

Credit
China Property

China Aoyuan (CAPG)

Decent 1H15 results

- ▶ **1H15 recognised sales up 48% y-o-y to RMB3.9bn, driven by a 31% y-o-y increase in the recognised average selling price; unrestricted cash of RMB4.2bn and RMB2.4bn raised from AOYUAN'18 cover short-term debt of RMB4.1bn**
- ▶ **Contracted sales in 1H15 up 18% y-o-y to RMB6.1bn; with the shift in the sales mix away from Guangzhou, as well as commercial properties, the contracted sales average selling price was down 23% y-o-y to RMB7,393/m²**
- ▶ **Maintain Neutral fundamental recommendation and hold trading call on CAPG'17, '18 and '19 at 107.625/108 (10.0%/9.9%), 100.5/101.125 (10.7%/10.4%) and 100.5/101 (11.1%/10.9%), respectively**

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Lack of further positive catalysts

On 11 August 2015, China Aoyuan (CAPG; rated B2/B, bond rated B3/B-) reported a decent set of 1H15 results. Driven by a 31% y-o-y increase in the recognised average selling price to RMB11,217/m² and a 12% y-o-y increase in the gross floor area delivered to 342,000 m², the group's recognised sales were up 48% y-o-y to RMB3.9bn. Its profitability, as measured by gross margin, remained steady with gross margin at 29% in 1H15. With improvements in operating efficiencies, the group's EBITDA margin widened to 14% in 1H15 from 12% in 1H14 and 2014, according to our estimates. We take comfort in the group's improved balance sheet liquidity, with unrestricted cash on hand reaching an all-time high of RMB4.2bn, which together with RMB2.4bn raised from the three-year onshore corporate bond AOYUAN'18 (coupon 5.8%), sufficiently covers short-term debt due of RMB4.1bn (part of which is collateralised by restricted deposits), as well as the outstanding land premium of RMB1.3bn. We expect the group's debt financing cost to decline from the end-June 2015 level, with a partial repayment of trust financing that is due in 2H15 and 1H16. The group's reported net gearing increased to 73% as of end-June 2015 from 62% as of end-2014 against its targeted net gearing of below 80%.

We believe China Aoyuan's contracted sales performance is on track to meet its full-year RMB13.5bn contracted sales target. In 1H15, the group recorded 18% y-o-y growth in contracted sales to RMB6.1bn, representing 45% of its full-year target. Yet, with the shift in the contracted sales mix away from Guangzhou, as well as commercial properties, its contracted sales average selling price declined 23% y-o-y to RMB7,393/m². This could pose

1. China Aoyuan: Adequate liquidity into 2H15

Year ended Dec (RMBbn)	1H15	2H15	HSBC 2015 previous	HSBC 2015 revised	Variance
Cash sales proceeds	5.3	6.4	11.0	11.7	6%
Construction costs	-3.6	-3.3	-5.5	-6.8	24%
Interest expense	-0.5	-0.7	-1.2	-1.2	0%
SG&A, tax	-0.9	-1.1	-2.0	-2.0	0%
Recurrent income	0.0	0.0	0.0	0.0	NA
Operating cash flow (OCF)	0.4	1.3	2.3	1.7	-26%
Land premium payment	-2.4	-2.6	-4.0	-5.0*	25%
Project/ project stake disposal	0.0	0.0	0.0	0.0	NA
Others	1.2	-1.2	0.0	0.0	NA
Free cash flow (FCF)	-0.9	-2.5	-1.7	-3.3	94%
Cash dividend	0.0	-0.2	-0.2	-0.2	20%
Share repurchases	0.0	0.0	0.0	0.0	NA
Retained cash flow (RCF)	-0.9	-2.7	-1.9	-3.5	86%
Additional onshore borrowings	0.6	0.0**	0.0	0.6	NA
Additional offshore borrowings	2.4	0.0	0.6	2.4	297%
Perpetual issuance/share placement	0.0	0.0	0.0	0.0	NA
Change in cash	2.2	-2.7	-1.3	-0.5	-61%
Unrestricted cash balance at beginning of year	2.0	4.2	2.0	2.0	NA
Unrestricted cash balance at end of year	4.2	1.5	0.7	1.5	113%

*Committed land premium payment of RMB3.9bn for 2015, as of end-June 2015. **Assumes RMB2.4bn raised from AOYUAN'18 in July 2015 to be used for refinancing of onshore debt, inclusive of trust financing. Source: China Aoyuan, HSBC forecasts

downward pressure on its profitability in the coming 1-2 years, in our view. Note that the group's land banking focus has been shifting away from Guangzhou since 2014. The group has also been pursuing international expansion, with projects in Australia contributing 7.5-10% to its contracted sales in 2015. To be specific, the group soft-launched the 70%-owned One30 Hyde Park project (previously known as 130 Elizabeth Street) in Sydney in August 2015 and generated some AUD150m in contracted sales, with gross margin in line with its mainland China projects (in terms of cash flow payments, the group received deposits of 10% upon signing of sale and purchase agreements, with the rest to be paid on handover of the properties, which is usually 2.5 years afterwards). We still expect China properties to be the group's major cash flow contributor in the foreseeable future.

2. China Aoyuan: Consolidated income statements

Year ended Dec (RMBm)	2012	2013	2014	1H14	1H15	Y-o-Y
Revenue	3,943	5,729	6,976	2,658	3,935	48.0%
Cost of sales	(2,757)	(3,971)	(4,909)	(1,846)	(2,779)	50.5%
Gross Profit	1,187	1,759	2,067	812	1,156	42.4%
Selling, admin & operating expenses	(607)	(670)	(770)	(242)	(280)	15.4%
Operating profit	580	1,088	1,297	569	877	53.9%
Finance costs	(66)	(44)	(65)	(35)	(59)	69.7%
Other revenue and gains	1,019	221	207	34	205	506.4%
Share of profit in associated & JCEs	(7)	(0)	9	1	(2)	NA
Tax	(593)	(513)	(666)	(249)	(465)	86.4%
Minority interest	(2)	(16)	26	(10)	(17)	64.4%
Net profit	930	736	809	309	538	74.0%
Memo item:						
Depreciation and amortisation	31	34	25	11	18	66.2%
EBITDA	961	770	835	320	556	73.7%
Total interests	(484)	(848)	(1,276)	(583)	(604)	3.6%

Source: China Aoyuan, HSBC

We maintain our Neutral fundamental recommendation on China Aoyuan with key upside risk as credit ratings upgrade from Moody's/S&P and key downside risks as aggressive international and debt-funded expansion. At 107.625/108, 100.5/101.125 and 100.5/101 (bid/ask), CAPG'17, '18 and '19 yield 10.0%/9.9%, 10.7%/10.4% and 11.1%/10.9%, respectively, we believe are fairly valued against low B-rated China property peers. We expect the USD225m CAPG'17, which carries a substantial coupon of 13.875% and is callable at 106.9375 from November 2015 onwards, to be redeemed in part or in full upon exercise of the call option. New offshore issuance, if any, may provide an entry point into the credit, in our view.

3. China Aoyuan: Consolidated balance sheets and key financial metrics

Year ended Dec (RMBm)	2012	2013	2014	1H14	1H15
Cash and cash equivalents	2,381	2,812	1,989	3,744	4,154
Restricted bank deposits	762	1,899	3,928	2,541	2,577
Properties for sale	11,548	19,437	24,947	21,036	26,205
Other short-term assets	1,992	2,632	2,286	2,685	2,844
Investment properties	1,949	2,419	2,728	2,450	3,356
Other long-term assets	2,180	731	908	636	1,178
Bank loans and borrowings	1,675	2,411	4,464	2,994	4,091
Trade and other payables	2,299	2,953	3,501	2,320	4,542
Sales deposits	4,244	6,463	8,772	7,892	7,497
Other short-term liabilities	1,887	3,136	3,641	3,346	4,326
LT borrowings	3,248	7,113	7,033	8,628	9,707
Others	356	332	341	332	412
Minority interest	152	305	1,315	270	1,733
Shareholders' equity	6,951	7,219	7,719	7,311	8,006
Memo items:					
Cash	2,381	2,812	1,989	3,744	4,154
Debt	4,923	9,524	11,497	11,623	13,798
Net debt	2,542	6,712	9,508	7,879	9,644
Total equity	7,104	7,524	9,034	7,580	9,740
Total capitalisation	12,027	17,048	20,531	19,203	23,538
Total assets	20,813	29,932	36,786	33,092	40,315
Financial metrics					
Gross margin (%)	30.1%	30.7%	29.6%	30.5%	29.4%
Operating margin (%)	14.7%	19.0%	18.6%	21.4%	22.3%
EBITDA margin (%)	24.4%	13.4%	12.0%	12.0%	14.1%
EBITDA/total interest (x)	1.99	0.91	0.65	0.55	0.92
Return on equity (%)	14.0%	10.1%	9.8%	8.2%	11.5%
Return on total assets (%)	4.9%	2.9%	2.4%	2.0%	2.8%
Debt/EBITDA (x)	5.12	12.37	13.77	18.15	12.40
Net debt/EBITDA (x)	2.65	8.72	11.39	12.30	8.67
Debt/equity (x)	0.69	1.27	1.27	1.53	1.42
Net debt/equity (x)	0.36	0.89	1.05	1.04	0.99
Debt/total capitalisation (%)	40.9%	55.9%	56.0%	60.5%	58.6%
Net debt/net total capitalisation (%)	26.4%	47.1%	51.3%	51.0%	49.8%
Cash/total assets (%)	11.4%	9.4%	5.4%	11.3%	10.3%

Source: China Aoyuan, HSBC

Disclosure appendix

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Rating changes for long-term investment opportunities

Recommendation History of CHINA AOYUAN

From	To	Date
Not Rated	Neutral	2013-12-11

Source: HSBC

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Source: HSBC

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Company	Ticker	Recent price	Price Date	Disclosure
CHINA AOYUAN	3883.HK	1.33	14-Aug-2015	6

Source: HSBC

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