion of non-current liabilities to balance the debt structure of CFLD. In this regard, CFLD should pay more attention to the imbalanced debt structure, optimize the debt structure, reduce the proportion of high-risk investments, and further optimize the capital structure.

4.3. Moderate introduction of strategic investors and reduction of equity concentration ratio

The equity concentration ratio of CFLD has always remained at a high level, which can solve the problem of equity dispersion of the company, but at the same time may damage the interests of other small and medium-sized shareholders, which is not conducive to the sustainable and healthy development of the company. CFLD can introduce strategic investors into the enterprise, which is conducive to optimizing the equity structure of the enterprise and further optimizing its capital structure. The participation of strategic investors can increase the weight of decision-makers among owners, establish checks and balances among controlling shareholders, and strengthen equity restriction mechanisms. In this situation, the largest shareholders still hope to influence the company's wealth through control, and they will have to pay higher costs, so this can effectively limit the excessive investment behavior of the major shareholders. Introducing external shareholders appropriately is beneficial for diversified business ideas, ensuring the healthy growth of the company in the medium to long term, improving the company's control structure, further reducing financial pressure, and improving the company's financing ability.

4.4. Utilize diversified financing methods to further expand financing channels

CFLD issued bonds for the first time in 2013 to raise funds, which provided sufficient funds for the company's development. However, from the current source of funds of CFLD, the proportion of internal financing and equity financing through the company is still low, mainly relying on debt Financing, resulting in a large debt scale. In today's market economy environment, relying heavily on debt Financing means huge financial risks for companies. At the same time, in the context of "deleveraging", financing through asset securitization products in the foreign exchange market has strategic significance for restoring the equity assets of enterprises. For the sustained and healthy development of the company, CFLD should attach importance to expanding financing channels, using derivatives, options, repurchase and other channels for financing. It can also learn from well-known real estate enterprises such as Poly and Vanke, promote diversification of financing methods, effectively correct the imbalance of capital structure, while dispersing the company's financial risks, and achieve maximum company value.

5. Conclusion

How to optimize the capital structure of China's struggling real estate enterprises under the background of "deleveraging" and achieve maximum enterprise value is the direction of this article's research. Based on the relevant research results of domestic and foreign scholars, combined with relevant theoretical knowledge, this paper analyzes and elaborates on the current macroeconomic environment and capital structure of CFLD. In the context of the national "deleveraging" environment, it can be concluded that the capital structure of CFLD still needs further optimization. The high proportion of current liabilities to total liabilities and high leverage are the norm in China's real estate industry, and the country is currently continuously strengthening supervision of real estate enterprises, accelerating the construction of the financial system, and creating a good environment for enterprises to expand financing channels. This article analyzes the selected cases through case analysis, and concludes that in the context of "deleveraging", enterprises should continuously improve their capital structure by reducing their asset liability ratio, accelerating the pace of deleveraging, adopting diversified financing channels, and further expanding their own financing channels, while achieving business goals and maximizing enterprise value.

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