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Wanda: Strategic Transition to an Asset-light Model



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JUNE 2019



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The Chinese conglomerate Dalian Wanda Group is one of the world's largest commercial property companies, with operations in real estate management, financial services, and the tourism and cultural businesses. The company is well known throughout China by way of its iconic Wanda Plazas – mixed-use centers that combine shopping, dining, and entertainment areas with residential and office spaces. It owns a vast array of businesses, ranging from its flagship commercial real estate holdings to theme parks, cinemas, hotels and asset management companies. Over the years, Wanda has grown to become a real estate industry leader with a well-respected brand in China.

In 2015, Wanda's founder and chairman Wang Jianlin surprised the market by announcing that the company would pivot to an asset-light strategy, during a speech at the 8th entrepreneurship forum of the Shenzhen Stock Exchange. Since then, Wanda has offloaded more than US \$10 billion of assets including hotels and theme parks.¹ With this move, Wanda has embarked on what it calls its 'fourth transformation' toward an asset-light business model. Aiming to leverage its brand value, Wanda has decided to shed its role as a traditional real estate developer to become a real estate operator.

Today, Wanda is helping property owners develop, build and operate commercial and cultural projects, as well letting others license its brand name. The company plans to fully transition and operate under the asset-light model by 2020, completely withdrawing from residential real estate development projects and thus significantly reducing its current financial liabilities.² The asset-light strategy is gaining popularity among other real estate developers too, in response to the increasing cost of capital, greater policy restrictions, and toughened property management service requirements. Wanda's

1 Yang, Yuan. "Dalian Wanda to Sell Theme Park Stakes to Sunac China." *Financial Times*. July 10, 2017. Accessed April 07, 2019. <https://www.ft.com/content/d3502eaa-652d-11e7-8526-7b38dcaef614>.

2 Dalian Wanda Commercial Management Group Co., LTD. "Lecture on 'Asset-Light' by Wang Jianlin at Shenzhen Stock Exchange." June 02, 2015. Accessed April 07, 2019. http://www.wandaplazas.com/en/2015/lastest_0602/816.html.

new strategy provides valuable insights for other real estate firms operating in the same area.

CREATION OF A REAL ESTATE GIANT

Since its founding in 1988 as a real estate company in Dalian, Liaoning, Wanda is now one of the most influential companies in China. It ranked 380th on the Fortune Global 500 List in 2017³, and was 9th among privately held companies in China.⁴ As of May 2018, Wanda had built and operated 249 Wanda plazas in more than 30 provinces, and expected to open 52 more in the same year.⁵ Assets totaled 625.7 billion RMB (US \$92.6 billion) with revenue of 214.3 billion RMB (US \$31.7 billion) in 2018. While Wanda is privately held, its commercial properties unit did go public in 2014, raising US \$3.7 billion⁶ as the biggest IPO in the history of the Hong Kong Stock Exchange at the time. But it unlisted two years later with plans to be listed in China.⁷

Over the last 30 years, Wanda has embarked on four major transformations:

- 1. Expanding from regional to national real estate development.** In 1992, the company expanded its operations to Guangzhou as one of the first Chinese firms to deploy a cross-regional strategy. Wanda soon grew rapidly in several major cities across China.
- 2. Shifting its focus from residential to commercial real estate.** With this, the Wanda Plaza was born – major urban complexes located in city centers that sport modern designs with a high-quality finish (see Exhibit 1).
- 3. Transitioning from being a real estate developer to an operator of tourism and cultural businesses.** Wanda boosted its investment in resorts, hotels, cinemas, cultural districts, theme parks and other entertainment businesses, in China and abroad.
- 4. Pivoting to an asset-light strategy.** In 2017, Wanda

sold 76 hotels and 13 tourism projects to Sunac China Holdings for US \$9.3 billion, and offloaded 77 hotels to R&F Properties for US \$2.9 billion.⁸ The following year, Wanda received a capital infusion by selling a 14% stake in its commercial properties unit for US \$5.4 billion to Sunac and three of China’s biggest internet companies – Tencent, Suning and JD.com.⁹

Exhibit I: Wanda Plaza



Source: Traxon Technologies¹⁰

3 Fortune, "Fortune Global 500: Dalian Wanda Group," Fortune Global 500, accessed April 29, 2019, <http://fortune.com/global500/2017/dalian-wanda-group/>.

4 Song, Jingli. "Top 10 Chinese Private Enterprises." *China Daily*. September 06, 2017. Accessed April 07, 2019. http://www.chinadaily.com.cn/business/2017top10/2017-09/06/content_31618619_2.htm.

5 Dalian Wanda Commercial Management Group Co., LTD. "Wanda Map." Wanda Map. Accessed April 07, 2019. <http://www.wanda.cn/map/>.

6 Ho, Prudence. "Dalian Wanda Commercial Properties Raises \$3.7 Billion in IPO." *The Wall Street Journal*. December 16, 2014. Accessed April 07, 2019. <https://www.wsj.com/articles/dalian-wanda-commercial-properties-raises-3-7-billion-in-ipo-1418700649>.

7 Alex Frew Mcmillan, "Wanda Is Leaving Hong Kong Stock Exchange; Will Others Follow?" *RealMoney*, August 16, 2016, accessed April 29, 2019, <https://realmoney.thestreet.com/articles/08/16/2016/wanda-leaving-hong-kong-stock-exchange-will-others-follow>.

8 Yang, Yuan. "Dalian Wanda to Sell Theme Park Stakes to Sunac China." *Financial Times*. July 10, 2017. Accessed April 07, 2019. <https://www.ft.com/content/d3502eaa-652d-11e7-8526-7b38dcaef614>.

9 Flannery, Russell. "Tencent, JD Group To Buy 14% of Wanda Property Flagship For \$5.4B." *Forbes*. January 30, 2018. Accessed April 07, 2019. <https://www.forbes.com/sites/russellflannery/2018/01/29/tencent-jd-group-to-buy-14-of-wanda-property-flagship-for-5-4b/#55cabbdf50a5>.

10 Hanjie Wanda Plaza, Wuhan, China, accessed April 30, 2019. http://www.traxontechnologies.com/us/showcase/showcase_details/14235/Hanjie%20Wanda%20Plaza%20%E2%80%93%20Wuhan,%20China.

Wanda attributes its ongoing success to four major business strategies. First, it uses what it calls the ‘order-based’ commercial real estate development model, which seeks retailer tenants before construction even begins. This model originated from a commercial cooperation between Wanda and Walmart in 2003, after which it struck similar joint development agreements with other international retailers. Under this model, Wanda’s large-scale commercial projects commence on the first day of construction, hence reducing investment risk. At the same time, retailers can quickly expand into mainstream Chinese cities with low rental costs given their upfront investment. This arrangement allows retailers to enjoy more tenant privileges, such as sub-leasing rights, which ultimately yields a win-win situation. Wanda’s early successes had a major impact on China’s domestic businesses, with other companies adopting its strategy as well.

Wanda’s second business strategy started with its move into the commercial real estate market. Like many other real estate companies, it relied on the sale of properties to obtain profits. However, in order to maximize sales, small-scale ‘segmented sales models’ are usually used. As a result, it becomes difficult to achieve effective planning and management of retail spaces when the property rights are excessively dispersed, subsequently increasing collection and management risk. Wanda Plaza, the flagship product of Wanda Commercial Group, by virtue of its ‘order-based’ business model is able to decide on retail allocations in advance of openings, a tactic that it used to encourage block purchases of retail space.

Wanda’s third business strategy was the early introduction of mixed-use spaces that integrated commercial with residential development, thus creating a new large-scale urban complex development model in China. Some of Wanda’s urban complexes are quite large in scale, with the total construction area of a single project generally between 50 and 1 million square meters, including residential areas, offices and hotels, as well as other forms of properties.

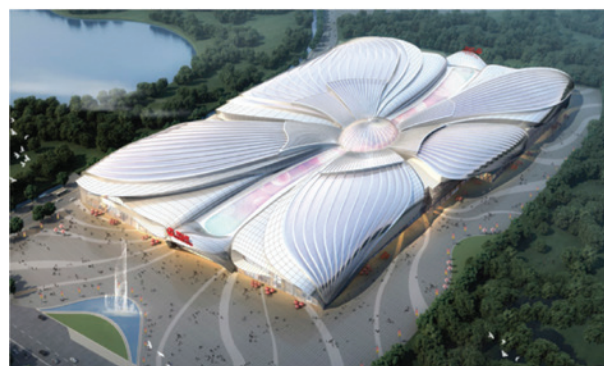
Around 2014 to 2015, China’s real estate market underwent a major transformation. First, the country’s economy entered a ‘new normal’ in light of big headwinds. Second, as local government and corporate debt continued to rise, asset prices also began to increase sharply. In order to manage financial risks, many real estate developers started to deleverage. Meanwhile, in the first- and second-tier cities where land and housing prices had risen rapidly, the government began tightening real estate policies. For example, many cities began to limit real estate purchases per household in an effort

to stabilize the market. As a result of this confluence of factors, profitability in the real estate industry declined significantly. Thus, many real estate companies sought to diversify their businesses.

The fourth business strategy, which resulted from changes in China’s real estate market, was to diversify into cultural investments. In 2015, Wanda’s cultural investments took off, but most of it was concentrated overseas. Through a series of mergers and acquisitions, Wanda became a diversified conglomerate. For example, in 2012, Wanda acquired AMC entertainment, a U.S. movie theater chain. Two years later, Wanda acquired Club Atletico De Madrid SAD, a professional sports club; and in 2015 Wanda bought LeTV Sports Culture Develop (Beijing) Co., a video streaming platform for live sports.

To further cement its intention to dominate in culture and entertainment, Wanda also developed a new product – Wanda Cultural Tourism City. It is a real estate project that integrates travel, shopping and entertainment experiences. These projects can average an unprecedented scale of 1-3 square kilometers. There are currently around 20 Wanda Cultural Tourism Cities in China (see Exhibit 2).

Exhibit 2: Design Sketch of Wanda Cultural Tourism City theme park and shopping center



Source: China Daily¹¹

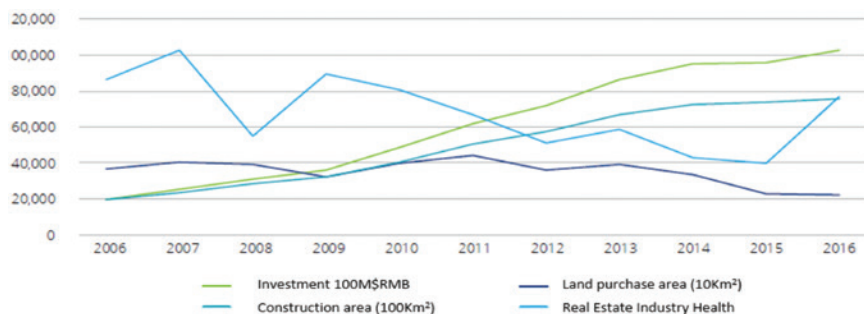
11 “Wanda Cultural Tourism City,” *China Daily*. June 26, 2014. Accessed April 07, 2019. http://www.chinadaily.com.cn/m/jiangsu/binhu/2018-12/13/content_17617670.htm.

INDUSTRY BACKGROUND

Currently, China accounts for 66.4% of the Asia-Pacific real estate market value. The Chinese real estate sector is valued at US \$65 trillion, five times the national GDP.¹² From March 1999 to April 2019, monthly housing prices have risen an average 8% year-over-year.¹³ Growth was mostly driven by a few factors such as the rapid urbanization in recent years, with population in big cities rising more than 2.7% a year as of 2017. In contrast, India's real estate market size was US \$120 billion in 2017.¹⁴

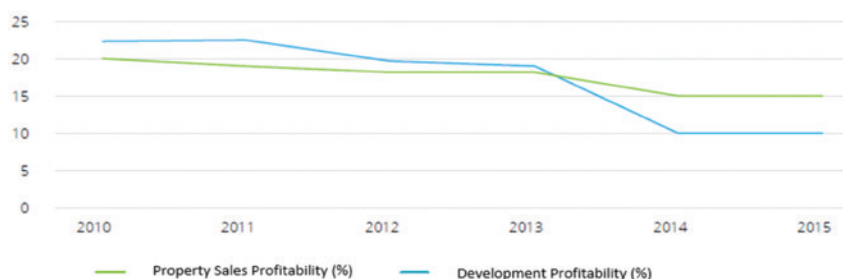
Urbanization trends remain strong in China as an estimated 124 million people are expected to migrate to cities between 2020 and 2030, but the real estate market itself is under pressure (see Exhibits 3 and 4).¹⁵ As Wanda's Wang Jianlin has said, "We believe the Chinese real estate industry has come to a turning point in terms of supply and demand, and the era of huge profit has come to an end."¹⁶

Exhibit 3: Real Estate Investment and Development



Source: Deloitte¹⁷

Exhibit 4: Real Estate Industry Profitability



Source: Deloitte¹⁸

China's real estate market historically favored new housing developments and property sales. Primary construction, however, will no longer be the norm. Secondary housing market transactions are expected to surpass new construction, which in turn is raising demand for high quality property management services. Real estate service operators that offer residential, real estate agency, and property management services are expected to be the winners. No wonder some of China's biggest developers are looking to enter these market segments. In pivoting, they benefit in another way: They are improving their balance sheets by selling off heavy assets to pay down debt.

WANDA'S ASSET-LIGHT STRATEGY

Since officially announcing its adoption of the asset-light business model, Wanda has since embarked on a full-scale transition. The company set out to leverage its brand value and offer high quality real estate services to gain a competitive advantage and profitably adapt

to the vagaries of the macroeconomic, political and real estate market environment. Another market leader, Greentown China Holdings, is also leveraging its brand name and management expertise to provide third-party construction and project management services in exchange for development fees.

As Wanda moves towards a more diversified business strategy, it is bound to influence China's real estate industry as well. Real estate's 'Golden Age,' spanning the 1990s to early 2000s, benefited from the rapid growth of the Chinese urban

12 思进 陈, "房地产市值450万亿, 超29个国家总和, 刚需: 跌一半也买不起," 网易号, accessed April 30, 2019, http://blog.sina.cn/dpool/blog/s/blog_5ef1fe090102ypf6.html.

13 CEIC, "China House Prices Growth [1999 - 2019] [Data & Charts]," [1999 - 2019] [Data & Charts], accessed April 30, 2019, <https://www.ceicdata.com/en/indicator/china/house-prices-growth>.

14 India Brand Equity Foundation, "Indian Real Estate Industry," IBEF, November 01, 2017, accessed April 30, 2019, <https://www.ibef.org/industry/real-estate-india.aspx>.

15 "Statistical Data." National Bureau of Statistics of China. Accessed April 07, 2019. <http://www.stats.gov.cn/english/>.

16 Dalian Wanda Commercial Management Group Co., LTD. "Lecture on 'Asset-Light' by Wang Jianlin at Shenzhen Stock Exchange." June 02, 2015. Accessed April 07, 2019. http://www.wandaplazas.com/en/2015/lastest_0602/816.html.

17 勇 李, "China Real Estate Industry Investment Promotion Report," April 2018, accessed April 29, 2019, file:///Users/aaronyu/Downloads/deloitte-cn-re-china-re-industry-investment-promotion-report-zh-180511.pdf.

18 Ibid.

population and shift in economic reforms. Today, a ‘Silver Age’ has emerged arising from competitive pressures and maturing market conditions.

THE COMPETITIVE LANDSCAPE

Housing demand in urban China has cooled due to rising prices, tightened credit, and an overall policy that discourages speculation. Sales by floor area, for example, dropped by 27% in October 2018, which is usually the high season for residential real estate sales.¹⁹ The changing business climate in China has also driven real estate companies to adapt by investing in upstream and downstream industries. This collective shift in business model is serious enough that real estate companies even changed their names to better represent their portfolio of diversified holdings. For example, Franshion Properties (China) Limited changed its name to China Jinmao Holdings Group Limited in 2015. A year later, Agile Property Holdings Limited changed its name to Agile Group Holdings Limited.

While Wanda’s asset-light strategy is part of this broad market transformation, real estate undoubtedly remains as one of its pillar businesses. The company is using its experience in commercial real estate development and operations, resource integration capability, and brand equity to attract third-party investors to development projects. That means Wanda will no longer seek to own Wanda Plazas. It will instead promise to deliver the Wanda experience to investors in shopping center projects. The company now offers investors a full range of services, from land acquisition, planning, design and development to investment, operations management and tenant acquisition, in exchange for profit-sharing.

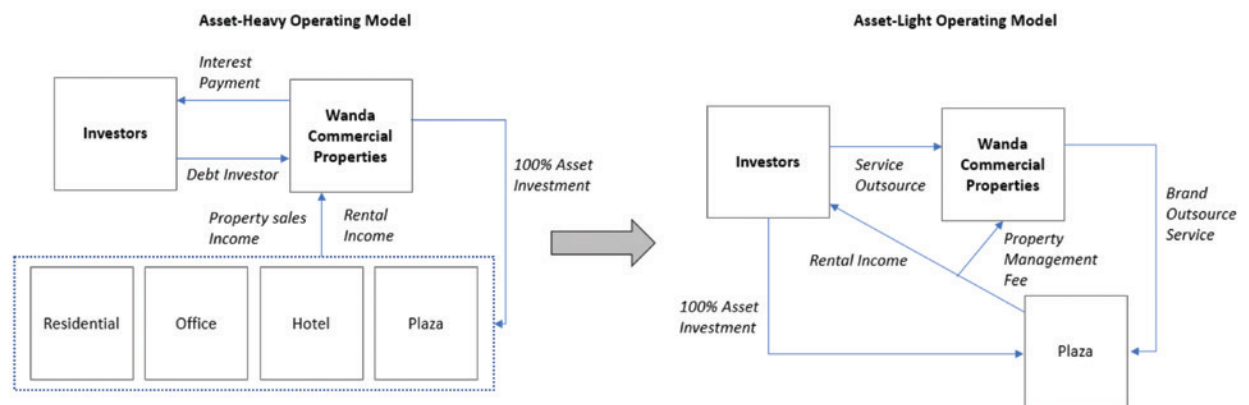
FROM HEAVY TO LIGHT: A NEW ASSET SERVICE FEE REVENUE MODEL

Wanda’s asset-light model means earnings will come not from asset appreciation but rather through service income. This frees up cash flow that normally would be tied up in land acquisitions, development and construction, and mitigates the risks of carrying a high debt-to-asset ratio, which is a pervasive problem in real estate development. Under its former heavy-asset model, Wanda relied on property sales and heavy borrowings to fund its real estate developments. It owned and managed all real estate developments such as the Wanda Plazas, and received all of the revenue generated from the asset.

With the adoption of the asset-light model, Wanda’s future real estate developments will be funded by external investors. Wanda will be responsible for site selection, project design and construction, tenant recruitment and property management, while leveraging its brand name. (Exhibit 5 illustrates the shift from an asset-heavy to an asset-light model). Essentially, Wanda is providing similar services that it once offered for its cultural tourism holdings. (Many of those projects have been sold to Sunac.)

According to Wanda Chairman Wang in the 2015 speech, “from 2017 onward, we will keep opening at least 50 new plazas every year, and over 40 of them will be asset-light. Of the 90 million square meters of our existing land reserve, over 20 million square meters are planned as self-owned properties, and 70 million are developed for sale. We plan to digest these 70 million square meters of properties within five years. In other words, ‘heavy assets’ will disappear from Wanda Plazas, meaning that Wanda Commercial Properties will be transitioned from a real estate developer to a business investment service

Exhibit 5: From an Asset-Heavy to Asset-Light Business Model



19 Jim, Clare. “China Property Market Feels Fresh Chill, ‘winter’ Is Coming.” Reuters. October 14, 2018. Accessed April 07, 2019. <https://www.reuters.com/article/us-china-property/china-property-market-feels-fresh-chill-winter-is-coming-idUSKCN1MOOYZ>.

operator – similar to hotel management companies – featuring fully asset-light operations.”²⁰

The success of the asset-light management model will be driven mainly by the high value add through operations. For example, Wanda aims to provide state-of-the-art technology to improve operational efficiencies. Wanda also plans to acquire stakes in other companies as a means to widen the reach of its brand identity for operational expertise. For example, Wanda recently became the operator of Shanghai Jing’an Mix Park, in addition to taking an equity stake. The Mix Park is one of the biggest shopping centers in Shanghai, with more than 300 brands. Within three days of opening in June 2018, it attracted more than 900,000 visitors.²¹ Wanda, as the brand operator of Mix Park, will be in charge of management output to ensure long-term growth and value creation.

RATIONALE BEHIND THE ASSET-LIGHT MODEL

As the commercial real estate market in first- and second-tier cities becomes more saturated – 504 new shopping malls opened in 2017 alone – developers have increasingly looked to third- and fourth-tier cities for potential growth opportunities.²² What they found was unmet consumer demand among a growing segment of China’s middle class, which comprises 30% of the total population and is expected to account for 57% of total consumption by 2020.²³ Because even though the population in third- and fourth-tier cities accounts for

nearly 53% of the country’s total, its shopping centers only comprise 16.5% of all such centers nationwide.

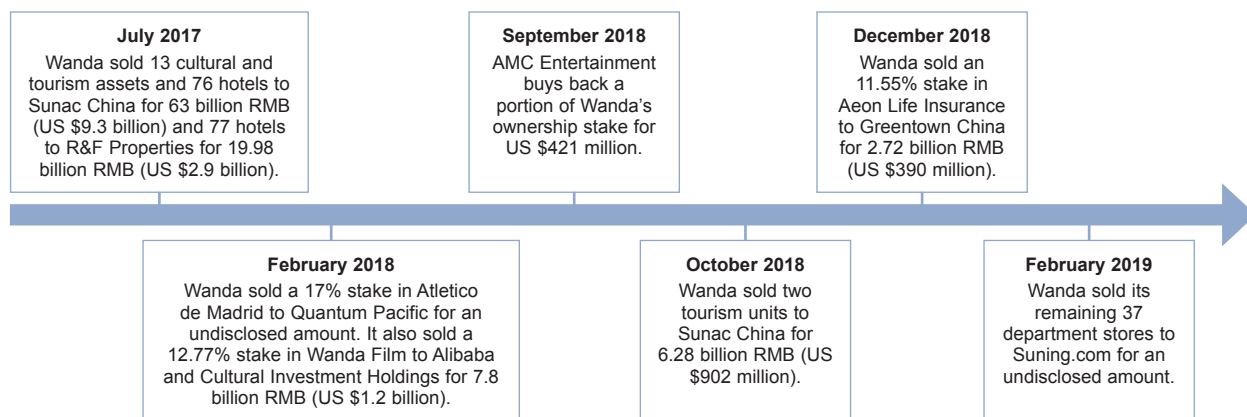
Meanwhile, traditional physical stores continue to face fierce competition from e-commerce retailers supported by a vast network of rapid delivery services. That means these bricks-and-mortar retailers, and especially shopping malls, have had to focus on providing good entertainment experiences to shoppers to entice them to visit. In this sense, Wanda Plazas are well-suited for this transformation because they have large movie theatres and top-notch restaurants along with stores – so a visit to a Wanda Plaza was always more than just about shopping. Indeed, Wanda’s expertise in ‘experience consumption’ makes its services highly attractive to other developers. Thus, Wanda was able to monetize its brand equity in new ways across retail, hotel, and cultural venues.

As it transitions to an asset-light model, Wanda has looked to other successful asset-light operators in the real estate sector, including the Simon Group, and CapitalLand. The Simon Group focuses on the rapid repatriation of funds post-project maturity, as well as the selling, distributing and packaging of REIT shares for sale in the open market. REITs are expected to expand in China in coming years, and Wanda will be well positioned to take advantage of any forthcoming policy change.

EXECUTION OF THE ASSET-LIGHT STRATEGY

In 2017, among the 49 newly opened Wanda Plazas, there were 24 projects that used the asset-light model,

Exhibit 6: Timeline of Select Wanda Asset Sales



20 Dalian Wanda Commercial Management Group Co., LTD. “Lecture on ‘Asset-Light’ by Wang Jianlin at Shenzhen Stock Exchange.” June 02, 2015. Accessed April 07, 2019. http://www.wandaplazas.com/en/2015/lastest_0602/816.html.

21 Jiemian Real Estate Shanghai. “静安大融城开业“火爆”北上海 三天客流近90万.” Jiemian.com. July 03, 2017. Accessed April 07, 2019. <https://www.jiemian.com/article/2279143.html>.

22 “Dalian Wanda to Open Nearly 900 Malls by 2025, Focus on Lower-tier...” Reuters. April 20, 2015. Accessed April 07, 2019. <https://www.reuters.com/article/dalian-wanda/dalian-wanda-to-open-nearly-900-malls-by-2025-focus-on-lower-tier-cities-idUSL4N0XH2MM20150420>.

23 Barton, Dominic, Yougang Chen, and Amy Jin. “Mapping China’s Middle Class.” McKinsey & Company. June 2013. Accessed April 07, 2019. <https://www.mckinsey.com/industries/retail/our-insights/mapping-chinas-middle-class>.

which accounted for nearly 50% of total projects.²⁴ Exhibit 6 provides an overview of Wanda's asset sales since its transition to the asset-light business model.

Of special note has been Wanda's relationship with Tencent and JD.com, after it sold them a stake in Dalian Wanda Commercial Properties Co. They have partnered in the development of a 'smarter' shopping experience designed to foster closer synergies between online and offline experiences for shoppers. Already, Wanda has developed a proprietary IT-based property management system: The 'HuiYun' system was rolled out in 2014, and will further help Wanda improve property management services while expanding its operating margin.

LOOKING AHEAD

Over the next five to seven years, Wanda intends to sell off all of its Wanda Plazas, either through an asset sale or packaged as REITS.²⁵ At the same time, the company will focus on deepening the financial foundation of its asset-light model by assuming operational oversight of 1,000 new Wanda Plazas by 2025. It will manage, but not own them in the conventional sense.

These firm-level changes are part of the broader transition underway in China in the real estate sector, in which easy access to credit has ended. Consolidation and transformation of business operations will be the trend in China's real estate sector for the foreseeable future. Wanda was one of the first developers to begin shifting its business model, and others have followed. Future

success will increasingly hinge on brand equity, the ability to forge the right partnerships, and protecting against an overreach in abilities. Thus far, Wanda seems to be on the right path.

Since Wanda adopted an asset light strategy and introduced new strategic investors, its asset-liability ratio has dropped from 71% to around 63%. One might also speculate that Wanda's transition is in preparation for an eventual IPO in China, as the company will be able to achieve a higher valuation as a technology and service-based enterprise and garner less scrutiny with its lower debt ratio.

Although there are many upsides to Wanda's asset-light strategy, it must also tread this path with some caution. First, Wanda will no longer be able to enjoy capital appreciation from owning real estate assets. Its main revenue stream is now highly dependent on its brand value, which takes years of flawless execution to yield any dividend. Second, with an increasing number of investors, Wanda may have a harder time implementing business strategies. In addition, Wanda may be exposed to contingent liability risk in the case of promised return for investors. Especially with an expansion to third- and fourth-tier cities, Wanda's service fees and rental returns may be lower than expected, which would require the company to absorb any losses from underperforming projects. Finally, as an operator, Wanda needs to excel in operational effectiveness, and that also means flawless talent recruitment and management.

²⁴ Dalian Wanda Commercial Management Group Co., LTD. "Lecture on 'Asset-Light' by Wang Jianlin at Shenzhen Stock Exchange." June 02, 2015. Accessed April 07, 2019. http://www.wandaplazas.com/en/2015/lastest_0602/816.html.

²⁵ Ibid.