

China Aoyuan Property

Establishing track record in the RMB10bn sales league

Key updates for 2014

- ▶ USD300m raised from issuance of 5NC3 CAPG'19-17c in January 2014, which helps broaden the group's offshore fund raising channels
- ▶ Contracted sales totalled RMB10.7bn in the first 11 months of 2014, up 33% y-o-y; we expect full-year contracted sales of RMB12-13bn, 80-87% of the company's target
- ▶ Active land banking activities, with RMB4.2bn earmarked for land acquisitions against RMB4.6bn for the full-year 2013; yet, we expect negative FCF to narrow in 2H14 vs. 1H14

Key events and risks to monitor in 2015

- ▶ Demand-supply dynamics and property inventory de-stocking in major cities; additional policy support from the Chinese Government, if any, including mortgage loosening
- ▶ Contracted sales performance versus target; land acquisitions and the corresponding funding strategy; whether the group will exercise its call option on CAPG'17-15c
- ▶ Further broadening of the group's offshore fund raising channels via USD HY bond issuance, CNH bond issuance or offshore syndicated loan

Our view

China Aoyuan Property generated contracted sales of RMB10.7bn in the first 11 months of 2014, up 33% y-o-y. The increase in contracted sales is driven by increase in gross floor area sold, with contracted gross floor area sold up 36% y-o-y to 1.2m sqm. Commercial properties account for 49% of its total contracted sales, while the average selling price was largely flat at RMB8,940/sqm. We note there is a possibility of the group missing its aggressive RMB15bn contracted sales target; yet, we believe the group will finish the year with contracted sales of RMB12-13bn, up 20-30% y-o-y, compared with RMB10bn in contracted sales in 2013. Driven by the group's land banking activities, with RMB2.7bn worth of land acquired in Chongqing, Guangzhou and Shaoguan in 1H14, the group's net debt increased to RMB7.9bn as of end-June 2014 from RMB6.7bn as of end-2013. Inclusive of restricted cash, its reported net gearing increased by 6ppt to 70% as of June 2014 from 64% as of end-2013. The group targets to keep its reported net gearing ratio at below 80%.

We take comfort from China Aoyuan Property's adequate balance sheet liquidity, with unrestricted cash of RMB3.7bn against short-term debt of RMB3.0bn, as of June 2014. The group also managed to diversify its offshore funding channel in 2014, with USD300m raised from 5NC3 CAPG'19 in January 2014. The group's debt capital structure has improved notably in 1H14, with onshore trust loan (which carries a high cost of 12-13%) reduced to RMB1.7bn as of June 2014 from RMB2.7bn as of end-2013, corresponding to 15% of total debt as of June 2014 against 28% of total debt as of end-2013. We note, however, the group has a track record of aggressive and opportunistic land banking. To be specific, it has earmarked RMB4.2bn for land acquisitions year-to-date against RMB4.6bn for the full-year 2013; although we note the pace of acquisition has slowed so far in 2H14 versus 1H14, with RMB1.5bn in land acquisitions so far in 2H14 versus RMB2.7bn in 1H14.

Albeit likely to miss the RMB15bn contracted sales target for 2014, we expect China Aoyuan Property's negative free cash flow to narrow in 2H14 versus RMB2bn in 1H14, with RMB1bn raised from Huaxia Insurance in November 2014 upon the sale of a 46% equity stake in the project company of Guangzhou Panyu Aoyuan Plaza. We maintain our Neutral fundamental recommendation with key upside risk as a material ramp-up in operating scale, while maintaining steady debt leverage, and key downside risk as an aggressive debt-funded expansion.

Company in a capsule

China Aoyuan Property is a Guangzhou-based developer with an established track record in Guangdong province, which accounts for 65% of its contracted sales in 1H14 and 53% of its land bank. As of 30 June 2014, the group has 42 property projects with a total land bank of approximately 12m sqm. Its average unit land cost stood at RMB1,105/sqm. Listed on the Hong Kong Stock Exchange, the group had an equity market capitalisation of HKD3.6bn (USD467m).

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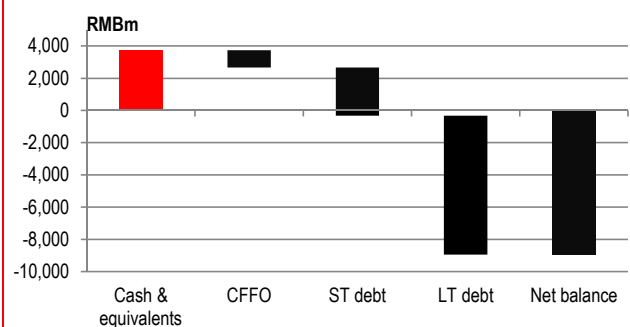
Rating outlook

China Aoyuan Property is rated B2 and B+ by Moody's and Fitch, respectively, with stable ratings outlook. Moody's revised the group's credit rating outlook back to Stable from Negative, citing reduced liquidity risk as the company delivered a strong contracted sales performance. Downgrade thresholds from Moody's include EBITDA margin falling below 15%, or the EBITDA-to-interest ratio falling below 1-1.5x, while downgrade criteria from S&P include interest coverage and leverage further deteriorating from the 2013 level, or if the liquidity position becomes weak. We view China Aoyuan Property as a mid-B credit with stable outlook.

Company data

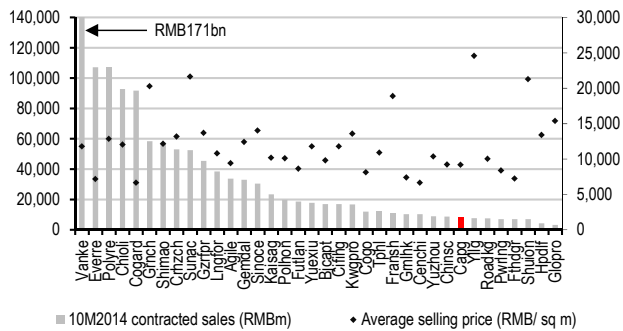
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|--------------------|-------------------------------------|---------|---------|
| Country | China | | |
| Sector | Property | | |
| Major shareholders | Mr. Guo Zi Wen and Ms. Jiang Min Er | 48.0% | |
| | Cathay Capital | 10.6% | |
| Key Bonds | Ratings (MY/S&P/Fitch) | Amount | Coupon |
| CAPG'17-15c | B3/S; NR; B+/S | USD225m | 13.875% |
| CAPG'19-17c | B3/S; NR; B+/S | USD300m | 11.25% |
| Sovereign ratings | China | | |
| (MDY/S&P/Fitch) | Aa3/S | AA-/S | A+/S |
| Corporate ratings | | | |
| (MDY/S&P/Fitch) | B2/S | NR | B+/S |

Liquidity snapshot (1H2014)



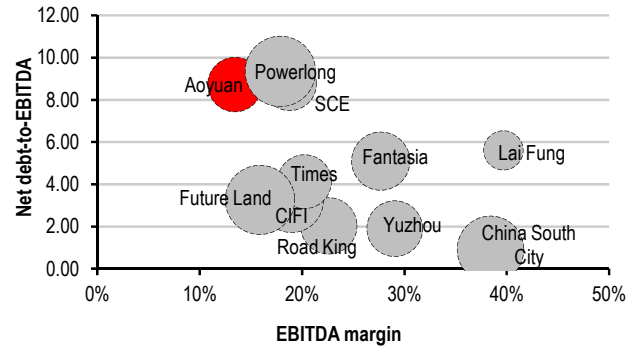
Source: HSBC

Aoyuan: 10M2014 contracted sales versus average selling price



Source: Company data, HSBC

Aoyuan: Leverage and profitability versus peers



Note: Size of bubble indicates relative scale of asset base; LTM1H14 figures shown
Source: Company data, HSBC

Consolidated financial summary

| Year to Dec (RMBm) | 2011 | 2012 | 2013 | 1H14 | Year to Dec (RMBm) | 2011 | 2012 | 2013 | 1H14 |
|--------------------------------------|---------|---------|---------|---------|---------------------------------------|---------|---------|---------|---------|
| Income statement | | | | | Net profit | 433 | 930 | 736 | 309 |
| Revenue | 3,022 | 3,943 | 5,729 | 2,658 | Depreciation and amortisation | 31 | 31 | 34 | 11 |
| - Sales of properties | 3,004 | 3,865 | 5,600 | 2,584 | Others | (598) | (956) | (685) | (451) |
| - Rental income | 6 | 31 | 49 | 27 | Funds from operations (FFO) | (134) | 5 | 85 | (130) |
| - Hotel revenue, management fee | 12 | 47 | 81 | 47 | Dividends from associates and JCEs | 0 | 0 | 0 | 0 |
| Cost of sales | (2,205) | (2,757) | (3,971) | (1,846) | Net changes in working capital | (88) | (2,917) | (1,822) | (942) |
| Gross Profit | 818 | 1,187 | 1,759 | 812 | Cash flow from operations (CFFO) | (221) | (2,913) | (1,737) | (1,073) |
| Selling, admin & operating expenses | (413) | (607) | (670) | (242) | Gross capex | (75) | (25) | (37) | (15) |
| Operating profit | 405 | 580 | 1,088 | 569 | Disposals | 131 | 2,911 | (25) | (26) |
| Finance costs | (26) | (66) | (44) | (35) | Investments | (2,419) | 1,489 | (1,888) | (907) |
| Other revenue and gains | 423 | 1,019 | 221 | 34 | Free operating cash flow (FOCF) | (2,584) | 1,462 | (3,687) | (2,019) |
| Share of profit in associated & JCEs | (22) | (7) | (0) | 1 | Debt | 1,270 | 151 | 4,740 | 2,945 |
| Tax | (336) | (593) | (513) | (249) | Equity | 2 | 0 | 4 | 0 |
| Minority interest | (10) | (2) | (16) | (10) | Dividends | (86) | (135) | (473) | 0 |
| Net profit | 433 | 930 | 736 | 309 | Others | 77 | 37 | (129) | (6) |
| Memo item: | | | | | Change in cash | (1,322) | 1,515 | 456 | 920 |
| Depreciation and amortization | 31 | 31 | 34 | 11 | Credit statistics | | | | |
| EBITDA | 464 | 961 | 770 | 320 | Gross margin (%) | 27.1% | 30.1% | 30.7% | 30.5% |
| Total interests | (373) | (484) | (848) | (460) | Operating margin (%) | 13.4% | 14.7% | 19.0% | 21.4% |
| Balance sheet | | | | | EBITDA margin (%) | 15.3% | 24.4% | 13.4% | 12.0% |
| Cash and cash equivalents | 877 | 2,381 | 2,812 | 3,744 | EBITDA/total interest (x) | 1.24 | 1.99 | 0.91 | 0.70 |
| Restricted bank deposits | 2,946 | 762 | 1,899 | 2,541 | Return on equity (%) | 7.2% | 14.0% | 10.1% | 8.2% |
| Properties for sale | 8,336 | 11,548 | 19,437 | 21,036 | Return on total assets (%) | 2.9% | 4.9% | 2.9% | 2.0% |
| Other short-term assets | 763 | 1,992 | 2,632 | 2,685 | Debt/EBITDA (x) | 9.98 | 5.12 | 12.37 | 18.15 |
| Investment properties | 1,383 | 1,949 | 2,419 | 2,450 | Net debt/EBITDA (x) | 8.09 | 2.65 | 8.72 | 12.30 |
| Amount due from JCE | 1,414 | 0 | 0 | 0 | (FFO+Div)/debt (%) | NA | 0.1% | 0.9% | NA |
| Deposits paid for land acquisitions | 0 | 1,705 | 0 | 0 | (FFO+Div)/net debt (%) | NA | 0.2% | 1.3% | NA |
| Other long-term assets | 1,196 | 474 | 731 | 636 | Debt/CFFO (x) | NA | NA | NA | NA |
| Bank loans and borrowings | 2,616 | 1,675 | 2,411 | 2,994 | Net debt/CFFO (x) | NA | NA | NA | NA |
| Trade and other payables | 1,409 | 2,299 | 2,953 | 2,320 | Debt/equity (x) | 0.74 | 0.69 | 1.27 | 1.53 |
| Sales deposits | 3,289 | 4,244 | 6,463 | 7,892 | Net debt/equity (x) | 0.60 | 0.36 | 0.89 | 1.04 |
| Other short-term liabilities | 1,206 | 1,887 | 3,136 | 3,346 | Debt/total capitalisation (%) | 42.6% | 40.9% | 55.9% | 60.5% |
| LT borrowings | 2,016 | 3,248 | 7,113 | 8,628 | Net debt/net total capitalisation (%) | 37.6% | 26.4% | 47.1% | 51.0% |
| Others | 151 | 356 | 332 | 332 | Cash/total assets (%) | 5.2% | 11.4% | 9.4% | 11.3% |
| Minority interest | 70 | 152 | 305 | 270 | | | | | |
| Shareholders' equity | 6,159 | 6,951 | 7,219 | 7,311 | | | | | |
| Memo items: | | | | | | | | | |
| Cash | 877 | 2,381 | 2,812 | 3,744 | | | | | |
| Debt | 4,632 | 4,923 | 9,524 | 11,623 | | | | | |
| Net debt | 3,754 | 2,542 | 6,712 | 7,879 | | | | | |
| Total equity | 6,229 | 7,104 | 7,524 | 7,580 | | | | | |
| Total capitalisation | 10,860 | 12,027 | 17,048 | 19,203 | | | | | |
| Total assets | 16,914 | 20,813 | 29,932 | 33,092 | | | | | |

Source: Company data, HSBC