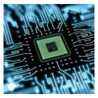
How a top-tier HK builder got into trouble



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Hsin Chong Group Holdings (00404.HK) has dismissed reports that it is on the verge of bankruptcy, calling them "groundless rumors".

Still, it cannot be denied that the Hong Kong construction company has a huge debt burden and its financials are less than reassuring.

Hsin Chong reported a loss of HK$2.7 billion last year, and its shares have been suspended from trading since early last month.

With 78 years of history, Hsin Chong has been involved in the construction of Hong Kong landmarks such as Mei Foo Sun Chuen, Kai Tak airport and Ocean Park.

More recently, it has won major contracts such as a visual arts museum in west Kowloon and an MTR project.

But while peers like Wai Kee Holdings (00610.HK) and Hanison Construction Holdings (00896.HK) are making good money – last year they reported profits of HK$670 million and HK$640 million, respectively – why on earth did Hsin Chong mess up so badly?

It must be noted that Hsin Chong is now controlled by Chinese billionaire Lin Zhou Yan, not the founding Yeh family.

There is another important change in the company: it has been heavily involved in mainland properties in recent years.

The company's Hong Kong business continues to do well, posting a pre-tax profit of HK$273 million in 2016, up 34 percent from the year before.

Sadly, it has suffered a HK$4.4 billion loss in mainland property development and investment business.

This leads us to another question: How could Hsin Chong lose money when mainland property prices have been shooting through the roof and leading property players such as Vanke, Evergrande and Sunac have been reporting soaring profits?

According to its financial statement, Hsin Chong made HK$64.81 million in property development and investment last year, but reported a fair value loss of HK$880 million in investment properties and HK$1.92 billon in impairment loss in properties under construction.

The truth is most of Hsin Chong's properties are located in third- or fourth-tier Chinese cities like Tieling in Liaoning province and Taian in Shandong province, which are some of the worst performing regions in the mainland.

Short seller Anonymous Analytics released a report in September last year, questioning if Lin is using Hsin Chong as his personal dumping ground for problematic and non-revenue-generating assets at the expense of minority shareholders.

Hsin Chong soon issued a statement to defend itself, insisting on its properties' positive outlook.

But when it released its annual results in April, the company booked a huge impairment loss for its properties.

Moreover, its auditor PricewaterhouseCoopers did not express an audit opinion on the company's consolidated financial statements last year due to “multiple uncertainties relating to going concern” and “transactions and balances relating to Mr. Zhou and his related entities”, among other reasons.

This led to the suspension of trading of the company's shares in early April.

The company's current liabilities totaled HK$12.67 billion at the end of last year, while its deposits, cash and cash equivalent amounted to only HK$410 million.

Also, it has borrowed HK$4.49 billion from financial institutions and other parties at an annual rate of 19.3 percent. That alone costs over HK$800 million in interest payments every year.

Hsin Chong continued to talk up its future and said it has placed a lot of emphasis on projects related to China's Belt and Road Initiative.

It has signed a memorandum of understanding with the Republic of Chad regarding major infrastructure projects.

Also, it intends to build a beach resort in Myanmar while looking for opportunities in several other countries.

Still, these grand plans may not able to generate any cash flow in the near future.

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